15 November 1994

Committee on Subsidies and Countervailing Measures

UNITED STATES - IMPOSITION OF COUNTERVAILING DUTIES ON CERTAIN HOT-ROLLED LEAD AND BISMUTH CARBON STEEL PRODUCTS ORIGINATING IN FRANCE, GERMANY AND THE UNITED KINGDOM

Report of the Panel
SCM/185

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I. INTRODUCTION

1. On 26 February 1993 and 29-30 March 1993, the European Community (hereinafter "EC) held bilateral consultations with the United States under Article 3 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (hereinafter "the Agreement") regarding the United States' preliminary and final affirmative countervailing duty and injury determinations on certain hot-rolled lead and bismuth carbon steel products originating in France, Germany and the United Kingdom. These consultations did not result in a mutually agreed solution and on 14 April 1993 the EC requested conciliation on this dispute under Article 17 of the Agreement (SCM/167 and Add.1). Conciliation on this dispute was carried out by the Committee on Subsidies and Countervailing Measures (hereinafter "the Committee") at its regular meeting held on 28-29 April 1993 (SCM/M/65).

2. On 19 May 1993, the EC requested that a panel be established under Article 17:3 of the Agreement to examine the matter (SCM/169). A special meeting of the Committee was held on 4 June 1993 to consider this request. At that meeting, the Committee established a Panel as requested by the EC (SCM/M/66). At that same meeting, the representatives of Australia, Austria, Brazil, Canada, Japan and Sweden reserved their rights to present their views on this dispute to the Panel (SCM/M/66). Immediately after the meeting at which the Panel was established, New Zealand requested that it be allowed to reserve its rights to present its views on this dispute to the Panel. This request was presented to the Panel after its composition was finalised.

3. On 3 August 1993, the Committee was informed by the Chairman in document SCM/173 that the terms of reference[1] and composition of the Panel were as follows:

Terms of reference:

"To review the facts of the matter referred to the Committee by the EEC in SCM/169 and, in light of such facts, to present to the Committee its findings concerning the rights and obligations of the signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement"

Composition:

Chairman: Mr. Hardeep Puri

Members: Mr. Patrick Robertson
Mr. Maamoun Abdel-Fattah

4. New Zealand's request to reserve its rights to present its views on this dispute to the Panel was accepted by the Panel.

5. The Panel heard the parties to the dispute on 27-29 September 1993 and 8-10 December 1993. In addition to the written and oral submissions by the parties to the dispute, the delegations of Brazil, Canada and Japan made submissions in writing to the Panel. The Panel submitted its findings and conclusions to the parties to the dispute on 14 October 1994.

II. FACTUAL ASPECTS

[1]The terms of reference had been agreed by the Committee at its special meeting of 4 June 1993 when it established the Panel. See SCM/M/66.

6. On 8 May 1992, the United States Department of Commerce (hereinafter "DOC") initiated countervailing duty investigations in respect of certain hot-rolled lead and bismuth carbon steel products originating in France, Germany and the United Kingdom.[2] On 28 May 1992, the United States International Trade Commission (hereinafter "ITC") preliminarily determined that there was reasonable indication that an industry in the United States was materially injured by the imports subject to these cases.[3] Preliminary affirmative determinations were published in this case by the DOC on 17 September 1992,[4] and the final affirmative determinations by the DOC were published on 27 January 1993.[5] The final affirmative injury determinations of the ITC were published on 17 March 1993.[6] Countervailing Duty orders imposing duties on certain hot-rolled lead and bismuth carbon steel products from France, Germany and the United Kingdom were published on 22 March 1993.[7]

7. The EC's complaint referred to the Panel was limited to the DOC's final affirmative countervailing duty determinations in these cases. The following factual information relating to this dispute is provided in two sub-sections below. In the context of the main claims of the EC before the Panel, the first sub-section provides some background information on the firms which were determined by the DOC to be beneficiaries of subsidies and the subsidies that were determined to be countervailable in the cases subject to this dispute. The second sub-section provides some general information on certain aspects of the DOC's methodology for determining subsidies through grants, equity infusions and loans; details of these methodologies are provided in Annex 1 to this Report which reproduces the relevant parts of the DOC's Proposed Regulations relating to estimation and calculation of countervailable subsidies. The second sub-section also indicates the particular years for which the beneficiary companies were determined to be "unequityworthy" or "uncreditworthy" by the DOC. Under the DOC's practice, if a firm is determined to be "unequityworthy" in a particular year, then government equity infusions in that year are treated as countervailable subsidies (see Annex 1). If the DOC determines that a government loan satisfies the

[2]57 FR 19884 (8 May 1992). The DOC also initiated an investigation involving Brazil.

[3]57 FR 27739.

[4]"Preliminary Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products From Germany", 57 FR 42971 (17 September 1992); "Preliminary Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products From the United Kingdom", 57 FR 42974 (17 September 1992); and "Preliminary Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products From France", 57 FR 42977 (17 September 1992).

[5]"Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products From France", 58 FR 6221 (27 January 1993); "Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products From Germany" 58 FR 6233 (27 January 1993); and, "Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products From the United Kingdom" 58 FR 6237 (27 January 1993).

[6]"Certain Hot-Rolled Lead and Bismuth Carbon Steel Products From Brazil, France, Germany, and the United Kingdom; Import Investigation", 58 FR 14422 (17 March 1993).

[7]"Countervailing Duty Order and Amendment of Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France", 58 FR 15326 (22 March 1993); "Countervailing Duty Order: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany", 58 FR 15325 (22 March 1993); "Countervailing Duty Order: Certain Hot-Rolled Lead and Bismuth Steel Products from the United Kingdom", 58 FR 15327 (22 March 1993).

DOC's specificity test and is made to a firm at below the market interest rate (which rate will vary depending on whether the DOC finds the recipient firm to be "creditworthy" or "uncreditworthy" under its creditworthiness methodology for the year in which the loan was made), then the DOC will treat the loan as a countervailable subsidy; the DOC's creditworthiness determination dictates which methodology will be used to calculate the amount of the subsidy benefit (see Annex 1).

(i) Beneficiaries and countervailable subsidies found by the DOC

(a) France

8. In the French case, countervailable subsidies were calculated for Usinor Sacilor, a multinational company. Usinor Sacilor is a holding company formed at the end of 1986 as a result of the merger of Usinor and Sacilor, which were previously separate companies owned by the Government of France.

9. The DOC determined that countervailable subsidies were provided to Usinor Sacilor through equity infusions, recurring and non-recurring grants, and long-term loans. Subsidies in the form of equity infusions and non-recurring grants were determined to be provided through prêts à caractéristiques spéciales (PACS) which were converted into common stock in 1981, 1986 and 1991; through the terms at which PACS were repaid by Usinor; through convertible bonds issued by Usinor Sacilor to Fonds d'Intervention Siderurgique (FIS) in 1983, 1984 and 1985 (which were converted to common stock in 1986 and 1988); through shareholders' advances provided by the Government of France from 1982 through 1986; and through equity infusions by the Government of France in 1978. Subsidies in the form of long-term loans were determined to be provided through loans from Fonds de Developpement Economique et Social (FDES) and Caisse Francaise de Developpement Industriel (CFDI) on which the borrower paid lower than market interest plus a share in profits according to an agreed formula; and through European Coal and Steel Community (ECSC) Article 54 loans which are provided for the purpose of purchasing new equipment or financing modernization. Subsidies in the form of recurring grants were determined to be provided through the French Government's payments as part of the programme providing ECSC Redeployment Aid (Article 56(2)(b)).

10. The PACS were an instrument akin to redeemable nonvoting preferred stock. In accordance with the restructuring plan in 1978, bonds previously issued on behalf of the steel companies and pre-1978 loans from Credit National and Fonds de Developpement Economique et Social (FDES) were converted into PACS. FIS, or steel intervention fund, was created by a decree of 18 May 1983, in order to implement the authority under the 1981 Corrected Finance Law for Usinor Sacilor to issue convertible bonds. The Government of France provided shareholders' advances beginning in 1982 with the last instalment being paid in 1986. All these advances were converted to common stock in 1986. The DOC concluded that they constituted equity infusions on terms inconsistent with commercial considerations and, consistent with the equity methodology adopted in these investigations, concluded that any benefits to Usinor Sacilor occurred at the point when these instruments were converted to common stock. For shareholders' advances, the DOC determined them to constitute countervailable grants at the time they were received on the grounds that no shares were distributed in return for these advances and that there was no evidence showing that the parties contemplated that the advances carried a repayment obligation.

11. The subsidies were allocated to Usinor Sacilor's total sales of merchandise produced in France, i.e. excluding Usinor Sacilor's sales of merchandise produced outside France by its subsidiaries, less shipment expenses on the sales of the domestically produced merchandise.

(b) Germany

12. In the case pertaining to the subject imports from Germany, the EC has challenged the DOC's determination of subsidy to Saarstahl AG (hereinafter "Saarstahl"). The DOC determined that countervailable subsidies were provided to Saarstahl through debt forgiveness by the Governments of

Germany and the Government of Saarstahl in 1989, debt forgiveness by private banks, and the Worker Assistance Program (see below).

13. Saarstahl went through restructuring, mergers and name changes in the years 1971 through 1989. The first restructuring plan for steel companies that were to become Saarstahl was adopted in the 1970s by the Government of Germany and the Government of Saarland. After certain changes, including the Government's acquisition of Saarstahl's stock, an agreement was signed in 1986 under which Dillinger (whose parent company was Usinor Sacilor) would manage Saarstahl in order to diagnose the company's problems and to delineate conditions for a potential merger. In April 1989, an agreement was reached between the Government of Saarland and Usinor Sacilor regarding the merger of Saarstahl and Dillinger, and thus Saarstahl and Dillinger became subsidiaries of a newly created company, DHS-Dillinger Huette Saarstahl AG. The agreement was conditioned upon the Federal and Saarland Governments' forgiveness of Saarstahl's RZVs.[8] In June 1989, pursuant to the merger agreement, the Governments also forgave and relinquished in addition the repayment of principal on their guaranteed loans to Saarstahl.

14. When the Government of Saarland began negotiating the merger of Saarstahl and Dillinger in 1985, the Government of Saarland presented a long-term restructuring plan for Saarstahl to Saarstahl's creditors (i.e. private banks) and requested that they forgive DM 350 million in loans. The DOC determined that, based on this request, in February 1986 private banks agreed to forgive DM 217.33 million of debt owed to them by Saarstahl, if the Governments of Germany and Saarland would forgive all debt owed to the Governments by Saarstahl and if the Government of Saarland would assure the future liquidity of Saarstahl. Pursuant to that agreement, in 1987 one bank forgave DM 541,000 in Saarstahl's debts, and in June 1989, at the same time the Governments forgave the debt owed to them by Saarstahl, the banks forgave DM 216.819 million of Saarstahl's debts. Previously, in 1983-85, several banks had forgiven interest accrued on Saarstahl's debts.

15. The Worker Assistance Programme provided assistance under Article 56 of the ECSC Treaty for "social adjustment". Under Article 56 of the ECSC Treaty, assistance is provided to persons employed in the coal and steel sectors who lose their jobs. The ECSC disburses assistance on the condition that the affected country makes an equivalent contribution. The DOC determined that recurrent benefits, equivalent to the portion of assistance attributable to the Government of Germany, were provided under this programme.

(c) United Kingdom

16. In the case pertaining to subject imports from the United Kingdom, the EC's claims relate to subsidies calculated for United Engineering Steels Limited (hereinafter "UES"), which was formed in 1986 as a joint venture company by the government-owned British Steel Corporation (hereinafter "BSC") and a privately owned company, Guest, Keen & Nettlefolds (hereinafter "GKN"). Both BSC and GKN contributed "productive units" (e.g. steel works, re-rolling mills), accounts receivable, cash, and inventories to the joint venture in return for shares in UES. More specifically, BSC contributed a major portion of its Special Steel Business which produced engineering steels, while GKN contributed its Brymbo Steel Works and its forging business. At the time of the formation of UES, BSC was wholly owned by the Government of United Kingdom. However, in 1988, BSC was privatized and now bears the name British Steel plc.

17. The DOC determined that subsidies were provided to UES through Regional Development Grants, equity infusions and loan cancellation at the end of 1980/81 fiscal year. The DOC determined that Regional Development Grants were received by the BSC between the fiscal years 1977/78 and

[8] RZV, or Rueckzahlungsverpflichtung, was Saarstahl's obligation to repay, on returning to profitability, the funds provided by the Federal Government and the Government of Saarland under the company's restructuring plan in the 1970s.

1985/86, and that equity capital from the Government was received by BSC every fiscal year from 1977/78 through 1985/86. Also, prior to the formation of UES, BSC's equity was written off in two stages (in 1981 and 1982) as part of the capital restructuration of BSC. The DOC determined that UES benefited from equity infusions inconsistent with commercial considerations but not from the subsequent write-off of the equity. In conjunction with the 1981/1982 capital restructuring of the BSC, certain loans together with accrued interest on them were cancelled at the end of the BSC's 1980/81 fiscal year.

18. The DOC determined the existence of subsidies granted to UES on the basis of the subsidies granted to BSC from which, as mentioned above, UES had acquired production assets. The criteria used by the DOC for this determination was that:

"a company's sale of a 'business' or 'productive unit' does not alter the effect of previously bestowed subsidies. The Department does not examine the impact of subsidies on particular assets or tie the benefit level of subsidies to changes in the company under investigation. Therefore, it follows that when a company sells a productive unit, the sale does nothing to alter the subsidies enjoyed by that productive unit.

The subsidies provided to a company presumably are utilized to finance operations and investments in the entire company, including productive units that are subsequently sold or spun off into joint ventures. Therefore as the company disposes of its productive entities, these entities take a portion of the benefits with them when they 'travel to their new home.'"

(ii) Some aspects of the DOC's methodology pertaining to the cases under review by the Panel

19. Under the methodologies used by the DOC (see Annex 1), the DOC calculates the amount of countervailable subsidy on the basis of a criterion of benefit to the recipient. Benefits provided through non-recurring grants[9] are allocated over a specified number of years following the year in which the grants are provided to the company. In steel cases, the benefits from non-recurring grants are allocated over a period of 15 years, consistent with the useful life tables of the Internal Revenue Service, which measure the average useful life of assets in the United States steel industry. In the cases under review, the DOC treated equity infusions in unequityworthy companies as grants given in the year of the equity investment. The benefits under the non-recurring grants and equity infusions are allocated to the individual years in the 15-year period by using a formula which is termed as a "declining balance methodology". This formula specifies a particular amortization of the principal and includes the use of a discount rate (see Annex 1). The DOC uses different discount rates depending on whether or not a company is determined to be creditworthy. The DOC countervails those benefits that are allocated to the period of investigation, which was calendar year 1991 for the cases under review. See Annex 1 for details.

20. Benefits provided through loans are allocated over the time period of the loan, and the amount of the benefits is based on the differences between the market rate of interest (which will vary depending on whether the recipient firm is deemed "creditworthy" or "uncreditworthy") and the loan's actual rate. The DOC's loan methodology also includes the use of a discount rate, which is the same as the selected market interest rate. The DOC countervails the benefits that are allocated through its loan methodology to the period of investigation. See Annex 1 for details.

21. In the French case, for the purpose of determining whether equity infusions and loans by the Government of France to Usinor Sacilor constituted countervailable subsidies, the DOC determined that

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[9]The DOC considers grants under a programme to be recurring if the recipient firm receives, or is likely to receive, them on an ongoing basis or if they are less than 0.5 per cent of a firm's total or export sales, depending on whether the programme provides domestic subsidy or export subsidy.

Usinor, Sacilor, and Usinor Sacilor (i.e. the relevant companies at the relevant time) were: unequityworthy during 1982 through 1988; equityworthy during 1991 (1989 and 1990 were not considered because there were no equity infusions during those years); uncreditworthy during 1979 through 1989; and creditworthy during 1990 and 1991. Thus, Usinor Sacilor was determined to be uncreditworthy in the years in which all grants were approved. As a result, the DOC used the same discount rate when calculating the benefits from non-recurring grants, equity infusions and loans in the years when Usinor Sacilor was determined to be uncreditworthy. The DOC used as the discount rate a rate of interest reported in the IMF publication "International Financial Statistics", and added a risk premium to this rate in accordance with the DOC's practice, as set forth in the DOC's Proposed Regulations.

22. In the United Kingdom case, the DOC determined that BSC was unequityworthy from 1977/78 through 1985/86. The petition did not allege that BSC was uncreditworthy in the years that the company received subsidies, and thus the DOC did not examine the BSC's creditworthiness in the case under review by the Panel. However, based on "Stainless Steel" and "Stainless Steel Review" cases[10] in which the DOC had determined that BSC was uncreditworthy for the fiscal years 1977/78 through 1983/84, the DOC decided to treat BSC as uncreditworthy in those years. As mentioned above, the subsidies which were determined to be countervailable in this case included equity infusions, grants and loan cancellation which was treated as a grant to BSC.

III. MAIN ARGUMENTS

23. The EC requested the Panel to find that the imposition by the United States of countervailing duties on imports of certain hot-rolled lead and bismuth carbon steel products originating in France, Germany and the United Kingdom was inconsistent with Articles 1 and 4:2 of the Agreement on the following counts:

1. the characterization of debt-forgiveness by private banks as a subsidy (German case);

2. the allegation that subsidies inhere in assets acquired at fair market value by UES from British Steel and that thus subsidies granted to British Steel benefitted UES (United Kingdom case);

3. determination that government equity infusions into firms deemed "unequityworthy" in accordance with the specific methodology applied by the DOC were subsidies (French and United Kingdom cases);

4. the loans granted by the government to firms deemed not to be creditworthy in accordance with the specific methodology applied by the DOC being characterized as subsidies (French case);

5. the resort to arbitrary benchmark interest rates for determining the alleged benefits derived under various subsidy programmes (French case);

6. the allocation of subsidies solely over the domestic production of a company (French case);

[10] "Final Affirmative Countervailing Duty Determinations on Stainless Steel Sheet, Strip, and Plate from the United Kingdom", 48 FR 19048 (27 April 1983), and "Stainless Steel Plate From the United Kingdom; Final Results of Countervailing Duty Administrative Review", 51 FR 44656 (11 December 1986).

7.the allocation of subsidies over an arbitrary chosen standard fifteen year period (French, German and the United Kingdom cases);

8.the recalculation of grants and other subsidies to be allocated over time according to the so-called declining balance method (French, German and the United Kingdom cases).

24. The EC requested the Panel to recommend to the Committee that the United States modify its regulations and practices so as to bring them in conformity with the Agreement.

25. The United States requested the Panel to find that the United States' imposition of countervailing duties was fully in conformity with the Agreement. The United States argued that its domestic authorities complied with the requirements of the Agreement on each of the above issues cited by the EC.

26. However, on the issue of calculation of subsidies for UES in the United Kingdom case (i.e. relating to EC's point 2 in paragraph 23), the United States informed the Panel that the DOC's determination on that issue was on appeal before the United States Court of International Trade (hereinafter "CIT"). The DOC had decided to use a revised methodology on that issue to calculate the subsidies, and on 26 August 1993, the DOC had petitioned CIT for an order remanding the determination back to the DOC so that it could apply its revised methodology on this issue to the facts of this case and issue a revised final countervailing duty determination. Among the arguments provided by the DOC for such a request was that it could not defend its previous methodology. Given the situation regarding this issue the United States suggested that the Panel put aside this issue and consider it if the EC wished that the Panel take up the revised determination. Nevertheless, as described below in the relevant section, the United States presented arguments in support of its original determination of this issue.

27. However, the EC maintained its submission regarding this issue and requested the Panel to rule on the matter as specified in its request for the establishment of the Panel.

28. The EC's arguments in this case were presented in a framework which first addressed certain legal points that were common to more than one particular issue, and then addressed legal aspects relating to specific issues. The presentation in the Descriptive Part of this Report follows the same framework.

1. General legal considerations

29. The EC presented its claims on the specific aspects of the determinations at issue in this proceeding against the background of several considerations of a general nature regarding the relevant requirements of the Agreement with respect to the determination of the existence of a countervailable subsidy. The arguments of the parties on these issues appear below in section (a). In addition, the parties presented to the Panel their views on the appropriate standard of review which should be adopted by the Panel in its examination of the issues before the Panel. The arguments of the parties on this matter appear below in section (b).

(a) Obligations of signatories with respect to the determination of the existence of a subsidy

30. The EC submitted that Article 4:2 of the Agreement, interpreted in accordance with the rules on treaty interpretation in the Vienna Convention on the Law of Treaties (hereinafter "Vienna Convention"), necessitated a determination of the existence of a subsidy before a countervailing duty may be levied, and that a determination of the existence of a subsidy in accordance with Article 4:2 required that there be a financial contribution by a government which resulted in a benefit to the recipient. The EC also submitted that a determination of the existence of a subsidy had to be based on an examination of all relevant facts, which precluded any resort to (rebuttable or irrebuttable) presumptions.

31. The United States argued that Article 4:2 did not address the issue of the determination of the existence and calculation of the amount of a subsidy and therefore provided little basis for the claims presented by the EC in this case. The United States considered that an interpretation of the Agreement in accordance with the rules of the Vienna Convention did not support the view that a financial contribution by a government was a necessary condition of the existence of a subsidy. The United States submitted that in the determinations at issue in this dispute the DOC had considered all relevant evidence on record, and that the EC's claim regarding the failure of the DOC to take into account all relevant facts in reality involved disagreement over questions of methodology or interpretation of the Agreement or over the weight to be accorded to certain evidence.

(i) Obligation to determine the existence of a subsidy

32. The EC argued that the Agreement aimed at striking a balance between, on the one hand, subsidization which might have adverse effects on or prejudice to the interests of other signatories, and on the other hand countervailing measures which might unjustifiably impede international trade. Of fundamental importance to avoid the improper use of countervailing measures was Article 4:2 which provided in relevant part:

"No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist..."

This provision was necessarily based on the premise that no countervailing duty may be levied unless a subsidy was shown to exist. It required, therefore, that a signatory show that a subsidy existed before a countervailing duty could be levied. Article 4:9 of the Agreement confirmed that a countervailing duty could remain in force "as long as, and to the extent necessary to counteract the subsidization". Further support for this could be found in Article VI of the General Agreement which was drafted in similar terms to Article 4:2 of the Agreement and which referred to "the estimated bounty or subsidy determined to have been granted" (emphasis added by the EC). The provisions of Articles 4:2 and 4:9 of the Agreement and of Article VI of the General Agreement were linked to Article 1 of the Agreement, which expressly stated that "signatories shall take all necessary measures to ensure that the imposition of a countervailing duty ... is in accordance with Article VI of the General Agreement ...", in addition to being in accordance with the terms of the Agreement. Article 1 thus provided an important reinforcement of the norm of Article 4:2.

33. The EC argued that the purpose for which countervailing measures were permitted under the Agreement was to offset trade distorting effects of subsidies resulting in material injury to the domestic producers. This required that a subsidy must at least be one of the causes of the injury. There must, therefore, be a causal link between injury and the subsidized imports and this link must result from the distortion of competition brought about by the subsidy. In consequence, the determination that a subsidy may be countervailed had to be based on some competitive advantage accruing from the subsidy to the company whose products were countervailed.

34. The United States argued that while the General Agreement and the Agreement contained procedures for countervailing duty investigations and rules for the levying of countervailing duties to offset injurious subsidized imports, neither instrument provided much guidance as to what constituted a countervailable subsidy or how to calculate its amount. Article VI:3 of the General Agreement provided that "no countervailing duty shall be levied ... in excess of the amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production, or export of such product in the country of origin or exportation...". This provision did not address the issue of the calculation of the amount of a subsidy, but indicated only that the amount levied not exceed the amount "determined to exist". Similarly, Article 4:2 of the Agreement addressed the levying of duties once the amount of the subsidy had been found. Note 15 ad Article 4:2 stated:

"An understanding among signatories should be developed setting out the criteria for the calculation of the amount of the subsidy."

To date, no such understanding had been developed. Simply put, therefore, the Agreement did not set down rules for how investigating authorities were to determine the amount of a subsidy. The limited purpose of Article 4:2 as well as of Article VI:3 of the General Agreement was to link the amount of duties levied to the amount of the subsidy found to exist. The United States argued that this interpretation of Article 4:2 was supported by the panel report in the "United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway" case (hereinafter "Salmon").[11]

35. In this regard, the United States considered that it was fundamental that a panel should avoid any invitation to create obligations that were not contained in the Agreement or in the General Agreement. Article 18 of the Agreement stated that a panel shall submit a report containing its "findings concerning the rights and obligations of the signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by this Agreement" (emphasis added by the United States). Where the negotiators of the Agreement either failed to reach agreement on particular issues, or otherwise chose not to address them in the Agreement, a panel should reject a request to step in and supply such obligations. To do so would be contrary to the well-established principle of international law that an agreement defined the scope of a party's obligations. On issues not covered by provisions of the Agreement, such as the methodology for calculating the amount of a subsidy, the panel should, at most, seek only to determine whether the investigating authorities' approach was reasonable (see *infra*, section (b) paragraphs 81 to 108).

36. The EC argued that Article 4:2, together with Article VI:3 of the General Agreement clearly required that a subsidy be shown to exist before a countervailing duty could be levied. The question of the existence of a subsidy was distinct from the question of the calculation of the amount of a subsidy. Though the Agreement and the General Agreement gave little guidance on what methods of calculation to follow when assessing the amount of the subsidy, any test of reasonableness applied in that context was irrelevant to the determination of the existence of a subsidy. The determination of the existence of the subsidy had to be addressed before one reached the problem of calculation. In the context of Article 4:2 and Article VI:3 of the General Agreement a determination of the existence of a subsidy was inevitable.

37. In this regard, the EC considered that none of the major issues in this case reached the question of calculation of the amount of the subsidy. For example, the issues in dispute regarding the treatment by the DOC of debt forgiveness by private banks as a countervailable subsidy involved the issue of the existence of a subsidy: private banks simply could not give a government subsidy. With regard to the DOC's approach to the sale of assets of a previously subsidized company, the issue was that subsidies did not "travel" in whole or in part with assets transferred at market prices. Therefore, there was no subsidy in such cases. With respect to the DOC's analysis of equityworthiness and creditworthiness of firms, a subsidy could not be found to exist on the basis of an analysis such as that performed by the DOC which omitted important facts and logical steps. With regard to the allocation of subsidies solely to domestic production in the French case, a part of the subsidy simply did not exist for French products and did not benefit them. Finally, the issues in dispute regarding the allocation of subsidies over a fifteen year period and regarding the declining balance methodology involved the interpretation of Article 4:2 of the Agreement and of the Guidelines adopted by the Committee. Both these methods had resulted in a finding of the existence of a subsidy where none existed. None of the above-mentioned questions could be decided by blanket application of a standard of reasonableness. These were questions of the interpretation of the Agreement and of the Guidelines adopted by the Committee. The Panel should not abdicate its responsibility for interpreting the Agreement by having immediate resort to the criterion of reasonableness.

[11] SCM/153, 4 December 1992, paragraph 245

38. The EC submitted that if, as argued by the United States, Article 4:2 had nothing to do with the issue of the determination of the existence of a subsidy, but only with the imposition of a duty after a subsidy had been found to exist, this would mean that the Agreement had lost one of its fundamental functions, namely to avoid that countervailing duties unjustifiably impede international trade, which would be contrary to the object and purpose of the Agreement. It would imply that investigating authorities of signatories could not only more or less do what they wanted where it concerned the calculation of subsidies (only loosely restrained by a vague "reasonableness" concept), but could also find subsidies where none existed because they did not have to respect the natural meaning of the term "subsidy".

39. The United States noted that the EC had based its claims only on Articles 1 and 4:2. Article 1 referred to ensuring conformity with other provisions of the Agreement and the General Agreement and as such was not operative in the absence of such other provisions. With respect to Article 4:2, the only other provision cited by the EC, the EC had failed to rebut the interpretation put forward by the United States, which was based on the plain meaning of the text. The United States argued that, read carefully, Article 4:2 (and Article VI:3 of the General Agreement on which it was based) limited only the authorities' levying of duties for subsidies found to exist. Article 4:2 did not in any way address the determination of the existence of subsidies or their amount; it only stated that the authorities shall not impose duties in excess of that amount. Furthermore, the placement of Article 4:2 in the Agreement supported this limited meaning as the provision appeared in an Article entitled "Imposition of Countervailing Duties" between a paragraph that concerned whether the amount levied should be the full amount found to exist and a paragraph that concerned non-discriminatory application of duties on all sources found to subsidize and cause injury. This placement reinforced the notion that Article 4:2 concerned the levying of duties, not the determination of whether subsidies existed or their amount. Had this provision been intended to cover these matters, it would have been more clearly written to indicate that purpose. In this respect, the contrast between Article 4:2 and the detailed and specific requirements in Article 6 on the determination of injury was significant. The only "definition" in the Agreement relevant to the determination of the existence of a subsidy was footnote 4 which defined a countervailing duty as "a special duty levied for the purpose of off-setting any bounty or grant bestowed directly or indirectly upon the manufacture, production, or export of any merchandise".

40. The United States made the following comments on the argument of the EC that if Article 4:2 had nothing to do with the determination of the existence of a subsidy but only with the imposition of a duty after a subsidy had been found to exist, this would mean that the Agreement had lost one of its fundamental functions, namely to avoid that countervailing duties unjustifiably impede international trade. Under the "plain-meaning of the term" interpretation advanced by the United States, Article 4:2 would play an important role in ensuring that countervailing duties did not unjustifiably impede international trade. Article 4:2 provided that a signatory shall not impose countervailing duties above the amount of the subsidy found to exist. Although Article 4:2 did not address how this initial subsidy finding was to be made, it did limit the duties that might be imposed to the amount of the finding. Duties in excess of this amount could be viewed as unjustified. Article 4:2 prevented authorities from imposing such excessive duties.

41. In this context, the United States further argued that it was important to bear in mind that other provisions in the Agreement also served the goal set forth in the Preamble of avoiding unjustified impediments to international trade. Chief among them was Article 6, pertaining to the existence of material injury. Article 6 set forth detailed requirements for a finding of material injury, the satisfaction of which was a prerequisite to the imposition of countervailing duties. Countervailing duties imposed in the absence of a finding of injury to a domestic industry could be viewed as an impediment to international trade without justification. Article 6 removed this possibility. Other provisions that served a similar function were Articles 2:1, 2:3 and 2:5. In short, there were numerous examples, including Article 4:2 under the interpretation advanced by the United States, of provisions of the Agreement that advanced the aim of avoiding unjustified impediments to international trade. To the extent Article 4:2 did not go further in the particular manner proposed by the EC, this was the responsibility of the drafters of the Agreement.

It would not be proper to ascribe additional meaning to a provision that was not suggested by its terms simply because some believed that to do so would serve a laudable goal.

42. The United States argued that the EC's claim that all of the issues now before the Panel were issues of determining the existence of subsidies rather than issues of calculation might be an attempt to avoid the operation of footnote 15 to Article 4:2, which stated that an understanding among signatories should be developed as to the calculation of the amount of a subsidy, and the fact that to date no such understanding had been reached. However, this claim involved a highly strained interpretation of a number of issues in this case. Although some of the issues could be said to concern the determination of the existence of a subsidy, others were calculation issues (e.g. net present value (NPV) issue and grant methodology). Issues that had, at a minimum, calculation aspects included the issue of the 15-year allocation period for subsidy benefits and the issue of the treatment of debt forgiveness by private banks, in which the DOC calculated the subsidy value in a situation involving a government guarantee and private bank debt forgiveness as the amount of the subsidy. In any event, consideration of many issues before the panel as "existence of subsidy" issues did not assist the EC because what guidance existed in the Agreement regarding the definition of the existence of a countervailable subsidy did not exclude any of the findings of the DOC in this case.

(ii) Financial contribution by a government as a necessary condition of the existence of a subsidy

43. The EC argued that the ordinary meaning of the term subsidy, interpreted in the context of other textual elements in the Agreement, supported the view that a financial contribution by a government was a necessary condition for the existence of a subsidy. Thus, Article VI:3 of the General Agreement provided in unequivocal terms that a countervailing duty may not be in excess of the amount of the subsidy "determined to have been granted". Article 1 of the Agreement explicitly referred to Article VI of the General Agreement and required that the imposition of a countervailing duty be in conformity with that provision. The Illustrative List of Export Subsidies annexed to the Agreement also used terms which indicated that there must be some financial contribution by a government in order for a subsidy to exist. In this regard, the EC referred to terms such as "provision", delivery", exemption", "remission" or "grant" by governments. These terms constituted important textual elements of interpretation in favour of the need of a financial contribution by a government as a necessary condition of the existence of a subsidy.

44. The United States argued that there was no basis in the Agreement for the EC's view that a financial contribution by a government was a necessary condition for the existence of a subsidy. The Agreement provided little guidance on what constituted a subsidy. Article VI:3 of the General Agreement provided that a countervailable subsidy may be granted "directly or indirectly". Note 4 to Article 1 of the Agreement defined a countervailing duty as "a special duty levied for the purpose of off-setting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production, or export of any merchandise" (emphasis added by the United States). This suggested that, for purposes of levying countervailing duties, subsidies were to be given a broad construction. Moreover, apart from these provisions, there was no other pertinent guidance in Part I of the Agreement - which concerned the application of countervailing measures - on the meaning of the term "subsidy". The text of the General Agreement and of the Agreement did not contain a "financial contribution" standard. The Chapter on subsidies and countervailing measures in the Dunkel Draft Final Act contained a "financial contribution" standard; in contrast, the existing Agreement, by which the present dispute must be judged, contained no similar provision. For many years, the United States had analysed the issue of identifying subsidies and of determining their amount from the vantage point of the recipient of the alleged subsidy -a "benefit to the recipient" approach. Nothing in the Agreement was contrary to this longstanding practice. This approach was consistent with the definition of the term "countervailing duty" in footnote 4 of the Agreement in that it looked to the producers of a product to determine whether and to what extent a bounty or subsidy had been bestowed on them.

45. Regarding the EC's references to the Illustrative List of Export Subsidies in support for the view that the Agreement contained a financial contribution test, the United States argued that this List did not

pertain to Part I of the Agreement, which concerned countervailing measures. Rather, the list was referenced in Article 9, which was found in Part II of the Agreement. As such, the List was not pertinent in determining rights and obligations arising under Part I of the Agreement. The two Parts of the Agreement were separate. The panel in the Salmon dispute had recognized this distinction with regard to an argument based on Article 11 of the Agreement, which was also in Part II. After discussing the distinction between Parts I and II, the panel stated that "the rights and obligations in Article 11 concerned the use of subsidies, not the use of countervailing measures" (Salmon, paragraph 238). Moreover, the List was by its own terms merely illustrative, not exhaustive. In addition, the "United States - Measures Affecting Imports of Softwood Lumber from Canada"[12] panel (hereinafter "Lumber") had noted explicitly that the List "contained items which could be said to contradict the 'cost to government' standard." (paragraph 343, footnote 156) One example was the reference in item (c) to "transport charges ... mandated by governments". Finally, the List was illustrative of export subsidies, which were not present in this case.

46. The EC argued that if, as the EC believed, the Panel had to address the question of the determination of the existence of a subsidy, the Panel could not avoid the question of what were the constituent elements of a subsidy. There might not be a definition of the term subsidy in the Agreement but that did not mean that it was impossible to glean from the Agreement some constituent elements of what was a subsidy. If the term itself did not provide sufficient clarity, recourse to the rest of the text of the Agreement was normal under Article 31 of the Vienna Convention on the Law of Treaties. The EC referred in this context to the textual elements mentioned supra in paragraph 43. These textual elements were in principle supported by the Lumber panel (paragraph 344 of the Lumber panel report). In light of that panel report in particular, the EC considered that it was highly exaggerated on the part of the United States to argue that concepts and terms from Part II of the Agreement and from the Illustrative List of Export Subsidies may not at all be resorted to for purposes of contextual interpretation. Even if Parts I and II had different purposes, as a matter of interpretation the text of a treaty had to be considered as a whole.[13]

47. The EC argued that the structure of the General Agreement provided further support for the view that a financial contribution by a government was a necessary condition for the existence of a subsidy. If countervailing duties were permitted to offset economic benefits that may result from actions of a government not involving a financial contribution by that government, many of the rules in the General Agreement could be discarded because the effects on trade of the actions to which those rules were directed (e.g. quotas, tariff levels, national regulation) could be addressed simply through countervailing duty policy. Such an interpretation was not consistent with the structure of the General Agreement. A financial contribution by the government was the crucial factor distinguishing subsidies from other non-tariff barriers.

48. The EC argued that given that the word "subsidy" was being used throughout the Agreement and also in Article 4:2, it must have some definite meaning which could not be modified at will by the signatories. The Panel should therefore not let itself be put off from its task by the past and present theological disputes on "cost to the government" versus "benefit to the recipient". Rather, the Panel should simply have recourse to the natural meaning of the term subsidy as prescribed by Article 31.1 of the Vienna Convention. In doing so, the Panel ought to find that a subsidy cannot exist without some kind of financial contribution by a government. Dictionary definitions pointed in this direction. Moreover, the great majority of the contextual elements advanced by the EC confirmed this interpretation. Relying on the natural meaning of the terms, however, would also bring the Panel to accept that a subsidy conferred a benefit on its recipient. This was important in connection with countervailing subsidies; there was no use in applying a countervailing duty if there was no benefit to the recipient. Imposing a countervailing duty in the absence of such benefit was purely punitive. The Agreement did not have a punitive goal.

[12]SCM/162, dated 19 February 1993.

[13] Ian Sinclair (1984), The Vienna Convention on the Law of Treaties, page 127 .

Countervailing measures were not punitive actions. They were measures to counterbalance unearned competitive advantages. The EC submitted on the basis of these considerations that the determination of the existence of a subsidy in accordance with Article 4:2 of the Agreement required a financial contribution by the government and that some benefit was thereby bestowed on the recipient.

49. According to the EC, such an interpretation of the term "subsidy" was correct in the light of the interpretative criteria of the Vienna Convention: there was an agreed term with a natural meaning which was confirmed by recourse to contextual elements, including the purpose of the Agreement. The situation was different with respect to the calculation of the amount of a subsidy. In that case there were not just controversies over the interpretation, the text of the Agreement itself made it clear that ulterior agreement between the signatories had to be found. Since such agreement was lacking hitherto, a panel was entitled to abstain from further searching for interpretation. However, a panel was not entitled to do so in case there was mere controversy over the implications of a term ("subsidy") which was accepted by all and normally had a clear and natural meaning. If a panel were to do that, Article 4:2 and the Agreement as a whole would lose much of their function of restraining over-eager countervailers.

50. The United States argued that its views on the limited guidance provided by the Agreement on the definition of what constituted a subsidy were supported by the principles of interpretation laid down in the Vienna Convention. Thus, with respect to the reference in Article 31 of the Vienna Convention to the "ordinary meaning to be given to the terms of the treaty" the Agreement contained no definition of a subsidy, as had been observed by the Lumber panel, and defined a countervailing duty as a special duty levied for the purpose of offsetting any bounty or grant bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise. Regarding the reference in Article 31 of the Vienna Convention to the context of a treaty provision, including the preamble and annexes and other agreements or instruments in connection with the conclusion of the treaty, the United States noted that the Preamble of the Agreement recognized that subsidies may have harmful effects on trade and production, and stated a desire that relief was made available to producers adversely affected by the use of subsidies within a framework of rights and obligations. The Preamble did not define what was a countervailable subsidy. The effects of subsidies mentioned in the preamble were manifested in Part I of the Agreement in the material injury provisions of Article 6. The lists of subsidies in Part II of the Agreement applied directly only to Part II and were only illustrative. Moreover, these lists contained examples that "could be said to contradict" the cost to government standard. (Lumber panel, note 156).

51. The United States further noted that there were no agreements or instruments related to the Agreement within the meaning of Article 31.2 of the Vienna Convention. Regarding the reference in Article 31.3 of the Vienna Convention to subsequent agreements, subsequent practice and relevant rules of international law, the United States argued that the practice of the United States since the Agreement was ratified had consistently been based on a "benefit to the recipient" approach. The United States did not agree with the view that adopted panel reports, such as the Pork panel report, should be considered as subsequent agreement or subsequent practice within the meaning of Article 31.3 of the Vienna Convention. However, if such reports were to be considered as constituting subsequent agreement or subsequent practice, one had to include the Lumber panel report which was more directly on point as to the guidance contained in the Agreement on the definition of a subsidy. No relevant rules of international law within the meaning of Article 31.3(c) of the Vienna Convention were applicable. Finally, the provision in Article 31.4 of the Vienna Convention that "A special meaning shall be given to a term if it is established that the parties so intended" and the supplementary means of treaty interpretation as envisaged in Article 32 of the Vienna Convention, including preparatory work and the circumstances of conclusion of a treaty, were also not applicable.

52. The United States considered that it was clear from the above that the EC's view that the Agreement mandated that all subsidies contain a government financial contribution under a cost to government standard found no support in the Agreement according to accepted means of treaty interpretation. Indeed, there were many further indications that the Agreement did not define a subsidy in

the manner suggested by the EC. For example, the EC itself had admitted as much before the Subsidies Committee in 1985, where the EC representative had stated that "No agreement had been reached on the definition of subsidy (cost to government versus benefit to recipient)."[14] Similarly, in a submission in the context of the Uruguay Round negotiations, the EC had noted "ambiguities and lack of precision, in the Code, on a number of crucial points" in, particular as to the "definition of a subsidy" and "definition of an actionable subsidy".[15]

53. The United States noted that commentators had echoed this conclusion. One analysis noted:

> "Forty years after the GATT and Articles VI and XVI were established and in spite of intensive negotiations in the Tokyo Round to interpret and expand the original GATT rules, today there is still no agreed definition of what is a subsidy, as opposed to general government measures, and of what is an 'actionable subsidy' under the GATT."[16]

Another commentator had observed:

> "The only conclusion one can therefore draw from the GATT and the Subsidies Code on this particular issue of definition is that neither agreement offers much guidance as to the types of practices in respect to which countervailing duties may be levied. Whether a signatory adopts a 'cost to government' or 'benefit to recipient' approach is a choice of policy, not a question of law; none of the two approaches is incompatible with the GATT or the Subsidies Code."[17]

54. With respect to the EC's argument that a financial contribution standard was necessary in order to provide a delimitation to the measures covered by Article VI and that, without such a boundary, there was a danger that Article VI would encroach on matters covered by other provisions of the General Agreement, the United States argued that the EC had not indicated the way in which such an encroachment would occur with regard to any of the issues before the Panel in this case. More fundamentally, it was not clear how such a policy-type consideration was relevant to the proper interpretation of the Agreement under Article 31 of the Vienna Convention. This supposed danger thus appeared to be a poor reason to invent a requirement that did not exist from a proper interpretation of the Agreement. Moreover, whether or not a particular measure could conceivably be covered by a GATT provision other than Article VI did not mean that Article VI could not also apply. Indeed, Article 19 of the Agreement, after stating that no action against a subsidy may be taken except in accordance with the General Agreement, as interpreted by this Agreement, indicated in note 38 that "this paragraph is not intended to preclude action under other relevant provisions of the General Agreement, where appropriate."

55. The EC argued that, if the criteria of Articles 31 and 32 of the Vienna Convention were applied to Article 4:2 of the Agreement, it was plain to see that a subsidy had to be found to exist before a countervailing duty could be imposed. The meaning of the word subsidy had to be ascertained by having

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[14] SCM/M/30, 10 January 1986, page 14.

[15] Elements of the Negotiating Framework, Submission by the European Community to the Negotiating Group on Subsidies and Countervailing Measures, MTN.GNG/NG10/W/31, 27 November 1989, page 1.

[16] G. Depayre and R. Petriccione, 1991, "Definition of Subsidy," in Jacques H. Bourgeois (ed.) Subsidies in International Trade - A European Lawyer's Perspective, page 67.

[17] R. Quick, 1991, "Calculation of Subsidy," in Jacques Bourgeois (ed.), Subsidies in International Trade - A European Lawyer's Perspective, page 101.

recourse to the ordinary meaning of the term. This was a task that had been deftly side-stepped by the United States in its submissions to this Panel as well as by the Lumber panel. Both seemed to take the view that the absence of a definition implied that there was no ordinary meaning of the term "subsidy" and moved on immediately to the context and purpose of the Agreement. This was demonstrably at variance with Article 31.4 of the Vienna Convention, which clearly stipulated that a special meaning shall be given to a term (and hence the ordinary meaning shall not be applied), only if it is was established that the parties so intended. As the signatories of the Agreement could not agree on a special meaning of the term 'subsidy", the ordinary meaning of that term applied. Dictionary definitions supported the view that the ordinary meaning of the term "subsidy" implied some contribution of money from the government to the expenses of a recipient in industry. Contextual elements in the Agreement, which had to be interpreted as a whole, supported this ordinary meaning. There was only one known example which would not seem to require some contribution or bestowal of money by the government but in that example the government reached the same result by formally mandating favourable transportation rates. Given the overwhelming support for the ordinary meaning in the context, this remained a very precisely circumscribed exception.

56. The EC argued that, if beyond the context, one looked at any subsequent agreement or subsequent practice within the meaning of Article 31.3 of the Vienna Convention, it was clear that the unilateral practice of the United States in applying the Agreement was of no value because it did not constitute "practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation." (emphasis added by the EC). On the other hand, it was self-evident that adopted panel reports fell either under subsequent agreement or under subsequent practice and, therefore, the Pork panel report was of considerable importance. It was clear, on the basis of the ordinary meaning of the word "subsidy" as well as of the contextual elements contained in the Agreement, that a subsidy was some kind of financial contribution of the government to the advantage of a recipient in private industry. This result of applying the primary rules of interpretation in Article 31 of the Vienna Convention did not leave the meaning of the term 'subsidy" obscure or ambiguous, nor did it lead to a result which was manifestly absurd or unreasonable. Hence, recourse to secondary means of interpretation, including the preparatory work of the treaty was unnecessary. What was known about the historical quarrel about the "cost to government" versus the "benefit to the recipient" approach could only lead a panel to conclude that it would be doing nothing extraordinary if it accepted an ordinary meaning interpretation (supported by contextual elements) which contained elements of both approaches.

57. In the view of the United States, there were numerous indicators that reinforced the view that the Agreement had little to say on the definition of a countervailable subsidy, and that what did exist could not be said to preclude the DOC's determination in this case. In addition to the text of the Agreement, statements made by the EC in the Committee and in the Uruguay Round negotiations and observations of commentators, there was also the following statement in the recently adopted Lumber panel report:

> "Neither Article VI of the General Agreement nor the Agreement provided a general definition of the term 'subsidy' ... The Panel noted that where the drafters of the General Agreement and the Agreement had intended to exclude certain government measures from the coverage of the term 'subsidy,' they had explicitly provided for such exclusion, e.g. tax exemptions or rebates pursuant to article VI.4 of the General Agreement." (Lumber panel report, paragraphs 340-341).

The arguments of the EC had failed to overcome this overwhelming evidence on the limited guidance in the Agreement concerning what was an actionable subsidy. If, as argued by the EC, the Illustrative List of export subsidies was intended to amount to an actual limitation on what was an actionable subsidy, one would expect more than simply a non-exhaustive, least-common-denominator list of a special kind of subsidy (export subsidies) that related to another Part of the Agreement (Part II as opposed to Part I). With respect to the EC's argument that the term "subsidy" was a commonly understood term whose meaning could be determined from, for example, a common dictionary, the United States considered it bizarre to claim that despite years of negotiations, substantial continuing negotiations and work of expert groups, the issue of what was a subsidy in an agreement devoted explicitly to subsidies and permissible responses thereto should be decided not on the basis of the document itself or anything connected with the negotiations, but on wholly extraneous items such as a general dictionary.

58. In response to a question by the Panel, the United States stated that it agreed that under Article 31 of the Vienna Convention the Agreement had to be interpreted taking into account the Preamble, Parts I and II and the Annexes. A separate issue however, was the weight that should be accorded to these particular elements of context. Part II of the Agreement applied to restrictions on signatories' ability to employ subsidies, not to restrictions on the imposition of countervailing duties. As such, although Part II might not be wholly irrelevant to a consideration of matters falling under Part I (which addressed imposition of countervailing duties), its relevance was nevertheless limited. Moreover, the particular provisions contained in Part II that were cited by the EC provided little support for the EC's claims as to the interpretation of the term "subsidy" in Part I, and, if anything, bolstered the position of the United States. The same was true for the Annex containing the Illustrative List of Export Subsidies. The List was referred to in Article 9:2 and therefore pertained directly only to Part II. With regard to the Preamble, again it was part of the context of the Agreement and was to be considered. It was generally recognized that preambulatory language did not itself impose legal obligations on a signatory. In this case, the EC had made much of the language in the Preamble that stated the signatories' desire "that countervailing measures do not unjustifiably impede international trade". Along with this language, the Preamble recognized that "subsidies may have harmful effects on trade and production" and, further, stated the signatories' desire "to ensure that the use of subsidies does not adversely affect or prejudice the interests of any signatory to this Agreement". The EC's presentation had omitted these portions of the preamble, which were necessary for a complete understanding of the preamble.

59. The EC stated that it was not asking for a definition of the term "subsidy", i.e. a special meaning of the term in the sense of Article 31.4 of the Vienna Convention. This would have been the task of the negotiators. Rather, it was asking for an interpretation of the term "subsidy" in accordance with the natural meaning of that term, as required by Article 31.1 of the Vienna Convention. Precisely because the signatories could not agree on a definition of the term, the Panel should probably avoid to give such a definition. On the other hand, signatories had agreed on the term "subsidy" and that term could and had to be interpreted by the Panel. The ordinary meaning of the word, as given in various dictionary interpretations, suggested that at the very least there had to be some monetary contribution by the government and a benefit to the private industry which received the subsidy.

60. In this latter regard, the EC noted the following dictionary interpretations of the term "subsidy." The Concise Oxford Dictionary (8th ed. 1990) referred to "money granted by the State or a public body etc. to keep down the price of commodities etc.; money granted to a charity or other undertaking held to be in the public interest." Webster's Third New International Dictionary referred to "a grant or gift of money or other property made by way of financial aid: as...(d) a grant of funds or property from a government...to a private person or company to assist in the establishment or support of an enterprise deemed advantageous to the public..." Black's Law Dictionary (6th ed. 1990) referred to "A grant of money made by government in aide of the promoters of any enterprise, work, or improvement in which the government desires to participate, or which is considered a proper subject for government aid, because such purpose is likely to be of benefit to the public."

61. In response to the reference made by the United States to statements by the EC representative in the Subsidies Committee, the EC argued that the Vienna Convention had created a clear hierarchical relationship between the primary means of treaty interpretation in Article 31 (text, context, object and purpose and other elements to be taken into account together with the context) and the supplementary means of treaty interpretation (including the preparatory work of the treaty and the circumstances of its conclusion) laid down in Article 32. The primary means and supplementary means of interpretation may only be used simultaneously, if the latter served to confirm the former. Use of the supplementary means, however, was only permissible as an independent means of determining the meaning of a treaty provision if

the interpretation according to Article 31 "(a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable." The signatories of the Agreement had agreed on the use of the term "subsidy" in the Agreement. That term had a straightforward and generally accepted ordinary meaning. If the criterion of the 'ordinary meaning of the term" was resorted to and analyzed in the light of the context of the Agreement, the outcome was that the term "subsidy" had to be interpreted to contain as minimum elements a monetary contribution from the government to a private industry which drew some benefit or advantage from that contribution. This outcome was not at all ambiguous or obscure and did not lead to a result which was manifestly absurd or unreasonable. Hence, there was no need to have resort to the supplementary means of interpretation, such as in this case the negotiating history in order to determine the meaning of the term "subsidy". *A fortiori*, the preparatory work could not be used to determine or undo an interpretation which was based on the primary means of interpretation, such as the ordinary meaning of the terms of the Agreement. For these reasons, the EC considered that statements about the history of negotiations, such as the statements made by the EC representative in 1985 in the Subsidies Committee, might have a certain historical or political value, but could not be a determining factor for the interpretation of the term "subsidy".

62. The EC identified the following specific contextual elements as support for its view that a financial contribution by a government was a necessary condition for the existence of a subsidy. First, footnote 4 to Article 1 spoke of a "bounty or subsidy bestowed directly or indirectly on the manufacture etc" (emphasis added by the EC). Secondly, Article VI:3 to which the Agreement was linked, referred to "the subsidy determined to have been granted" (emphasis added by the EC). Thirdly, Articles 11.1 and 11.3 of the Agreement and the Illustrative List of Export Subsidies used terms such as "provision," "delivery," "exemption," or "grant" by a government, and mentioned "any other charge on the public account." (emphasis added by the EC) The sole exception was formed by internal transport and freight charges "mandated by governments," which indicated that if there was no monetary contribution or remission by the government, there had at least to be mandatory action by the government. However, this exception did not change the basic thrust of these contextual elements. Fourthly, the preamble of the Agreement contained a balance between two functions of the Agreement: combating the harmful effects on trade and production of subsidies and restraining the unjustifiable impediments resulting from countervailing measures; the second function could not properly counterbalance the first, if there was total liberty in the interpretation of the notion of countervailable subsidy. Finally, there was a contextual, systemic argument based on the structure of the General Agreement in favour of the interpretation of the term "subsidy" as involving a financial contribution by a government.

63. The EC noted that some of the above-mentioned contextual elements were supported by the Lumber panel (Lumber panel report, paragraphs 340-342). However, in that case these contextual elements were finally not crucial to the outcome, since "it was not clear on the ... record that Canadian provincial stumpage programmes could not in fact include an element of governmental cost or revenue foregone" (Lumber panel report, paragraph 343), but the panel's analysis as such of these elements supported the EC's view.

64. In response to the arguments of the United States on the EC's reference to the structure of the General Agreement as a relevant factor in interpreting the term "subsidy", the EC argued that there was nothing surprising about the argument based on the structure of the General Agreement. Seen in the light of Article 31 of the Vienna Convention, this was a contextual argument which derived certain conclusions from the structure of the General Agreement as a whole in relation to Article VI. Looking at the structure of the General Agreement and the Codes linked to it, one could see that distinctions were made between different non-tariff barriers and that these were linked to different remedies. In particular, the unilateral remedy of imposing countervailing duties was specifically limited to government subsidies resulting in injury to the domestic industry of other countries. If the notion of subsidies was extended to such an extent that even (non-mandatory) government action which did not involve some money contribution from the government to a private party was regarded as a subsidy which could be remedied by the unilateral imposition of countervailing duties, a threshold was crossed and other such government action not

involving a contribution of money or of revenue foregone (quantitative restrictions, national regulations, technical barriers) could conceivably also be countered by countervailing duties. This was contrary to the structure of the General Agreement and the Codes which clearly had created a compartmentalization between the different non-tariff barriers and which restricted countervailing duties to the compartment of subsidies.

65. In this regard, the EC considered that its argument concerning the relevance of the structure of the General Agreement was in no way contradicted by footnote 38 to Article 19 of the Agreement, as argued by the United States. Obviously, a practice of a contracting party which in part constituted a subsidy with injurious effects and in part a domestic regulation contrary to the national treatment required could be attacked under both relevant provisions and could be countered as to its subsidies aspect by countervailing duties and as to its national treatment elements by a return to conformity with that requirement (or compensation or retaliation, after dispute settlement). In such cases, the distinction between the different infringements and their remedies is maintained. The approach of the United States to the notion of subsidy would in the final analysis lead to the blurring of these distinctions, to the possible use of countervailing duties as remedies for actions other than governments subsidies, which would be contrary to the structure of the General Agreement and its Codes.

66. The United States argued that if one examined definitions of a subsidy not only in common dictionaries but also in economic treatises and other sources, it was evident that there was a fairly wide variation in definitions of the term "subsidy" and it was not possible to say that there was a common or ordinary understanding or meaning of the term. Moreover, it was not correct to say, as the EC claimed, that there was a consensus that the concept was limited to cases involving a "financial contribution" by governments. For example, the New Encyclopedia Britannica (1984) stated that "a subsidy is a direct or indirect governmental payment, economic concession, or special privilege granted to private firms, households, or other governmental units in order to promote a public objective" (emphasis added by the United States), the Encyclopedia of Economics (1981) stated that subsidy was "a type of financial assistance or a concession having economic value granted by a government to certain producers (emphasis added by the United States), and the Dictionary of Business and Economics by C. and D. Ammer (1984) stated that subsidies were "government support", including such items as "shelters from competition".

(iii) Obligation to take into account all relevant facts

67. The EC argued that the Report of the panel in the matter of "United States - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada"[18] (hereinafter "Pork") was relevant to the obligations of signatories of the Agreement in respect of the determination of the existence of a countervailable subsidy. This panel report interpreted Article VI:3 of the General Agreement, the terms of which were almost identical to those of Article 4:2 of the Agreement. The report addressed two issues. First, the panel decided that Article VI:3 of the General Agreement, interpreted in its context, imposed upon the United States as the contracting party invoking that Article, the obligation to demonstrate that it had met the requirements of Article VI:3. Secondly, the panel considered whether the United States had taken into account all facts relevant for the determinations made. In so doing, the panel confirmed that: (i) "Article VI:3 permits contracting parties to levy a countervailing duty on a product only if a subsidy has been determined to have been bestowed on the production of that particular product" and (ii) "the existence of a subsidy must result from an examination of all relevant facts" (emphasis added by the EC). The panel considered that the issue was not whether the United States had applied a methodology for establishing facts consistent with Article VI:3, but rather whether the facts which the United States did take into account were all the facts relevant for the determination it made.

[18] DS7/R*, panel report adopted 11 July 1991. See BISD 38S/30.

68. The EC argued that on both points addressed by the Pork panel similar reasoning applied for the purposes of Article 4:2 of the Agreement. Article 4:2 stated that a subsidy must be "found to exist" and its terms were almost identical to Article VI:3 of the General Agreement, which spoke of a bounty or subsidy "determined to have been granted". Thus the Pork panel report completed the obligation of substance of Article 4:2 by confirming that findings made in respect of the existence of a subsidy and, consequently, the allocation of a subsidy, had to result from an examination of all relevant facts.

69. The EC submitted that a proper consideration of all the relevant facts must take place in accordance with the normal tenets of logic (i.e. such considerations could not be internally inconsistent) and in conformity with economic reality. A consideration of the relevant facts which proceeded in a manner contrary to these basic requirements could not be considered a proper consideration at all. Furthermore, the combined requirements of discharging the burden of proof that the requirements of Article 4:2 had been met and of showing that all relevant facts had been taken into account in doing so, barred a signatory from having resort to presumptions in determining that a countervailable subsidy exists. Any resort to presumptions *ipso facto* implied that not all relevant facts had been considered and used as elements in discharging the burden of proof of the existence of a subsidy. In other words, presumptions could not and should not be used to circumvent a signatory's duty to perform an independent assessment of all the relevant facts of a case.

70. The EC submitted with respect of the issue of the measurement of a countervailable subsidy that, though the Agreement did not set precise criteria, Article 4:2, in combination with the principles reaffirmed by the Pork panel, set at least a limit to the amount of the subsidy found to exist. This could happen in two ways. Where no subsidy could be demonstrated to exist at all on the basis of all the relevant facts, the imposition of a countervailing duty was apparently contrary to Article 4:2. Moreover, where a flaw in the discharge of the burden of proof or of the required consideration of all the relevant facts could be shown to have led to, or to be capable of leading to, an overstatement of the subsidy, this also led to an infringement of Article 4:2 to the extent that a countervailing duty was then levied in excess of the amount of the subsidy concerned (which on the basis of all the relevant facts could not be demonstrated to exist at the indicated level).

71. With regard to the EC's reference to the Pork panel report as support for the claim that a contracting party invoking Article VI had to demonstrate that the requirements of that provision were met, the United States submitted that the claim that a signatory must "demonstrate" compliance with the obligations of the Agreement or the General Agreement begged the question of the nature of these obligations. Articles VI:3 and 4:2 of the Agreement required only that a signatory levy a duty no greater than the amount of the subsidy found to exist. What a signatory need not do, however, was to demonstrate to the Panel that a subsidy either did in fact exist or existed in the amount found. Article 4:2 stated that duties shall not be levied above the amount "found to exist," not above the amount "that in fact exists". At the time of the determination, the authorities must be satisfied that the evidence before them supports a finding that a subsidy exists; however, a Panel should not attempt to conduct a *de novo* review of whether a subsidy did in fact exist in the amount found by the authorities. The panel in the Lumber case had specifically rejected this kind of review, stating that it was "not for the Panel to determine whether Canadian stumpage pricing practices were in fact subsidies", but whether a reasonable, unprejudiced mind could find that they were. This proposition was particularly appropriate in this case since Article 4:2 did not address how a subsidy was to be calculated. More recent reports such as Resin, Lumber and Salmon have not cited the portion of the Pork panel report cited by the EC as guidance in interpreting the requirements of the Agreement. These recent reports provided a set of logical principles for panel review. Thus, the bald statement from the Pork panel report that a challenged party must "demonstrate" conformity with the Agreement provided little assistance to the panel in conducting its review in this case.

72. The United States noted that the second proposition for which the EC cited the Pork panel report was that report's rejection of a two-factor statutory test to determine whether a subsidy provided to producers of an agricultural product also can be deemed to have been provided to processors of that

product. There the panel found that, because the statutory test was limited exclusively to a consideration of only two factors, it did not permit examination of "all relevant facts". Thus, that panel's limited conclusion was that a party may not preclude, from the outset, any possible examination of facts that may be probative of the issues before it. None of the issues before the panel in this proceeding involved such a situation. The EC had cited the "all relevant facts" language from the Pork case to make arguments that had nothing to do with what the panel in that case had addressed. In several places, the EC's challenge was not to the DOC's refusal to consider record evidence, but to the weight the DOC chose to give the record evidence in its analysis. This was particularly so with regard to the EC's challenge to the DOC's equityworthiness and creditworthiness findings.[19] However, the EC could not show that the DOC had failed to consider any probative record evidence. Alternatively, the EC used the language from the Pork panel report to challenge the DOC's methodological choices, some of which involved highly complex economic issues over which economists might themselves disagree, and which the Agreement did not begin to address. An example was the EC's discussion of "inside" investors with regard to the DOC's equityworthiness findings. In the absence of guidance in the Agreement, the authorities' methodology could be based on any reasonable methodology.

73. The United States noted that the EC additionally claimed that the "all relevant facts" language in the Pork panel report amounted to a blanket prohibition on the use of all evidentiary "presumptions". The purpose of this argument was unclear because the DOC had not applied any presumptions that determined the outcome of any issue in the case before this Panel. Moreover, the Pork panel did not rule out use of all presumptions. At issue in that case was, in essence, a statutory presumption that was irrebuttable in that it did not permit consideration of any factors other than the two specifically listed, regardless of the apparent relevance of the facts in a particular case. Presumptions were a well-known evidentiary device that, when properly used, could advance the fact-finding process with no diminution of the search for the truth. Neither the General Agreement, the Agreement nor the Pork panel report prohibited the use of rebuttable presumptions.

74. The EC submitted that the Pork panel report made it clear that all the relevant facts had to be considered and that no logical steps necessary for the determination of the existence of a subsidy may be skipped. The Pork panel's statement on the importance of a consideration of all relevant facts was not circumscribed by the nature of the United States legislation in question. There was no indication in that panel report that the restriction in the United States statute to two factual criteria for establishing a subsidy in favour of a product (what the United States referred to as the preclusion at the outset of any possible examination of facts that may be probative of the issues before an investigating authority) played any role at all in the panel's reasoning. The panel simply stated that all relevant facts must be considered when determining the existence of a subsidy, and even went so far as to suggest to the United States what the facts to consider and the logical steps might have been in order to derive the existence of a subsidy on pork products from a subsidy on swine production. It was unimaginable, if only for reasons of natural justice, that the existence of a subsidy be determined on any other basis than all relevant facts. The Pork panel ruling spelled out a rule of natural justice which ought to be self-evident (and which was also inherent in such notions as "error of fact" and "error in the appreciation of the facts") namely that all relevant facts had to be considered and all necessary logical steps had to be taken before one could arrive at the conclusion that the production of certain goods had been subsidized. This approach to the methodology for finding the existence of subsidies could not be reconciled with the use of presumptions, whether irrebuttable or not.

75. The EC argued that it was legitimate to request the Panel to consider how the DOC applied the United States law standard to the facts in the cases which had been referred to the Panel. This was a very different request from a "request to re-weigh evidence" and one which the EC considered was properly within the Panel's terms of reference.

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[19] *infra,* sections III.4 and 5

76. The United States noted the following with regard to the actual situation at issue in the dispute before the Pork panel. The panel in that case stated that "the subsidies granted to swine producers could be considered to be bestowed on the production of pork only if they had led to a decrease in the level of prices for Canadian swine paid by Canadian pork producers below the level they have to pay fro swine from other commercially available sources" (Pork panel report, paragraph 4.9). As to this question, the panel concluded that the two factors the United States had identified were not "all the relevant facts" necessary to answer the question. Thus, as framed by the panel, the situation in that case involved a factual issue - whether a programme caused a price decrease for swine - and whether one could look only at two factors to decide that factual issue. In the present case, by contrast, there was not a single factual issue in which the DOC had not considered all the evidence before it.

77. The United States considered that, lacking a firmer basis for challenging the DOC's determinations, the EC attempted to cast as many issues as possible as a failure to examine relevant facts, even where its real disagreement was over other matters. On its face, the proposition that authorities must examine "all relevant facts" was unobjectionable. However, the EC stretched and twisted this idea beyond all recognition. For example, the EC's claim that in its determination that certain equity infusions were countervailable subsidies the DOC failed to consider all relevant facts by not considering that governments behaved differently than private investors[20] involved a disagreement over the interpretation of the Agreement, i.e. whether investigating authorities were required to consider a government's actions by whether it acted in accordance with certain public policy motivations or whether it was permissible to measure the government's action by whether it was consistent with commercial considerations. In respect of the EC's claim that the DOC failed to consider that so-called "inside" investors had different motivations than "outside" investors[21], the disagreement was over economic theory, i.e. whether there was a fundamental difference in motivation or whether, instead, all investors could be said to invest at the margin. Even when that disagreement was overcome, there was still disagreement over methodology, i.e. whether it was reasonable to focus on the reasonable private investor, or whether the test had to be based on special circumstances of particular investors, such as those that had made past investments. The EC's claim that the DOC had failed to give proper consideration to "future-oriented" factors in its analysis of equityworthiness and creditworthiness of certain companies[22] involved a disagreement over the weight to be given to evidence in light of the record as a whole. While the DOC had considered all evidence on the question of how lenders and creditors were likely to view the companies the EC simply wished that the DOC had given more weight to certain information. Finally, the EC's claim that in its equityworthiness the DOC had failed to consider whether a company's subsequent performance showed that the company was equityworthy[23] was based on faulty reasoning. Events taking place after an investment occurred could not logically have been considered by an investor at the time of the investment.

78. The EC argued in this context that what all relevant facts were was not exclusively determined by the record established by the authorities in the United States. Referring to the panel report in the "Korea - Anti-Dumping Duties on Imports of Polyacetal Resins from the United States"[24] case (hereinafter "Resin"), one could say that it was the Panel's task to rule on the consistency with the Agreement of the determination by the DOC of the existence of a subsidy and not with the record upon which that determination was based (Resin, paragraph 212).

[20] infra, section III.4 (a)(i).

[21] infra, section III.4 (a)(iii).

[22] *infra,* section III.4 (a)(ii).

[23] *infra,* section III.4 (a)(ii).

[24] ADP/92, 2 April 1993.

79. The EC also noted that the Resin panel report required that a party "substantiate" the injury allegedly suffered by the domestic industry. Taking abstraction from the injury aspect, it would seem that this requirement of substantiation contained the same two elements present in the Pork panel report: consideration of all relevant facts and including all necessary logical steps in the decision. On a procedural level, these requirements were also to be found in Article 2:15 of the Agreement. It was obvious that, if proper reasoning was absent in the determination of the existence of a subsidy, the subsidy could not be said to have been shown to exist, either in part or in its entirety. Hence, the countervailing duty levied would necessarily be in excess of the amount of the subsidy, contrary to Article 4:2.

80. The United States argued that while investigating authorities may not ignore relevant or vital facts, it did not mean that a signatory was relatively free to introduce new facts to a Panel that it did not present to the investigating authorities. If additional information could be adduced after the conclusion of the investigation, then all determinations would be vulnerable to an allegation of violation of the Agreement no matter how full and fair the proceedings were. This was understood by the Lumber Panel whose underlying standard was "whether a reasonable, unprejudiced person could have found, based on evidence relied upon by the United States at the time of initiation, that sufficient evidence existed of subsidy, injury and causal link to justify initiation of the investigation" (paragraph 335). The United States urged this Panel also to follow the example of the recently adopted Report of the Lumber panel.

(b) Standard of Review

81. In response to the United States argument concerning the standard of review to be followed by panels, according to which in cases where the Agreement either offered limited guidance or was silent panels should only examine whether the interpretation of the national investigating authorities was a reasonable one,[25] the EC argued that the questions before this Panel were questions of interpretation of the Agreement and the Panel should decide in accordance with the rules of interpretation embodied in the Vienna Convention and should not abdicate its responsibility for interpreting the Agreement by having immediate resort to the criterion of reasonableness.

82. The EC argued, with respect to the interpretation of the term "subsidy", that the lack of definition of this term in the Agreement should not amount to an impossibility to interpret. The two parties before the Panel disagreed as to the interpretation of the term 'subsidy'. It was often the case that agreements were susceptible to more than one possible interpretation. If this was not the case, there would be no need for dispute settlement. In such cases, it was the duty of the panel to find the best possible interpretation on the basis of the rules of the Vienna Convention.

83. The EC further argued that the rules of the Vienna Convention made it clear that a treaty should be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of their object and purpose. Accordingly, recourse to both the rest of the text and any subsequent practice or agreement as well as any relevant rules of international law was permissible (Art. 31). Recourse to supplementary means of interpretation (including the preparatory work) would be permissible only in order to confirm the meaning resulting from the application of Art. 31 or to determine the meaning when the interpretation according to Art. 31 either leaves the meaning ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable.

84. In this case, the EC argued, the Panel's approach should be dictated by the basic criterion whether there has been infringement of the Agreement. As a second step, in cases where the Agreement left discretion to domestic authorities in exempting a provision and these authorities were called to assess complicated sets of facts whereby they exercised their economic judgement, panels could have recourse to

[25] See *supra*, paragraph 35.

complementary (not: other) criteria of interpretation. Such criteria could be inspired by elements common to the systems of administrative law of the signatories, since the Panel acted here as an international tribunal of administrative law examining the consistency of actions of domestic administrative authorities with the requirements of the Agreement.

85. The EC submitted that such criteria had already been developed in various administrative laws in Europe and had been espoused by the European Court of Justice (hereinafter "ECJ"). Such criteria could be the "manifest error of fact", "the manifest error in the appreciation of facts" and "arbitrariness". These were not methods of interpreting the law, but criteria by which to judge executive action when the law granted discretion. All three criteria were firmly linked to the interpretation of the Agreement and to the question whether the Agreement had been infringed. Moreover, they were fully consistent with Article 18:8 of the Agreement that spelt out the task of the Panel.

86. The United States argued that although, where the Agreement was silent, it could be argued that an investigating authority was free to employ any methodology, the United States had not espoused this approach. Instead, the United States argued that even in cases where the Agreement was silent, a panel should review actions of investigating authorities under a "reasonableness" standard. The rationale behind this rule was that even on issues not covered by explicit requirements in the Agreement, the Agreement could not be interpreted to permit authorities to act in an unreasonable way. According to this standard, the appropriate test was whether authorities applied a and not the reasonable approach because in many, if not most, situations there were a variety of outcomes on a particular question that a reasonable, unprejudiced mind could reach. Thus, the Panel should decide, as the Lumber panel did, whether, a reasonable, unprejudiced person could have made the subsidy finding the authorities did (paragraph 335). As recognized by the Lumber panel, the rôle of a panel was not to determine whether it would have made the same determination the authorities made, had the Panel been the decision-maker in the first instance. This principle was endorsed also by the Salmon panel (paragraph 251), the Resin panel (paragraph 227) and the panel on "New Zealand - Imports of Electrical Transformers from Finland"[26] (paragraph 4:3; hereinafter "Transformer"). The test in Lumber was whether a reasonable mind "could" - not "would" - have found as the authorities did. Almost by definition, if an interpretation was a reasonable one, it could not be inconsistent with the Agreement. On matters for which the Agreement did not specify a particular outcome, only if the authority's method was outside the bounds of rationality would a violation of the Agreement exist.

87. The United States further argued the "reasonableness" standard applied both to issues of interpretation of the provisions of the Agreement where the Agreement was silent and to factual issues.

88. The United States argued that it was often the case that language in an international agreement failed to provide decisive answers. In that respect, the Agreement could be assimilated to a spectrum, where at one end one can find very precise Articles (like Art. 4:2 which explicitly limits the levying of duties to the amount the authorities find to exist) and, on the other, provisions that indicate that the Agreement is more than ambiguous on an issue, it is silent (like footnote 15 concerning the calculation of the amount of a subsidy). In this context, the Panel should, at first, ask the question whether the Agreement addressed a particular issue. If the answer to this question was affirmative, it should further ask the question to what degree of specificity and precision was provided. If these initial questions were not posed, then the Panel ran the danger, under the guise of interpretation, to create new obligations for the parties to the Agreement that were never agreed by them. This, however, contravened the international law principle that states are not bound by obligations they have not agreed to.

89. The United States argued that if in applying this test, the Panel found that a provision was susceptible to only one interpretation it should stop there. If, however, it found that more than one

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[26]L/5814, 19 June 1985, report of the panel adopted on 18 July 1985, see BISD 32/55.

interpretation were permissible, it should not follow the EC's proposal to choose the "best" interpretation. This could turn into an invitation that a Panel try to resolve issues that were left unresolved by the drafters of the Agreement. The Panel should not try to arrive at a single, best interpretation of a provision of the Agreement where the Agreement was silent or ambiguous on an issue and more than one approach could achieve the principles and objectives of the Agreement. The limited guidance in the Agreement applied to the panel review as well because on the one hand, the Panel's role was to interpret the Agreement and on the other, as already stated, if this was not the case the international law principle according to which a party cannot be bound by something it did not agree to would be defeated.

90. Consequently, because the Agreement does not mandate that either approach be applied, the United States argued that it would be wrong to pronounce in this case on the long-standing dispute between the EC and the United States whether the "cost to government" or the "benefit to recipient" approach was the appropriate criterion for the qualification of a subsidy. The Panel should limit itself in examining whether the interpretation advanced by the investigating authorities was consistent with a reasonable interpretation of the Agreement.

91. The United States argued that the Parties to this dispute agreed on the need for a standard of review to ensure that panels do not effectively legislate amendments to the Agreement, but disagreed over what that standard should be. The "manifest error" and "arbitrariness" standard mentioned by the EC provided for a less meaningful review than the "reasonableness" standard from the perspective of both United States and the EC jurisprudence. The word "arbitrariness" generally equated to the "arbitrary and capricious" standard of review under United States law, that was to be found in both the United States Administrative Procedure Act (dealing with federal administrative law) and the 1930 Tariff Act (dealing with anti-dumping and countervailing duties determinations). "Reasonableness" was found in the description of the "substantial evidence" standard in the Tariff Act; this standard was "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." According to the jurisprudence of United States Federal Appellate Courts, the substantial evidence standard provides for a more rigorous standard than the arbitrary and capricious standard. Thus, under United States law, a reasonableness test provides for more searching review than an arbitrariness test. The ECJ review, on the other hand, deals mainly with three issues: whether procedural rules have been observed, whether facts have been accurately stated and whether a manifest error of appraisal or misuse of powers has occurred. In its judgment on Ballbearings II, the ECJ ruled that, on issues requiring an appraisal of complex economic situations, the Commission had freedom to choose the method it deemed most appropriate. This standard provided a quite limited review of determinations of the Commission and led commentators to state that the EC standard was less rigorous than the United States standard.

92. Moreover, the United States reiterated that a number of panel Reports (Lumber, Transformers, Salmon, Resin) supported the approach advanced by the United States, whereas no panel Report supported the EC's approach. In Transformers, for example, the Panel, addressing an issue of methodology, "noted that Article VI did not contain any specific guidelines for the calculation of cost-of-production and considered that the method used in [that] particular case appeared to be reasonable." There was a reason why prior panels used the concept of reasonableness: an examination for reasonableness accords due respect to the interpretation of the authorities who are entrusted with carrying out the Agreement, while at the same time ensuring that the Agreement is applied in a coherent and rational manner.

93. The EC argued that the Transformers and the Resin panels did not apply the "reasonableness" standard. The other two panels were not dealing with a question of interpretation of the Agreement when they referred to the reasonableness standard, but were judging whether investigating authorities had properly assessed factual questions before them. If the "reasonableness" standard applied at all, something to which the EC was firmly opposed, it was in such factual situations. The EC argued that none of the major issues in this case reached the question of calculation of the amount of the subsidy. Consequently, none of them could be decided by a blanket application of the standard of reasonableness. Moreover, the

panel Reports referred to by the United States remained unadopted. Also, the Salmon panel Report (paragraph 275) used the term "error of fact" which was being advanced by the EC.

94. The EC had initially argued that the United States had shifted in their domestic jurisprudence to the 'substantial evidence' standard that seemed to be more rigorous than 'reasonableness'. However, following a clarification by the United States on this issue, the EC agreed that there was no shift in the United States' position in this regard.

95. The EC was opposed to the idea of transplanting one concept taken from the national legal system of one signatory to the GATT. The "reasonableness" standard was rooted in United States case law concerning judicial deference to executive action and was not adapted to international agreements. In the "Chevron" jurisprudence[27], the United States Courts stated that only if the specific intention of Congress could be deduced from the text and history of the statute should the United States Courts fully interpret the law. If not, any reasonable interpretation advanced by the administration should be judged as consistent with the requirements of the law (deference model). In this respect, earlier panels had erred and their reports remained unadopted. This was precisely why the EC advanced the idea that the Panel could be inspired by elements common to systems of administrative law of the signatories. This approach is embedded in Art. 38 of the Statute of the International Court of Justice whereby the general principles of law recognized by civilised nations figure among the recognized sources of international law. These are principles generally applied and common to national legal systems of the United Nations members: there was at least one such principle, the prohibition for panels to engage in a *de novo* review. The Panel could find common ground between administrative law in Europe and the administrative law of other signatories to the Agreement. The standard should permit to correct arbitrary actions and serious mistakes of national authorities concerned, both where it concerned the establishment and the economic assessment of facts. The first part was addressed by the "manifest error of facts" standard, whereby the Panel would examine whether a highly relevant piece of information was not asked for or was not sought out by investigating authorities and such information was indispensable to a proper assessment of facts. The second part was addressed by the "manifest error of appreciation" standard. Arbitrariness added an additional limit to discretion of investigating authorities, since an interpretation could be reasonable but still arbitrary. Thus, the EC approach accommodated the ruling of Pork panel, namely to take into account all relevant facts.

96. Moreover, the EC argued that resort to reasonableness as soon as no specific intention of the drafters could be found was not in full conformity with the Vienna Convention; it contravened Art. 32. In fact, the "reasonableness" standard replaced the Vienna Convention in this respect. However, it could not apply to interpretation of international agreements as specific criteria for this purpose had been agreed and embodied in the Vienna Convention.

97. The EC further argued that Articles 31 and 32 of the Vienna Convention contained all the necessary tools for the interpretation of the Agreement, i.e the criteria of interpretation in Articles 31 and 32 of the Vienna Convention were exhaustive and sufficient to guide a panel in its interpretation of the Agreement. There was no indication in the Agreement that the Signatories had wanted to add another criterion of interpretation or wanted to contract out of the classical criteria of interpretation. Moreover, the rules of interpretation of the Vienna Convention had always been sufficient for international courts and arbiters, and there was no reason to assume that panels needed anything more than other international courts and tribunals for the interpretation of the Agreement. Therefore, the EC did not agree that the Agreement offered limited guidance in the application of the Vienna Convention's rules of interpretations.

98. The United States reiterated its arguments that the issues before the Panel related primarily to an assessment of the factual situation by the investigating authority (see section (a) above). Further, the United States argued that it was not trying to "foist" its own standard of judicial review on GATT, as alleged

[27] Chevron USA, Inc. v National Resources Defense Council, 467 US 837 (1984).

by the EC. Rather, a standard needed to be applied which provided a meaningful review but was not so intrusive as to transform a Panel into an independent investigating authority and legislator, a point on which both parties agreed.

99. The United States argued that the "reasonableness" standard was not inconsistent with the Vienna Convention; On the contrary the two tests were complementary. Actually, Articles 31 and 32 of the Vienna Convention answered the question what does a particular text mean; conversely, they did not answer the questions quid in case where if applying these tools, more than one interpretation was reasonable. This question was addressed by the "reasonableness" standard. Indeed, without this or a similar standard, on issues not settled by the Agreement, one may be left with either *de novo* review, which the EC itself stated was unacceptable, or no review at all.

100. The United States observed that use of the tools provided for in the Vienna Convention will, in many cases, permit a Panel to reach a conclusion as to precisely what a provision means. In such a situation, only one interpretation could be reasonable. In other cases, application of the Vienna Convention principles may permit a Panel to determine that, although the precise meaning of a provision is not established, certain boundaries can be established around it. In this situation, an interpretation that were to go beyond these boundaries would not be a reasonable interpretation. In still other cases, the matter will not be covered by any Agreement's provision at all, even after application of Vienna Convention tools. In these cases, the authorities can be said to possess maximum - but not unbounded -discretion. Reasonableness would still be the test. Thus, it was clear that the concepts the United States was advancing: (1) had at their core the search for consistency with provisions of the Agreement; and (2) were based on Vienna Convention concepts.

101. Moreover, the United States argued, the "reasonableness" standard, in conformity with the rules of the Vienna Convention, kept in mind the guidance contained in the Agreement and determines the limitations that might exist with respect to the implementation of the obligations arising from the Agreement. One could accordingly, distinguish between cases where only one interpretation was permissible, cases where only boundaries could be established by the Panel and, as a result, any interpretation beyond those boundaries would be judged inconsistent and cases where the matter was not covered by the Agreement and "reasonableness" was the appropriate test to examine the action of the investigating authorities. Consequently, the test was in full conformity with the Vienna Convention.

102. The EC argued that interpretation in accordance with the criteria of the Vienna Convention did not lead to "judicial legislation" or treaty drafting by a panel. According to Article 31 of the Vienna Convention, the interpretation of the term "subsidy" ought to begin with the ordinary meaning of the term. The United States was objecting already to this first step in the application of the Vienna Convention criteria. The absence of such a definition did not mean that interpretation according to the ordinary meaning was impossible. To the contrary, recourse to the ordinary meaning of the term would be excluded, if a "special meaning" (i.e. a definition) had been agreed, in accordance with Article 31.4 of the Vienna Convention. In the absence of such a "special meaning", recourse to the ordinary meaning was logical (a step which the Lumber panel had omitted). The term "subsidy" had been agreed upon by all parties and, though no special meaning in the sense of Article 31.4 of the Vienna Convention could be agreed, the term had a clear ordinary meaning which must be considered as representing a common understanding between the parties. This ordinary meaning must be interpreted in its context. Otherwise, instead of legislating, the panel would be giving too much leeway to Signatories imposing countervailing duties and the Agreement would apparently serve very little purpose.

103. In response to a question by the Panel, the EC argued that the Panel should interpret the Agreement in conformity with the criteria embodied in Articles 31 and 32 of the Vienna Convention and should not limit itself in providing an assessment of whether the parties acted in good faith; in particular, in case of two opposing interpretations based on good faith, the Panel should choose the proper one.

104. The United States argued that good faith concerned motives and intentions, whereas "reasonableness" concerned rationality and logic. In this respect a good faith action could be unreasonable. Moreover, the concept of "good faith" appeared more applicable to other situations, separate from the case of panel review under the Agreement, that were also covered by the Vienna Convention, such as a country's interpretation of a bilateral treaty. For these reasons, the concept of "good faith" did not obviate the need for, or advisability of, a reasonableness standard with regard to the authorities' interpretation of Agreement provisions. The United States also took issue with the EC's argument that an "arbitrariness" standard added an additional limit to the discretion of investigating authorities beyond "reasonableness". "Reasonableness" implied the presence of a logical basis; it was hard to imagine arbitrary action having such a basis.

105. In response to a question by the Panel, the EC argued that in case where the 'reasonableness' standard was adopted and investigating authorities could advance only one of the possible interpretations, they may do away with any motivation of their choice of one interpretation of the Agreement over another. Moreover, another reasonable interpretation than the originally advanced could be said to be the basis of the decision; this would counter the duty of proper reasoning as embodied in Article 2:15 of the Agreement. In this respect, the EC noted that the concepts of "manifest error" and "arbitrariness" are not self-standing criteria; if this was not the case, the general basis of interpretation would have been ignored and, as a result, the necessary consistency and predictability in the jurisprudence of Panels, of substantial importance to the development of international trade, could not have been maintained.

106. The United States argued that Article 2:15 and "reasonableness" addressed separate issues, since the former contained the obligation to set forth the factual findings and the legal conclusions reached. "Reasonableness" concepts did not imply the ability to ignore the stated basis for actions.

107. In response to a question by the Panel, the EC argued that the "reasonableness" standard, if adopted, could lead to a highly variable application of the Agreement since, in cases where no specific intention could be detected, any reasonable interpretation would be deemed to be consistent with the requirements of the Agreement.

108. The United States argued that the reasonableness concepts it was advocating, which were based on the Lumber panel report, provided for a uniform and coherent application of Agreement principles. It was true that in many situations there was not just one right approach; rather, more than one reasonable methods could take place, none of which could be said to be contrary to the principles of the Agreement. This was not a function of the "reasonableness" standard; this was a reflection of the fact that for many issues the Agreement did not provide for one and only methodology.

2. Debt forgiveness by private banks

109. The EC argued that the DOC's finding that forgiveness of debt by the private banks in the German case constituted a countervailable subsidy violated Articles 1 and 4:2 of the Agreement, because under the GATT and the Agreement the actions of private parties could not constitute a subsidy, the Governments had not provided any financial contribution to the private banks, had not imposed any mandatory "requirement" that the banks forgive the debt, and had not provided any guarantee which led the banks to forgive the debt. The EC considered, therefore, that the United States had countervailed a subsidy which did not exist.

110. The EC recalled that there was a long term restructuring plan for Saarstahl in which both the Governments (the federal Government as well as the Government of Saarland) and the private banks which were creditors to the company participated in order to make the company viable. In the context of this restructuring plan for Saarstahl, the private banks forgave a portion of the principal of their unguaranteed loans in 1989 (DM 216.819 million). The DOC had made a finding that since the loan forgiveness was required by the Governments, the contribution of the private banks constituted a

countervailable subsidy. In particular, the DOC stated that "we determine that the subsequent forgiveness of principal was countervailable because it was required by the governments as part of a government-led debt reduction package for Saarstahl and because the two governments guaranteed the future liquidity of Saarstahl, thereby implicitly assuring the private banks that the remaining portion of Saarstahl's outstanding loans would be repaid."[28] This was in contrast to the treatment by the DOC of a previous action by the private banks. Between 1983 and 1985, the private banks had forgiven interest payments on long and short term loans (DM 106.8 million), but the DOC found that since this forgiveness was unrelated to the assistance provided by the Governments, it did not confer a countervailable subsidy.

111. The EC noted that the DOC's reason for finding the banks' action countervailable was "significant evidence of German Government's extensive involvement and lack of any evidence that banks would have acted absent the government's intervention." It seemed that the DOC was, in countervailing the private banks' action, applying the term "requirement" which appeared in the United States legislation. The EC considered this test contrary to the Agreement; both the approach as laid down in United States legislation and its application by the United States authorities were contrary to the Agreement. This test ignored the need for financial contribution by the government, and failed to establish a link between the Government's action and the action of the private party which might amount to there being a subsidy in the sense of that term as used in the Agreement.

112. The EC argued that it was the established principle of the General Agreement and of the Agreement that actions of private parties did not as such constitute a subsidy. Neither the General Agreement nor the Agreement referred anywhere to subsidies granted by private non-governmental bodies. Article 8:1 of the Agreement recognized that subsidies were "used by governments to promote important objectives of social and economic policy". Paragraphs 1 to 3 of that Article referred to commitments on the part of signatories, i.e. governments, to avoid using subsidies in a manner inconsistent with the Agreement. Paragraph 1 of Article 9 and paragraphs 1 and 3 of Article 10 also referred specifically to obligations on the part of signatories. These provisions indicated a clear requirement for government intervention before any action could be construed to be a subsidy. Discussions between government officials and private banks did not amount to government intervention. An interpretation that even non-binding action by the government, and parallel action with private parties, can result in a subsidy would not correspond to the normal interpretation of the Agreement. Such an interpretation was not supported by any provision of the Agreement. In the same way, in the field of anti-trust, almost simultaneous price movements in an oligopolistic market, were not considered to be evidence of a conspiracy or concerted action to fix prices, but a natural phenomenon of following the oligopolistic price-leader. It was called conscious parallelism, and was not prohibited in anti-trust law. Likewise, conscious parallelism in this case did not amount to a subsidy.

113. The EC argued that financial contribution by the Government was an indispensable prerequisite for the existence of a subsidy (see Section 1 for more details on this point). Financial contribution by the government might arise where the Government uses a private party as a means for channelling funds to a third party, or provides the private party with financial compensation for action which it had taken. In this case however, the government's assurances involved neither a cost to, nor contribution by, the Governments. Also, since the privatization of Saarstahl in 1989, the Government had made no financial contribution to the company. While the Governments may have contributed by way of financial contribution to the overall debt reduction package, they did not contribute to the private banks' part of the package. No government benefit was channelled through the banks, nor were the banks given compensation from the Governments for the funds they put into the venture which might therefore have effectively incited them to act as they did. There was no evidence that the Governments were either able to exercise any control over the private banks' activities, or that they threatened to impose any sanction on

[28] *op.cit.*, page 6235, column 1, paragraph 3.

the banks if they did not forgive loans to Saarstahl. Hence the "presumption" of a subsidy was not justified.

114. The EC disagreed with the view that the Agreement permitted action of private parties to be countervailed where it was "required" by a government. Moreover, even this standard, invented by the DOC, was not met in this case. The evidence before the DOC pointed to the conclusion that the private banks' actions were motivated by assessments of the continuing commercial viability of Saarstahl, not by requirements imposed by the Governments. It did not bear out the conclusion that the banks' action was required by the Government, using the definition of that term adopted by the DOC. The evidence before the DOC demonstrated simply that the Governments initiated the debt reduction plan. The correspondence between the Government of Saarland and the private banks explained the negotiations which led to the banks forgiving DM 217 million in loans and clearly demonstrated that the banks were neither directed by the Governments, nor forced by obligation imposed by the Governments, to forgive a portion of the outstanding debt of Saarstahl. There were no subsidies since there was no government contribution and no government compulsion. The DOC had in this case countervailed actions which were simply not subsidies. Before levying a countervailing duty, a signatory to the Agreement had to demonstrate that a subsidy existed. Moreover, since Article 4:2 did not permit countervailing duties in excess of the amount of the subsidy found to exist, it followed that the countervailing of a non-existent subsidy was clearly prohibited.

115. Further, the EC argued that there was nothing in the behaviour of the private banks to indicate that their assessment of the financial situation of Saarstahl and their motivation in forgiving a portion of the loans was any different from those prevailing at the time of their earlier forgiveness of interest payments on loans, which the DOC had found not to be a countervailable subsidy. The mere fact that the Government initiated a debt forgiveness package did not mean that the banks were "required" to participate in the plan. The EC noted that the DOC's findings emphasised the interdependence of the Governments and the private banks' action (58 FR 6235). The EC found it difficult to understand the relevance of this factor to the issue of whether a government had granted a subsidy or not. The fact that the banks acted in parallel with the largest creditors of Saarstahl (i.e. the Governments) to secure the financial future of the company was hardly evidence that the Governments "required" the banks to act. Rather parallel action by all Saarstahl's major creditors, governmental and private, was necessary if the company was to survive. In any major crisis concerning the survival of a company, the major creditors had an interest to act in concert while pursuing their best interests. The fact that the action was beneficial to their debtor cannot alter this. The United States' approach would amount to arguing that as soon as the government happens to be one of the creditors involved in this time-honoured scenario, the private creditors were giving government subsidies. Moreover, the "requirement" standard, as it appeared in United States legislation distorted the natural meaning of the term subsidy as used in the Agreement and was contrary to the general principles of international law (from which the Agreement did not derogate on this point) regarding the circumstances in which the behaviour of private parties could be attributed to the State.

116. The EC argued that the single element in the Agreement which may be deemed to plead in favour of the idea that, in exceptional circumstances, private enterprises could be deemed to have granted subsidies without financial contribution from the Government, was restricted to export subsidies and required a mandatory action by the government: it was item (c) of the Illustrative List of export subsidies. However, item (c) was a narrow exception relating to export subsidies in the form of reduced transport charges. It was one exception among many textual elements in the Agreement and therefore not decisive. It could not be interpreted to diminish the general principle underlying the GATT and the Agreement, namely that private action did not constitute a subsidy and that subsidies used by governments supposed some form of financial contribution by the government. The EC argued, in addressing the question of the circumstances in which a subsidy might exist despite the absence of a financial contribution by the government, that the precise wording of exception in item (c) of the Illustrative List was significant as it clearly posited the requirement of mandatory action by the government. This indicated that mere parallel action was not sufficient. Banks must be mandated in some way by the government, or must be placed

under sanction in order to forgo income or grant contributions to the industry under investigation. The DOC seemed to share this view, since in the final determination it stated that "forgiveness of principal was countervailable because it was required by the government as part of a government-led reduction package ...". In this case, both the Governments and the banks acted in parallel, and the action of each was to serve its own interests. There was no mandatory requirement from the Government for the banks to act in the way that they did. The EC's interpretation of the term "mandated" was that the Government imposes a legal requirement on the private parties with a threat of sanction for non-compliance.

117. Addressing the DOC's argument that the Governments guaranteed the future liquidity of Saarstahl, thereby implicitly assuring the private banks that the remaining portion of Saarstahl's outstanding loans would be repaid, the EC argued that the DOC's determinations did not explain exactly why it had considered this element to be one of the decisive elements in the existence of a countervailable subsidy. The DOC seemed to assume that this aspect of the package contributed to what it described as the requirement upon the private banks to act in a certain way. The EC considered that the DOC was not justified in treating an "assurance" on the part of the Governments relating to its future conduct, which could not be legally enforced by Saarstahl, and which was in any event unquantifiable, as rendering the banks' action to be a countervailable subsidy. These assurances involved neither a cost to, nor a contribution by the Governments. They were apparently made in 1986, and there was no evidence that the Governments made any payments at the time of the debt forgiveness in 1989 in support of this "implicit assurance" or thereafter. The "assurance" of liquidity was nothing more than a statement of intention by the Governments of the common interest they shared with the private banks in ensuring the future commercial viability of Saarstahl. The liquidity assurance did not constitute an effective or real requirement on the banks to act in the manner in which they did. The banks had their own commercial reasons for participating in the plan.

118. The United States recalled that in the present case the DOC had noted in its determination "the government's extensive role in bringing about the private bank's debt forgiveness" and the respondents' failure to provide any documentation to support their claim that banks' actions were commercially sound. The United States argued that the Governments had initiated the plan, approached the banks, negotiated with the banks, and provided the necessary inducement. The banks were willing to forgive a portion of Saarstahl's debts if the Government provided a guarantee to the banks. The Saarstahl/Dillinger merger was contingent on the German Government's forgiveness of all Saarstahl's debt to the Government, including guaranteed debts. In turn, the Government's debt forgiveness was contingent upon additional debt forgiveness by private banks. Unlike a previous interest forgiveness by private banks, on this occasion the Government took the initiative and proposed a concerted Government bank effort. In response to the Government's request, the banks agreed to forgive DM 217 million at the time of the merger, on the condition that the Government forgive all of its guaranteed loans to Saarstahl, and guarantee the liquidity of Saarstahl. The Government agreed to both conditions. In the German scheme, private debt forgiveness was required for the deal to go through. The facts of the case supported a finding that the subsidy was "provided" by government action, and that it was "required" for the debt restructuring plan. The Agreement did not define the concept of subsidy in such a way as to exclude the type of action in the German case from coverage.

119. The United States argued that it was left to the signatories to reasonably interpret what constituted a subsidy. If government action directly or indirectly bestowed a benefit, that benefit was countervailable. Footnote 4 to Article 1 specifically stated that subsidies could be provided "indirectly", and the term "indirectly" was not defined. It defined a countervailing duty as a special duty levied for the purpose of offsetting any bounty or subsidy bestowed directly or indirectly on the manufacture, production, or export of any product. One reasonable interpretation was that it could include cases concerning involvement of private parties. In essence, a subsidy was provided indirectly when the government's action sets in motion events that result in a benefit to the producer. There was nothing in the General Agreement or the Agreement that stated, or even suggested, that a government cannot indirectly bestow a countervailable benefit through the actions of private parties. Thus, countervailable private action in those rare

circumstances in which the private action was the direct result of government intervention was consistent with the General Agreement and the Subsidies Agreement. Where government action was lacking, a subsidy would not be found to exist. In the present German case, for example, the DOC found that the 1983-85 debt forgiveness by private banks did not involve a countervailable subsidy because there was no indication of any government role.

120. The United States argued that the EC had provided little support for a claim that action by private parties cannot be considered an actionable subsidy. The Illustrative List, while not pertinent to Part I of the Agreement which pertained to countervailing measures, expressly recognized subsidies in cases in which the government played a primary role, but a private party was the direct supplier of the benefit. For example, item (c) of the List included transport and freight charges provided or "mandated" by the government. In this context, the United States argued that since the Illustrative List was by definition illustrative, item (c) was significant only in that it supported the general proposition that private parties may be involved in the provision of a subsidy and not a specific proposition that a subsidy would arise only when the Government mandated a particular action.

121. The United States agreed that government action was required element of a countervailable subsidy, but disagreed that the government's action must entail a financial contribution. Two situations cited by the EC, i.e. private parties acting as a conduit for subsidy and they being mandated to provide subsidies, were examples of a subsidy being provided with the involvement of private parties, but these were not the only situations that could qualify under the Agreement. Indeed, the first situation - a private party acting as a conduit for the provision of government funds - was not explicitly contained in the Illustrative List, and therefore contradicted the EC's claim that a subsidy must be on the List to qualify as a subsidy. The second situation - a mandate that a private party provide a subsidy - involved no government funds and therefore contradicted the EC's claim that a subsidy required a financial contribution. The Agreement provided little guidance on this aspect, and it was not possible to set out criteria for capturing all future situations. The issue was fact-intensive and had to be examined on a case-by-case basis. In the United States' view, for a subsidy to exist the Agreement required, (a) government action, (b) that government action was more than minor, insignificant, or incidental, and (c) that government action resulted in a clearly identifiable benefit bestowed.[29] Where the primary actors were private parties and the government involvement was only incidental, there would be no countervailable subsidy. For example, if steelworker's' association paid for renovation of a steel plant and installation of new safety devices for workers, the renovation fund would be a private gift, not a government subsidy. The fact that the government may have to approve the plans and grant building permits for the construction to proceed did not transform it into a government subsidy. Even though the government action was necessary, it was only incidental to the overall transaction.

122. The United States addressed the EC's argument that the DOC's conclusion that the bank's debt forgiveness was "required" by the government was wrong because there was no government coercion and no penalty if the banks refused. The United States said that this argument misinterpreted the DOC's determination. In the Final Determination, the DOC stated that the private debt forgiveness was "required by the government as part of a government-led debt reduction package." That statement referred to the fact that the Government's debt forgiveness, and in turn the merger, were contingent upon the private debt forgiveness, i.e., it was "required" in order for the deal to go through. It did not mean that the banks acted out of a legal obligation or under threat of sanction; nor was actual compulsion and indispensable element

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[29]The United States gave the example of the DOC investigation of New Steel Rails from Canada, where a government grant was given to a railroad that enabled the railroad to charge lower freight rates to steel companies. The grant was the origin of the benefit to the steel companies, and the benefit was the lower rates charged by the railroad. Although the government did not mandate that the railroad lower rates to steel companies, it provided an indirect benefit by enabling the railroad to provide lower rates.

to a finding of a subsidy. The basis for finding the forgiveness of Saarstahl's private debts to be countervailable was significant evidence of the German Government's "extensive involvement" and the lack of any evidence that the banks would have acted absent the government's intervention. The respondents were offered the opportunity to provide contrary evidence, but they did not do so.

123. In an answer to a question by the Panel, the United States said that "in finding the debt forgiveness to be 'required' by the government, the DOC arguably went beyond what is mandated even by U.S. law. ... the U.S. defines domestic subsidies as those 'provided or required', directly or indirectly, by government action. ... the facts of this case support a finding that the subsidy in question was 'provided' by government action." Moreover, nothing in the General Agreement or the Agreement mandated that a subsidy be "required" by the Government. The term "required" appeared in United States' domestic law, and signatories were free to impose additional requirements beyond those mandated by the Agreement. Meeting these additional requirements did not affect whether the authorities had acted in conformity with the Agreement. In this case, the DOC had met the requirements of the Agreement.

124. Regarding the EC's argument that the banks merely acted according to their own financial interest, as they did in 1983-85, the United States said that to find a subsidy mechanism countervailable, it was not necessary to find that third parties employed in that mechanism acted against their own interests. The relevant point was that the Government played an extensive and crucial rôle in securing the private debt forgiveness for Saarstahl in 1989. The evidence of record clearly supported this conclusion. There was no government involvement at all in the banks' 1983-85 interest forgiveness; in contrast, the private debt forgiveness in 1989 was contingent on the government's debt forgiveness and guarantee of Saarstahl's liquidity.

125. The United States argued that the EC's claim that the Government's guarantee was merely a statement that the government would stay involved, was not supported by any record evidence. The evidence of record clearly indicated that the guarantee was a necessary condition for the debt forgiveness to occur. The DOC had also observed the "lack of evidence" to the contrary on this issue that might have rebutted the clear documentary evidence on the record. There was no evidence to suggest that the banks would have proceeded without the guarantee; to the contrary, by making the provision of a guarantee a condition of the debt forgiveness, the banks indicated that they would not have proceeded without it. The guarantee provided by the Government (shown, for example, by the Government's letter to the banks of 4 April 1986) eliminated the possibility of bankruptcy that would deprive the banks of repayment of their loans.

126. The United States argued that the record evidence concerning the private debt forgiveness consisted primarily of the exchanges of letters between the private banks and the Government. These documents indicated that the banks set out terms and conditions under which they agreed to forgive a portion of Saarstahl's debts, and the Government agreed to those terms and conditions. In its questionnaire response to the DOC, Saarstahl confirmed that, in the letters the banks had "agreed" to forgive debt provided certain conditions were met. In view of these facts, it would not be unreasonable to conclude that the Governments' commitments were legally binding. The Government made its commitment to the banks in writing; it could not have been clearer. Absent any contrary indication, a reasonable conclusion in such a case was that the commitment was legally binding. Even if it was not legally binding, this commitment would be kept for other reasons too (e.g. as a political matter, the Government could not fail to honour its commitment, or that commitments are kept for various reasons other than legal compulsion). Legal enforceability was not the real issue; the key point was that the banks obviously believed that the Government's guarantee was a meaningful commitment that would permit them to forgive the loans. They expressly conditioned their forgiveness on the guarantee, and it was this commitment that constituted the necessary Government action that permitted a subsidy to exist.

127. In answer to a question by the Panel whether the alleged "guarantee" by the Government or the debt forgiveness by the private banks was the subsidy, the United States argued that both the guarantee and

the debt forgiveness were elements of the subsidy in question. Under United States law, there were three elements to a domestic subsidy: government action, benefit and specificity. The subsidy at issue was analogous to a government loan guarantee that resulted in a lower interest rate; there the government action would be the guarantee, which provided the benefit, i.e. the interest savings. In the present case, the government action was a guarantee, but the benefit it provided was debt forgiveness. Although the "subsidy" itself involved both the guarantee and debt forgiveness, the DOC determined the amount of subsidy according to the amount of debt forgiveness, since the forgiveness represented the benefit received. As noted elsewhere, there was no understanding between Agreement signatories over calculation of the amount of a subsidy. While the banks were under no legal compulsion to forgive Saarstahl's debts, the government's action, i.e. the guarantee, was necessary to make it commercially reasonable for a private party to forgive the debts. Therefore, the Government guarantee had the result of providing Saarstahl with the benefit of private debt forgiveness, i.e. the government action could be said to have provided a countervailable benefit.

128. Further explaining the analogy, the United States said that government loan guarantee provided a benefit to a company, indirectly, by inducing a private party to take action (i.e., making a loan) that was beneficial to the company. In the case of countervailable government loan guarantees, it was the USDOC's practice to calculate the benefit in one of two alternate ways, depending on the evidence available: (1) the amount by which the interest rate of the loan was lower than the interest rate of a benchmark private-sector loan; or (2) the amount by which the guarantee fee charged by the government was lower than the fee for a private guarantee. The present case also involved a government guarantee, but one that was different than a loan guarantee and which produced a different type of benefit. The German Government's liquidity guarantee (and debt forgiveness) resulted, not in a lower interest rate or reduced guarantee fee, but rather in debt forgiveness by the private banks. Unlike the loan guarantee situation, there was no private-sector benchmark against which the government's action at issue could be measured. There was no established private market for something as far-reaching as a "liquidity guarantee." Moreover, unlike the loan guarantee situation, the benefit in this case was not simply a preferential interest rate; rather, the benefit was the writing off of debt altogether. As such, it was entirely appropriate for the DOC's to value the benefit conferred as the full amount of the loan forgiveness.

129. The EC argued that the relevant criteria relating to the nature and extent of the Government involvement are that the Government's contribution should be financial in nature and that where the Government does not itself grant the subsidy the extent of this involvement should be sufficient to establish a link, or interdependence, between the Government action and that of the third party which makes the grant. The link in question must be a particularly close one, otherwise the meaning of the term subsidy as used in the Agreement was undermined. In case there was no contribution of a financial nature by the Government, the Government action must compel the third party's action. Thus the correct criterion to determine subsidy in this case was whether there was a legal requirement with the threat of sanction in the event of non-compliance.

130. Regarding the United States' argument that liquidity assurance was a guarantee, the EC argued that the Government's commitment was vague and general, and was not even analogous to a loan guarantee (a loan guarantee would have been spelt out more clearly). The assurance was in no way enforceable under domestic law. Parties in commercial transactions would generally be sufficiently prudent to enshrine those elements of a deal which they considered to be legally binding in a form reflecting their nature, rather than in the form of a loose commitment contained in a letter. This would be even more likely if this element of the deal was as important as the United States claimed it to be. To be legally enforceable in Courts, an intent on the part of the "guarantor" to be legally bound should be clear from the letter itself. Characterizing the "liquidity assurance" as a guarantee (which in any event appeared to be an afterthought on the part of the United States and could not be deduced from the DOC's determination), therefore constituted a manifest error of fact and should be rejected by the Panel.

131. The EC argued that the United States' arguments did not counter the general established principle of the GATT and the Agreement was that the action of private parties did not constitute subsidies, relying as they did on the absence of any specific provisions on this question and on the wording "directly or indirectly" in an interpretative footnote which was not designed specifically to address the issue of private party participation. The plain meaning of the word "subsidy", in the context and in light of the object and purpose of the Agreement, required that there be a flow of money from the Government through the private party for a subsidy to exist. Furthermore, situations in which private parties can act in a manner which attracts the responsibility of the State were, as a matter of international law, very closely circumscribed. This was shown, for example, by the draft Convention produced by the International Law Commission on the codification of the rules of customary international law relating to state responsibility.[30] There was no indication in the Agreement that it derogated from general principles of international law in this respect. The phrase "acting on behalf of the State" was echoed in the term "mandated" in the Illustrative List. Therefore, the United States' expansive interpretation which was tantamount in international law to saying that banks engaged the responsibility of the government, conflicted with the standards established in international law. Normal rules of interpretation under international law enjoined the Panel to take account, together with the context, any relevant rules of international law applicable in relations between the parties. Such relevant rules of international law in the present context included the customary rules of state responsibility.

132. The EC argued that the Government of Saarland was a majority shareholder in Saarstahl, and the statements concerning the future liquidity of Saarstahl were entirely in keeping with the Government's status and role as majority shareholder. Also, they were made in the context of a restructuring plan which involved contribution by all participants. Thus, the purpose of the statements was to confirm to the private banks that the government would continue to participate in the restructuring plan designed to assure Saarstahl's survival and would not withdraw from its position as a shareholder. Moreover, even within the logic of the United States law "requirement" test, it would still be the task of the United States investigating authorities to find out whether "the banks would have acted absent the government's intervention" and their reliance on "lack of evidence to the contrary" amounts to unjustifiable presumption.

133. The EC argued that the United States claim that both the "liquidity assurance" and the debt forgiveness formed elements of the subsidy in question was inconsistent with its basic premise for countervailing the subsidy, namely that it was the "guarantee" that made the deal commercially viable for the banks. If it was the "liquidity assurance" which was of crucial importance then this was what actually should be countervailed. However, the "liquidity assurance" was unquantifiable. Moreover, it involved neither a

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[30] The EC referred to Article 8 of the International Law Commission Draft Articles on State Responsibility, which states: "The conduct of a person or a group of persons shall also be considered as an act of the State under international law if (a) it is established that such person or group of persons was in fact acting on behalf of that State; or (b) such person or group of persons was in fact exercising elements of the governmental authority in the absence of the official authorities and in circumstances which justified the exercise of those elements of authority". The EC also cited from the International

(footnote continued)

Law Commission's Report on the Draft Articles to the United Nations General Assembly where in respect of Article 8, paragraph (a), the International Law Commission stated: "the Commission wishes nevertheless to make it quite clear that, in each specific case in which international responsibility of the State has to be established it must be genuinely proved that the person or group of persons were actually appointed by organs of the State to discharge a particular function or to carry out a particular duty, that they performed a given task at the instigation of those organs. " Yearbook of the International Law Commission, 1974, Volume II, Part One, pages 277, 284-285.

cost to, nor a contribution by the Governments, even on a contingent basis. All it involved was the confirmation of the participation of the Governments in the activities of the company as shareholders.

134. Regarding the EC's reference to the International Law Commission's Draft Convention on State Responsibility, the United States argued that this Draft Convention had essentially no relevance to the present case. When completed, the convention would pertain to a completely different subject matter than the present case - i.e., the circumstances in which a state could be held accountable for wrongful acts under customary international law. This was not the issue with regard to the EC's provision of subsidies in this case. There was no allegation that such domestic subsidies were inconsistent with the EC's obligations under the Agreement, or with any other international obligation of the EC. Rather, the issue was whether it was improper for the United States to impose countervailing duties on such subsidies. Thus, possible EC responsibility for wrongful acts did not arise. Further, the draft articles did not apply because the issue before the Panel with regard to debt forgiveness was one of interpretation of a substantive treaty provision. The question for the Panel involved the interpretation of the boundaries of the term "subsidy" as found in the Agreement. The draft articles did not concern themselves with treaty interpretation as such.[31] Moreover, the subsidy found by the United States in this case specifically involved the German Government. This Government action, which led to the bestowal of a benefit, formed the basis for the finding of a subsidy.

135. The United States argued that any claim that the banks would have acted the same way in the absence of government action was not only unsupported by the record, but also amounted to a challenge to the weight the DOC chose to give the evidence of record, and as such was not a basis for finding a violation of the Agreement. Also, the EC had stated, without citation to any record evidence whatsoever, that the Governments' guarantee of Saarstahl's liquidity was "nothing more than a statement of intention by the Governments of the common interest they shared with the private banks." That characterization was contrary to the evidence of record, which included a plain statement by the German Government that it would "secure the liquidity" of Saarstahl. The banks expressly stated that their agreement to forgive a portion Saarstahl's debts was based on the understanding that the "debts remaining after a partial forgiveness will be duly paid."

136. The EC argued that the Panel should focus on the essential questions of interpretation of the Agreement and measure the facts in issue against the standard set by the Agreement. In this context, the EC recalled its arguments relating to the interpretation of the term "subsidy". Further the EC argued that it was legitimate to request the Panel to consider how the DOC applied the United States law standard to the facts in the cases which had been referred to the Panel. This was a very different request from a "request to re-weigh evidence" and one which the EC considered was properly within the Panel's terms of reference.

3. Sales of assets of a previously subsidized company

137. The EC argued that the DOC's determination in the United Kingdom case that subsidies received by one company were transferred to another, independent, company when the latter acquired assets which

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[31]In support of its arguments concerning the draft articles, the United States referred to the Yearbook of the International Law Commission 1973, Volume II at 169, and Yearbook of the International Law Commission 1980, Volume II, Part 2 at 27. From the latter reference, the United States cited the following text: "It should ... be pointed out again that the purpose of the present draft articles is not to define the rules imposing on States, in one sector or another of inter-State relations, obligations whose breach can be a source of responsibility and which, in a certain sense, may be described as "primary". In preparing the present draft the Commission is undertaking solely to define those rules which, in contradistinction to the primary rules, may be described as "secondary", inasmuch as they are aimed at determining the legal consequences of failure to fulfil obligations established by the "primary" rules."

were once owned by the former was inconsistent with Articles 1 and 4:2 of the Agreement. The EC argued that a signatory had to show that a subsidy existed and that some benefit accrued from that subsidy before levying a countervailing duty. In addition, the determination regarding a subsidy must be based on an examination of all relevant facts. The EC recalled that the DOC had addressed the acquisition of assets by United Engineering Steels Ltd. (hereinafter "UES") from British Steel (hereinafter "BSC"), and had found that subsidy to BSC had continued to benefit UES. The EC argued that in view of the record evidence in the DOC proceedings, the DOC's reasoning did not demonstrate that a subsidy had been granted to UES, or passed through to it from BSC. Indeed, the DOC had failed to provide any explanation as to why it had concluded that UES was realising a benefit from the subsidies to BSC that justified the need to impose countervailing duties to "offset" such benefits.

138. The <u>EC</u> recalled that the DOC had determined that UES was a joint venture company independent from its parent companies, created through an arm's length transaction in which market prices were paid by UES to BSC. The DOC had determined that subsidies provided to BSC <u>after the formation</u> of UES did not automatically pass through to UES.[32] Nonetheless, with respect to the subsidies granted to BSC prior to the formation of UES, the DOC had determined that a company's (in this case the BSC's) sale of a "business" or "productive unit" did not alter the effect of previously bestowed subsidies, i.e. the benefits inhered in the assets irrespective of the price paid for them. Among the reasons given by the DOC for such a determination was also that levying a countervailing duty in such a situation avoided the creation of an opportunity for circumvention of the countervailing duty law. According to the DOC, if the original recipient were to be treated as having received the benefits of the subsidies, this would invite subsidy recipients to sell off units that produced or exported countervailed merchandise to the United States, and "in the end, a 'bubble' of subsidies would remain with a virtually empty corporate shell which would not be affected by any countervailing duties because it did not produce or export the countervailed merchandise to the United States. (*ibid.*)

139. The <u>EC</u> argued that since UES paid market prices for its productive assets in an arm's length transaction, the benefits arising from any past subsidies were reflected in the purchase price and were not passed through to the purchaser. The significance of the fair market value nature of the transaction was that the price paid reflected the present value of the future economic benefits to be derived from that asset, and the fair market value included the residual value of any remaining countervailable benefits received. Thus, the DOC had countervailed subsidies that never existed. The DOC's findings were based on assumptions that a subsidy was passed through from BSC to UES which were not borne out by the relevant facts. A private company that paid market value to purchase an asset from a subsidized state owned company had no competitive advantage over any other non-subsidized competitor since both had paid market value for their productive asset. The EC argued that such reasoning had been followed by the DOC in prior determinations,[33] and it seemed that the DOC's final determinations in the lead and bismuth investigations represented a clear shift in its position on this issue. The approach of the DOC in the cases under review would imply that a purchaser of a subsidized asset or business unit was deemed to be subsidized regardless of the price he paid, simply because he bought that asset from a company that had received subsidies. This approach would require that in addition to the purchase price which extinguishes a subsidy the purchaser repay the subsidy, and this may result in an additional repayment which was greater in value than the market value of the assets. Furthermore, a logical conclusion of the DOC's approach that benefits inhered in the assets irrespective of the market value paid for them, would be that the benefits remain in them despite repayment of the subsidy.

[32] 58 FR 6240.

[33] In support, the EC mentioned "Oil Country Tubular Goods from Canada" (hereinafter "Tubular Goods", 51 FR 15037, 22 April 1986 and "Lime From Mexico" (hereinafter "Lime"), 54 FR 1753, 17 January 1989.

140. The EC recalled that the Pork panel had found that subsidies granted to Canadian swine producers could be considered to be bestowed on the production of pork only if they had led to a decrease in the level of prices of Canadian swine paid by Canadian pork producers below the level they had to pay for swine from commercially available sources (paragraph 4.9). Thus, that panel's finding was that an entity purchasing the subsidized product had to receive some benefit, and the panel had rejected the presumption that a subsidy given to one entity necessarily benefitted a separate entity. Moreover, the panel had suggested that a factor which might be taken into account by the investigating authority (i.e. the United States authority in that case) was the per unit cost of producing the additional output of swine that the subsidies caused (paragraph 4.10). In the lead and bismuth case, the DOC did not even address the question of whether factual evidence of a benefit arising from a subsidy, such as reduced selling prices or reduced production or running costs, existed. Thus, the DOC had ignored economic reality and its determination was not based on full consideration of all relevant facts. For example, the DOC could have looked at whether there was any reduction in the fixed cost component for UES as a result of acquiring the assets; the only way in which this would have happened would be if the assets were purchased at less than full value. Alternatively, the DOC could have considered whether the marginal costs of UES were reduced by acquiring the previously subsidized assets. Again, when assets were acquired at full market value, that value reflected the efficiencies and corresponding reduced marginal cost associated with the assets bought. In the present case, the costs of operation for UES were no different than if it had acquired the assets from a non-subsidized company. In the EC's view, if a company was no better off as a result of the governments' actions, it cannot be considered as subsidized and cannot be subject to a countervailing duty. It was beyond doubt that no subsidies were granted to UES. The DOC did not advance the factual basis for its findings but had based them on an unexplained and unjustified presumption that subsidies given to a company inhere in individual assets The recourse to presumption was irreconcilable with the requirements set by the Pork panel.

141. The EC argued that an inconsistency in the United States' argument was that while the constant theme of the United States' submission was that it applied the standard of benefit to recipient rather than cost to the government, in this case it did not look at whether any benefit accrued to the party to whom the subsidy was passed through. The EC argued that the Agreement permitted a signatory to levy a countervailing duty to offset trade-distorting effects of subsidies, as shown for example by the Preamble and Article 11 of the Agreement. The first preambular paragraph of the Agreement showed that the objective of permissible countervailing duties within the framework of the Agreement was to counteract the unfair advantage enjoyed by a company benefitting from a subsidy. According to the Pork panel, the relevant facts must show how the production of the countervailed party was benefiting from subsidies received by another party. Thus, when assets changed ownership, it was important to show that subsidies received by previous owners of the assets provided ongoing competitive advantages to the new owner. However, the DOC in its determination had failed to indicate what it considered to be the nature of the subsidized competitive advantage enjoyed by UES. The DOC's determinations stated that "the subsidies provided to a company presumably are utilized to finance operations and investments in the entire company, including productive units that are subsequently sold or spun off into joint ventures". Thus the DOC's determinations seemed to be based on the presumption that subsidies were used to finance operations in the entire company, and on the further presumption that the benefits were transferred to the new owner of productive assets. The latter presumption which was particularly relevant for the point under discussion was nowhere substantiated by the evidence, and thus did not meet the requirement under the Agreement.

142. The EC attached importance to the requirement that an investigating authority demonstrate the benefit that a governmental action confers on the production of particular merchandise, and therefore the distorting effect of that action on the trade in that merchandise, in order to conclude that the governmental action constitutes a "subsidy" that was bestowed on that production. In the particular context of sale of assets, the EC considered that if funds determined to constitute a subsidy were provided to one company, a signatory may not impose countervailing duties on the products of another company unless there was a clear and convincing basis for concluding that the subsidies in issue were benefitting the production of merchandise by the second company in a manner that justified the imposition of "offsetting" countervailing

duties. Note 4 to Article 1 of the Agreement provided that a countervailing duty was "a special duty levied for the purpose of offsetting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise". Under that provision a signatory may impose countervailing duties on production of particular merchandise, only to "offset" a bounty or subsidy that had been bestowed on the production of that merchandise.

143. The EC then addressed the DOC's argument that sales of previously subsidized assets, such as in the case under review, could be a form of anti-circumvention. The EC argued that Articles 1 and 4:2 of the Agreement established a clear requirement that before imposing a countervailing duty it was necessary to establish that a subsidy existed, i.e. it was required that an objective assessment be made that a subsidy had been bestowed on the production of a company and that benefits had been derived from this. The objective of the disciplines imposed by the Agreement was to prevent, to the extent possible, adverse trade effects from the use of subsidies and to permit signatories to counteract such adverse effects where they materialized. To construe the possibility that signatories applying countervailing duties should seek to avoid every opportunity for circumvention was contrary to both the letter and the spirit of the Agreement. If the DOC's approach was founded on more general considerations of avoiding circumvention of United States' countervailing duty law, rather than specific considerations relating to the transaction in question, the imposition of countervailing duties on UES was a particularly inappropriate vehicle for this. Moreover, it was inconsistent with the Agreement's requirement that countervailing duties should only be imposed in respect of subsidies which had on the basis of relevant factual considerations been determined to exist.

144. The EC further argued that since the UES had paid full market value for the assets, there was no opportunity for circumvention of the countervailing duty. Also, on the facts of the case before the DOC no evidence was presented that circumvention of countervailing duties was a motivation for BSC's and GKN's actions. In the light of the DOC determination that the transfer of assets to UES was consistent with commercial considerations, it was hardly conceivable that the purpose of the transaction was to sell the assets used to produce merchandise for export to avoid the rigour of the United States' countervailing duty law. Furthermore, regardless of the intentions of BSC and GKN in creating UES, there was (as argued above) no subsidy to UES on the basis of a pure effects test and none of the benefits conferred to BSC by the subsidies it received were passed through to UES. Therefore, no circumvention could occur. Circumvention could have occurred only if UES had been subsidized and those subsidies went uncountervailed.

145. The United States argued that the issue under consideration was one of the many examples of an issue for which there was no explicit rule in the Agreement or methodologies on the point. As such, until there was a more specific agreement between signatories over such rules, the Panel should not overturn the determination unless it finds it to be unreasonable.

146. The United States argued that the EC did not contest that subsidies to BSC were not tied, i.e. they were not to particular units of that company; thus, the Special Steel Business of the BSC benefited from the previous subsidies, and consistent with the Agreement and the Guidelines, those subsidies could be allocated over time. Before the formation of the joint-venture, the Special Steels Business produced and sold the lead and bismuth steel bars that were subject of these proceedings. After the formation of the joint-venture, the product continued to be produced at the same plants using the same workers. The unit took with it such balance sheet items as receivables accumulated by the Special Steels Business. The change was only that the unit had been purchased in an arm's length transaction, and the issue was whether such a transaction affected the allocation of subsidies to the unit that would otherwise have occurred. If all subsidies were considered to remain in the original company, then that company could have its productive units removed and end up no more than a shell, and yet have all subsidies attributed to it. Thus, the mere formation of a new corporate unit using a portion of the company's assets did not mean that the unit no longer had a share of the subsidies the original company received.

147. The United States stated that the issue before the Panel was whether the fact that the unit was the subject of an arm's length transaction involving another party changed this result. Stated differently, did a sale of a company, or unit of a company, extinguish all subsidies previously received by the company or unit, or otherwise automatically prevent the company or unit from being allocated any of the previous bestowed subsidies? A second, related issue also arose: if the transaction did not automatically extinguish prior subsidies, to what extent, if any, did the purchase price nevertheless represent repayment of the subsidies. Regarding the first issue, the DOC had considered the arguments and determined that privatization did not automatically extinguish all previous subsidies. Regarding the second issue, the DOC did not find that any of the purchase price should be considered as repayment. Since then, the DOC had changed its position on this point, and had asked the United States Court of International Trade to remand the case so that the DOC could make a revised finding based on a different methodology. The United States said that the new determination of the DOC would be the appropriate determination to consider because the previous one had now become moot, and no definitive duties would be assessed based on the previous determination.

148. The United States said that the EC's argument that arm's length transaction essentially eliminated any possibility that the unit be considered to be subsidized seemed to be based on the notion that the transaction price represented the entire value of whatever subsidies the unit had received previously; thus none could be said to reside with the purchased unit any longer. Presumably, under this view, subsidies in an amount equal to the transaction price would then have to be allocated back to the main company, in this case BSC.

149. The United States argued that it did not believe that the Agreement required an assessment of subsidies in the manner that was being suggested by the EC. The EC's view was that the subsidies be measured not by their amount when granted, properly allocated over time, but by the competitive or market effect the subsidies produce on the company, determined as of a later date. The Agreement did not require measurement of subsidies in terms of their resulting competitive or market effects. The Agreement contained no "general" definition of a subsidy, and no understanding among signatories had been developed on the calculation of subsidy. Examples in the Illustrative List were in Part II of the Agreement, they were not exhaustive, and did not relate to the particular issue of subsequent sale of assets. Thus, there was little basis for arguing that the Agreement required authorities to adopt the particular effects test proposed by the EC. Moreover, there was no mention of competitive "effects" of subsidies in the Parts of the Agreement addressing the determination of countervailable subsidies; effects of subsidies were only relevant with regard to the determination of injury, as effects of subsidies were mentioned only in Article 6 of the Agreement. By finding that subsidized imports caused material injury to an industry in the United States, a finding not challenged by the EC, the United States had fulfilled any requirements to consider the effects of the subsidies. Thus, the EC's references to the Preamble were unavailing. Another reason for this was that preambular language did not create any binding legal obligation.[34] Also, the Salmon panel[35] had rejected an analogous argument that subsequent effects of taxes must be accounted for in determining the amount of subsidy.

150. The United States further argued that the Guidelines on Amortization and Depreciation indicated that subsidy benefits could be considered to be spread out over particular periods of time regardless of whether the particular recipient of the subsidy later performed well or poorly, as reflected in its market value. Since the purchase in the EC case occurred years after many of the subsidies at issue were received, the EC's argument implied that the competitive effect of a subsidy must be determined as of a date later

[34] To support its point, the United States referred to the Report of the panel on "United States - Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway", ADP/87, dated 30 November 1992, paragraph 369 and footnote 206.

[35] SCM/153, 4 December 1992, paragraph 245.

than when the subsidy was granted. The Guidelines did not mandate, or even contemplate, that authorities would undertake to follow the actual progress of particular assets, or of the value of companies that own them, to determine the competitive effect the subsidy was having. Not only was the effects analysis not mandated by the Agreement, but it would likely require the authorities to follow and track the subsidy over time in a manner that would be impossible to administer. It was not clear how this would be done. Therefore, since the EC's claim that automatic extinguishment (or automatic "no pass through") occurred in cases of arm's length transaction was based on the "subsequent competitive effects" theory, and since this theory was flawed, it implied that the fact that the transaction was at arm's length did not automatically prevent the unit from being considered to have received subsidies.[36]

151. The United States also argued that, on its face, the issue as formulated by the EC (i.e. in terms of "pass through") might be viewed as not too different from how the United States authorities viewed the issue in terms of repayment. Saying that a certain amount of subsidies should be allocated to a spun-off unit is similar to saying that a certain amount "passed through" to that unit. However, a requirement to affirmatively show "pass-through" suggested that the subsidy would not normally be considered to be allocable to the spun-off unit. This supposition was not accurate in the case of untied subsidies, in which every unit of a company would normally be considered to share. The United States did not believe that the EC's concept of "pass-through" must be applied under the Agreement. Neither Party claimed that the subsidies at issue no longer existed. That was why it was most useful and logical to view the issue as an issue of allocation. The authorities must apply a reasonable methodology for allocating subsidies as between a purchased unit and the company from which the unit originated. The DOC had applied such a methodology in its revised approach.

152. The United States argued that it did not agree with the EC's conceptualisation of "pass-through" if the EC was arguing that this was a concept that required something more than (1) the provision of subsidies that benefit a productive unit of a company; (2) sale of that productive unit as a complete unit; and (3) a reasonable evaluation of the extent to which the purchase price offsets the subsidies the unit received. DOC's original determination clearly contained the first two elements. As to the third, as noted above the DOC changed its methodology. As a result, there was now agreement between both Parties that the purchase price should be taken into account. The Panel could therefore decide the issue on this basis and leave further pronouncements to future cases where they would be necessary to a decision.

153. The United States observed that the original subsidies were "untied"; thus the subsidies conferred benefits on all units of the company, including SSB. The EC argued in the context of allocation of subsidies over production that untied subsidies automatically conferred a benefit on all units of the company, and that it would be impossible to affirmatively show this fact because it was what normally happens. So too in this instance: it would be a futile exercise to try to make an additional "showing" that the subsidies somehow "moved" when the unit was sold. In view of this futility, to say that some unspecified extra showing must be made would be tantamount to a blanket rule that a unit purchased at arm's length cannot possibly be allocated any of the subsidies the unit had received, a rule to which the United States would strongly object.

154. The United States also clarified that the EC's description of the issue as involving "sale of assets" was a misnomer because the DOC had determined that it was not appropriate to consider allocating benefits to individual assets that were sold, but that it should instead limit its analysis to transactions involving larger units capable of producing goods. In this case, the sale involved an entire functioning productive unit of BSC: the SSB.

[36]In this context, the United States informed the Panel that unlike its old methodology, the its new methodology did consider the purchase price to be a relevant aspect in the determination of subsidy arising in a situation of a sale of previously subsidized assets.

155. Regarding the Pork panel's decision cited by the EC, the United States said that case had involved a very different situation than the present case. There, no subsidy had been provided directly to pork producers, only to swine producers. The question there was, in what way had pork producers received a countervailable subsidy? In the present case, there was no question that prior to 1986, BSC, which included its Special Steel Business, received subsidies from the United Kingdom Government. If one were to analogize to the Pork case, one would look to the situation of the swine producers, who, like BSC, received the subsidies directly. No party to the Pork case argued that, with regard to the swine producers who received subsidies directly, there was any requirement to determine the existence of subsidies on the basis of their effects on the production or price of swine. Indeed, in the Pork case, the Panel "fully recognized that subsides need not in all cases, particularly in cases involving only one industry, have a price effect to be countervailable."

156. About the different methodology used in two prior DOC determinations, the United States said that the Lime case was a preliminary determination, and Tubular Goods involved assets subject to receivership proceeding. Also, the DOC's analysis had evolved. The real issue was whether the determination now before the Panel is in accordance with the requirements of the Agreement.

157. Addressing the EC's comments regarding anti-circumvention, the United States argued that the DOC had explained that an automatic "non-allocation" concept, like that suggested by the EC, possessed another problem, i.e. it would invite abuse that could frustrate the legitimate purposes of the countervailing duty law. The EC had overlooked that the analysis contained in the determination affirmatively supported the findings made by the DOC that subsidies were properly allocable to the spun-off unit. As the administering authority, the DOC would be remiss in carrying out its duty if it were to ignore the negative ramifications of an approach suggested by particular parties.

158. The EC disagreed with the United States' assertion that the effects of subsidies were only relevant to the "determination of material injury", but did not expand on this issue because it argued that the main issue before the Panel was whether the subsidy was passed through to UES. The EC argued that the United States was conspicuously silent about this issue. The EC explained that the reason for the EC to invoke the argument relating to "effects" of the alleged subsidy was to illustrate that the United States had not attempted to prove any pass through, but merely assumed that it occurred. In reality, the United States could not have proved the pass through since it did not take place. In this context, the EC argued that the United States has mischaracterized the EC's argument and then replied at length to what it described as the "competitive effects" argument rather than explaining why it considered that the subsidy was "passed through" to UES.

159. The EC argued that the term "automatic extinguishment" was not relevant in the context of a transaction involving a "sale of a portion of a company's assets". This issue, and the arguments developed by the United States in this respect, may be relevant to an analysis of a situation in which a privatization of a company takes place and the principal consideration was whether that privatization "extinguishes" the previous subsidies allegedly granted to the company prior to privatization. Here the issue was whether the sale of assets transferred the benefits to the new joint-venture company. Furthermore, the issue of repayment of subsidies and the new determination by the DOC were also not before the Panel, nor was the issue whether a corporate restructuring situation was altered where the corporate unit "was the subject of an arm's length transaction involving another party". The only issue before the Panel was: one company (BSC) sold assets to another independent company (UES) for their market value; subsidies were allegedly granted to the first company: were the alleged subsidies transferred, or passed through, to the second company with the sale of assets? The United States had tried to reformulate the issues before the Panel and addressed a number of questions which were not before the Panel. The EC argued that the United States had to demonstrate that subsidies had been passed through from BSC to UES. The arguments

provided by the DOC[37] amounted to nothing more than bald statements without factual foundation or intellectual justification. The DOC's findings were based on assumptions that a subsidy was passed through from BSC to UES. These assumptions were not borne out by relevant facts. The arm's length transaction at market value removed any basis for imposing countervailing duties.

160. Regarding the United States' point that the determination of the DOC on this point was moot, and that the relevant determination would be the one based on the new methodology, the EC argued that it could not accept that the matter be ruled moot after a revision on remand. The Committee had referred to the Panel the final determination in the Lead and Bismuth case made on 27 January 1993. Also, the so-called "new methodology" was based on the same basic reasoning and assumptions on subsidies "travelling with their assets" to their new home. These were the points that the EC was challenging in the present case, because they ignored that in this situation there was no lasting effect in the form of a competitive benefit to the new owner and because such unexplained and unjustified presumptions were contrary to the dictum of the Pork panel. Furthermore, the United States was stressing that it can apply any "reasonable" methodology (quod non) and since the United States was often changing methodologies for different aspects, there was enhanced uncertainty because there was no guarantee that it may not reintroduce this objectionable practice at a future date. The EC, therefore, had a legal interest in a panel ruling on the present issue, whatever its fate in the United States court proceedings.

161. About the United States argument relating to the Guidelines, the EC said that it did not contest the principle of allocating benefits overtime, but argued that the use of this principle must be consistent with the Guidelines and Article 4:2 of the Agreement. The EC explained that it was not arguing that the investigating authorities must "follow and track the subsidy in a manner that would be impossible to administer". Rather its argument was that the United States must show that a subsidy was passed through to the company whose products were exported before the question of allocation of such subsidies over time.

162. The EC contested the United States' argument that the situation in the Pork was different, and said that the fact that in the Pork panel there were two distinct like products at issue cannot detract from the principle that pass through of subsidies between separate economic entities must be demonstrated on the basis of all relevant facts and cannot be assumed. The case presently under review by the Panel involved an assessment of the circumstances in which subsidies can be passed through from one company to another which was separate from the first company. The panel in the Pork case had determined that a pass through of subsidy benefits had to be demonstrated on a factual basis before countervailing duties can be imposed.

4. Equityworthiness

163. The EC argued that in determining that subsidies were provided through government's purchase of equities in the French and United Kingdom cases, the DOC may have found subsidies where none existed and/or may have overstated the amount of subsidies. Therefore, the countervailing duties imposed in these cases were higher than the amount of subsidy, in violation of Article 4:2 of Agreement. The EC argued that the DOC's methodology resulted in higher subsidies for two main reasons.

164. First, the DOC used the criteria of "reasonable private investor", which was not the appropriate criterion for government investment because it did not take into account that government investment and motives for that investment were different from those for private investment. Even assuming the criterion of reasonable private investor was appropriate, there were problems on account of the way in which the

[37](i) "Therefore, it follows that when a company sells a productive unit, the sale did nothing to alter the subsidies enjoyed by that productive unit"; (ii) "Therefore, as the company disposes of its productive entities, these entities take a portion of the benefits with them when they 'travel to their new home'".

DOC had used it in the cases under review. The DOC had not applied it in a manner consistent with logic, economic reality, or all relevant facts because the indicators used by the DOC were exclusively backward looking and did not take account of prospective factors. The benchmark used by the DOC had shifted from "reasonable" to "prudent" investor in a wanton fashion. Furthermore, a reasonable private investor was invariably an outside investor, whereas the investment in the French and the United Kingdom cases were made by the governments, which were inside investors. The rational investment decisions of an inside investor may be considerably different from those of an outside investor.
165. Second, in the French and United Kingdom cases, in calculating the amount of subsidization the DOC had treated equity investments in "unequityworthy companies" as grants given in the year of the equity investments. This was again a situation where all the relevant economic situations were not taken into account, resulting in an overstatement of the countervailing subsidy or in a finding of subsidy being made where none was present.

166. The United States explained that in examining whether a government's infusion of equity into a company amounted to a subsidy, the DOC generally determined whether the infusion was made on terms not consistent with normal commercial considerations. This was easier to determine if a company had publicly traded shares because then the DOC could compare the share price with the price paid by the government. In cases without publicly traded shares, the DOC considered whether a reasonable private investor would have made the investment in the company at the time of the infusion. If the answer to this question was in the affirmative, then the company was determined "equityworthy", and the infusion was not determined to confer a countervailable benefit. However, if a reasonable private investor would not have invested in the company at the time of the infusion, then the company was determined to be "unequityworthy" and the equity infusion was determined to be a countervailable benefit. The USDOC's test for determining equityworthiness was whether, "from the perspective of a reasonable private investor examining the firm at the time the government equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable period of time." In making this determination, the DOC examined a broad array of available evidence which included, among various other factors, future prospects.

167. The United States argued that in the French and United Kingdom cases, the DOC findings were fact-intensive and reflected a thorough consideration of the record evidence and points raised by respondents (58 FR 6222-3 and 6241). There was no doubt that a reasonable, unprejudiced person, on the basis of the record before the DOC, could have made the subsidy determination the DOC made in those cases. Thus, no violation of the Agreement existed.

168. The United States argued that public policy objectives could be used to rationalize most subsidies, but this did not make government actions any less subsidies that may be countervailed. The DOC's methodology was reasonable and took into account the relevant prospective factors and the behaviour of private investors. Regarding "outside" and "inside" investors, the United States argued that it was an accepted proposition in economic analysis that the investment behaviour of all investors was based on the marginal return to investment. Therefore, in any particular situation, investors behaved in the same manner whether they were "inside" or "outside" investors.

169. With respect to the treatment of equity infusions to an unequityworthy company as a grant to that company, the United States argued that the DOC was correct in its approach because if the Government had acted like a reasonable private investor, the company would not have received any equity investment from the Government. Therefore, all of the equity infusion by the Government was an additional amount which otherwise would not have been received by the company.

170. The discussion of these issues is organized by first focusing on the DOC's use of a "reasonable private investor" test for determining the existence of a subsidy resulting from a government equity infusion, and then considering the arguments relating to treatment by the DOC of equity investment in unequityworthy firms as grants to those firms for purposes of calculating the amount of a subsidy.

(a) Use of a "reasonable private investor" test

171. The EC recalled that in the French and the United Kingdom cases, the DOC had determined that the companies concerned were "unequityworthy" during certain periods of time and therefore the equity infusions they received from the governments were determined to be countervailable subsidies. For deciding whether a company was equityworthy, the approach of the DOC was to use a benchmark of whether a "reasonable private investor" would have invested in the company (see Annex 1). In choosing this benchmark, the DOC took the rational behaviour of an investor as the basis for its decision. The EC argued that any such assessment of rationality could not be partial under the Agreement, and just as the signatory to the Agreement had to take account of all the facts relevant for the determination made under the Agreement, the investigating agency had to take account of the full rationality involved in making government equity infusions in a company and not apply a truncated logic to such decisions. A selective approach to the relevant economic facts and to economic logic would lead to an infringement of Article 4:2 of the Agreement to the extent that a proper consideration of the relevant economic facts and of economic logic would have led to a finding of no subsidy or of a lower subsidy than was actually found. In view of this requirement, the EC argued that the reasonable private investor benchmark was inadequate because (a) it was not the appropriate criterion for government investment, and (b) even if it was considered to be the appropriate criterion for government investment, the DOC had not applied it in a manner which was consistent with logic, economic reality, or all the relevant facts. Therefore, the decisions in the French and the United Kingdom cases were not based on all relevant facts and had not conclusively demonstrated that the companies in question were indeed "unequityworthy" during the periods mentioned in the decisions.

172. The United States argued that equityworthiness was an issue not covered specifically by the Agreement's provisions, and both sides agreed that in such a case a Panel's review must be limited. The whole concept of equityworthiness was one that arguably went beyond what was required by the Agreement. In view of the lack of Agreement coverage, investigating authorities could arguably find that all government infusions of equity were subsidies, at least in the absence of any private benchmark infusion into the same companies. In practice, the DOC did not go that far but undertook an examination based on a "reasonable private investor" standard for a finding of a subsidy.

173. In response to a question by the Panel, the United States explained that an unequityworthy company was one that would not earn a reasonable return on investment in a reasonable period of time, and thus not be able to attract investment from a reasonable private investor. The expected return on investment may or may not be zero or negative. It was not possible to quantify precisely for all cases the level of return necessary to make a company equityworthy, because circumstances differed from case to case, from industry to industry, and from country to country. However, the lower the expected return on investment the more likely it was that the company will be found to be unequityworthy.

(i) Alleged failure to take account of public policy objectives

174. The EC argued that the reasonable private investor criteria was inherently biased and flawed in so far as it took the private investor as benchmark for government investment decisions because it was well known that in mixed economies, governments invested for motives different from those of private investors, for example with public policy objectives rather than maximising of profits or returns on investment. The reasonable private investor benchmark ignored this reality and placed government investment in the straight jacket of purely "commercial considerations". While government investment might under certain circumstances contain an element of subsidization and may therefore be countervailable, the generally accepted financial and economic indicators used to determine that such was the case had to be balanced against legitimate public policy considerations. For a reasonable government investor "a reasonable rate of return within a reasonable period of time" may be different from the same notions for a "reasonable private investor". What might not satisfy a reasonable private investor may be

rational for a public investor to accept in view of the long-term public policy goals. This was relevant in the context of the Agreement because the Agreement had been concluded between countries many of which had mixed economies, and it could not be presumed that they had accepted an agreement which was inherently biased against government investment by allowing their treaty partners to ignore the non-commercial motives for government investment and by applying a purely private investor standard in judging government equity infusions in companies.

175. The United States argued that most, if not all, subsidies provided by a government could be rationalized from the perspective of the government's public policy goals. However, such motives and objectives did not make government actions any less subsidies that may be countervailed. If the test the investigating authorities were supposed to apply was whether the company was one in which a reasonable government investor would have invested, it was difficult to imagine a case where a countervailable subsidy could ever be found. Such a test would be circular, i.e. the fact that the government invested in a company was proof that the company was one in which a government investor would invest. No such test was required by the Agreement. Moreover, it would be extremely difficult to second guess the public policy purposes of the government's investment. The Salmon report ruled that, although a country may use subsidies for important social purposes, such subsidies may be countervailed if the requirements of subsidy, injury and causal link were established.

176. While agreeing with the United States' argument that second guessing the public policy purposes of public investment might be difficult, the EC argued that it was nonetheless possible to determine that certain claims were valid that the actions were taken for public policy purposes. Further, the EC argued that the issue before the Panel was not whether it was necessary to determine by how much a reasonable public investor would have acted differently from a reasonable private investor, but that in light of the requirement that all relevant facts be considered, it was unacceptable that the relevant difference between public and private investors was not taken into account when determining that a subsidy existed. Given the different approach that a reasonable public investor would normally take, the United States could not have determined beyond doubt that a subsidy existed.

177. The EC argued that the two features of public investment, i.e. public policy goals and not necessarily aiming for maximum returns, did not lead to a circular test, and the reasonable public investor standard did not invariably lead to a finding of equityworthiness and to a justification of any equity infusion made for public policy purposes. If a government made an investment for social reasons only and without any serious chance of breaking even in the long run, such an investment would not respond to the "reasonable public investor standard". Some standard for determining what would be acceptable return on investment for a public investor could be devised. Though difficult, this had to be done in order to properly take into account the fact - acknowledged by the United States also - that public investors behaved differently from private investors. Thus, not all relevant facts were taken into account by the United States investigating authorities, and therefore they cannot have determined that a subsidy existed since the different approach taken by a public investor could have led to the conclusion that no element of subsidization was present here.

178. The United States pointed out that the EC had acknowledged that it was difficult to second guess the public policy purpose of public investment, but then stated that "it is possible to determine that certain alleged public policy purposes were bogus" without stating how one would implement a "bogus purpose" standard or why this type of public policy was within the purview of the Agreement. In fact, the EC's reasonable government standard would, if adopted, make it practically impossible to find the existence of a countervailable subsidy because from the government standpoint, all subsidies can be said to be "reasonable". Also, the EC was simply proposing a different test, i.e. a reasonable government investor test, without explaining why the Agreement required that particular test. There was nothing in the Agreement that mandated that test, and it was incorrect to say that unless the authorities used that test they were not considering all relevant facts. The EC itself apparently applied a standard similar to the USDOC's reasonable private investor test in evaluating equity infusions under its State Aids Code.

179. Regarding the difficulty in distinguishing public policy purpose behind particular investments, the EC argued that it was not impossible to weed out the public policy purposes which were obviously a pretext or had no credibility. Also, the feature of government investor, i.e. acceptance of a lower rate of return than a private investor, could be more easily determined. The EC's basic objection was that the acknowledged features of government investment were not considered in the DOC's determinations. Only if the determination of the existence of a subsidy would have been properly performed by an equityworthiness test which would take account of all relevant facts, including the difference between public and private reasonable investors, could the question of calculation arise and then would it become relevant to calculate what (lower) level of return would satisfy a reasonable public investor. For the EC, the basis of calculation of a subsidy was the cost to the government. The EC emphasized that the recalculation of a subsidy was not a proper task for a Panel, but a Panel could properly express itself on the question of whether an "error of fact" had been committed in marshalling all elements which had led to the determination of the existence of a subsidy. The EC also argued that in making a suggestion that the "reasonable public investor standard" would not be met if a government makes an investment without any serious chance of breaking even in the long run, it was intending to show the bounds of "reasonableness" circumscribing the specific behaviour of a "reasonable public investor". This was to affirm the meaningful character of the test in a determination of a subsidy, if it was made through an "equityworthiness" determination.

(ii) Alleged failure to take account of prospective indicators

180. The EC argued that even if, for the sake of the argument, the EC accepted that the reasonable private investor standard benchmark could be the appropriate yardstick for a "reasonable public investor" and could take account of all the relevant facts, there was still another major problem with the DOC determination, namely the indicators used in the DOC decisions. While the indicators in the DOC's proposed methodology may include various present and past indicators (see Annex 1), in practice the DOC relied primarily on indicators which were almost exclusively financial in nature, i.e. "current and past indicators of a firm's financial health calculated from that firm's statements and accounts [and] the rates of return on equity in preceding years".[38] These indicators did not pay much attention to the "real economy" in which the firm operated (such as cyclical nature of the market, and the products sold and the product innovation by the firm) or to the structure of the firm itself (its management and labour force, and any improvement or restructuring which may have taken place), i.e. factors which determined the long-term health of the company. Thus, the indicators used by the DOC were backward looking because they concentrated on past financial performance and indicators, and did not pay attention to prospects and likelihood of improvement.

181. The EC said that in the United Kingdom case, the indicators used were returns on assets and equity, profit margins and the absence of distribution of dividends. The DOC's decision in the United Kingdom case did not respect even the United States' own Proposed Rules to the extent that no attention was paid to indicators concerning the firm's future prospects despite material indicating the BSC's future viability being placed on the record of the investigation.[39] Therefore, it was clear that the decision in that case was not based on all relevant facts and did not reflect the true economic choice facing the investor or the true situation of the company concerned.

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[38]The other indicators which the DOC may use were "the firm's future financial prospects, including market studies, economic forecasts etc. [and] equity investment in the firm by private investors."

[39]These were an analysis by independent consultants titled "Study of the Viability of the British Steel Corporation (1985)", as well as the positive forecasts by an independent study bureau, Data Resources Inc. (first quarter 1984). These studies which were placed on the record in the UES submission of 24 August 1992 were also provided to the Panel by the EC.

182. The EC said that in the French case, some indicators of future prospects (a report by McKinsey and Co.) were considered by the DOC in addition to those related to past financial performance, i.e. substantial losses, negative stockholders' equity, rate of return on assets and profit margin on sales. However, the DOC had argued in its decision that the projections of the McKinsey study should not lead to ignoring the negative financial indicators: "in our [i.e. the DOC's] view, a prudent investor would not assess the reasonableness of investing in the newly restructured company without taking into consideration the tremendous financial difficulties of both companies [i.e. Usinor and Sacilor] ..." (*op. cit,* page 6222). The EC argued that this approach revealed another difficulty inherent in the "reasonable private investor" approach, insomuch as the latter now became "prudent" rather than "reasonable". This assessment rested on the assumptions of risk avoidance in private investors which were completely arbitrary. The private investor was reduced to an investor who did not take any risk, even if there was good and trustworthy information from a reputable independent firm, such as McKinsey and Co., that a company after restructuring would leave its past financial difficulties behind and become a reasonably thriving concern. The United States' approach fundamentally negated the economic reality that investment was about providing "risk capital".

183. Regarding the French case, the EC further argued that the DOC had found that "beginning in 1988, the company reported positive rates of return on both assets and equity for the preceding years"(ibid., page 6222, last column). With the benefit of hindsight, it was therefore easy enough to see that not just prospects were positive but also real results started to improve after 1987. This fact was not taken fully into account by the DOC for the years 1987-1991, but only for 1991 itself. The EC noted that the DOC's decision admitted that "the equity methodology does not recognize the subsequent performance of the company receiving the equity investment" (ibid., page 6224), and argued that this clearly demonstrated to what extent the equityworthiness analysis was biased in favour of negative indicators of past financial performance. Under the United States' approach even if an investor was proven right in his faith in the future of the company on the basis of serious forecasts of the future, and the company was turned around with the help of his investment, that investment would still be regarded as a subsidy because it ought not to have been made according to the United States' preconceptions about what was a "prudent" investor.

184. The EC then argued that practical experience in the private sector indicated that even companies which would be considered to be in dire straits under the DOC's indicators had been able to raise capital, obviously because there was a positive assessment of their future capabilities. In this context, the United States steel industry itself was a prime example because it was able to raise additional capital in the early and middle 1980s after it had lost billions in the early years of the decade and hundreds of millions thereafter. For example, Bethlehem Steel sold 5 million shares of stock for $82.5 million in May 1985, although the company had lost $1.47 million in 1982, $163.5 million in 1983, $112.5 million in 1984 and between $60 and 80 million in the first quarter of 1985. US Steel sold $3.84 billion in stock despite having reported losses of over $1.5 billion in those years. The EC said that this information was on the record of the investigation.

185. The United States disputed the EC's claim that the DOC had not considered all the relevant information, including prospects of the firms. According to the Proposed Regulations, future prospects were an explicit element of the DOC's equityworthiness analysis: "future prospect of the company, effects of economic cycles, effects of restructuring efforts of the company and the nature and outlook of the market." As well, the DOC's ultimate test for equityworthiness was not backward-looking; i.e., whether "the firm showed an ability to generate a reasonable rate of return within a reasonable period of time." The EC's challenge was, in effect, a disagreement with the weight the investigating authorities gave the studies predicting the company's future performance, as compared with other record evidence. This was no basis for a finding of a violation of the Agreement. Several previous panels had found that a disagreement over the weight given to record evidence was no basis for finding a violation of the Agreement.

186. The United States argued that in the United Kingdom case, the DOC considered all evidence of record on the question of equityworthiness, including the studies on future prospects submitted by the United Kingdom respondents and cited in the EC's first submission. In view of the sustained negative trends, the DOC determined that the studies suggesting improved future outlook, though relevant, were not dispositive. Also, though the United Kingdom respondents submitted the studies to the DOC prior to the preliminary determination, they did not raise any issue concerning them in their briefs leading up to the final determination. In view of the respondents' lack of interest, it was not surprising that these aspects were not explicitly discussed in the determination.

187. The United States argued that in the French case, the DOC considered the report by McKinsey and Company and addressed that information explicitly in its determination. It weighed the information provided in this report along with the financial analysis conducted for each of the years 1982 through 1991. The report was aimed at what steps could be taken in the context of restructuring to enable the firm to meet the EC's so-called "viability criteria". Hence the focus of the report's analysis was not the focus of a potential investor. The objective was to place the firm on such financial footing as would enable it to cover its major cost items without having to resort to external financial assistance; the report did not speak directly to how the firm would or might assure its stockholders a given rate of return on their investment. Thus, the report's conclusions had to be considered in light of its stated purpose as well as the recent historical performance of the company under a variety of financial indicators. The record evidence portrayed a firm which had experienced extreme financial difficulty during the period 1978 through 1988, although the company showed some improvement in profitability beginning in 1988. Moreover, the study by McKinsey and company suggested that the restructured company would become "a reasonably thriving company", but given the company's poor past performance and thus the extensive risk involved in investing in it, any investor would seek a better prognosis than "reasonably thriving": the riskier the investment, the higher the payoff would have to be to attract investment. Also, any reasonable investor would pay close, probably the closest, attention to a company's performance to date. Since seeing into the future was impossible, information on a company's actual performance was the only "hard data" available and represented the company's proven track record. Of course, an investor might also look at a company's future plans and prospects, and indeed the DOC did as well. In making its determinations the DOC considered the evidence of record pertaining to all elements of its equityworthiness test, including any information on firms' future prospects. Finally, an investor, in addition to judging whether the report was of value, would also have to consider other issues such as whether the French Government and company would be willing to undertake the fairly substantial restructuring called for in the study, and if so, whether, in view of the company's previous experience, the effect on the fortunes of the company would be even as significant as suggested in the report.

188. The United States argued that the EC had mischaracterized the DOC methodology because the DOC reasonable private investor standard did not presume that private investors never assumed any risks. The methodology reflected the view that a reasonable private investor would act reasonably in assessing the degree of risk associated with a potential investment. The United States also contested the EC's claim that a reference to a "prudent" investor in the French determination represented a departure from the reasonable private investor test. Prudence was clearly an aspect of being a reasonable investor; put another way, a reasonable investor would not make an imprudent investment.

189. Addressing the EC's point that companies which would be considered to be in dire straits under the DOC's indicators had been able to raise capital in the early and middle 1980's, the United States argued that if a company had been able to get capital from private investors during the relevant period, the DOC would consider the company to be equityworthy and would not even undertake an equityworthiness analysis. However, none of the affected European companies had presented any evidence indicating that they had been able to raise capital from private investors. Moreover, the United States argued that the evidence gathered by the DOC did not indicate that the prospects for the turn-around of the affected European companies were good or that the potential payoff in the unlikely event of success was sufficiently high to attract a reasonable investor.

190. Regarding the EC's argument that the DOC did not take into account the firms' performance subsequent to the infusion of capital in determining equityworthiness, the United States argued that according to its methodology, the DOC did not determine whether the investment in fact turned out to be a good investment; nor was such a test required by the Agreement. Instead, the DOC practice was to ask whether, based on the information available at the time of the infusion, a reasonable investor would have invested in the company. If the investor would not have done so, then the government gave the company capital that it would not have otherwise been able to obtain. A later event could not change whether a reasonable private investor would have invested at the time. The DOC's analysis also was neutral in that it also avoided revisiting investments that appeared sound when made, but that later turned sour.

191. The EC argued that the United States' response to the EC's claim that "prudent" rather than "reasonable" investor standard was used by the United States, evaded the issue by arguing that prudence was an aspect of being a reasonable investor or that a reasonable investor would be reasonable in assessing the degree of risk in any investment. This raised the question whether the "reasonable private investor test" was a real test at all or a catch-all phrase which admitted of different nuances and thus was purely arbitrary in the end. In fact, the United States had argued that it was not really the "reasonable private investor" that was the yardstick but whether "the individual investment reflect(s) a reasonable assessment of commercial considerations" (or whether it would yield a reasonable return). If the United States must shift the focus of its yardstick so many times, that was clear indication that this criterion was highly arbitrary in its application and must, therefore, be rejected by the Panel. Also, in isolation of the particular circumstances of the case, the DOC's criterion of whether the individual investment reflected a reasonable assessment of commercial considerations, would turn into a totally abstract assessment of investment.

192. The EC argued that in reality the United States' "reasonable private investor" test was inadequate also because the United States paid no attention to the prospects of the firm. This was also reflected in United States argument that the past information was the only "hard data". This raised the question of whether a "reasonable private investor" would ever invest in a new company which by definition had no "proven track record". Furthermore, in the current dispute, it appeared that from the published determination in the United Kingdom case that the prospects of the firm had not been considered at all. Now the United States was arguing that the prospects were considered, but that the DOC was not obliged to mention the consideration of all record evidence in the decision. The important question for the Panel in this regard was on what basis to make decisions on questions of alleged infringement of the Agreement. To the EC it was inescapable that the decision of the investigating authorities must be the basis of the Panel review. In the absence of weighing up of the BSC's prospects against its past performance, the reasoning of the decision could not bear the final amount of the countervailing duty found because one element of the subsidy was not considered and therefore the DOC could not have established the subsidy on the basis of all relevant facts.

193. The EC argued in the French case, the final decision of the DOC did not pay serious attention to indicators of possible future improvement in performance (indicators which were subsequently proved correct), and to the information on the United States steel companies' capability to raise equity capital in the mid-1980s in spite of massive losses they had suffered. It was crucial that all this evidence be considered; it was not a question of merely reweighing. There was ample evidence on record that the McKinsey report focused exactly on a number of issues that would have been of great interest to an investor and would have assured him that the company in question would be a going concern in the near future and was thus equityworthy. The affidavit of Marcel Genet, a director of McKinsey and Co. in Paris, described the objective of the study; this affidavit was part of the record of the investigation. The objective was to review in detail the official restructuring plans of the companies merged into Usinor/Sacilor and to determine whether the adherence to these plans would result in meeting the EC viability criteria. These criteria consisted of certain figures (a certain level of earnings before interest, taxes and depreciation, assuming certain level of depreciation and level of interest and other financial charges and a certain requirement of remuneration of equity) which would have been of interest to the average investor. The

McKinsey study arrived at the conclusion that the restructuring plan would lead the merged companies to meet the viability criteria set by the Commission. This would have given the investors the reassurance that Usinor/Sacilor was equityworthy. The years 1988-91 were good years and Usinor/Sacilor returned dividend payments during those years. Furthermore, in the near future the main shareholder, the French Government, will be receiving money for its shares when it will privatize Usinor/Sacilor. These facts were not influenced by the fact that some of these shares were obtained in "bad" years for the company. According to the logic of the DOC methodology, the dividends nor the money from the sale of shares could not have happened.

194. The EC argued that the exclusion of ulterior knowledge by the United States was not neutral because it wilfully excluded available information and through this artificial construct determined that governments should not have invested, even though their reliance on certain available information was proved correct. In this way, countervail law became punitive rather than compensatory. It was a question of government investors relying on serious forecasting which argued that an ailing company could be successful if certain measures were taken. If such prospective elements of information were proved right, reliance on it should certainly not be punished by countervailing duties. About the importance of taking account of later events, the crucial point was not that the investment was successful but that what happens later on (and what we know now) could help decide whether the reasonable investor (and in particular the inside investor) properly relied on information about the future prospects of the firm. In the case of *prima facie* unequityworthy firms, it was not the later equityworthiness which sanctified the investment *post factum* but the fact that this later equityworthiness showed that the contemporaneous information which led to the conclusion that future equityworthiness was highly likely under certain circumstances, was correct and could therefore lead to an investment with an acceptable risk factor. Thus, there was no subsidy.

195. The United States reiterated that the DOC did consider the information on future prospects. For example, it explicitly discussed the information in the French case, and relied, in part, on a forecast of future performance to find Usinor/Sacilor equityworthy in 1991. This was an aspect that had not been challenged or mentioned by the EC. In the United Kingdom case, the DOC examined information on prospective factors, since it was the practice to do so and it was required by its proposed rules. The determination properly contained a detailed discussion of the factual information that enabled the DOC to reach its equityworthiness determination. The Agreement did not require that all record information be discussed in the determination. The EC had not pointed to any provision in the Agreement that contained such a requirement. Indeed, although the studies were technically on the record of the United Kingdom case, the respondents themselves did not even focus on them as an issue in the final investigation. Moreover, the provision pertaining to what must be in a public notice of a determination, i.e. Article 2:15 of the Agreement, was not within the terms of reference of this Panel.

196. The United States reiterated that the orientation of the study regarding equityworthiness submitted by the respondents in the United Kingdom case (entitled "Study of the viability of the British Steel Corporation"), was also similar to that of the McKinsey study, i.e. it concerned the "viability" of the company rather than how an investor would evaluate whether to invest in the company. With regard to the other report cited by the United Kingdom respondents (i.e. the study by Data Resources, Inc.), the United States argued that this study was a forecast of the United States market rather than a study of the BSC. Furthermore, such a study was discussed explicitly by the DOC in a previous determination[40] that was cited by the DOC in the present United Kingdom case (58 FR 6241).

197. The United States argued that even accepting the inside and government perspectives (*quod non*), post-investment information would still not be relevant because it could not have been considered at the time of the investment. In this context, the United States reaffirmed its position that the DOC's

[40] Stainless Steel Plate from the United Kingdom; Final Results of Countervailing Duty Administrative Review, 51 FR 44656 (11 December 1986).

procedure was neutral: as the DOC did not consider information showing that an investment in an unequityworthy company proves to be a good investment, in the same way it did not consider information showing that an investment into an equityworthy company ultimately went bad. In both cases the information was not relevant to the question to be answered. Contrary to the EC's assertions, DOC's methodology was not "punitive". No one was punishing the government for having made an investment. Where a finding of unequityworthiness is made, the DOC finds simply that the company was not one in which a reasonable private investor would have invested, and thus the infusion amounts to a subsidy. Moreover, no one was claiming that the government "should not have invested" in the company. The DOC was not in the business of judging what is good government policy, only whether a subsidy exists. Signatory governments were free to invest in companies in their territory; however, if a subsidy were provided thereby (and injury and causal link exist), an importing country may impose a countervailing duty.

198. The United States took issue with the EC's argument that, based on the United States' reference to whether an "investment reflected reasonable commercial considerations", the United States had shifted its standard for assessing equityworthiness. The DOC's test was whether "from the perspective of a reasonable private investor examining the firm at the time the government equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable period of time." This standard was addressed to an assessment of the firm, from the vantage point of the reasonable private investor. Whether an investment in a company reflects "reasonable commercial considerations" depends on the likely return to the investor based on the earnings of the company. Thus, the statement that the "investment reflected reasonable commercial considerations" was in substance no different than saying that the company in which the investment was made "showed an ability to generate a reasonable rate of return within a reasonable period of time", which was the DOC's standard quoted above.

199. In an answer to a question by the Panel, the United States argued that regardless of whether individuals within the French Government may or may not have had knowledge relevant to whether the Government was likely to implement the far-reaching plan suggested by the McKinsey & Co. study, a private investor would not have known this. The aim of the equityworthiness test was to examine whether the government provided a benefit that a reasonable private investor would not have provided, and this information would not have figured in a reasonable private investor's calculation, i.e. this information would not be among the factors which would have influenced a reasonable private investor's investment decision in this case.

(iii) Alleged failure to take account of the perspective of an inside investor

200. The EC further argued that in the eyes of the DOC, a "reasonable private investor" was an outside investor. However, in the cases regarding products from France and the United Kingdom, the investor was the government which was an inside investor or owner-investor. The rationality of an outside investor was likely to differ considerably from the rationality of an inside investor and any approach that did not take this economic reality into account was illogical and contrary to relevant facts and economic reality. For an inside investor who had a big stake in a company, it made commercial sense to continue to invest in such a company even whilst an outside investor would no longer do so. The inside investor would be concerned about safeguarding and recovering his existing stake in the company. He faced the risk of losing all or a substantial amount of his existing stake in an ailing company if that company was bankrupted or liquidated: the company would be worth more as a going concern, and therefore the inside investor (irrespective of whether he was a private or a public investor) would be motivated to help keep the company in operation and provide additional investments to that end without thereby acting in a commercially unsound manner. If the inside investor provided further investment and helped turn the company around, where an outside investor would not have done so, this could not be taken to mean that the capital infusion was unsound and, therefore, amounted to a subsidy. Moreover, an inside investor had greater expertise and knowledge about the company and the market in which it operated and therefore was usually better capable than an outside investor to assess the prospects for future profitability of the company. Also, the fact that an outside investor may be less well informed and less confident of his

information about the firm's prospects, usually will make him demand a higher rate of return than the inside investor.

201. The EC then addressed the argument in the DOC's determination that both inside and outside investors made investments "at the margin [and that] a rational investor does not let the value of past investment affect present or future investment decisions. The decision to invest is only dependent on the marginal return expected from each additional equity infusion" (*op. cit.*, page 6245, middle column). The EC argued that this marginal investment theory was based on the notion of opportunity costs, and failed to acknowledge the economic reality that inside investors may for some time accept a negative return on their assets as long as over the longer term the net capitalized value of the stream of income from their assets was likely to remain positive. Thus the unequityworthiness decision could not stand, the existence of a subsidy could not be demonstrated and therefore Article 4:2 had been infringed.

202. The United States argued that the DOC had specifically addressed the issue of "inside" investors. The DOC had explained that the rational investment decisions of inside and outside investors were not fundamentally different, and were based on the "marginal return expected from an equity infusion". Thus, the DOC had considered that it should not undertake a separate analysis of inside and outside investors. This analysis was reasonable and in accordance with economic theory; whether it made sense for an investor to retain past investment, as opposed to whether it would be economically rational for that investor to make new investments in the same firm, it was basic economic philosophy that rational investment decisions were made at the margin, without regard to previous investments. Numerous economic treatises supported this proposition[41] and the EC had not rebutted it. The EC's contrary position represented essentially a disagreement over economic theory. The Panel should decline the EC's invitation to decide which side was "right" on complex issues of economic theory. An attempt by the Panel to determine which side was "right" on complex economic issues such as this one was equivalent to *de novo* review. The United States did not believe that the *de novo* review was the appropriate approach a Panel should take, and this understanding was shared by the EC. Rather, in keeping with panel practice, the Panel should determine whether there had been a violation of the Agreement. In this case, the DOC's analysis was logical, explained, and supported by economic theory.

203. Further, the United States argued that the focus of the DOC analysis (or methodology) was to determine whether the individual investment reflected reasonable commercial considerations. An attempt to account for the situation of any particular investor would not focus on the relevant question, i.e., did the individual investment reflect a reasonable assessment of whether it would yield a reasonable return?

204. The United States said that the EC was not correct in arguing that the DOC's equityworthiness methodology failed to acknowledge the economic reality that investors may accept a negative return on their assets as long as the net capitalized value of the stream of income from their assets was likely to remain positive. The DOC's methodology accounted for such a criteria, which could apply to both inside and outside investors, by examining whether there was a likelihood of earning a reasonable rate of return within a reasonable period of time. Moreover, if, as argued by the EC, a return from investment was merely positive and only likely to be earned, then such an investment opportunity should be traded in for other investments by any reasonable private investor.

205. In response to the United States' argument that investments were made on the basis of returns at the margin, the EC argued that the economic textbooks referred to by the United States treated general investment theory; they did not consider the position of an inside investor in an ailing company. That economic textbooks did not acknowledge the different rationality of the inside investor compared to an

[41]In support of this point, the United States referred to Goldfeld and Chandler, 1986, The Economics of Money and Banking, Ninth edition; Harrington and Wilson, 1989, Corporate Financial Analysis, third edition; Westerfield and Jaffe, 1990, Corporate Finance, second edition.

outside investor did not imply that it did not play a role in real life. This was not a question of focusing on a particular investor in a particular situation, as the United States was asserting. It was a matter of focusing the analysis on a different type of investor, which was completely left out of consideration. If the yardsticks were conceived in such a way as to leave out of consideration important relevant facts which were either accepted by both parties (governments were different investors from private investors) or could be demonstrated (prospects inherently not taken into account; inside investor different from outside investors), this was contrary to the Pork panel Report and led to the determination of the existence of a subsidy, where there was none.

206. The EC argued that an inside investor who stood to loose considerable amounts of assets invested in the past could not but have a different view of a possible investment in the company concerned from that of an outside investor. If the company remained viable, the inside investor may recover a large part of his investment than would otherwise be the case. Typically such an investor was faced with the situation in which he would engage in an extremely costly liquidation of assets or participate in a restructuring of assets. With liquidation, he may end up with negative net worth even if he invested in an alternative high-yielding investment. With restructuring, even low-yielding investment in the restructuring of the company will cause his net worth to be positive. In addition, his past investment would have been saved. The fact that such commonly known facts were ignored implied that the decision on "equityworthiness" and hence on the existence of a subsidy had not been based on all the relevant facts and must therefore be ruled contrary to Article 4:2 of the Agreement.

207. Moreover, the EC argued that the government as a less than fully commercial investor and as an inside investor would have been quite content with the prognosis of the McKinsey study that if restructuring was done, Usinor/Sacilor would again be a reasonably thriving company. This would clearly be sufficient for a public investor to make the investment. Moreover, the United States did not attack the conclusions of the McKinsey Report, merely the purpose for which it was written. The EC also insisted that the difference of opinion about the McKinsey report was not a question of different weight given to the facts of the case. The report was in reality completely ignored since it was not weighed up against the negative indicators.

208. The United States noted that there was no such recognized class of investors as "inside" investors; it was essentially a construct of the EC developed for the purposes of the proceedings. In fact, the EC had acknowledged general lack of support for its position in economic theory. The EC had not produced any evidence that the phenomenon occurred in practice. Every company had owners, be they a single individual, a group of persons, or the government, and thus potential "inside investors" existed for every contemplated investment. This being the case, if the EC's contention on this issue were true, one would think that academics and the financial community would have written extensively on differences between the investment considerations of new and existing investors. The EC had failed to find a reference to this issue in the literature. In fact, the alleged differences did not exist. Under these circumstances, there was no basis for finding that the authorities acted in a manner contrary to the Agreement.

209. The United States argued that the term "reasonable private investor" was being used as a short form for the more detailed requirement by the DOC, i.e. whether "from the perspective of a reasonable private investor examining the firm at the time the government equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable period of time". The focus of the DOC's analysis was to determine whether the individual investment reflected reasonable commercial considerations, as opposed to whether the behaviour of the particular investor could be explained by reason of that investor's experience or situation. The marginal return theory which underlay the DOC's equityworthiness analysis was founded on the widely accepted understanding that rational investors ultimately assessed each investment opportunity on its own merits. If the discounted net present value of the expected return from the new investment under consideration was less than that which would be expected to be earned on an alternative investment, then the proposed investment at issue would still not be made by a rational investor. As an economic concept, the marginal return to an investor was the

investor's total return from an increment of investment; this included the return to other equity of the investor.

210. In an answer to a question by the Panel, the United States said that a new investment in a firm could, in theory, affect the returns (or losses) derived from previous investments in the firm. As a practical matter, though, the likelihood that any single investment, especially into a large corporation such as a steel producer, would have a significant effect on existing investments was not great, and may be difficult to quantify. The more important point, however, was that to the extent a new investment may affect returns on existing equity, it still would not make a rational "inside" investor more likely to invest than an "outside" investor. Although as an analytical matter, one can imagine a situation in which the "attributes" of a particular investor might influence that investor's expected net rate of return on a given investment, rational investors will nevertheless seek an investment that maximizes the return.[42] Thus, while specific "attributes" may reveal something about the particular investor, they will say little, if anything, about the relative attractiveness of the investment opportunity itself. As this was at the heart of whether a "reasonable private investor" would consider it sensible to sink money into a given project, specific "attributes" of an investor were of no material use in determining whether a subsidy existed. In addition, attempting to assess and quantify particular characteristics of individual investors in the context of particular facts would invite a speculative analysis into the intentions and motivations of specific investors, something which was impossible to substantiate or verify. Discerning the circumstances in which a government equity infusion gives rise to a countervailable subsidy involved some of the most complex aspects of subsidy valuation methodology. Expanding the analysis to consider facts and factors pertaining to particular motivations or attributes of individual investors would add greater complexity and unpredictability to the analysis, but would not contribute meaningfully to a better understanding of the reasonableness of the particular investment at issue. By employing a "reasonable private investor" standard, the DOC focuses on objective, quantifiable data which can be assessed by all on equal terms and which lent itself to an impartial evaluation of whether investment decisions were made rationally at the margin. Moreover, perhaps most important to the case at hand, the status as an "inside" or "outside" investor will not affect marginal rate of return such that special and different treatment should be accorded to inside investors in an analysis of equityworthiness. Whenever it makes commercial sense for an inside investor to invest, it will also make sense for an investment to be made by an outside investor.

211. The United States said that to understand this, it was important first to understand the "value" of previous investments. To the extent previous investments had value, the value was in the potential of the assets developed by the investments to generate income in the future. If, for example, these assets consisted of machinery that produced an obsolete product, in reality there will be no investment to "save," since that prior investment has no value. Thus the real question with regard to the relevance of "past investments" was the potential of the assets procured thereby to generate income. This potential, together with the potential earning power of the new investment itself, were relevant to an investment calculation both for existing owners of the company and for new investors. This meant that the more a new investment stood the chance of making existing company assets produce greater income, the more likely it will be that the new investment will make commercial sense. However, if it did make commercial sense, it will do so equally for inside and outside investors. On the other hand, where the income-generating potential of a company was low, a rational investor, inside or not, would not invest simply to avoid the possibility that assets procured from prior investments in the company might be liquidated. The prospect of meagre anticipated profits during a reasonable number of years means, in effect, that the real "value" of the previous investments - i.e., the ability of the company's assets to generate income - was low. This situation was not far removed from the facts of the United Kingdom case. In that case, BSC posted

[42] For example, the fact that a given investor's cost of capital would be less than another's would play a role in determining the ability of the investor to assume the risk of a given investment. Alternatively, another investor may achieve a higher rate of return than a differently-situated investor due to the tax ramifications of an investment to that investor.

consistent and serious financial losses, and showed little or no ability to generate reasonable returns for potential investors. Indeed, it was noteworthy that, although the EC had claimed repeatedly that the concept of inside investors should have been "taken into account" by the DOC, they had failed to show how, viewed from the perspective of a rational investor, an "inside investor" would have found it worthwhile to invest in BSC for the years in which the DOC found BSC to be unequityworthy.

212. Furthermore, the United States said that the DOC's equityworthiness analysis did include a consideration of potential return from all assets of the firm, including existing assets. For example, in the DOC's determination in the case of Steel Wheels from Brazil (which was cited and quoted by the DOC in the United Kingdom case before the Panel), the DOC explained that "[b]oth a rational outside investor and a rational owner investor make investment decisions at the margin. The relevant question for both types of investors is: What is the marginal rate of return on each cruzeiro/cruzado invested? An investor in USIMAS does not ignore the potential return from the assets that the company has already acquired. The potential for a favourable return from those assets is an integral part of the investment calculus. However, a rational investor does not let the value of past investments affect present or future investment decisions. The decision to invest is only dependent on the marginal return expected from each additional equity infusion" (54 FR 15523, 18 April 1989). The DOC examines whether a particular investment opportunity was consistent with commercial considerations, and the fact that a potential investor may already have equity in the company did not change the appropriateness of this test. To illustrate its argument that so-called inside and outside investors were equally likely to invest in a company, the United States provided an example which is reproduced in Annex 2.

213. The United States then argued that the issue of the behaviour of so-called inside investors was not addressed by the Agreement in any way. As such, particularly where the issue involved technical expertise in an area entrusted to the authorities, the Panel should seek to determine only whether the authorities' analysis of the issue was a reasonable one. There were many issues on which even the experts may not agree on a single "right" answer. Provided the authorities' decision was a reasonable one, it should not be found to be in violation of the Agreement. In this case, the United States had cited substantial support in economic writings for its position with regard to investment behaviour, and had explained the rational basis supporting it. By contrast, the EC's allegations were just that -- allegations without substantive backing.

(b) Government equity infusion treated as a grant in the calculation of the amount of a subsidy

214. The EC argued that by treating equity investment by the government in "unequityworthy companies" as grants given in the year of the equity investment, the DOC had not taken into account all relevant economic facts. This resulted in the finding of a countervailable subsidy where none was present, or at the very least, in considerable overstatement of the countervailable subsidy, thus violating Article 4:2.

215. The EC recalled that the DOC had regarded the equity infusions as grants on the grounds that when a company was "uncreditworthy" it "is in such poor financial condition that it cannot attract capital [and] any capital it receives benefits the company as if it were a grant ..." (*op. cit.*, page 2223). The EC noted that in the present case, the DOC had for the first time departed from its long-standing rate of return shortfall (RORS) methodology used for the valuation of equity infusions in "unequityworthy" companies. The RORS methodology determined the countervailable benefit in such cases by multiplying the difference between the firm's rate of return on equity and the national average rate of return on equity for firms in the country in question by the amount of the equity infusion.[43] In comparison to the RORS methodology, the new methodology led to higher countervailing duties. The fundamental flaw with the new approach was that the inherent nature of equity investment was such that it could never be identical to, or be treated as, a grant. A grant was a gift that the company was never expected to repay or to yield any return. An equity investment provided the owner with an ownership interest and an expected return.

[43]The EC referred to 54 FR 23385 to illustrate this point.

Even if a company were, for the sake of the argument, not "equityworthy", this did not mean that the provider of equity abandoned all rights to future returns, as he would if he were bestowing a grant. This was true even if a company were making a loss: the equity investor would still expect to have a stake (and a say) in the company and did not expect an immediate, but a longer term return on his investment. This was recognized by the DOC itself. When discussing the petitioners' claim that equity, loans and grants in wholly government-owned firms should be treated identically, the DOC stated that "equity investments, unlike grants, do represent a claim on the company and even in a wholly government owned company, equity investments are normally based upon some expectation of return" (*op. cit.*, page 6229). The EC argued that this basic fact of economic life did not change when the company started making a loss or its financial indicators became negative. The basic claim on a stake in the company and some claim on future returns were not reduced to nought thereby. An equity infusion would become a grant at the moment when equity would be written off by the investor. Before that moment the ownership stake and the claim to a return on investment would always remain. But the United States did not want to wait until that moment; the United States wanted to punish the government investor right away, thus ignoring the compensatory character of countervailing duty law.

216. The United States argued that finding a company unequityworthy was tantamount to saying that the company could not have attracted investment capital from a reasonable investor in the infusion year based on the available information. Therefore, from the recipient firm's perspective, all of the capital was capital it would not have otherwise received, and thus may be valued in the same way as a grant. In other words, were it not for government infusion, the firm would not have obtained equity from any private sources because the firm was not equityworthy. Therefore, the whole amount of the infusion was the benefit received. This approach was consistent with the DOC's "benefit to recipient" approach, which was permissible under the Agreement.

217. The United States said that the DOC changed its methodology because it had concluded that "the RORS methodology does not provide an accurate measure of the benefits arising from government equity investments in unequityworthy companies" (58 FR 6223). Under the Agreement, the investigating authorities may employ any reasonable methodology for calculating the amount of the subsidy. In the cases under review, the DOC's decision to countervail the full amount of equity infusions made to firms found to be unequityworthy was entirely reasonable: it followed from the benefit to recipient approach, which was consistent with the Agreement, and were it not for the government's decision to invest, the firm would simply have not received an infusion, regardless of whether or not the investor then became a part owner of the company. By looking at the investor's ownership and return, the EC's criticism was based on a "cost-to-government" approach which was not used by DOC and not required by the Agreement or General Agreement. In an answer to the Panel's question, the United States said that treating an equity infusion as a grant meant that the subsequent write-off of that equity would not be an event leading to an additional countervailable benefit. Moreover, this was an issue of calculation of the amount of the subsidy, inasmuch as the EC argued that DOC's methodology overstated the amount of the subsidy. There was no understanding among signatories on how to calculate the amount of a subsidy. Finally, with regard to the EC argument that the United States authorities should have waited until an equity infusion was written off before countervailing it, the United States said that in the French case this argument was of no consequence because the equity was written off immediately after the infusions took place.

218. The EC argued that an equity infusion providing an ownership interest and an expected return had nothing to do with a cost-to-government or benefit-to-the-recipient approach. The ownership rights acquired and the right to future returns also diminished the benefit to recipient of an equity infusion, even if the company concerned were unequityworthy. In the case of Usinor/Sacilor, 1988-91 were good years and Usinor/Sacilor returned dividend payments during those years. According to the logic of the DOC methodology this could not have happened. The improved performance of the company and the dividends were not influenced by the fact that some of the shares had been obtained in "bad" years for the company.

Creditworthiness

219. The EC argued that the DOC's findings of subsidies on the basis of its analysis of creditworthiness were inconsistent with Articles 4:2 and 2:15 of the Agreement. As in the case of the equityworthiness analysis, the criteria used by the DOC did not permit them to make a finding of subsidies or of a level of subsidization on the basis of a consideration of all relevant facts, and therefore the countervailing duties were higher than the amount of subsidies, in violation of Article 4:2 of the Agreement. In addition, the determination of the DOC did not show a proper weighing up of the past and prospective factors, thus infringing the duty of proper reasoning underpinning a decision under Article 2:15 of the Agreement. Moreover, in the French case the DOC resorted to a discount rate that overstated the interest rate in comparison to that apposite to the transactions concluded by the recipient company Usinor Sacilor. For this reason too, the subsidy was calculated at a level not in conformity with the actual level of the subsidy, and hence the countervailing duty imposed was contrary to Article 4:2.

220. The United States argued that the DOC's determination of creditworthiness was based on all relevant facts, including record information regarding future forecast and predictions, and was not inconsistent with any provision of the Agreement. Also, the rate of discount used in the French case was appropriate because the respondents had not provided the required information, and the DOC was correct in choosing the highest rate of interest for the uncreditworthy company.

221. The arguments relating to creditworthiness are presented as follows. Section (a) below provides the arguments pertaining to the DOC methodology for determining creditworthiness and, as in the case of equityworthiness, issues such as inside investors and consideration of prospective factors. Section (b) addresses exclusively the issue of the discount rate chosen by the DOC in the French case.

(a) The DOC's methodology for creditworthiness and the consequence in the French case for the determination of the countervailable subsidy

222. The EC said that in the French investigation, the DOC had applied its so-called "creditworthiness" methodology which was in many respects close to its "equityworthiness" approach (see Annex 1). The EC argued that the DOC's creditworthiness analysis also did not allow that all relevant facts be considered, in that prospects of the firm under consideration were not considered when addressing the question as to whether an inside lender (such as the government in this case) would grant another loan to a company under such circumstances.

223. The EC argued that similar to the equityworthiness analysis, the factors considered in the creditworthiness methodology by the DOC were rooted in the past and were insufficiently forward-looking to permit full consideration of all relevant facts. In fact, the Proposed Rules of the DOC for determining "uncreditworthiness" were contradictory because though they contained criteria incorporating both present and future factors, in reality the actual determination could only be based on the assumed ability of the firm to pay over three years prior to the conclusion of the loan by the government. Therefore, any attention to prospective factors could never be decisive under the DOC's methodology. This lack of consideration of all relevant facts was borne out by the decision in the French case where the DOC restricted itself to merely stating that it disagreed "that a lender would rely solely on future profitability resulting from restructuring", and considered this basis as sufficient to dismiss the extensive arguments advanced by the respondents that prospective elements (similar to those mentioned in the context of equityworthiness) determining creditworthiness should also be taken into account.

224. The EC argued that at the time of the French company's restructuring in 1986 it was apparent to a well-informed lender, and certainly to an "inside" lender such as the government, that the prospects of the company for the future were good and that there were the McKinsey study and a number of indicators which pointed to a future which would inspire sufficient confidence in a lender to decide that the company

was creditworthy: gross margin as a percentage of sales increased from 26.9 per cent in 1985 to 30.1 per cent in 1986. Interest expense as percentage of sales dropped from 6.1 per cent in 1984 to 5.7 per cent in 1985 and to 4,9 per cent in 1986. Earnings before interest, taxes and depreciation (EBITD) rose from 1.7 per cent in 1984 to 4.9 per cent in 1986.[44] The DOC's dismissal of the respondents' arguments regarding the relevance of the prospective factors by merely stating that a lender would not rely solely on future profitability resulting from restructuring was not a sufficient basis for the finding made in the final decision. A properly argued decision under Article 2:15 would have required a weighing up of backward-looking and prospective factors in which the latter ones ought to have received a greater weight than accorded by the DOC. The absence of a proper weighing of the relevant factors was sufficient to constitute an infringement of the duty of proper reasoning underpinning a decision under Article 2:15 of the Agreement.

225. The EC noted that in considering creditworthiness in the French case, the DOC after having looked at various financial data restricted itself to stating that "the company may have had difficulty in meeting its short-term obligations" (*op. cit.*, page 6223, left column). Obviously the material used by the DOC was not sufficient to make a clear case that short-term obligations could not be met, and thus the DOC was admitting that financial ratios could not fully support the determination. If in addition, forward-looking indicators and the perspective of certain inside lenders would have been properly part of the decision, the determination could have been different also for years preceding 1990-1991. It was common knowledge that lenders might have good reasons for lending to a loss-making company, and this might lead to a different, but nevertheless economically rational, assessment of government subsidies. For a lender, in particular an inside lender, a company's ability to service and repay its existing debt was crucial, even if various financial indicators were negative and a company was making losses. Thus, if a loan would enable the company concerned to continue to pay and service its debt, it could be an entirely economically sound decision to grant another loan to the company (or for that matter to make new equity investment in the company). Therefore, the criteria used by the United States authorities did not permit them to assess all relevant facts in the case, and led to a finding of subsidization (and imposition of countervailing duties) in violation of Article 4:2 of the Agreement.

226. The United States said that its creditworthiness analysis was similar in many respects to the equityworthiness analysis. The DOC considered whether a company was creditworthy as part of the determination of whether and to what extent a loan provided by the government was a subsidy. The determination of creditworthiness or uncreditworthiness also provided the basis for determining the appropriate "discount interest rate" to use in allocating subsidy benefits over time. In essence, the analysis attempted to determine whether a company was a reasonable credit risk or whether it was among the worst credit risks for which the private lender would require a premium interest rate. The analysis was complex and the DOC considered a number of factors that were appropriate to the facts and circumstances of each case (see Annex 1), in order to analyse whether the respondent had "sufficient revenues or resources to meet its costs and fixed financial obligations" based on data from the three years prior to the year in which the respondent and the government agree upon the terms of the loan. The information examined included, among other information, information on the company's actual performance and on its future financial position.

227. The United States said that with regard to Usinor and Sacilor, the DOC first determined, in accordance with its decision in a prior investigation, that the companies were uncreditworthy from 1978 through 1981 on the basis of certain indicators (see 58 FR 6223). For the years 1982 to 1989, the DOC examined several indicators and noted that Usinor Sacilor reported a profit in one year (i.e. 1988), and carefully considered the company's financial outlook as a result of the 1986 restructuring. The DOC found that the numerous negative indicators outweighed the other circumstances. With regard to the respondents' arguments based on a study by McKinsey and Co., the DOC, following the reasoning in the equityworthiness analysis, had rejected the undue emphasis on the restructuring. The DOC explained

[44]The EC said that all this information had been communicated to the DOC during the investigation.

that "we disagree that a lender would rely solely on future profitability resulting from the restructuring". The DOC did not then discuss the McKinsey study in detail in the creditworthiness section because, earlier in its decision, it had discussed that study fully when explaining its equityworthiness determinations. For 1990 and 1991, the DOC found that Usinor/Sacilor's financial situation had changed, that "Usinor Sacilor was able to generate sufficient cash flow to meet its current and long-term obligations", and thus the company was determined to be creditworthy.

228. The United States argued that the DOC practice was to consider all data relevant to whether a company was creditworthy, including consideration of future oriented factors and not only the data for the previous three years. This had been confirmed in the DOC's proposed regulations. Moreover, the questionnaire in the French case sought information on these factors. Therefore, the mere fact that the DOC did not find the McKinsey study presented by the respondents to be sufficiently probative was no substantive basis for the EC to characterize the DOC's creditworthiness test as not giving true consideration to future-oriented factors. While the EC's argument was that the consideration of future prospects should receive a greater weight, the EC had failed to identify what provision in the Agreement required this, or how it was necessary to do so in order to conduct a reasonable assessment of a company's creditworthiness.

229. Regarding the use of the term "may" in the DOC's statement that "[t]he liquidity ratios indicated that the company may have had difficulty in meeting its short term obligations", the United States argued that the DOC examined a number of liquidity and debt ratios, and on the issue of the ability to meet short-term obligations reached the conclusion that was appropriate to the financial ratios that it was examining. The DOC observed that there were possible difficulties in meeting short-term obligations. The financial ratios, though a useful tool, were simply indicators and provided a snapshot picture of the financial position of the company at a particular point in time. They were not definitive as data on a company's actual borrowings, and thus the use of the term "may" by the DOC was entirely proper. In fact, had a more definitive statement been made based on the ratios, the objection would surely have been raised that DOC went beyond what the ratios had indicated. Actual data on the company's borrowings was preferable, but it was not provided in the French case despite the DOC's requests. The company had asserted that it was able to obtain loans from private sources without government assistance or guarantee, but provided no data to support this assertion despite the DOC's requests. Therefore, under Article 2:9 of the Agreement, absent the requested data from Usinor/Sacilor on the company's creditworthiness, the DOC had to rely on financial ratios, such as the liquidity ratios among others, to assess Usinor/Sacilor's creditworthiness. Further, it was important to remember that, in reaching its creditworthy determination, the USDOC examined not just liquidity ratios, but other debt ratios as well, such as times-interest-earned, long-term debt, and debt-to-equity. The USDOC noted, for example, that "the interest coverage ratios were negative".

230. The United States argued that the DOC had considered all the evidence on the factual issues and its methodology represented a reasonable attempt to measure the creditworthiness of respondents for the purpose of loan subsidy calculations. Therefore, the DOC's methodology was fully in conformity with the Agreement. The determination was fact-specific and involved a weighing of the record information. Moreover, there was no sound economic reason to suggest why a creditor with outstanding loans to an illiquid company (i.e. an inside creditor) would be more favourably disposed to providing additional loans to that company than would a lender which had no outstanding loans to the company.

231. Regarding the DOC's statement that "the company may have had difficulty in meeting short term obligations", the EC argued that the United States was itself admitting that its financial ratios could not fully support the determination of uncreditworthiness. This was already a fundamental flaw in the determination. If in addition forward-looking factors and the inside perspective of certain lenders would have been properly part of the decision, the determination could have been different also for the years preceding 1990-91.

232. The EC emphasized that its argument did not relate to reweighing evidence. Rather, it was arguing that certain factors were not admitted into the final decision on creditworthiness at all, i.e. the DOC decision was not made on the basis of the relevant facts. The EC reiterated its argument that consideration of future prospects was even inherently impossible given the way in which the DOC had formulated the criteria for its determination of creditworthiness. Consequently, the final decision was always going to be taken on the basis of the past performance. The EC also argued that if the yardsticks applied by the DOC to the assessment of facts were such that they left out of consideration important relevant facts, which were either accepted by both parties (i.e. governments were different investors from private investors) or could be demonstrated (prospects not taken into account; inside investors being different from outside investors), then the assessment was contrary to the Pork panel and led to the determination of the existence of a subsidy where there was none.

233. The EC argued that the internal inconsistency of the United States' Proposed Rules in practice contributed to a cavalier attitude towards proper reasoning in the determination in the French case. The statement in the determination read "With respect to respondent's arguments, we disagree that a lender would rely solely on future profitability resulting from restructuring". This was a gross exaggeration of the position of the respondents. The respondents had never argued that a lender would rely solely on future profitability. Thus the DOC statement was clearly a self-created strawman which was cut down. An administration that really valued forward-looking and backward-oriented factors equally would have weighed up the one against the other. This had not been done at all. In this perspective a statement of simple disagreement with a wilfully overstated position of the defendant did not amount to proper reasoning. The requirement of proper reasoning was a corollary of the requirement of Article 2:15 of the Agreement to give the reasons and the basis for an affirmative finding of a subsidy. Such reasons could not be just any reason; they must be sufficient to support the findings made and to enable the Panel to verify compliance with the Agreement. By failing to provide a reasoned analysis weighing up the backward and forward looking criteria, the DOC failed to comply with this requirement and did not provide "reasons and basis" for its findings and conclusions on all material issues of law and fact.

234. The United States argued that in the case of creditworthiness, the DOC's Proposed Regulations, through inadvertence, did not accurately reflect DOC practice. Because the regulations were only proposed regulations, to the extent there was any discrepancy between them and actual DOC practice, DOC practice was controlling. While the Proposed Regulations described the creditworthiness test as an enquiry into whether the respondent had sufficient revenues or resources "in" the three most recent years prior to the bestowal of the subsidized loan, the DOC practice was to examine whether the respondent had sufficient revenues or resources "based on data from" those three years, which includes forecasts or predictions produced sometime during those three years. This was demonstrated by various factors: (a) the Proposed Regulations include a consideration of the company's future financial position and it would be illogical to list a factor to be considered and then explicitly exclude any consideration of that factor when the ultimate determination is made; (b) the creditworthiness test relied on the perspective of the private lender who would have access to future looking studies; (c) the DOC's determination in this case had a substantial discussion of the McKinsey study submitted by the respondents; (d) the consideration of prospective factors had long been an important part of the creditworthiness test. The DOC had explained this as far back as in 1984[45], and this was confirmed in the DOC's Proposed Regulations; and (e) the DOC's questionnaire in the French case showed the seriousness with which the DOC viewed the future-oriented factors.[46] Thus there was no substantive basis for the EC's characterisation of the DOC's creditworthiness test as not giving true consideration to future-oriented factors. The mere fact that the DOC did not find the study presented by the French respondents, i.e. the McKinsey study, sufficiently

[45]Subsidies Appendix, Cold-Rolled Carbon Steel Flat-Rolled Products from Argentina, 49 FR 18,006, 18,019.

[46]The United States provided a copy of the relevant questions to the Panel.

probative of Usinor Sacilor's creditworthiness did not support that characterization. The DOC's determination showed that DOC had carefully analysed and explained its creditworthiness test and the significance of that study. This study was addressed already in the DOC's discussion of equityworthiness, and there was no need to repeat the analysis in the discussion on creditworthiness. Also, the DOC's statement quoted earlier by the EC was made during the course of a lengthy discussion on creditworthiness, and viewed in that context the DOC's statement clearly showed that the DOC reasonably found that the predictions of the McKinsey study did not outweigh the accumulated mass of negative evidence.

235. The United States argued that the basis for economic analysis of lending behaviour was similar to that for equity investment, which showed that there was no difference between an "inside" or "outside" lender in the assessment of a lending opportunity. As explained in the context of the analysis of equityworthiness, any lender ("outside" or "inside") would base his decision on the marginal return to his lending. In any particular situation, therefore, the behaviour of both the inside and outside lenders would be based on the marginal returns, and thus their lending behaviour would not differ.

(b) Alleged reliance on an inappropriate discount rate in the French case

236. The EC recalled that for calculating the benefit, the DOC had resorted to a discount rate based on the lending rates from an IMF publication. Due to the French company allegedly not reporting its actual cost for long-term fixed rate debt, the DOC resorted to the highest annual interest rate in the IMF publication and added a risk premium. The lending rate selected from the IMF was taken from the French "Journal official de la République Francaise", which was the maximum official discount rate and represented the highest interest rate permitted under any circumstances for lending in France and was generally used for very short term lending (such as overnight or for a few days only). Also, in the EC's view, the United States never seriously verified with the IMF what kind of rates these were and for what kind of loans they were valid. The United States had recourse to a rate that was actually not used for medium- to long-term lending, was not available as such in France, and was the highest annual interest rate in the IMF publication. Such a lending rate was not an appropriate benchmark for long term loans to an industry. The IMF rate selected was consistently higher than any other medium term interest rate that could have been resorted to, i.e. prime rate, pibor 3-month, TMO-OECD.[47] The EC argued that the DOC was bound to choose benchmark interest rate in conformity with economic reality and not one which would lead to the imposition of a countervailing duty higher than the actual subsidy. As a result of its unreasonable recourse to the IMF rates, the United States had levied a countervailing duty in excess of the subsidy and, therefore, was in breach of its obligations under Article 4:2. The fact that the IMF rates were very close to the OECD rates provided by the respondents for business overdrafts and advances, and to the rates charged to individuals, was a further indication that the IMF rates were not appropriate for medium to long-term loans.

237. The EC further argued that the notion of risk premium might in itself be controversial; there were indications on the record that banks simply refrained from lending to "bad risks" rather than apply a risk premium. Also, the DOC's practice of taking 12 per cent of the prime rate as the risk premium was arbitrary, and the considerations on which this calculation of risk premium was based had not been clarified by the United States: there was no indication of this being based on any reality in the financial markets concerned.

238. The United States said that the DOC questionnaires had asked the Government of France and the company to identify the appropriate benchmark interest rate, i.e. the highest annual interest rate commonly available in France for long-term loans for medium to large companies posing a serious credit risk. Although called a "long-term" rate, the rate is actually defined by the DOC as pertaining to a loan having a repayment period of one-year or longer. In response, the Government of France had suggested the

[47] Data comparing some of these rates from 1978 onwards was provided to the Panel.

TMO-OECD rate, which was a private bond rate. There was no apparent relationship, nor was one offered, between this rate and the loan rate asked for by the DOC. During the verification visit, the officials of the "Banque National de Paris" (hereinafter "BNP") had informed the DOC that French banks used the TMO-OECD rate "when determining the basis for lending medium term and long-term [and then] add a few percentage points" to that rate when determining a final lending rate. No more precise explanation was provided, nor were the officials able to explain what rate applied specifically to companies posing a serious credit risk. Thus, because of the deficiencies of the information provided, the DOC sought and used other available information. The rate provided in the IMF statistics represented an average of French bank lending rates to the private sector, and it was an actual lending rate that came closest (among the information on record) to the highest commonly available rate for private sector loans of one-year or more duration. In contrast, there was no evidence to indicate that the rates suggested by BNP were even a rough estimate of the rates actually used.

239. The United States further argued that having failed to supply sufficient information despite several opportunities to do so, the respondents could not later complain about the information the authorities ultimately relied upon. After not providing adequate information during the investigation, the EC was now resorting to information not part of the record before the investigating authorities. The EC had pointed to no record information indicating that the IMF rate was the "maximum official discount rate ... for a few days". Rather, the evidence indicated that the IMF rate represented an average of French bank lending rates to the private sector. The Panel must not entertain a challenge on the basis presented by the EC. A fundamental principle of Panel's review is that it must proceed according to the facts made available to and gathered by the investigating authorities during the investigation. Resort to extra-record information would deprive the authorities of their right to consider information in the first instance, and the right of parties to the investigation to comment on such information. Moreover, the DOC's choice of the IMF rate was a rational one; hence no violation of the Agreement existed.

240. Regarding the addition of a risk premium, the United States explained that the DOC included a risk premium to calculate the additional benefit attributable to a loan to an uncreditworthy firm. This was to take into account the fact that the company would not have obtained loans at the rates that were commonly available. Otherwise, the actual benefit of the government loan to the company would be understated. The methodology was to calculate the benchmark interest rate for a long-term government loan by taking the sum of 12 percent of the prime interest rate in the country in question and one of the alternative rates of interest specified in the Regulations.

241. The EC argued that in this case, the company (Usinor/Sacilor) was asked to provide information on interest rates of thousands of loans which it had concluded over a long period, and it was not capable of meeting this requirement in the short period of time given. It thus suggested alternative information, i.e. OECD rates, and in the circumstances this was not at all unhelpful. The DOC had in other cases relied extensively on OECD rates. Moreover, as the officials from the BNP confirmed during verification, these TMO-OECD rates were used in France for determining the basis for medium-term and long-term industrial loans (and therefore were not merely a bond rate).[48] Also, a submission by Usinor/Sacilor confirmed that at verification the BNP officials did not state, as the United States had indicated, that the BNP added a few points to the rate when determining the final rate. Rather, they had said that since the published rate could be up to a week old, the bank would adjust the rate to reflect the most current market conditions. The BNP officials had explained that the TMO-OECD rate was generally used by banks as a point of reference for their loans to private industry, but the banks may adjust company specific loan rates for individual clients depending on the specific circumstance of the client and specific credit market situation (i.e. adjust the rate up or down). Such actual transactions formed the basis for the TMO rates

[48]The TMO rate is a weighted average of all medium- and long term issues periodically calculated by the Institut National de la Statistique et des Etudes Economiques (INSEE), which is published by the OECD.

for the next period, and thus the TMO rate remained the best published rate usable by the DOC as benchmark for long term corporate lending in France. The TMO-OECD rate had been put on the record by both the petitioners and the respondents. It represented the average corporate bond interest rate for bonds issued in the secondary market in France. It was a rate on which the DOC had relied in the past and also relied in the present case for years when Usinor/Sacilor was found creditworthy. Despite this (and despite the other aspects mentioned above), the DOC decided to rely on best information available (hereinafter "BIA") and apparently selected the highest rate they could find which had some vaguely arguable link with the medium term.

242. The EC argued that compared to the TMO-OECD rate, the IMF rate was inappropriate as it was characterized as "bank lending rate, usually to meet the short-and medium term financing needs of the private sector", and it also included elements of consumer credit and was thus clearly overstating the rate big companies (even if they were considered credit risks) would have to pay for medium- to long-term loans. The DOC could have easily seen that these rates at 15 per cent were closer to the OECD rates for private credit (16 to 19 per cent). Also, contrary to the DOC's practice and Proposed Regulations, these rates were applicable to individuals and not just to individual borrowers. Moreover, it seemed that the DOC had recognized that the IMF rate concerned was an improper one in the subsequent decisions on countervailing duties on flat-rolled products, for which the DOC rejected the IMF rate and resorted instead to long-term rates provided by the OECD. The EC believed that the DOC had committed a manifest error of fact in selecting the IMF short-term lending rate as appropriate in the French case, and thus the countervailing duty imposed was contrary to Article 4:2 of the Agreement. The resort to BIA had been unreasonable, as the information used was in no way better in quality, or more reliable than the one provided during the investigation. Moreover, the United States did not seem to have taken the precaution of obtaining direct information on the nature of the rate used. Instead of seeking clarification on these rates from the IMF, the DOC was content with the printed text of the publication; in contrast, Usinor/Sacilor got its information on the rates in the IMF publication by speaking to IMF officials. The EC did not believe that this way of proceeding by the DOC had led to a proper consideration of the facts. Whether or not BIA was used, a manifest error on the nature of the benchmark rates resorted to and the unwillingness to inform oneself better should not be accepted by the Panel.

243. The EC argued that the issues it raised were not restricted by the record established by the United States authorities; the EC was invoking its own rights under the Agreement, not those of corporations from the EEC.[49] The EC did not agree that the issues being raised had to be limited to those contained in the investigation record. This was contrary to the Resin and the Salmon panels Reports, and would be counter to the reasoning underlying the Pork panel. All relevant facts were not necessarily those brought together in the record by the national authorities and a "manifest error of fact" can also consist of not considering a fact which is vital to the determination made. This was clear from the Resin case (paragraph 212) and the Salmon panel (paragraphs 217-219). As provided in Article 18:1, the Panel must review the facts of the matter and the consistency of the determination of the existence of a subsidy in light of those facts and the Subsidies Agreement. The facts of the matter were not necessarily the same as the facts on the record of the national administrative authorities, especially if they decided to ignore or completely rule out certain facts or considerations which were considered pertinent by others. Moreover, in this case, Usinor/Sacilor had represented during the proceedings that the IMF rate was a short-term overdraft rate and not a long-term lending rate, and therefore the interest rate drawn from IMF publications was inappropriate. Thus, this issue was on the record.

244. The United States argued that the EC had not contested that it had cited extra-record information in its objection to the use of the IMF rate by the DOC. The EC had pointed to no record information indicating that the IMF rate was the "maximum official discount rate ... for a few days." Rather, the evidence indicated that the IMF rate represented an average of French bank lending rates to the private

[49] In support of this point, the EC referred to paragraph 212 of the Report of the Resin panel.

sector. The credibility and relevance of the information provided by the EC on that rate was questionable, since the EC had not even indicated the source of this information. All that was before the Panel was bare allegations. What Usinor/Sacilor claimed before the DOC on this issue was no more substantive than what the EC had claimed before the Panel. Neither Usinor/Sacilor nor the Government of France presented any evidence suggesting that the IMF lending rate was partially a consumer rate, though they had been placed on notice through the DOC's September 1992 preliminary determination (approximately two weeks before the deadline for submitting factual information under DOC regulations) that the DOC might use the IMF lending rate as the benchmark rate. Usinor/Sacilor waited until after the deadline passed and then stated in a brief (following verification), without citation or explanation, that the rate was a "short-term consumer overdraft rate". Thus, there was no "evidence" in DOC's record that the IMF lending rate was a short-term overdraft rate or otherwise tied it to consumers. Under these circumstances, the DOC's reliance on the IMF lending rate was wholly proper, and was based on the available evidence.

245. The United States argued that the EC did not dispute that the DOC acted properly by seeking the highest annual interest rate commonly available for long-term loans in the country under investigation, as the DOC's proposed regulations require for uncreditworthy companies. Rather, the dispute centred on a factual question, namely, whether the DOC properly selected the IMF lending rate for France over a TMO-OECD bond rate. Since, as with most other issues described earlier, this issue was not treated by any provision in the Agreement, the Panel should simply review the finding for reasonableness. The United States argued that the DOC clearly made the proper selection, given the "facts available", as allowed by Article 2:9 of the Agreement. The DOC's questionnaires sought information from the French respondents regarding the highest long-term fixed rate commonly available in France. In their responses, the French respondents provided no company-specific loan rates and instead simply maintained that the appropriate rate to use was the TMO-OECD rate. However, this rate was a private bond rate, and the French respondents at no time provided any basis for connecting this rate to the loan rate sought by the DOC. Furthermore, verification provided no useful information on this point. In this regard, the United States stood by its verification report and argued that the BNP officials did not provide any more precise explanation of the actual lending rate than that BNP would "add a few percentage points" to the TMO-OECD rate. Thus, the most that statement indicated was that the TMO-OECD rate was a reference point for setting loan rates, not that it was the loan rate itself. Moreover, the stated relationship between the bond rate and the loan rate (i.e. "add a few percentage points") was imprecise. Furthermore, in its submission, Usinor/Sacilor had indicated that the rate would have had to be further adjusted, stating that "since the TMO rate was at least a week old, if not a month old, it was used as a benchmark and the actual rate of lending would depend on the credit market's conditions on that day and on the particular borrower ...". As a result, the DOC conducted further investigation of its own, examining several rates in addition to the TMO-OECD rate. The DOC selected the IMF lending rate for France, published by the IMF. It was a reliable rate, and because it was higher than the other examined rates, including the TMO-OECD rate, it more accurately reflected the high-credit-risk status of the company at issue, in accordance with the DOC's proposed regulations. For this reason, the TMO-OECD rate would still have been a less appropriate rate than the IMF rate for the particular firm at issue, which the DOC found to be uncreditworthy, even if the uncertainties in the TMO-OECD rate had not been present, or even if for the sake of argument it were assumed that the TMO-OECD was a commonly available country-wide lending rate.

246. About the use of the OECD rate by the DOC in subsequent cases the United States argued that, unlike the present case, in the three cases[50] in which the issue arose the banks in the countries under

[50]See Final Affirmative Countervailing Duty Determinations: Steel Products from Belgium, 58 FR 37273, 37288-89 (9 July 19993), Comment 6; Certain Steel Products from France, 58 FR 37304, 37314 (9 July 1993), Comment 9; Certain Steel Products from Germany, 58 FR 37315, 37322-23 (9 July 1993), Comment 1.

investigation provided DOC with specific loan rates appropriate for high-credit-risk firms. Moreover, the DOC was able to verify these rates. In no case did the DOC use a rate comparable to TMO-OECD for uncreditworthy companies. In the French flat-rolled case, for example, the DOC used Credit National Bank's equipment loan rates, and although these rates were listed in an OECD publication they were not the same as the TMO-OECD bond rates.

247. The United States argued that the use of a risk premium equal to 12 per cent was not arbitrary. Rather, it was based on long-standing DOC practice and the reasoning that gave rise to it was well-documented; as far back as in 1984, in the Subsidies Appendix accompanying Cold-Rolled Carbon Steel Flat-Rolled Products From Argentina; Final Affirmative Countervailing Duty Determination and Countervailing Duty Order (49 FR 18006), the DOC had explained why and how it developed the 12 per cent risk premium. Furthermore, in using the risk premium the practice of the United States was to use the prime interest rate of the country being investigated. Thus the DOC approach accounted directly for the realities of the involved financial markets.

248. The United States argued that it was not clear that a real issue regarding whether extra-record information may be brought before a Panel was present in this case. Because the EC had not even indicated the source of the information or provided any supporting documentation it was difficult to conclude that the EC's claim was "information", let alone "relevant" or "vital" information. Assuming an issue did exist concerning the ability to bring extra-record information before a Panel, the United States did not agree that a party was relatively free to do so. The "facts of the matter" in Article 18:1 must be understood in the context of what was being reviewed. The issue before the Panel was whether a particular action by an investigating authority complies with the Agreement. Thus, it was logical that the facts at issue were those that were before the investigating agency. Article 2:14 of the Agreement required that except in special circumstances, investigations shall be completed in one year. Thus the Agreement did not expect perfection in gathering information, only such reasonable efforts as were appropriate to enable the authorities to make determinations entrusted to them under the Agreement. In this case, the DOC had made such efforts.

249. The United States argued that the EC's reference to the Salmon panel Report on this issue was unavailing. The portion of the panel report cited by the EC (i.e. paragraphs 218-219) did not concern new information, but new claims. Even as to claims, the panel had suggested that failure to raise a claim may affect the Panel's view of its merits. The one place where the panel was faced with extra record information (paragraph 289), it found it to be irrelevant to the issue of compliance of the authorities' determination with the Agreement.

250. The United States argued that while investigating authorities may not ignore relevant or vital facts, it did not mean that a signatory was relatively free to introduce new facts to a Panel that it did not present to the investigating authorities. New information could virtually always be generated after the conclusion of the administrative proceedings to support one outcome or another. However, to conclude that investigating authorities should have taken account of such information would do serious damage to the system established by the Agreement for the conduct of countervailing duty investigations. The countervailing duty determinations were entrusted to domestic authorities by the Agreement, and full participatory rights were granted to the interested parties. If additional information could be adduced after the conclusion of the investigation, then all determinations would be vulnerable to an allegation of violation of the Agreement no matter how full and fair the proceedings were. This was understood by the Lumber Panel whose underlying standard was "whether a reasonable, unprejudiced person could have found, based on evidence relied upon by the United States at the time of initiation, that sufficient evidence existed of subsidy, injury and causal link to justify initiation of the investigation" (paragraph 335). The United States urged this Panel also to follow the example of the recently adopted Report of the Lumber panel. The administrative authorities had to undertake such reasonable investigation efforts that were appropriate to enable them to make the determination entrusted to them in the Agreement, and the DOC had undertaken such efforts.

6.<u>Allocation of subsidies over production</u>

251. The <u>EC</u> argued that in the French case, the allocation by the DOC of the entire subsidy to only the domestic production of Usinor Sacilor resulted in a duty higher than the amount of subsidy, thus violating Article VI:3 of the General Agreement and Article 4:2 of the Agreement. Moreover, the DOC shifted to the respondent the obligation to demonstrate that a lower amount of subsidy benefitted the products under investigation. The methodology followed by the DOC in this case resulted in the investigating authority imposing countervailing duties on the basis of a presumption and thus not on the basis of all the facts relevant for the determination it has made, a requirement confirmed by the <u>Pork</u> panel.

252. The <u>EC</u> recalled that the DOC had determined that equity infusion subsidies granted to Usinor Sacilor (which has subsidiaries producing products under investigation in France and in other countries) should be countervailed by allocating the total amount of subsidy found to exist exclusively over the domestic (i.e. French) production of that company. This was different from the past practice of the DOC under which it had determined that a subsidy should be considered as benefitting a part of a company's production or export only if it was determined that it was "tied" to a particular product or to exports. In the French case, the DOC's decision for allocating the subsidy to only the domestic production was based on "the programs from which the subsidies at issue arose, ... the GOF's [i.e. Government of France's] contemporaneous controlling ownership position in Usinor Sacilor, ... [and the DOC's conclusion] that the GOF was seeking to promote domestic social policy and domestic economic activities and therefore to encourage domestic production." Thus, the DOC had stated that it could not allocate the equity infusion subsidies granted to Usinor by the French Government to the company's production outside France unless it had "a clear reason to believe" that the benefits encouraged the foreign production. The EC argued that the DOC had established a presumption that equity infusion subsidies were tied to the production of Usinor-Sacilor in the country of the government granting the subsidy and had concluded that "[c]onsistent with our approach to subsidies tied to a product or market, we believe that it is reasonable to allocate the benefits of the subsidies at issue, which we have determined are tied to domestic production, fully to domestic production." However, the burden of proving that the product under investigation benefitted from a subsidy was on the investigating authority, not on the respondent. Recourse to presumptions was contrary to the requirement that the facts taken into account be all the facts relevant for the determination made.

253. The <u>EC</u> noted that the United States did not contest the EC's claim that the alleged subsidies at issue in the French case resulted from equity infusions. An equity infusion could by its nature only benefit the receiving company as a whole. This was acknowledged by the DOC in its Proposed Regulations (Section 355.47(c)(2)) which mentioned that equity infusions should be considered as untied subsidies. By definition, the benefits resulting from equity infusion to a company should be allocated <u>over the total production of that company</u>, wherever that production took place. Moreover, in the case of Usinor/Sacilor, the company receiving the capital infusion was the holding company positioned at the top of the Usinor/Sacilor multinational group, supervising and controlling all its subsidiaries located in France or outside. Logic required that the benefit of a subsidy related to equity infusion at the top of a multinational be allocated over the total production of that multinational. By not taking account of the nature of the alleged subsidy and thereby imposing an excessive duty, the United States had infringed the obligations stemming from Article 4:2 of the Agreement which, in combination with the <u>Pork</u> panel, prohibited the imposition of a countervailing duty for subsidies which did not benefit only the products under investigation but other products (here primarily German products). The question in this case was primarily to determine how much of the total alleged subsidy granted to the whole of the company's production actually benefitted the product exported from the country under investigation. Allocation of a higher level of subsidies would imply the countervailing duty exceeding the amount of the subsidy actually benefitting the products produced in and exported from France.

254. Replying to questions by the Panel, the EC explained that its arguments regarding the allocation of subsidies in the French case did not imply that subsidies granted in a foreign country to a subsidiary of a multinational company should be allocated to the production of the parent company in another country, even if that subsidy resulted from equity infusion. While advantages received by a parent company consisted of various forms of returns on its investments in the subsidiary, it was extremely rare that a subsidiary invested in its parent company. Therefore, in the case of equity infusion, a subsidy granted to a subsidiary in one country did not benefit the rest of the group, except if this company had, itself, subsidiaries or if this subsidiary invested in another member of the group. The EC explained this further by using as an example a situation when the company incurred a loss. If a parent incurred losses, a subsidiary would not cover them. It had no practical (and certainly no legal) responsibility to do so. The statutory goals of the subsidiary were normally restricted to caring for its own viability, whereas the statutory goals of the parent normally included assuring the health of the group. Similarly, if a parent needed new equipment, the subsidiary will not finance it (other than indirectly, by being profitable and contributing to group profits). Thus a subsidiary was a form of operation for the parent company, but the reverse was not true, i.e. a parent was not a form of operation for the subsidiary. Further, the EC argued that the parent and the subsidiary were two legal entities, not two economic entities. The Pork panel requirement that a pass-through be demonstrated applied to arm's-length transactions, and where the entities were related, as in the case of a parent and subsidiary, or subsidiaries and parent in a consolidated group, there was no pass-through issue. The parent was integrally linked to, and indeed a reflection of, its subsidiaries.

255. Addressing the DOC's finding regarding contemporaneous controlling ownership by the Government, the EC argued that ownership by a government of a controlling interest of a company, by itself, did not establish a link between a subsidy and a particular production. The EC pointed out that the United States authorities themselves recognized that public ownership of a company could not be, as such, a countervailable subsidy. However, the United States' argument regarding public ownership of the French company implied that public ownership was no longer considered as a neutral element but became an additional factor in order to establish the countervailability of an equity infusion.

256. The EC then addressed the DOC's conclusion that an equity infusion was tied to the production in the country of the government making the investment because any government would be reluctant to spend its taxpayer's money for the benefit of subsidiaries of a state-owned company located abroad. The EC argued that this conclusion was not based on any facts in the record and, furthermore, was not logical. If a government was responsible vis-a-vis its taxpayers for the use of their money, such a responsibility could be perfectly fulfilled through foreign investments, if such investments contributed to the development of the state-owned company and, thus, to the welfare of the country. Public intervention in a company need not aim immediately and directly at promoting domestic social policy or domestic economic activities through increased domestic production in some sectors; such an attitude might even prove economically inappropriate and might turn out to be a waste of taxpayers money. Just as the shareholders of a privately-owned multinational company may wish to diversify their sources of production in order to improve the returns on their investment, or take positions on a foreign market, a company owned by the French Government may wish to establish or purchase subsidiaries abroad for the same reasons. The EC argued that if the French Government had in mind to promote exclusively the French production, it would have set conditions for its investment, knowing that, if it would not do so, the capital infusion can not but benefit the whole company. Therefore, the presumption of the DOC that a government, when investing in a company, would primarily seek to promote domestic social policy and economic activities was not compelling.

257. The EC argued that in the present case, the DOC had shifted the burden of proof to an extent contrary to the obligation of positive evidence borne by the investigating authority when conducting countervailing duty investigations. This meant that the determination was made on the basis of a presumption that a subsidy was tied to the domestic production of the holding company instead of being based on "all the relevant facts" of the case. A presumption was not only contrary to the requirements of the General Agreement, it also challenged one of the most elementary principles of procedural law found

in all legal systems of the world, i.e. *probatio incumbit eius qui dixit* (or, he who makes the claim must bring forward the evidence). This was certainly true for anti-dumping and countervail law. This approach was supported by the language of the Preamble of the Agreement and by the findings of the Pork panel. Article VI:3 of the GATT and Article 4:2 of the Agreement clearly showed, confirmed by findings of various panels, that it was up to the investigating authorities to demonstrate that a subsidy did exist. Moreover, such demonstration must be based on an examination of all the relevant facts.

258. The EC argued that under the presumption defined by the DOC, the respondents would have to bring forward "adequate evidence to give [DOC] a clear reason to believe" that the subsidy at issue benefitted Usinor's foreign production. This was not just a high standard of proof, it was one which was impossible to meet in practice. Indeed, it was not possible to prove positively that an equity infusion had actually benefitted the company as a whole, since that was, by definition, what normally happens. Moreover, under the procedures used by the DOC, the respondents were to be given a chance to show that the subsidies were benefiting the company's production abroad after the DOC had made its finding on "tying" "on the basis of all factual evidence". However, if a subsidy was determined to be "tied", as it was by the DOC, to a particular production then it cannot logically directly benefit another production at the same time. If it was determined by the DOC to be "tied" "on the basis of all factual evidence", it was not clear how the respondent, being unable to provide satisfactory evidence to the contrary could give the DOC any "clear reason to believe" that the subsidies, nonetheless, provided benefit that encouraged foreign production. Moreover, if the DOC, which was legally required to give evidence to support its findings, cannot (and refused to try to) show a restriction by tracing capital flows, a respondent certainly cannot and should not be required to disprove DOC's presumption by tracing capital flows.

259. The EC said that if the Panel were to be of the opinion that presumptions were not contrary to the requirements of the General Agreement and of the Agreement, it should nonetheless reject the kind of presumptions introduced by the DOC in the French case, because they were based on irrelevant factors and created a *de facto* impossibility of rebuttal. The use of presumptions could be tolerated only with respect to secondary issues, i.e. when recourse to presumptions by the investigating authorities would not affect essential aspects of the determination such as allocation of subsidy over production. It had to be limited to issues where administration of countervailing duty legislation was facilitated without exempting the authorities from discharging the burden of proof on every finding which would have some impact on the amount of duty imposed. In any case, they should be rebuttable. This was not the case here.

260. Furthermore, the EC argued that the development of the procedure in the French case showed that the respondent company materially could not have offered to DOC "clear reason to believe" that the alleged subsidy could have benefitted foreign production. The DOC sought no information in its questionnaire on what operations did or did not benefit from the alleged subsidy. In its preliminary determination, the DOC allocated the subsidy over the total sales of the company. The factual record in the French case was closed on 27 September 1992, before any issue of allocation was raised. The petitioners in that case made arguments on allocations only in November 1992. At that time, the respondents were no longer in a position to submit any factual evidence which could give the DOC any "clear reason to believe" that the subsidy at issue also benefited foreign production of the group. Thus the record could not contain detailed information on the issue of allocation of the alleged subsidy because both the questionnaire and the preliminary determinations had not addressed this issue and the record had been closed before the petitioners raised it. These facts confirmed that the DOC did not, and in practice could not, base its findings on all relevant facts. These procedures also cast some doubt about the conformity of the procedure followed by the DOC with the "proper reasoning" standard of Article 2:15 of the Agreement.

261. The United States argued that the EC was not challenging the United States' use of a "tying" approach in determining how to allocate the subsidies at issue to the respondent's sales, but instead was insisting that the United States improperly presumed that the subsidies at issue were tied to domestic production. However, the EC had misunderstood the DOC's determination. The DOC did not begin

its analysis by presuming that the subsidies at issue were tied to the respondent's domestic production, but treated the issue as a question of fact. It employed a two-step analysis analogous to its procedure with regard to subsidies "tied" to a particular product. It first looked at the factual question of whether the subsidy at issue was "tied" to domestic production, and did not make use of any type of presumption, but simply examined various facts of record. These facts included "the programs from which the subsidies at issue arose" (58 FR 6231), the purposes of the French Government in setting up the programmes, and the fact that the French Government owned the company and was thus both grantor and recipient of the subsidies. The principal evidence relied on by the DOC to find that subsidies in the French case were "tied" to domestic production came from the Government of France's questionnaire response submitted during the investigation. This included not only the Government's own narrative version of the nature, goals and purposes of the subsidy programmes at issue, but also various additional evidence in the form of attachments, quotations and citations which supported or expanded on the narrative, i.e. protocols which the Government entered into with the French steel companies and their major creditors, President Mitterand's press statement, Cabinet meeting minutes, and the McKinsey study which focused on a restructuring plan to modernize or expand plants in France. These sources described the goals and purposes of the programmes from which the subsidies at issue arose. In setting forth the aims of the programmes, repeated references were made to the "French steel industry" and "our industry", in circumstances which made clear that the reference was made only to production in France. Additionally, the French Government owned Usinor Sacilor, and thus not only were the government's aims in providing the subsidy apparent, but it was in a position to see that these aims were achieved.

262. Referring to the evidence on record, the United States argued that in describing the Government of France's struggle to keep the French steel industry viable, President Mitterand had acknowledged that the situation had created "a dramatic problem to the workers who live it, to the regions where they live, and to the entire country". The Government of France's response to the DOC showed that up until 1984, the Government's efforts were "characterized by adoption and implementation of measures to restore the economic viability of the French steel industry which was based on faulty premises proffered by well-intentioned advisors". Beginning in 1984, the Government of France re-examined "the forecasts underlying the previous investment plans which had brought about the hoped for viability of the steel companies. ... Given the heavy costs we have incurred thus far, either we would restructure our steel industry to make it viable on its own without any further state aids, or close it down". The United States said that the principal component of the Government of France's approach was one last substantial subsidization, as part of a major restructuring of the French steel industry. This restructuring, implemented in 1986, "called for significant reductions of capacity, deep cuts in employment, modernization of equipment and alleviation of financing costs." It was at that time that the Government of France financed the principal subsidies at issue here. On the basis of this and other record information, the DOC concluded that the subsidies given by the Government of France were indeed tied to domestic production in France, a conclusion that the record amply supported.

263. The United States argued that after this factual determination of "tying" was made, the second step was for the DOC to determine how to allocate the subsidies to Usinor Sacilor's sales. The DOC determined that the subsides should be allocated to sales of Usinor Sacilor's domestic, i.e. French, production. This allocation was based on a reasonable methodological determination that "tied" subsidies will benefit "the products as to which those subsidies provided incentives to produce and sell" (58 FR 6231). In the course of making this determination, the DOC considered whether there was evidence in the record showing that even though the subsidies at issue were "tied" to domestic production, the subsidies actually would have encouraged foreign production. The DOC examined whether there was "a clear reason to believe" that the "tied" subsidies nevertheless would have encouraged foreign production, and determined that there was not (58 FR 6231).

264. The United States argued that the Agreement contained little guidance as to what constituted a countervailable subsidy. Thus the investigating authorities were free to apply any test, provided it was reasonable, for determining whether and to what extent a subsidy existed. The "tied" approach used by the

DOC in the French case represented a reasonable approach for dealing with government subsidies provided to respondents with multinational production. The DOC had reasonably determined, based on the facts in the record, that the Government of France's subsidies at issue were "tied" to French production of steel. The United States further argued that in arguing that the DOC had used a presumption, the EC was actually focusing not on the factual determination of "tying" but on the second part of the DOC's analysis, i.e. the DOC's allocation methodology. However, having determined the issue of tying on the basis of factual evidence, the DOC's analysis included the second part simply as an additional opportunity for the respondents to get a ruling in their favour. To the extent that the second part of the analysis could be construed as involving a "presumption", it did not detract from the main part of the analysis, i.e. the factual part. Once it was understood that the DOC did not apply a dispositive presumption, but rather first determined that the subsidies were tied to French production, the EC's arguments relying on the Pork panel failed. In essence then, the EC's challenge was simply a request that the Panel reweigh the evidence of record on the highly factual issue of whether the Government of France's subsidies were "tied" to domestic production. As explained earlier, this was not an appropriate request.

265. The United States agreed that the petitioners had raised the issue of "tying" for the first time in November 1992. However, the EC had not shown how it had been prejudiced by this fact. With regard to the submission of factual information, the United States argued that the initial questionnaires to the French respondents sought all information that would have been relevant to the tying question, and the EC had not identified additional evidence the French respondents would have submitted to the DOC on this issue. The initial questionnaires contained questions seeking detailed information on the nature and likely effect of each of the subsidy programmes at issue, the government policy behind the programme and what criteria the firm had to meet in order to be eligible for the subsidy. This was precisely the type of information that was relevant to the factual determination of "tying" made by the DOC.[51] With regard to the opportunity to present arguments, the French respondents availed themselves of the opportunity to brief the issue at length before the DOC.

266. Regarding the United States' proposed regulation that treated equity infusion as untied subsidies, the United States argued that the DOC had explained that its product-tying regulations did not "contemplate a situation where the firm was a holding company with not only domestic subsidiaries engaged in the production of products." In the context of multinational production, issues not otherwise present counselled against automatically applying to a multinational respondent regulations pertinent to a product-tying context. In the multilateral context for example, it was not at all clear that a government can be expected to provide subsidies (whether in the form of equity infusions or otherwise) that fostered, at what would be considerable cost to its own taxpayers, manufacturing or production and economic and social health in foreign countries. It was far more likely that taxpayer revenue would be dedicated to support domestic production in order to promote domestic economic and social health. Thus, the DOC did not make assumptions about tying based on treatment of equity infusions when they arise in a different context, but rather examined the facts of record as a whole on this issue and, in doing so, considered all relevant facts.

267. With regard to the EC's claim that the DOC had used a presumption by allocating subsidies to domestic production, the United States reiterated that a two step approach was used in this case, and the first step in this approach involved the DOC's factual determination of whether the subsidies were "tied" to production in France. The United States noted that the DOC had altered its approach in subsequent cases, in which it used as a starting point the presumption that subsidies were tied to domestic production. This essentially put the burden on respondents to provide evidence indicating that the subsidies were not tied, i.e. they benefitted foreign production also. However, since the present case involved a factual determination, the relevant question for the Panel was whether a reasonable, unprejudiced mind could find the information sufficient to support the conclusion that the subsidies were tied. The EC's allegation that a

[51]A copy of the questionnaire was provided to the Panel.

presumption was applied in the present case took the Panel away from this question and might be an effort to pull the approach used in subsequent cases into the present case. This was not appropriate because if there was a disagreement over the subsequent case, that must wait for a later panel. The present proceedings must not prejudge important issues that did not arise until subsequent proceedings.

268. Further, the United States argued that while the issue of presumption was not present in this case, it did not mean that reliance on a presumption could not be proper. A presumption was a well-established and fairly widely used evidentiary device.[52] The effect of the most common form of presumption was to place on a particular party the burden of persuading the trier of fact with regard to a particular issue. Presumptions arose from logic and experience. Also, a presumption could be rebutted or overcome with evidence showing that what was probably true was not in fact true in the particular case at hand. An open mind to receive such contrary evidence was important. Properly applied, a presumption could make a factual enquiry more efficient with no diminution of the search for the truth. Presumptions were extensively used and there was no incongruity between using a presumption and the requirements of the Agreement, provided the presumption had proper foundation. There were no provisions of the Agreement to the contrary.

269. Regarding the United States' arguments on the use of presumptions, the EC argued that the United States had de facto recourse to a presumption and that its so-called factual determination of the restriction of the benefit of the equity infusions to French production was at best a disguise for a presumption. The EC's view was based on the actual course the investigation had taken and, as argued above, on the "factual" determination being reached at the last minute and not prepared by any questions or research which were specifically directed at making or supporting such determination. The EC fully maintained its position that such de facto recourse to a presumption was contrary to the Agreement and the relevant case law. In the alternative the EC believed that the determination was totally unsupported by the relevant facts or by the record assembled in the United States case and thus, for the reasons provided above, represented both a manifest error of fact and a manifest error in the appreciation of the facts.

270. The EC argued that the evidence presented by the United States failed to meet the evidential requirements in substance. The EC said that it had not been able to find any questions in the DOC's questionnaire that were relevant to the issue of "tying". None of the United States' questions was directed towards the issue of whether the programmes in issue benefited the whole company or only that part of the company based in France. The questions asked by the DOC were standard questions which, though they seemed to reveal an implicit restriction of the investigation to the national territory, in the past had not been an obstacle to DOC allocating benefits over the total consolidated sales without regard to national borders. These questions, therefore, in principle were not capable of allowing DOC to draw positive conclusions about the restriction of the benefit of the equity infusion to sales from subsidiaries in one (national) territory. Furthermore, nowhere had the United States made reference to a document mentioning that the infusion should benefit exclusively production facilities located in France. The excerpts from the narrative response of the French Government to the countervailing duty questionnaire did not include any material evidence that the equity infusion actually benefitted only French domestic production. The programmes described could have benefitted any subsidiary, irrespective of its location, and it did not appear anywhere that conditions were attached to their attribution. Likewise, the press statement of President Mitterand was not convincing; it was a political statement with no legal binding effect on French companies. President Mitterand could not by press conference give binding instructions to management of government-owned companies to restrict the benefit of an equity infusion to French products. Also, European politicians were likely for years to come speak in terms of national interest, but government-owned companies had gone multinational a long time ago. Semantic arguments such as references to "the French steel industry" or "our industry" were not compelling. It would not enter the mind of a shareholder to exclude, when talking about its company, the foreign subsidiaries owned by this

[52]For example, see McCormick's Hornbook on Evidence, 1987.

company. The term "industry" in the French case applied to Usinor/Sacilor because the French steel industry was only composed of the Usinor/Sacilor group. Moreover, the EC recalled that in Cabinet meeting minutes of March 29, 1984 and President Mitterand's press statement of April 4, 1984, it had been reported that "the two large nationalized firms (i.e. Usinor and Sacilor) lost 10 billion French francs in 1983. This loss figure corresponded broadly to the recorded losses of the Usinor group (French Francs 5.4 billion) and the Sacilor group (French Francs 5.6 billion) and not on French operations alone. Furthermore, the Protocols mentioned by the United States actually contradicted the United States' position that France only intended to restructure and revitalize domestic production. The German operations of Usinor Sacilor had their origin in the 1978 restructuring plan. At that time Dillinger became part of the Sacilor Group. The overall aim of the restructuring plan was to make the French industry internationally competitive and viable, and this goal included both domestic and foreign operations. The McKinsey study also did not provide evidence of the type claimed by the United States. This report referred to synergies to be achieved between Unimetal and Arbed of Luxembourg and other rationalizations on a European scale. The subsidies at issue were the total capital infusions to Usinor and Sacilor and the Usinor Sacilor Group. Moreover, the EC argued that Usinor Sacilor had continued to invest in production outside France all through the period of investigation and that capital within the holding company continued to flow to the Group's foreign subsidiaries.[53] Thus, the DOC had relied on an irrebuttable presumption and ignored the "relevant facts". The "facts" later cited by the United States (but not referenced in the DOC's determination), did not support the presumption used by the DOC.

271. The EC contested that government ownership should have any *a priori* effect on how an equity infusion is used in a multinational company. The EC argued that France was a country under the rule of law, where a government-owned firm was at arm's length from the administration and the latter could only impose certain actions on such firms by specific, legal decisions. For the equity infusions, no such specific decisions were taken or other formal government instructions given, either for restricting the benefit of the infusions to France, or for extending them to German production. Any choice of the use of equity funds can only be taken by the managers of the company and not by the shareholders. When such decisions were taken, management reports were made containing the decision regarding the use of equity funds. The United States did not supply any evidence of this kind, and therefore its allegation that the government was "in a position to see" how the infusion would be spent remained at the level of pure assumption, i.e. the so-called evidence presented by the United States was below the level required from an investigating authority, and had no probative value on the question of allocation of an alleged subsidy over production. Under such circumstances, the DOC should not deviate from the application of its long recognized principle that equity infusions could not *per se* be tied to a particular production of a company.

272. The EC argued that there was no difference between this so-called "decision" of the DOC based on non-existent and flimsy evidence to the effect that the benefits of the equity infusions concerned were restricted to French production and a presumption to the same effect. Such a presumption, especially if it was *de facto* irrebuttable, as in this case, was contrary to the requirements of Article 4:2 and the Pork panel. The EC argued that except for the above-mentioned three reasons advanced in the DOC determination, which had the characteristic of a presumption and did not support that decision at all, the United States did not mention which other facts could justify the determination together with those referred to in the text of the DOC determination.

273. Further, the EC argued that the United States had tried to present the Panel with an embellished version of the DOC's original determination on the issue of allocation of subsidies over production. Its description mostly added to the text of the determination or re-interpreted it in order to contradict the EC's

[53] In support, the EC provided the Panel with information from the Annual Reports of Sacilor for 1982 and 1983 (which were submitted to the DOC) and of Usinor Sacilor for 1992, Sacilor's General Meeting Report (30 June 1989, which was submitted to the DOC), and Sacilor's consolidated financial statement for 1983.

arguments. The United States' submission stated that the DOC "examine[d] various facts, which might include [those mentioned in the findings and] any other evidence addressing the likely beneficiaries of the subsidy". However, the determination did not allow one to infer that such an exhaustive analysis was followed by the DOC. It did not state that various facts or any other evidence were examined. It did not mention that evidence other than the factors expressly mentioned in the text were reviewed by the DOC. In this context, the words "on the record before us" in the decision could not be deemed to cover these concepts. As was confirmed by the Resin panel report, it was only the public notice, not the administrative record *per se* which was relevant as a statement of reasons. Therefore, the Panel could not base its findings on some unspecified reference to the record. Also, the United States did not specify in its submission what "any other evidence" consisted in the present case. Furthermore, the criteria presented to the Panel by the United States as those used by the DOC in its determination were either not found in the DOC decision or were not identical. For example, the United States had referred to "communications between the government and the respondent relating to the subsidy provided pursuant to the programme at issue". The DOC did not mention this factor at all. If any communication which addressed the use of subsidies existed, the United States would not need to talk in general terms about the French Government's objectives and position to fulfil these objectives. It could simply have quoted those communications. Such an approach by the United States demonstrated that its claims were not well-founded, and that if the DOC needed such an extended "interpretation" *a posteriori* of the content of its determination, it had obviously failed to meet the standard of the Pork panel to consider all relevant facts and include all necessary logical steps in the decision.

274. The EC argued that even if, as claimed by the United States, other facts were actually taken into account, the DOC still failed to meet the requirement to substantiate its findings. Nowhere in the text of the determination were any of these factors listed, nor the rejection of other factors really explained. Under those circumstances, the EC could only conclude that the United States did not substantiate its findings, thus infringing the requirements of the Pork and the Resin panels and, in addition, of Article 2:15 of the Agreement. If any signatory could come forward with an interpretation of its published determination which significantly departed from the language of that determination and if such an interpretation was upheld by a panel, this could exonerate this signatory from fulfilling the requirements of the Pork panel. What was at issue before the panel was the DOC's determinations of 27 January 1993, not the expanded version of these determinations put forward by the United States in its submissions. The Panel should disregard the attempt of the United States to give an interpretation of the determinations of the DOC, and instead to rely exclusively on the actual language of the DOC's determination The Resin panel confirmed the obligations with respect to evidence and burden of proof contained in the Pork panel. The Resin panel had considered that the KTC (i.e. the investigating authority) had failed to substantiate its findings. In substance, this obligation required the investigating authority to base its analysis on all relevant facts, to clearly and precisely explain what facts led to the conclusion reported in the determinations and why factors leading to other conclusions did not prove sufficiently determinant. The text of the DOC determination was scanty in terms of information, and the United States' submissions to the Panel did not show that the DOC had based its findings on all relevant facts. Moreover, as the DOC conducted the entire investigation at the level of the consolidated company and did not ask for data demonstrating capital flows to Usinor/Sacilor's non-French subsidiaries, the only relevant data in the record were consolidated financial reports. Those demonstrated that Usinor/Sacilor financed operations and made industrial investments in its subsidiaries generally, but by definition did not detail routine flows of funds to every subsidiary.

275. The EC argued that the facts of the procedure had led it to believe that the DOC simply put its routine series of questions, failed to ask any specific question regarding to what extent the subsidies provided to Usinor/Sacilor benefitted French versus non-French production, and in its preliminary determination allocated total subsidies over consolidated world-wide sales. Moreover, DOC raised no questions pertaining to this issue during verification and was not interested in it during the administrative hearing. It was only in the final determination that the benefit of the subsidies was presumed to be restricted to the sales of the French subsidiaries and the burden of disproving it was imposed on

Usinor/Sacilor. As argued earlier, such a presumption was substantially irrebuttable as it was basically impossible to trace throughout a consolidated enterprise, capital flows which were not specifically earmarked but were general infusions. It was procedurally irrebuttable as the presumption was advanced in the final determination after the record of the domestic investigation had been closed.

276. The United States argued that to the extent that the EC was suggesting that the only subsidies that were at issue in the French case were equity infusions, the EC was not accurate because the Government of France's subsidies also included large grants in the form of shareholder advances and numerous preferential loans. To the extent subsidies were equity infusions, the EC's claim ignored the information that showed the aims and goals of these programmes were to advance the fortunes of the industry in France, and that the French Government was, through its position of ownership, in a position to make these aims and goals a reality. Thus, the DOC did not assume that the fact that some subsidies were equity infusions meant that they were automatically "untied". The DOC examined all the facts of record on the tying question. In full compliance with Article 2:15 of the Agreement, the DOC had identified all material facts pertinent to its findings and conclusions. The three key elements of its finding were set forth in the determination. Not all of the specific information from the record pertinent to these elements was itself cited in the determination. There was an important difference, however, between citation and description of record information on points upon which the authorities relied in the determination, and advancing new bases for the determination altogether. The latter situation arose in the Resin case. There, the Korean Government raised wholly new grounds for the finding not contained in the written determination. For example, Korea argued that the authorities based their determination of injury in part on the magnitude of the margins of dumping; however, there was no indication in the determination that this was the case. By contrast, here the three broad elements supporting the DOC's finding of "tying" were clear. Before the Panel, the United States had identified information from the record on which the DOC's specific findings were based, and in doing so had not presented any new findings or new bases for the determination. Further, the United States said that Article 2:15 was not in the Panel's terms of reference. The Panel's terms of reference specifically referred to the EC's request for the establishment of a Panel and Article 2:15 was not raised in that request.

277. The United States argued that all of the references to "French industry" and "our industry" were made at a time when the French steel industry had not yet been restructured into Usinor Sacilor group. Several major steel companies existed in France, and therefore the reference to "French industry" and "our industry" did not reflect that France had only one steel company, the Usinor Sacilor group. For this reason, these references remained highly probative on the "tying" question. Regarding the factual information that was used by the DOC, the United States argued that the EC had not said what other information would have been required by the DOC in its investigation on the issue of subsidies being "tied" to domestic production.

278. Regarding the United States' point that all the alleged subsidies were not equity infusions, the EC said that the United States had introduced this argument very late during the proceedings. The EC's conviction that the alleged subsidies were all equity infusions had been voiced during consultations and conciliation, had been repeated in the first submission before the Panel and during the first meeting with the Panel. The United States had not availed the opportunities to contradict this view at any of these occasions and should not be allowed by the Panel to introduce this point at such a late stage in the proceedings.

279. The EC further argued that the PACS and FIS instruments and shareholder advance, which accounted for almost the entire subsidy found by the DOC, were converted into common stock and thus constituted equity infusions. Insofar as the preferential loans, i.e. the FDES and CFDI loans, were not equity infusions, they were consolidated at the parent company level in 1990 and 1991, and thus any benefit during the period of investigation was to the holding company and the subsidies were thus untied.

7. Allocation of subsidies over a 15-year period

280. The EC argued that by applying a methodology for allocating non-recurring grants over a period of 15 years, the DOC had violated the requirements of Article VI:3 of the GATT, Article 4:2 of the Agreement, and of the Guidelines on Amortization and Depreciation[54] which the signatories to the Agreement had agreed regarding the rules for allocation of subsidies over time in the calculation of countervailing duties.

281. The EC argued that the general rule in the Guidelines, under the "common issues" in paragraph 3.2 of the Guidelines, was that the investigating authority, when it determines the average useful life of assets for the purpose allocating subsidies over time, must select a reasonable period for the firms being investigated, and no other rules in the Guidelines could be deemed to detract from it, since they must be interpreted in the light of it. Consistent with the general rule in paragraph 3.2 of the Guidelines, authorities may "determine a reasonable period based on the average life of assets owned by the firm" (Guidelines, paragraph 4.2.2, emphasis added by the EC). The EC noted that paragraph 5 of the Guidelines provided specific rules on grants which covered two possible situations. One was when a grant was used to buy assets, and in this case, the commercial life of the assets purchased should be the basis for the allocation period (paragraph 5.2.1). Second was when grants were not used to buy assets. In this case, the useful life of other assets may be resorted to rather than the life of specific assets (paragraph 5.2.2). In light of the general rule in paragraph 3.2 (reinforced by the text in paragraph 4.2.2, which concerned loans), the words "average commercial life of assets" in paragraph 5.2.2 must be interpreted as the average commercial life of assets for the firms being investigated. Furthermore, paragraph 2 of the Guidelines unambiguously obliged the investigating authorities to fully explain why they chose a particular method for allocating the subsidy. Therefore, the United States must justify the amortization period chosen in respect of every investigation it conducted. Even a periodic explanation for the 15 year period chosen by the United States would not be in conformity with either the Guidelines or with the requirements of Article 2:15 of the Agreement on proper reasoning. A cursory statement by DOC in its determination about the use of the 15-year rule did not meet the requirements of the Guidelines, which require a full explanation of the allocation method chosen.

282. The EC argued that a period that was too short would cause the duty imposed during a particular year to be in excess of the subsidy that should have been allocated to that year; a period that was too long would result in a countervailing duty being imposed when no subsidy should have been found to exist during the period of investigation. Thus, if the period employed was not reasonable then the countervailing duty imposed would violate Article VI:3 of the GATT and Article 4:2 of the Agreement. The period selected was reasonable if it was based on the economic and commercial realities of the firm being investigated. If the period was not based on the facts of the firm, then it was not reasonable. It was clear that the 15-year period employed by the DOC in the lead and bismuth investigations was not based on the circumstances of the firms investigated and, therefore, was a violation of the Agreement. The DOC made absolutely no attempt to determine a reasonable period based on the economic and commercial realities of the firms investigated in the lead and bismuth investigations. It merely applied a rule it had been using in all countervailing duty investigations of all types of steel products from all countries for at least eleven years. In fact, the DOC had admitted that this 15-year rule was based on a study done more than 30 years ago, and that the subject of the study was companies in the United States[55]. The 15 year allocation period was taken by the DOC from the 1977 United States Internal Revenue Service ("IRS") Class Life Asset Depreciation Range System ("Class Life System"), which was used to calculate the amounts of depreciation deductions allowable when determining the taxable income of a corporation under the United States income tax. This study had not been revised since that time with respect to the steel industry: there was no record of any study of the steel industry after 1962, and a supplemental study may

[54]Hereinafter, the "Guidelines". BISD 32S/154

[55] Statement of the United States on the Request of the European Community for Conciliation, at 3.

have been done on some industries in the late 1970's but was apparently not directed at the steel industry. Furthermore, the IRS study was conducted by the United States tax authorities for income tax policy purposed only. The DOC, rather than attempting to determine an appropriate period for allocation of subsidies, used the 15-year rule in countervailing duty investigations as a matter of administrative convenience. The DOC had defended this 15-year rule on the grounds that it provided consistency with its practice and predictability in steel countervailing duty investigations. The EC argued that the fact that an arbitrary rule had been applied for many years may demonstrate that application of the rule was consistent and predictable, but it did not demonstrate that the rule was reasonable within the meaning of the Guidelines.

283. The EC argued that the fact that 15-year class life period was out of date and unreliable was demonstrated by the fact it was no longer used by the United States tax authorities. The Class Life System was repealed in 1981.[56] Like most other companies in the United States, the United States steel companies now depreciated their tangible property for income tax purposes over a 7-year period.[57] Moreover, on several occasions the United States courts had found the use of the 15-year rule in steel countervailing duty investigations to be "unreasonable" under United States law.[58] One such decision pointed out that the 15-year rule was "unreasonable and not in accord with Congressional intent that the benefits be allocated over a period of time reflecting the commercial and competitive benefit of the subsidy to the recipient."[59] Among the criticisms of the United States courts when they rejected the use of the 15 year rule in the past was that the DOC had failed to explain its rationale for the use of this methodology.

284. The United States argued that the Agreement did not contain any understanding on how to calculate the amount of a subsidy. To assist investigating authorities in determining allocation period, the Committee had issued the Guidelines, which recognized that the economic impact of a grant was not limited to the day when the grant was received. The purpose of the Guidelines was to provide "reasonable alternatives for the amortization and depreciation of subsidies arising from loans and grants." In general, the Guidelines (paragraph 2) indicated that the allocation period "should be based on reasonable and generally accepted financial and accounting practices". They specifically acknowledged, however, that "financial and accounting theory and practice do not provide any single acceptable method" (paragraph 2). The Guidelines provided examples of acceptable methods but did not purport to set out all possible reasonable methods. With respect to allocation of grants, the Guidelines set out several alternatives. For example, in paragraph 5.2.2 the Guidelines stated that the investigating authority may "[i]n the case that the grant is not used for the acquisition of physical assets such as plant or equipment used in the production of a particular product or group of products, allocate such a grant over a reasonable period reflecting the average commercial life of assets."

285. The United States argued that the phrase in paragraph 3.2 of the Guidelines which stated that the investigating authorities should select "a reasonable period for the firms being investigated", did not equate to a firm-specific mandate. An analysis based on "the firms being investigated", i.e. steel-producing firms, was equally valid under this provision. Indeed, the latter approach "minimize[s] the impact of differences in book-keeping methods," a goal urged by the Guidelines (paragraph 3.1). Moreover, paragraph 5.2.2. of the Guidelines stated that grants may be allocated over "a reasonable period reflecting the average

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[56]This repeal was effected on January 1, 1981, by the Economic Recovery Tax Act of 1981 (Public Law No. 97-34).

[57]Section 168(c)(1), (e)(1) of the Internal Revenue Code of 1986. Rev. Proc. 87-56.

[58]British Steel, 632 FR 59 (CIT 1986); IPSCO Inc. v. United States, 887 F. Supp. 614 (CIT 1988).

[59]British Steel, Id. at 69.

commercial life of assets". Hence, there was no requirement, express or implied, that the allocation period be company-specific.

286. The United States argued that the selection of the allocation period was expressly placed within the administering authority's discretion (paragraph 1). The 15 year allocation period used by the DOC, based on a thorough and far-reaching analysis of the steel industry, was fully consistent with the Guidelines. It was a period that reflected the "average commercial life of assets". The 15-year figure for steel industry was based on an extensive Treasury Department study that was conducted in 1977, which was later updated and revised, and had since been reviewed and retained. The DOC had consistently applied a 15-year allocation period in steel investigations since the early 1980s and since then had repeatedly explained the basis for its choice of the period[60]. The United States noted that the argument that DOC had failed to explain the rationale for selecting the 15 year period had not been earlier raised in the dispute settlement proceedings. The practice of using 15 year allocation period was not new, nor was the underlying rationale unknown to the EC or to any other party. The extensive comments of the parties showed a thorough understanding of the history and the rational for the 15 year allocation period. Further, the EC's "failure to explain" argument sprang from, and was dependent on, its substantive argument that the Guidelines required firm-specific allocation period. However, the use of allocation based on the average life of assets of firms in the steel industry was entirely consistent with the Guidelines.

287. The United States argued that while it was true that the IRS analysis did not include EC firms, the steel industries in the EC countries under investigation were, like the United States industry, large and well-established industries that compete on a global basis. Therefore, it was inconceivable that they would have fundamentally different experience, in general, with plant and equipment. Not surprisingly, there was no record evidence indicating any meaningful differences. To the contrary, in the proceedings, the respondents from the United Kingdom had conceded that 15 years was a reasonable estimate of steel industry assets.

288. The United States agreed that the United States Tax Code currently permitted companies to depreciate over seven years. However, this was irrelevant because the accelerated depreciation did not reflect (nor purport to reflect) average useful life of assets. Rather it reflected government policy to create tax incentives to invest in capital equipment. The IRS had maintained a 15-year class life for steel producing assets. This class life reflects the actual average commercial life of assets, as permitted under the Guidelines.

289. The United States argued that the consistency of the DOC action with the United States domestic legislation was not at issue in these proceedings. The Panel had to consider the consistency of the action with the Agreement and the Guidelines. The United States recalled that the Guidelines were adopted after DOC began to use its 15-year methodology, and argued that the United States would not have permitted adoption of Guidelines inconsistent with its practice at the time. The Guidelines were adopted in 1985 and the DOC had continued to use this methodology. There had been no complaint against the DOC's methodology earlier.

290. The EC argued that the United States' submission was misleading when it claimed that the substantive conclusions of the study which formed the basis for the 15 year period were reviewed and a considered decision was reached as to their continued applicability. The information with the EC indicated that the study was updated and revised in 1979, but thereafter its consistency with the actual steel industry was never examined. The subsequent reviews were only *pro forma* readoptions of the 1977 study for unrelated tax purposes.

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[60]The United States referred to Certain Steel Products from Belgium, 47 FR 39304, 39317; Carbon Steel Wire from Belgium, 47 FR 42403; Cold-Rolled Carbon Steel Flat-Rolled Products from Argentina, 49 FR 18006; and Certain Steel Products from Austria, 58 FR 37217, 37230.

291. The EC disagreed that the Guidelines could be interpreted to mean that the reasonable time-period applied to the industry being investigated instead of the individual firms, arguing that this was wrong on the basis of the natural meaning of the words of the text (first interpretative criterion of the Vienna Convention Article 31). It was obvious from the determinations in question that the DOC had not made any attempt to follow the Guidelines and had not seriously explained why it had once again followed the 15-year rule. The only plausible explanation for the practice of using 15 years for allocating subsidies was administrative convenience. The United States courts had systematically found the DOC practice to be arbitrary, and the decisions of the United States courts were instructive. The United States courts had tested the DOC practice against a standard of arbitrariness which was generous to the DOC in comparison to the reasonableness standard prescribed by the Guidelines, and had consistently found it wanting.

292. The EC argued that the rigid application of the 15 year average useful life found in the 1977 Treasury Department study to assets owned and operated by French, German and United Kingdom steel producers in the 1990s was inherently arbitrary. There had been significant changes in the equipment used to produce steel both in the United States and in other countries over the past 15 years. The average life of assets in the United States steel industry in the 1970s could not be compared with the situation at present, let alone with the situation in Europe where steel mills modernized earlier and more thoroughly than in the United States. There was no positive evidence on the record compiled by the DOC that supported the assumption that the calculation of useful life of steel making equipment in the 1970s offered any insight into the useful life of equipment operated by the United States producers in the 1990s, and even less so for the producers in France, Germany and the United Kingdom. Even if this were not so, the DOC's 15 year period would fail to meet the requirements agreed to in the Guidelines because the Guidelines established a firm-specific and not an industry wide test. The useful life of steel-making equipment varied by firm depending on, *inter alia*, the type of steel produced, the degree to which the production process is integrated, and the technological sophistication of the firm. Recognition of this fundamental point was reflected in the decision of the Agreement's signatories to establish a general requirement in the Guidelines that subsidy allocation periods based on the average life of assets be "reasonable ... for the firms being investigated". The United States was avoiding the plain meaning of this requirement. Since the Guidelines referred to specific firms under investigation in paragraph 3.2, any general explanation for the steel industry was of no relevance to the firms under investigation. Also, given that subsidy investigations were directed to specific firms and not to the whole economic sector, the reference to "firms being investigated" must be taken to mean "the specific firms under investigation" and not the economic sector concerned as a whole.

293. The EC argued that investigating authorities would be relieved of their obligation to investigate if the Panel accepted the United States' contention that the average life of United States steel assets could be projected on a world-wide basis because the DOC was not presented with evidence that disproved to its satisfaction the assumption that the general type of equipment used to produce steel in foreign countries was the same as the equipment used to produce steel in the United States. The United States' position was thus inconsistent with the basic requirement of Article 2:1 of the Agreement that countervailing duties be imposed only pursuant to investigations.

294. The United States argued that there were a number of reasons for reasonably interpreting, as the DOC did, that the phrase "the firms being investigated" in the Guidelines referred to firms in the steel industry under investigation and not the individual firms. The phrase was contained in a statement that used the term "should", which was more of a hortatory term rather than a mandatory one (such as "shall"); it was contained in a list of general provisions where one would not expect a provision containing the kind of precise requirement alleged by the EC; and paragraph 5.2.2. of the Guidelines, which stated that an appropriate method for allocation was "the average commercial life of assets," made no mention of a firm-specific requirement.

295. The United States argued that as found by the Lumber panel, the Agreement required that the authorities render a determination that a reasonable, unprejudiced person, on the basis of the evidence before the authorities, could have made. Thus, the question in the present context was whether a reasonable, unprejudiced person could have employed the class-life tables on the issue of allocation of subsidies over time. Without question this was the case. The IRS study was detailed and comprehensive when issued in 1977. It was later revised, and again reviewed. At a minimum, the IRS class-life tables based on that study were reviewed at least as recently as 1986. While a more recent study would, of course, have been even better, the United States was not aware of such a study, and the EC had not identified one. In fact, the IRS study upon which the class-life tables were based appeared to remain the most thorough study available today on the issue of useful life of steel assets. Also, the DOC's rationale was well known to the respondents in these cases, and to argue that a fresh explanation must be provided in every single case would be to exalt form over substance. The Guidelines must be interpreted in a reasonable fashion.

296. The United States did not view the Guidelines as incompatible with its existing practice, and there was no indication that any other signatory to the Agreement thought otherwise when the Guidelines were adopted. In fact, an EC Commission representative had acknowledged that the 15-year allocation period did not run afoul any requirements of the Agreement.[61] Moreover, in the cases under review, the German respondents did not question the 15-year period, the United Kingdom respondents went further and conceded that it was accurate, and in the French case the record evidence demonstrated that 15 years was a reasonable estimate of the historical depreciation of steel assets; the data drawn directly from the annual statements of the French companies at issue demonstrated an average depreciation experience since 1978 of just over 16 years.[62]

297. The United States argued that the United States court decisions were not at issue under the Agreement, in view of the Guidelines on Amortization and Depreciation expressly recognizing the average useful life of assets as a reasonable allocation methodology. Moreover, the DOC had fully explained the basis for its use of a 15-year allocation period for steel assets. Regarding the United States court cases cited by the EC, the United States said that in British Steel Corp. v United States, the United States Court of International Trade (hereinafter "CIT") remanded the case back to the DOC after questioning whether the average useful life of assets could be used as an allocation methodology in that case. Under the Agreement, this was not an issue in view of the Guidelines expressly recognizing the average useful life of assets as a reasonable allocation methodology. A subsequent case, IPSCO Inc. v. United States (IPSCO I), concerned whether the DOC had fulfilled procedural requirements of the United States Administrative Procedure Act with regard to "rulemaking". The CIT held that DOC's standard practice of relying on the IRS class life tables constituted a "rule" that was subject to formal rulemaking requirements. Without such a rule, the CIT held that the United States administrative law required that DOC explain the basis for its selection of the allocation period based on the facts of the particular case. Like the British Steel case, conformity with the United States administrative law was not at issue before the Panel. On remand, the DOC confirmed its use of the 15-year allocation period for the IPSCO I case. In IPSCO II, the CIT found that there was not substantial evidence in the record indicating why it was appropriate to rely on the tax tables. This was not so in the present case, where one respondent had agreed that 15 years was a reasonable estimate of the useful life of steel assets, another had not even challenged the 15-year period during the investigation, and the record evidence with respect to a third was consistent with the tax tables.

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[61] In support of its argument, the United States referred to "Official Journal of the European Communities", No. C 51/16, 22 February 1993.

[62] With regard to the French case, the United States provided the Panel with Exhibit 1 of the Case Brief on Behalf of Petitioners (23 November 1992), which contained data from annual reports of Usinor, Sacilor, and Usinor Sacilor for the years 1978-1991.

298. The EC argued that the United States' contention that the respondents had agreed with the validity of the 15 year allocation period was an *ex post facto* attempt to justify a determination on grounds other than those actually relied on by the DOC. In its final determination, the DOC did not even attempt to justify its use of a 15-year amortization period on the basis of company-specific analysis because it never undertook any such analysis. Thus, even if all the assertions made by the United States regarding company-specific data collected by the DOC were accurate, it would not cure the defects in the determination. More generally, the DOC failed to meet the procedural requirement to articulate the reasons for rejecting arguments against the use of the 15 year amortization period. The EC submitted that the obligation to explain the rationale for a decision was case-specific, no matter how long-standing a practice may be, the Guidelines required an administering authority to deal with the merits of each challenge to it. Moreover, the factual assertions made by the United States misrepresented the position taken by the French and British respondents in the proceeding.

299. The EC argued that in support of the claim that the data submitted in the French case demonstrated that a 15 year allocation period was reasonable, the United States had referred to the arguments made by the petitioners in their case brief. No reference was made by the United States to the data put on the record by the Government of France and Usinor/Sacilor.[63] The respondents' submission not only supported a useful life of less than 15 years but noted that the shorter useful life was recognized in the DOC's own Verification Report (11.8-years verified for 1991). Thus, the DOC's own analysis supported the French argument and contradicted the petitioners' data that the United States now wanted the Panel to accept as persuasive evidence. Also, the United States' assertion that the United Kingdom respondents conceded that 15 years was a reasonable estimate of the historic depreciation of steel assets, was based on a submission that actually argued strongly against the 15-year amortization period on other grounds (i.e.. the caption was "Petitioners' Arguments Supporting the 15-Year Amortization Methodology Must Be Rejected"). As such it could not fairly be read as an endorsement of DOC's methodology.

300. The EC argued that even if the United States were correct in contending that the 15-year amortization period was appropriate for all United Kingdom and German producers, that determination would not automatically hold for producers in other countries. The Guidelines required the investigating authority to analyze the average useful life of assets "for the firms being investigated". Where, as was the case with Usinor/Sacilor, verified data supported an amortization period that was less than 15 years, the problem cannot be cured because a 15-year period may reflect the experience of other companies in other countries.

8. Declining Balance Methodology (DBM)

301. The EC recalled that the DOC calculated the amount of subsidy from non-recurring grants by using the "declining balance method" it first proposed in 1989 and had applied since that time (see Annex 1). Under the Proposed Rule, non-recurring grants were generally allocated over time. To find the amount of a grant attributable to the year it is investigating, the DOC divided the amount of the grant by the number of years it considered to be a reasonable period. The DOC then added to the amount of the grant it has allocated to each year an amount equal to the amount of interest the DOC assumes would have been earned during that year on the sum of all the grant amounts allocated to that year and to subsequent years in the reasonable period. Finally, the DOC determined the present value at the beginning of the year being investigated of the amount of grant plus interest allocated to that year. The interest rate the DOC uses in these calculations is normally the actual cost of long-term fixed rate debt of the firm being investigated. However, when the DOC concludes that a firm is not creditworthy, i.e. no lender would lend the firm money at any rate of interest, the DOC adds a "risk premium" to the interest rate it would otherwise employ.

[63] The EC provided a copy of the relevant pages of the French submission to the Panel.

302. The EC argued that the declining balance methodology used by the DOC was inconsistent with Article VI:3 of the GATT and Article 4:2 of the Agreement because this methodology resulted in levying a countervailing duty in excess of the amount of the subsidy granted. Moreover, there was no linkage between the DOC's amortization schedule and the real-world usage of the subsidy, and the discount rate was often selected in an arbitrary manner. This involved adding an amount to the face value of the grant under the declining balance methodology, and greatly exaggerated the amount of countervailing duty. Hence the DOC could not meet its burden of proving that the countervailing duties it imposes using that methodology meet the requirements of Article VI:3 of the General Agreement and Article 4:2 of the Agreement.

303. The EC emphasized that the calculation of countervailing duties should be based on the one concrete piece of data that was available, i.e. the face value of the grant (or the subsidy). It was this amount only on which the General Agreement and the Agreement permitted countervailing duties to be imposed. Though the Guidelines permitted the subsidy to be spread out over time, nothing in these Guidelines permitted the recalculation of the amount of the subsidy. Thus, when a grant was spread out over time, the provisions in the Agreement and the Guidelines prohibited a countervailing duty exceeding the portion of the face amount of the grant that was allocated to the year being investigated. The DOC's declining balance methodology violated these requirements. Simple calculations showed that the DOC's declining balance methodology inflated the amount of a subsidy in comparison to the same subsidy attributable to each year if a straight line allocation is employed, i.e. the corresponding face value of the subsidy on which the countervailing duty had to be levied was considerably exceeded by the final amount determined according to the declining balance methodology.[64]

304. The United States argued that the General Agreement and the Agreement provided simply that the authorities shall not levy duties in excess of the amount of the subsidy found to exist. The Agreement, the General Agreement and the Guidelines did not specify how the amount was to be calculated. Thus any reasonable methodology was permissible. A net present value (hereinafter "NPV") analysis, which was the basis for the declining balance methodology, was universally accepted in the business world.

305. The United States argued that it was beyond dispute that the benefits of one-time, non-recurring subsidies were not necessarily limited to the year of receipt, but may instead be allocated over a certain number of years. This reflected the fact that grants may continue to benefit a company well after the date of receipt. Such an allocation raised another methodological issue because money had a "time-value". It was generally understood that the real value of money, e.g. one pound, received today was greater than the value of one pound received one year or five years from today, even though the nominal (or face) value of each pound was the same. This was because, in addition to the effects of inflation, a pound received today, rather than at a later date, included the benefit of the opportunity to put the pound to use. For the same reason, the value of 100 pounds today was worth more than 10 pounds received in each of the next ten years. This principle of the time value of money was universally recognized by textbooks on finance, accounting, and economics. The DOC had long taken into account the time value of money by applying a discount rate to the benefits to be allocated over time. The rate ensured that the NPV to the recipient of the subsidy cash stream, when allocated over time, equalled the face value of the subsidy. The NPV methodology attempted to ensure that the company would be indifferent to a choice between receiving the subsidy in lump sum and receiving it in increments over time. As such, the NPV methodology enabled the countervailing of the full amount of the actual benefit received, and no more. It reflected economic

[64]The EC gave an example which is as follows. Suppose the amount of the grant was 100, the allocation period was 10 years and the rate of interest used in the declining balance methodology was 10 per cent. Then, the declining balance methodology would result in the following allocation for each year of the fifteen year period: 15.15, 14.55, 13.94, 13.33, 12.73, 12.12, 11.52, 10.91, 10.3, 9.7, 9.09, 8.48, 7.88, 7.27 and 6.67 (total = 163.64). A straight line benefit methodology would result in an annual amount of 6.67, totalling 100 over a fifteen year period.

reality, and in no way levied duties in excess of the amount of the subsidy. It was fully consistent with the Agreement and the General Agreement. It was ironic that on other issues the EC argued vehemently that subsidy determinations must be in conformity with economic reality, and yet also claimed that the investigating authorities must be blind to a concept as basic to the operation of any economy as the time-value of money.

306. The United States pointed out that the heading of EC's argument ("Declining Balance Methodology") referred to the DOC's practice, in allocating benefits over time, of assigning a greater percentage to the earlier years, and a steadily declining percentage to later years. This practice sprang from the common-sense proposition that, although a one-time subsidy continued to benefit the recipient for a number of years, the benefit gradually decreased over time. However, it was clear that the EC was not challenging the DOC's declining balance methodology itself, but only the use of the net present value methodology, which was a separate concept.

307. The EC argued that while use of discount rate to calculate the value of money over time may be correct for various purposes, the use of this technique to allocate countervailable subsidies led to imposition of countervailing duties in excess of the subsidy granted. A linear reparation of the face value of the subsidy, and not the use of discount rate, would be in conformity with Article 4:2 of the Agreement. Article 4:2 expressly prohibited the levying of countervailing duties "in excess of the amount found to exist". The Panel had to decide whether the terms in the Agreement should be given their natural meaning. The text meant what it said, and the United States declining balance methodology violated the plain meaning of the Agreement because it resulted in imposition of countervailing duties in excess of the amount of the subsidy granted. Moreover, the United States had conceded that the DOC's NPV adjustment to the amount of a subsidy resulted in the imposition of countervailing duties that exceeded the "face value" of the subsidy.

308. The EC argued that when grants were provided to companies, they typically involved grants (or other benefits) received "today" and spent "today". More often than not, the receiving company would use the grant (or other subsidy) to purchase production equipment or to cover some other current operating costs. Amortization of such a subsidy over a period of years was a convention that was acceptable under the Guidelines. However, the addition of an amount representing the net present value of a totally hypothetical income stream attributed to the subsidy amount was not authorized by the Guidelines and indisputedly increased the amount of the subsidy above the subsidy amount that was properly subject to amortization or depreciation. When a producer of lead and bismuth steel uses a grant to purchase assets, the benefit should not exceed the depreciation costs incurred on those assets in any given year. Under the DOC's methodology, it invariably did. Thus, in addition to legal reasons, there were compelling economic reasons to adopt the straight-forward legal proposition that the plain language of Article 4:2 meant exactly what it said.

IV. ARGUMENTS PRESENTED BY THIRD PARTIES

(a) Brazil

309. Brazil argued that the DOC had identified subsidization and calculated subsidy margins on the basis of methodological approaches that were unreasonable and devoid of economic rationale. Brazil requested the Panel to find that the United States had rendered final determinations that contravened the United States' basic obligations under the Agreement and the General Agreement, in particular Articles 1 and 4 of the Agreement.

44. Brazil argued that to fulfil its mandate the Panel had broad authority within its terms of reference to determine the correct legal standard applicable to the facts of the dispute, to decide if the administering authority considered all of the facts before it, and if the application of the correct legal standards to all of the facts before the authority was correct, appropriate and reasonable.

310. Brazil addressed four main issues relating to the dispute: effects of privatization, treatment of equity infusions as grants, equityworthiness and debt forgiveness.

(i) Effects of privatization

311. Brazil argued that the DOC determination regarding how the sale of allegedly subsidized assets to a private company should be treated was not in conformity with the application of the Agreement's principles to the privatization process. The United States' erroneous decision-making with respect to the privatization issue had led to widespread violations of Article 4 of the Agreement by imposing countervailing duties in excess of any subsidization levels, adversely affecting the rights of a number of signatories, including Brazil, under the General Agreement and the Agreement.

312. Brazil argued that the DOC determination revealed that the United States failed to comprehend that a subsidy benefit from the ownership of an asset stemmed from the owner's terms of acquisition of the asset. If an owner paid full market value for an asset (or a production entity), he did not enjoy any competitive benefit in using that asset to export goods to other countries. The new owner must operate his company, and sell its products, as any other non-subsidized company that acquired assets at fair market value. The prior subsidy benefits that might have been conferred to a previous owner of the asset did not get transferred to the new owner. Rather they remained with the original (i.e. subsidized) owner in the form of "profit" obtained in the fair market sale of the asset. Whether in the case of acquired assets, or acquired equity, the costs for the acquiring company were defined by whether the new fiscal obligation equalled that of any non-subsidized private company, i.e. whether the new company continued to enjoy any competitive benefit. The United States' inability to recognize the legal implications of even this simplest form of privatization, i.e. a transfer of assets, had led to erroneous determinations in the cases where the privatization issues were more complex (e.g. the DOC's June 1993 final determinations in investigations involving flat-rolled steel which included Brazil).

313. Brazil argued that in view of the increasing trend towards privatization around the world, a proper and justifiable analysis of the relationship between the principles of the Agreement and the privatization process was crucial. The issue was particularly important to Brazil due to its privatization program. The shortcomings of the DOC approach had already led to several countervailing duty determinations in violation of Article 4.

(ii) Treatment of equity infusions as grants

314. Brazil argued that the DOC practice, which departed from previous DOC practice, of calculating the amount of subsidy resulting from an equity infusion was devoid of any rationale, ignored plain economic realities and had resulted in the imposition of excessive countervailing duties in violation of Articles 1 and 4 of the Agreement.

315. Brazil argued that the DOC methodology which treated equity infusion as a grant was based on the incorrect presumption that the investor will never receive a return an investment. Even if an investor did not realize a return on the investment in the short term, the investor would still maintain a right to a return in the long term. Brazil said that this methodology paralleled that used in the DOC's investigation of Brazilian leaded bar, in which the investor received a return to equity when the subject company was privatized. In addition to overlooking the return from equity to an investor though privatization, the DOC's approach failed to account for the other ways in which a company might reduce the level of subsidization associated with an equity infusion. These included an increase in net worth of the company through reinvested earnings, the repurchase of its own equity by a company, and dividend distribution to the equity holders. All of these eventualities had the effect of reducing the subsidy value of an equity infusion to a company, since they represented some form of return to the investor. None of these circumstances would occur in connection with an outright grant of capital to a company.

(iii) Equityworthiness

316. Brazil argued that the DOC's equityworthiness methodology was inappropriate because it ignored economic realities. In the French and United Kingdom cases, the DOC, in applying its methodology, focused only on short-term static financial ratios and the viewpoint of a private outside investor. By doing so, it ignored at least two important factors, i.e. the long-term viewpoint of an investor, and the unique considerations of an "owner-investor". Therefore, the DOC found subsidy where none existed. Without due consideration for the long-term projections and the special interests of an owner-investor, the DOC methodology would almost always find a subsidy where no subsidy existed.

317. Brazil argued that the static short-term financial indicators used in the DOC methodology did not focus on the future financial health of the company. To adequately evaluate the long term earning prospects for a company, any equityworthiness test must consider long-term projections based on restructuring plans, economic cycles, and the market outlook. The heavy reliance by the DOC on the short-term ratios distorted the analysis of equityworthiness and assumed that the investor ignores the long-term benefits of investment. Only a short-sighted and naive investor would rely exclusively on the short-term financial indicators used by the DOC.

318. Brazil argued that by failing to make a distinction between an owner-investor and an outside private investor, the DOC did not recognize the different considerations between the two types of investors. An owner-investor had a previous financial stake in the company. On occasion, unanticipated events could compromise a company's ability to generate the return on investment anticipated by the investor. The unanticipated events may arise due to sudden changes in market conditions or may relate to some change in government regulation. In these circumstances, the owner-investor faced a decision either to invest more capital based on long-term projections to ensure a potential long-term gain on his past and new investment, or to provide no new capital and thus potentially eliminate the likelihood of any long-term return on the original investment. In many circumstances, the owner-investor would opt to invest additional capital in the company to fortify his investment. A reasonable private outside investor, on the other hand, due to no previous financial stake in the company would not be concerned with protecting his investment.

319. Brazil argued that the analytic failure of not accounting for the difference in investment behaviour and lack of consideration of long-term factors had led to a series of erroneous and unreasonable determinations by the DOC, as in the leaded bar investigation before the Panel. Brazil requested the Panel to find that such a methodology was in violation of Article 4:2.

(iv) Debt forgiveness by private banks

320. Brazil argued that in the German case, the treatment by the DOC of the debt forgiveness by private banks as a countervailable subsidy was based on a failure to consider the economic and financial justifications for a bank to reduce the debt of a company to maintain its interest as a creditor. The DOC thus imposed countervailing duties where no subsidization occurred, in violation of Articles 1 and 4 of the Agreement.

321. Brazil argued that the important aspect of the transaction was that both the bank and the private company benefitted from the transaction. The DOC failed to understand and consider the economic realities of a bank's decision to participate in the transaction. Such transactions did not confer a subsidy, but rather were dictated by commercial considerations. Besides being unreasonable, given the market-driven realities of debt reduction schemes of Germany, the DOC determinations that such mechanisms conferred subsidies contravened the basic principles of the Agreement.

(b) Canada

322. Canada focused on the DOC's treatment of pre-privatization subsidies (i.e. the issue relating to the sale of previously subsidized assets). Canada was concerned with the justification provided by the DOC for its approach and with the implications of the approach for determining a countervailable subsidy under the General Agreement and the Agreement. Canada noted that this approach represented a significant divergence from previous determinations, and argued that it did not build on previous decisions in terms of economic rationale, nor was it consistent with the requirements in the General Agreement and the Agreement.

323. Canada argued that pre-privatization subsidies per se did not constitute a countervailable subsidy under the General Agreement and the Agreement. As a matter of economic logic the value of such subsidies was reflected in the price paid for privatized companies or assets. There was, therefore, an obligation on any signatory proposing to levy countervailing duties to offset pre-privatization subsidies to investigate the terms of the transaction in which the companies or assets were sold. While the Agreement did not provide an explicit definition of subsidy, this did not mean that any government action may be construed as a countervailable subsidy: this could be seen for example, from the report of the panel on "Operation of the provisions of Article XVI".[65] The history of Article VI and XVI of the General Agreement, the history of the Agreement, as well as various General Agreement panels, had identified guidelines that limited what were considered to fall within the scope of the term subsidy.[66] Before a measure could be countervailable, it had to be determined to be a subsidy within the meaning of the General Agreement and the Agreement. Given that countervailing duties were only intended to offset market distortions caused by subsidies, it had to be demonstrated that a buyer of previously subsidized assets received a commercial benefit. Allowing countervailing duties on pre-privatization subsidies without an investigation into the terms of the privatization transaction itself would extend the right to countervail beyond the range of practices that could legitimately be considered subsidies.

324. Canada argued that Article 4:2 of the Agreement provided that no countervailing duties shall be levied on any imported product in excess of the amount of the subsidy found to exist. For pre-privatization subsidies to be considered a subsidy for the purposes of countervail there must be evidence that any subsidy granted to a firm or assets being privatized were passed through to the purchaser. In the determination under review by the Panel, the DOC had failed to demonstrate how the privatization of previously subsidized assets based on market principles could provide a specific benefit to the purchaser of the privatized assets.

325. Canada recalled that in the Lime case[67], the DOC had found that a subsidy (whether it be an equity infusion, the repayment of debt or an outright grant), which increased a company's net worth, would be reflected in the selling price established through a transparent, competitive bidding process. A private investor who paid the market price would, in effect, repay the government for the prior subsidies. As a result, the privatized company would emerge cleansed of any prior subsidies since the value of any subsidies to the company would be accounted for in the net worth of the company. With the benefit to the company from previous subsidies extinguished, market distortions that might have resulted from continuing benefits were also extinguished. However, the DOC had abandoned this correct market-based approach in two subsequent determinations, including the determination which was the subject of review by the Panel.[68] The DOC methodology in the case under review would continue to penalize new private companies purchased at a fair market value, with countervailing duties on the basis that subsidies were received prior to sale. However, what the DOC must look at was the actual transaction and any actual

[65] Panel report adopted 21 November 1961, BISD 10S/201.

[66] In this regard, Canada referred to the arguments it had submitted to the Lumber panel.

[67] 54 FR 1753.

[68] 57 FR 57806, 57808; and 58 FR 37394.

pass through of subsidies rather than some arbitrary methodology for establishing whether countervailable subsidies existed subsequent to privatization. Therefore, where the DOC assessed a countervailing duty against a privatized firm or a previously government-owned asset that had been transferred to a private investor at fair market value, the DOC would violate Article 4:2 because no subsidy conferring a benefit existed, since the market value paid would include the value of any prior subsidy.

326. Canada further argued that the Preamble of the Agreement recognized that the emphasis of the Agreement should be on the effects and uses of subsidies. Imposing countervailing duties on goods produced from pre-privatized firms or assets ignored the fact that sale at fair market value in effect repaid prior subsidies. Subsidies that had been repaid could no longer be considered to have effects that required recourse to countervailing duties. Thus, to the extent that the effects of prior subsidies on the performance of the newly privatized firm were ignored by the DOC approach, the United States' actions were inconsistent with the Preamble and the intent and spirit of the Agreement.

(c) Japan

327. Japan argued that Article VI of the General Agreement and the accompanying Agreements were exceptions to the fundamental principles of the General Agreement, which was recognized also by General Agreement panels.[69] The authority to invoke these exceptions was based on the premise that signatories would use these exceptions in extremely well-founded circumstances, and that any imposition of countervailing duties would be founded on reasonable calculations and methodologies. Although specific methodologies and approaches were not referred to in the Agreement, there was the underlying and fundamental requirement that the methodologies used by investigating authorities should be reasonable and defensible as the best approach available to the administering authority. The determination and calculation of subsidy rates that were not logically and economically defensible could, and often did, result in an imposition of countervailing duties in excess of the actual values of subsidy, which was a violation of Article 4:2 of the Agreement.

328. Japan argued that many aspects of the DOC's findings in the cases under review were not based on economic reason, nor on the facts before the DOC. Therefore, the determinations were not justifiable, and had resulted in the improper imposition of countervailing duties. This was inconsistent with Article 4:2, and with the United States' obligations under the General Agreement.

329. Japan argued that one of the cardinal rules of statutory construction was that the authority to invoke exceptions to a general rule should be interpreted narrowly. This was supported by the Pork panel Report (paragraph 4.4), and several other panel Reports.[70] In view of the narrow interpretation to be accorded to Article VI exceptions, the standard of reasonableness should be fully respected in the course of consideration by the Panel. If the determination by the United States did not conform to the standard of reasonableness, the determination was likely to be in violation of Article 4:2 of the Agreement.

330. Japan argued that there was an established and well respected principle that the burden of proving compliance with General Agreement obligations was on the administering authority. The burden on the

[69] Pork, paragraph 4.4, "EEC - Regulation on imports of parts and components from Japan", BISD 37S/132, paragraph 5.17.

[70] "United States - Definition of industry concerning wine and grape products", SCM/71, adopted on 28 April 1992, paragraph 4.5; "European Economic Community - restrictions on imports of apples", adopted on 22 June 1989, BISD 36S/135, paragraph 5.13; "Canada - Import restriction on ice cream and yoghurt", adopted on 5 December 1989, BISD 36S/68, paragraph 59; "United States - Customs user fee", adopted on 2 February 1983, BISD 35S/245, paragraph 84; and "Norway - Procurement of toll collection equipment for the city of Trondheim", adopted on 13 May 1992, GPR/DS2/R, paragraph 4.5.

administering authority stemmed directly from its efforts to invoke an exception to its basic obligation under the General Agreement. The General Agreement panels had consistently noted this burden in examining a contracting party's efforts to invoke one of the exceptions to the general rules under the General Agreement.[71] Japan saw no reasons to change those precedents in the case of the United States' determinations under review, and thus argued that the United States was expected to demonstrate affirmatively that its determination was based on the appropriate and defensible methodologies applied to the underlying facts.

331. Japan requested the Panel to examine whether the determination made by the DOC was based on a presumption. Japan said that avoiding the burden of proof to consider carefully all the facts before it, and using presumptions instead, conflicted with obligations under the General Agreement, because a determination should be based on reasonable analysis of all the underlying facts. In this regard Japan argued that for the issue of sale of previously subsidised assets in the United Kingdom case, the DOC's analysis of the facts and application of the relevant legal principles was insupportable, and contrary to any economic rationale. This flawed determination, and the United States' decision to collect duties based on this decision, clearly violated Article 4 of the Agreement. The DOC determination had focused incorrectly on whether an asset was acquired originally with the benefit of subsidization. The DOC's analysis failed to focus on the most relevant aspect of the transaction, i.e. the relationship between the asset and the owner of the asset. It was precisely this relationship, defined by the terms of the asset acquisition, that determined whether the mere ownership of the asset constituted unfair subsidization.

332. Japan noted that prior to the arm's length transfer of assets to the joint venture, BSC owned the assets. Assuming, arguendo, that the assets were obtained originally with the benefit of some form of subsidization, BSC had the benefit of ownership and use of the assets with a reduced cost from the fair value. However, if the subsidized assets were transferred or sold to a new entity at fair market value, this entity (the acquiring entity) did not enjoy the same competitive benefit as the selling entity had. The financial obligation for the acquiring entity to price its finished products to generate a return on the full value of the assets stemmed precisely from the price at which the assets were acquired. The DOC determination revealed that the United States had not considered that due to acquiring the assets at fair market value, UES had to price its finished products in such a way to generate a return on the fair market value of the assets. The DOC's determination revealed that the United States was unable or unwilling to concede that the conditions under which assets were acquired, and the consequent effect on the cost and pricing of products produced by those assets, eliminated any competitive benefit in the marketplace. Therefore, as a result of the flawed and incomplete economic analysis in the underlying investigation, the United States was currently imposing countervailing duties in excess of any level of subsidization that may exist, which was a violation of Article 4.

333. Japan noted that in calculating the value of the benefit from past equity infusions, the United States had presumed that equity infusions provided the same type of financial benefit as a grant of capital. Japan argued that this presumption was unreasonable and devoid of any economic rationale, resulting in a finding of subsidies in excess of those that existed. Therefore it violated Article 4 of the Agreement. Although, in certain circumstances, an equity infusion may in fact confer the same benefit as a grant (if the conferring government retained no claim on the company's equity or if the equity infusions were made by the Government under unusual investment circumstances, such as high ownership by the Government), there was no basis for presuming that this was always the case. In fact, in the event of a

[71] "Canada - Administration of the Foreign Investment Review Act", adopted on 7 February 1984, BISD 30S/140, paragraph 5.20; "Japan - Restrictions on imports of certain agricultural products", adopted on 22 March 1988, BISD 35S/163, paragraph 5.1.3.7; "European Economic Community -Restrictions on imports of dessert apples", adopted on 22 June 1989, BISD 36S/93, paragraph 12.3; and "Canada - Import restrictions on ice cream and yoghurt", adopted on 5 December 1989, BISD 36S/68, paragraph 59.

rebuttable presumption, this would represent a lack of consideration of the economic and financial circumstances surrounding government equity infusions. An irrebuttable presumption that equity infusions were identical to grants represented an approach and methodology that did not examine the underlying facts. The DOC's determination, without any justification, to equate mechanically equity infusions and grants demonstrated an explicit decision to ignore facts on the record. The presumption that the competitive benefit associated with equity infusions and grants was equivalent, overstated the value of the benefit to the companies subject to investigation, and violated Article 4:2.

334. Japan then argued that for reasonably calculating subsidy rates, signatories must recognize the realities of a changing trade environment in which companies' productive activities were no longer based exclusively in one country. The operational presence of companies in a number of countries was increasingly prevalent, and signatories must therefore ensure that their countervailing duty investigation accounted for this reasonably and properly. To do otherwise would violate Article 4. In this context Japan argued that in the French case, the allocation by the DOC of the benefit only over the domestic production of the company located in France was a presumption. Moreover, it was an incorrect presumption. Capital infusions, including subsidies, could and frequently did affect a company's world-wide operations. Due to the fungibility of capital, an infusion received in a company's home country (such as a grant or a working capital loan) may easily be transferred to the company's foreign operations. Thus, it was unreasonable to presume that a subsidy benefit did not convey beyond a company's domestic production. Any presumption made by the United States under its trade laws, including its countervailing duty law, should be consistent with economic rationale. The incorrect presumption made by the United States reflected a broader tendency to place the burden of proof on the responding company, and then claiming that the burden had not been met. This approach, which was not based on an economic rationale, often led to the imposition of excessive countervailing duties in contravention of Article 4:2.

335. Japan recalled that in calculating the allocation of benefits of a grant from the government, the United States had used a "benefit stream formula". Japan argued that the use of this formula in this and other cases overstated any conceivable benefit to the companies subject to investigation. Japan's primary concerns with the formula related to the allocation period used by the Untied States in the formula. Japan was of the opinion that the United States government's identification of the useful life was unreasonable. In the underlying investigations, the United States did not consider the allocation periods in the country subject to investigation. This directly violated the Guidelines, which advised investigating authorities to use allocation period that were based on the experience of the firm being investigated (e.g., paragraph 5.1 of the Guidelines). Also, the allocation period should be based on the period in the country in question since the very objective was to measure the value of the benefit in the country in question. It was precisely the benefit's value in the country in question that must be used to calculate the ad valorem subsidy associated with the company's exports. The value of the benefit to the company operating in the United States, for example, was irrelevant. Yet this was precisely the standard used by the United States in the underlying proceedings by relying on outdated tax depreciation schedules used by the United States tax authorities. Japan argued that as in the case of anti-dumping proceedings, the United States should use the depreciation schedules in the country subject to investigation as the appropriate allocation period.

V. FINDINGS

1. Introduction

336. The dispute before the Panel arose from a complaint by the EC regarding the imposition by the United States of definitive countervailing duties on imports of certain hot-rolled lead and bismuth carbon steel products from France, Germany and the United Kingdom. These duties were imposed in March

1993[72], following final affirmative countervailing duty determinations made by the United States Department of Commerce (hereinafter: "DOC") in January 1993 and final affirmative determinations of material injury made in March 1993 by the United States International Trade Commission.

337. In the proceedings before this Panel, the EC contested the imposition of these countervailing duties on grounds relating exclusively to the final affirmative countervailing duty determinations of the DOC.[73] The final affirmative injury determinations of the United States International Trade Commission were not at issue in these proceedings.

338. The EC requested the Panel to find that the imposition of these countervailing duties by the United States was inconsistent with Articles 1 and 4:2 of the Agreement by reason of the following aspects of the final affirmative countervailing duty determinations of the DOC:

(i) the finding of the DOC in the investigation of imports from Germany that debt forgiveness by private banks constituted a subsidy;

(ii) the finding of the DOC in the investigation of imports from the United Kingdom that with the sale of assets from a previously subsidized firm to another firm a "pass through" of subsidies occurred;

(iii) the findings of the DOC in the investigations of imports from France and the United Kingdom that infusions of equity capital in certain firms by the Governments of France and the United Kingdom were subsidies, and the methodology applied by the DOC in calculating the amount of these subsidies;

(iv) the finding of the DOC in the investigation of imports from France that loans provided by the French Government to certain firms were subsidies, and the discount rate applied by the DOC in this investigation for the purpose of calculating the amount of subsidies arising from various programmes;

(v) the allocation by the DOC of subsidies solely over domestic production in the investigation of imports from France;

(vi) the allocation by the DOC of subsidies over a period of fifteen years in all three investigations; and

(vii) the application by the DOC in all three investigations of a "declining balance" methodology for the purpose of allocating grants and other subsidies over time.

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[72] Countervailing Duty Order and Amendment of Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from France, 58 FR 15326 (22 March 1993); Countervailing Duty Order: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany, 58 FR 15325 (22 March 1993); Countervailing Duty Order: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 58 FR 15327 (22 March 1993)

[73] Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France, 58 FR 6221 (27 January 1993); Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany, 58 FR 6233 (27 January 1993); Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 58 FR 6237 (27 January 1993)

339. The EC requested the Panel to recommend that the United States modify its regulations and practices so as to bring them into conformity with the Agreement.

340. The United States requested the Panel to find that in respect of the above-mentioned issues the final affirmative countervailing duty determinations of the DOC in the investigations of imports of certain hot-rolled lead and bismuth carbon steel products were in full conformity with the obligations of the United States under the Agreement.

341. With regard to the finding of the DOC in the investigation of imports from the United Kingdom of a "pass through" of subsidies, the Panel noted that the United States had informed it of a change in position of the DOC on this matter subsequent to the issuance of the original determination in January 1993. Following a remand order from the United States Court of International Trade, the DOC had issued a revised determination reflecting the DOC's current position on this issue. While the United States suggested that the Panel could consider this revised determination, it also presented arguments in support of the original determination on this issue.[74]

342. The Panel noted that the EC in introducing its complaint referred only to Articles 1 and 4:2 of the Agreement as the legal basis of its claims, but that in presenting its detailed arguments, the EC sometimes also invoked other provisions, in particular Article 2:15.[75]

2. General

343. The Panel noted the divergent views of the parties on several questions of a more general legal nature regarding the scope and interpretation of the provisions invoked by the EC and the appropriate standard of review to be applied by the Panel in the examination of the issues in dispute.[76]

Article 4:2 as legal basis of the claims presented by the EC

344. The Panel noted that the parties disagreed on the extent to which the provisions invoked by the EC were relevant to the specific issues raised by the EC in support of its claims. This disagreement related in particular to the invocation by the EC of Article 4:2.

345. The EC argued that the major issues in dispute in this case involved the question of *the determination of the existence of a subsidy* and as such had to be reviewed in light of the requirements of Articles 1 and 4:2. In support of its view that these provisions contained obligations of signatories regarding the determination of the existence of a subsidy, the EC advanced the following arguments. Firstly, Article 4:2 required that there be a determination of the existence of a subsidy as a prerequisite to the imposition of a countervailing duty. This requirement was reinforced by Article 1. Secondly, a determination that a subsidy may be countervailed had to be based on some competitive benefit accruing from the subsidy to the company whose products were countervailed. Thirdly, interpreted in accordance with public international law rules on treaty interpretation, as codified in the Vienna Convention on the Law of Treaties, the term "subsidy" required that there be a financial contribution by a government. Consequently, a determination of the existence of a subsidy in accordance with Article 4:2 required that a financial contribution by a government be shown to exist. Fourthly, the report of the panel in the dispute between Canada and the United States on countervailing duties applied by the United States on imports of

[74]See *infra,* section 4

[75]See for example *supra,* paragraphs 79 and 219.

[76]See *supra,* paragraphs 29-108

pork from Canada[77] indicated that a determination of the existence of a subsidy in accordance with Article 4:2 required a consideration of all relevant facts in accordance with the normal tenets of logic and in conformity with economic reality. Closely related to this requirement for consideration of all relevant facts was the requirement of proper reasoning as contained in Article 2:15. Finally, since a signatory imposing countervailing duties had the burden of proof of the existence of a subsidy and was required to make a determination that a subsidy existed on the basis of an examination of all relevant facts, the use of presumptions as the basis for a determination of the existence of a subsidy was precluded under the Agreement.

346. The EC further argued that, although the Agreement did not set forth precise criteria with respect to the *calculation of the amount of a subsidy*, Article 4:2 was relevant to this issue in two ways. Firstly, Article 4:2 was violated where a countervailing duty was imposed and no subsidy could be demonstrated to exist on the basis of a consideration of all relevant facts. Secondly, Article 4:2 was violated where a flaw in the discharge of the burden of proof or of the required consideration of all relevant facts could be shown to have led to, or be capable of leading to, an overstatement of the subsidy because in such a situation a countervailing duty was levied in excess of the amount of the subsidy concerned, which on the basis of all relevant facts could not be demonstrated to exist at the indicated level.[78]

347. The United States considered that the EC's characterization of the issues in dispute between the parties as involving the determination of the existence of a subsidy rested on a highly strained interpretation of a number of these issues, but that in any event, even if these issues were regarded as questions relating to the determination of the existence of a subsidy, the limited guidance provided by the Agreement on what constituted a countervailable subsidy did not preclude any of the findings made by the DOC in the cases before the Panel. The United States submitted that Article 4:2 addressed neither the issue of the determination of the existence of a subsidy nor the issue of the calculation of the amount of a subsidy and therefore provided little basis for the claims presented by the EC to the Panel. Article 4:2 only concerned the levying of a countervailing duty once the amount of a subsidy had been determined; the limited purpose of this provision was to link the amount of duties levied to the amount of the subsidy found to exist. The footnote to Article 4:2 made it clear that this provision did not contain rules on the calculation of the amount of a subsidy. Article 1 referred to ensuring conformity with other provisions of the Agreement and the General Agreement and as such was not operative in the absence of such other provisions. The United States rejected the argument of the EC that an interpretation of the term "subsidy" in accordance with public international law rules on treaty interpretation indicated that a financial contribution by a government was a necessary condition for the existence of a subsidy. With respect to the argument of the EC that a determination of the existence of a subsidy must be based on a consideration of all relevant facts, the United States argued that the statements in the Pork panel report on the requirement of a consideration of all relevant facts addressed a factual situation completely different from the cases before the Panel. While this notion of consideration of all relevant facts in itself was not objectionable, the EC had not been able to show in the present dispute that the DOC had failed to consider any probative record evidence. The United States also considered in this regard that the EC improperly relied on this notion of a consideration of all relevant facts to raise issues which in reality involved differences over the interpretation of the Agreement, differences on economic theory or disagreement as to the weight to be given to the evidence in the record. The United States further argued that the reference in the Pork panel report to the requirement to consider all relevant facts did not rule out use of all presumptions, but that in any event, in the cases before this Panel the DOC had not applied any presumptions that determined the outcome of any issue.

[77]United States-Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada, Report by the Panel adopted on 11 July 1991, BISD 38S/30 (hereinafter "Pork" panel report).

[78]See *supra*, paragraph 70.

348. The Panel noted that the EC claimed that in the final affirmative countervailing duty determinations at issue in this dispute the DOC had acted inconsistently with the obligations of the United States under the Agreement, particularly by reason of errors committed by the DOC in determining the existence of subsidies. The invocation of Article 4:2 by the EC as support of all its claims raised the question of whether, assuming that the issues before the Panel were properly characterized as relating to the determination of the existence of subsidies[79], Article 4:2 could be the basis for a claim that a signatory had acted inconsistently with the Agreement by committing errors in the determination of the existence of a subsidy.

349. The Panel noted that Article 4:2 provides:

"No countervailing duty shall be levied (footnote omitted) on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product (footnote omitted)."

The second footnote to this provision states that: "An understanding among signatories should be developed setting out the criteria for the calculation of the amount of the subsidy." The Panel noted that such understanding had not been developed by the signatories of the Agreement.

350. The Panel considered that, interpreted in accordance with the ordinary meaning of the terms used in this provision and having regard to its context, i.e. its inclusion in an Article addressing the "Imposition of Countervailing Duties", Article 4:2 would not seem to specifically address the question of the determination of the existence of a subsidy. Rather, it would seem that this provision dealt only with the question of the maximum amount of a countervailing duty which could be imposed after a subsidy has been found to exist and the amount of that subsidy calculated. Under this narrow interpretation, Article 4:2 was violated only if the amount of a countervailing duty imposed by a signatory exceeded the amount of the subsidy *as determined by that signatory.*

351. The Panel noted that the EC's reliance on Article 4:2 was based on a broader interpretation of the meaning of this provision. The EC interpreted Article 4:2 as prohibiting the levying of a countervailing duty in excess of the amount of the subsidy *properly determined to exist.* In arguing what constituted a proper determination of the existence of a subsidy under Article 4:2, the EC advanced substantive standards, such as the concept of a financial contribution by a government as a necessary condition for the existence of a subsidy, and more evidentiary and procedural standards, such as the notion of a consideration of all relevant facts and the requirement of proper reasoning to support a determination of the existence of a subsidy.

352. The Panel did not contest that, as argued by the EC, the words "the subsidy found to exist" in Article 4:2 indicated that this provision was "necessarily based on the premise that no countervailing duty may be levied unless a subsidy was shown to exist"[80], but in the Panel's view it did not logically follow from the fact that Article 4:2 *presupposes* a determination of the existence of a subsidy that Article 4:2 also governs the determination of the existence of a subsidy and contains specific requirements regarding substantive and evidentiary criteria for making such a determination.

353. The Panel noted in this regard that in some cases the arguments presented in the dispute before the Panel by the EC with reference, *inter alia,* to Article 4:2 involved the interpretation of specific terms of the Agreement, such as whether the term "subsidy" could be applied to the conduct of private parties. In other cases, these arguments involved an alleged failure of the DOC to consider certain facts and/or a

[79]The Panel noted the disagreement between the parties on this question.

[80]See *supra,* paragraph 32.

failure of the DOC to offer proper reasoning in support of its findings. To consider that on all these issues the relevant obligations arose from Article 4:2 was in the Panel's view inconsistent with the wording and specific function of Article 4:2 in the Agreement and with the function of other provisions in the Agreement.

354. With regard to the particular claims of the EC about the alleged failure of the DOC to consider certain facts or to provide adequate reasoning of how certain facts had been weighed[81], the Panel noted that several provisions of the Agreement, in particular those in Article 2, embodied the fundamental requirement that a countervailing duty be imposed only pursuant to determinations of the existence of a subsidy and of material injury caused by subsidized imports made on the basis of factual evidence obtained through investigations initiated and conducted in accordance with the requirements of the Agreement. The obligation of investigating authorities to properly examine relevant facts and to provide proper reasoning to substantiate their findings resulted from this fundamental "duty to investigate" in Article 2, rather than from the expression "subsidy found to exist" in Article 4:2. The Panel noted that it was an essential principle of treaty interpretation that each provision of a treaty be construed so as to give it effect in light of its particular function within the context of the treaty as a whole. Thus, if in a given case a signatory did not provide adequate reasoning in support of a factual finding, this entailed a violation of its obligations under the Agreement. However, in the Panel's view, it would be inconsistent with an interpretation of the Agreement in which each of its provisions was given its distinct meaning to conclude that, by failing to provide adequate reasoning, a signatory *ipso facto* acted contrary to Article 4:2 by imposing a countervailing duty in excess of the amount of the subsidy found to exist.

355. The Panel noted the reference made by the EC to the Pork panel report in paragraph 5.1 of that panel report contained the panel's conclusion that:

"... the United States countervailing duties on fresh, chilled and frozen pork from Canada are being levied inconsistently with Article VI:3 of the General Agreement *because the United States' determination that the production of pork had benefitted from subsidies was not made in accordance with the requirements of that provision.*"[82]

This conclusion was necessarily based on the proposition that Article VI:3 of the General Agreement was an adequate basis for the panel to examine the legal and factual sufficiency of "the United States' determination that the production of pork had benefitted from subsidies". Since the wording of Article 4:2 was almost identical to that of Article VI:3 of the General Agreement, it could be argued on the basis of this statement in this panel report that Article 4:2 was relevant to an examination of alleged errors committed by a signatory in making a determination of the existence of a subsidy. However, the Panel also noted the following statement in paragraph 4.8 of this panel report:

"The Panel noted in this respect that the words in Article VI:3 'to determine' and 'estimated' *as well as the practices of the contracting parties under that provision, as reflected in Part I of the Subsidies Code,* indicate that the decision as to the existence of a subsidy must result from an examination of all relevant facts."[83]

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[81] For example, the claims of the EC regarding the findings of the DOC that subsidies arose from the provision of equity capital by the Governments of France and the United Kingdom and from the provision of loans by the Government of France.

[82] BISD 38S/30, at 47 (Italics added)

[83] BISD 38S/30, at 45 (Italics added)

In the Panel's view, the above statement indicated that the Pork panel had not derived the "all relevant facts" standard solely from the words "determine" and "estimated" in Article VI:3 of the General Agreement.

356. The Panel realized that it could be argued that, even if Article 4:2 did not directly govern the criteria for the determination of the existence of a subsidy, where a signatory erred in making a determination of the existence of a subsidy, e.g. by failing to substantiate such determination with factual evidence, this necessarily resulted in a violation of Article 4:2, on the grounds that this Article "presupposes" a valid finding of the existence of a subsidy.

357. However, the Panel considered that under the logic of this argument any error committed by a signatory in determining the existence of a subsidy would *ipso facto* constitute a violation of any provision in the Agreement which contained expressions similar to the expression "the subsidy found to exist" in Article 4:2; in each case, it could be argued that the provision in question necessarily presupposed that the existence of a subsidy had been properly determined. For example, under this approach an error in the determination of the existence of a subsidy could be said to be an *ipso facto* violation not only of Article 4:2, but also of Article 4:3, in so far as the reference in this latter provision to "all sources *found to be subsidized*" could also be argued to presuppose a valid determination of the existence of a subsidy. Ultimately, this line of reasoning resulted in an interpretation of isolated phrases in a manner entirely divorced from the meaning within the Agreement as a whole of the particular provisions within which those phrases appeared.

358. In light of all the above considerations, the Panel was of the view that in reviewing the individual issues raised by the EC under Article 4:2, it should be careful to interpret this provision in accordance with the natural meaning of its terms and its specific function in the Agreement and avoid any overstretching of the meaning of this provision. The Panel noted that the EC raised a range of issues under Article 4:2. In the Panel's view, on some of these issues Article 4:2 might be more pertinent than on other issues. The Panel therefore decided that it should determine in the context of each particular issue whether or not Article 4:2 was relevant.

Financial contribution by a government as a necessary condition for the existence of a subsidy

359. The Panel then noted the conflicting views of the parties on the question of whether or not under the Agreement a financial contribution by a government is a necessary condition for the existence of a subsidy.

360. The Panel considered that its task was to make findings on the specific grounds on the basis of which the EC alleged that the imposition of countervailing duties by the United States was inconsistent with the Agreement. The Panel noted that in these proceedings the EC had stated its general view that a proper interpretation of the Agreement indicated that a financial contribution by a government was a necessary condition of the existence of a subsidy. The Panel also noted, however, that on many of the specific issues raised by the EC in support of its claims the EC presented arguments which did not involve the question of whether a financial contribution by a government is a necessary condition for the existence of a subsidy. The Panel considered that it was not appropriate for the Panel to pronounce itself on disputed questions of interpretation of the Agreement if such questions were not essential to the resolution of the specific issues raised by the EC's complaint. The Panel therefore decided to address the question of whether under the Agreement a financial contribution by a government is a necessary condition for the existence of a subsidy if, and to the extent to which, it would find that this question was essential to enable the Panel to make findings on a particular issue.

Consideration of All Relevant Facts

361. The Panel then noted the views of the parties on the argument of the EC that a proper determination of the existence of a subsidy under Article 4:2 required that all relevant facts be taken into account.

362. The Panel considered that the proposition that a proper determination of the existence of a subsidy required that all relevant facts be considered was indisputable. The Panel recalled in this regard its views stated above regarding the implications of the duty to investigate in Article 2 as well as its reservations on the argument of the EC that this requirement followed specifically from Article 4:2.[84]

363. Given the extent to which the EC relied on this requirement to consider all relevant facts in support of its claims, the Panel wished to note several considerations by which it was guided in its review of the issues before it in light of this requirement of a consideration of all relevant facts.

364. Firstly, the Panel considered that what mattered in the context of a panel's review under Article 18 was whether facts which were legally relevant, i.e. relevant to a proper determination in accordance with the requirements of the Agreement, had been considered. Whether a particular fact was relevant in this sense might necessitate an interpretation of particular provisions of the Agreement. In this regard, the Panel was of the view that a number of issues raised by the EC on the basis of the "all relevant facts" standard might raise questions of interpretation of the Agreement. Secondly, the Panel found it important to distinguish between the question of the consideration of all relevant facts and the question of the weight to be accorded to certain facts as compared to other facts. Where, in a particular case, there was a disagreement between the parties as to whether certain facts should have outweighed other facts, this did not by itself constitute sufficient reason to find that not all relevant facts had been considered. Thirdly, it appeared to the Panel that on some of the issues raised by the EC the question was not whether the DOC had in fact "considered" or "examined" certain facts, but whether the DOC had provided an adequate explanation of how its findings took into account such facts. Finally, the Panel was of the view that a review of whether in a given case all relevant facts had been considered had to take account of the provisions of Article 2:9 regarding situations in which authorities seek, but are not provided with certain factual information.

Use of presumptions

365. The Panel then noted the disagreement between the parties as to whether or not the Agreement permits signatories to rely on presumptions when conducting countervailing duty investigations.

366. In the Panel's view, the question of the alleged use by the DOC of presumptions arose only in connection with some of the issues raised in the claims of the EC. Moreover, there was disagreement between the parties on whether presumptions had in fact determined the outcome of the findings made by the DOC on those issues. Under these circumstances, the Panel considered that it should not pronounce itself on this question in general terms, but that it should first determine whether or not the DOC's findings on those issues were indeed based on presumptions and, if so, determine in the context of those particular issues, whether the use of presumptions rendered the findings of the DOC inconsistent with the Agreement.

Standard of review

367. The Panel then noted the positions taken by the parties on what was referred to as the "standard of review" to be applied by the Panel in its examination of the issues before it. The parties differed in particular on whether, in matters of interpretation, the Panel should be guided exclusively by customary

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[84] See *supra*, paragraph 354.

rules of international law on treaty interpretation or should also be guided by a standard of "reasonableness", especially in respect of matters not specifically addressed in the Agreement.

368. The Panel considered that under its terms of reference its task was to determine whether or not in respect of the issues raised by the EC the United States had acted inconsistently with the Agreement by reason of the final affirmative countervailing duty determinations made by the DOC. In so far as this required the Panel to interpret provisions of the Agreement, the Panel held that, as an international agreement within the meaning of Article 2 of the Vienna Convention on the Law of Treaties, the Agreement had to be strictly interpreted in conformity with the customary rules on treaty interpretation as laid down in Articles 31 and 32 of that Convention.

369. The Panel noted, however, that the rules of treaty interpretation in the Vienna Convention did not necessarily give sufficient guidance to a panel on issues involving the legal appreciation of facts in lights of evidentiary requirements of the Agreement. For example, while these rules were relevant to an interpretation of the meaning of the concept of "positive evidence" in Article 6 of the Agreement, these rules alone did not necessarily enable a panel to determine whether or not in a given case certain facts qualified as "positive evidence". The Panel noted that it was mainly in this limited context of a review of factual assessments in light of evidentiary standards that several previous panel reports had used terms like "reasonable". In the Panel's view, the use of such terms in these reports was a consequence of the fact that a review by a panel of factual determinations for consistency with the Agreement on the one hand had to provide for a meaningful review of the factual basis for such determinations, while on the other hand avoiding a *de novo* examination by panels. That these terms were used in these panel reports in the review of factual assessments could not be seen as an endorsement of what the EC, referring to certain case law in the United States, termed a "deference model"[85] with regard to matters of interpretation of the Agreement.

370. The Panel further noted the arguments of the parties as to whether certain concepts advanced by the EC, such as "manifest error of fact", "manifest error in the appreciation of facts" and "arbitrariness", were appropriate criteria to be applied by the Panel in matters involving assessments of facts by investigating authorities.

371. As stated above, the Panel considered that a review by a panel of the legality of a factual assessment by investigating authorities had to provide for a meaningful examination of whether a particular determination was supported by fact, but could not simply be a *de novo* examination of the facts by the panel. The Panel was not persuaded that the concepts suggested by the EC performed this function better than the concepts used in certain previous panel reports. In any event, the Panel was of the view that the criteria for a review by a panel of factual assessments by domestic investigating authorities of signatories against the requirements of the Agreement could not be based on a simple transposition of standards applied in domestic administrative law of signatories.

3. Debt forgiveness by private banks as a subsidy

372. The Panel turned its consideration to the request of the EC that the Panel find that the United States acted inconsistently with its obligations under Articles 1 and 4:2 of the Agreement when in the investigation of imports of certain hot rolled lead and bismuth carbon steel products from Germany the DOC found that a subsidy existed by reason of debt forgiveness by private banks to a German steel producer.

[85] See supra, paragraph 95.

373. The Panel noted that in the final determination in this investigation[86] the DOC first discussed financial assistance measures taken by the Governments of Germany and Saarland in the years 1971 through 1989 in connection with various restructuring plans for a German steel producer, Saarstahl. The DOC determined that debt forgiveness by the Governments of Germany and Saarland in 1989, on the occasion of a merger between Saarstahl and Dilinger, a French-owned steel producer, was a subsidy.[87]

374. The Panel noted that the DOC then addressed the question of whether a subsidy had been provided to Saarstahl as a result of the participation of commercial banks in the restructuring plans for Saarstahl during the period 1978-1989:

"Commercial banks also participated in the restructuring of Saarstahl during the period from 1978 through the final restructuring of the company in 1989. During part of this time period they provided both short- and long term loans to Saarstahl which were not guaranteed by the Governments of Germany or Saarland. In the years 1983 through 1985, the banks forgave Saarstahl DM 106.8 million in interest on these loans. This forgiveness was in response to the company's poor financial condition and was not made at the request of, or related to any assistance provided by, the Governments of Germany and Saarland.

Toward the end of 1985, the Government of Saarland presented a long-term restructuring plan for Saarstahl to Saarstahl's creditors and requested that they forgive an additional amount of DM 350 million in loans. Based on this request, the banks agreed to forgive DM 217.33 million of debt owed to them by Saarstahl, if the Governments of Germany and Saarland would forgive all debt owed to them by Saarstahl and if the Government of Saarland would assure the future liquidity of Saarstahl. With the signing of the EV, the governments forgave Saarstahl's debt owed to them, as discussed above, and the commercial banks forgave a portion their (sic) unguaranteed loans to Saarstahl.

The talks on the forgiveness of Saarstahl's debt were based on the common notion that all of the participants, including the private and public creditors, would have to contribute to the restructuring of Saarstahl if this restructuring was to be successful. The Governments of Germany and Saarland made their forgiveness dependent on private creditors also forgiving a portion of their claims against Saarstahl. The private creditors laid down the same condition with regard to the claims of the Governments of Germany and Saarland.

We determine the forgiveness of interest payments in the years 1983 through 1985 did not confer a countervailable subsidy on Saarstahl because the banks were acting independently, without any direction or participation by the Governments of Germany and Saarland. *However, we determine that the subsequent forgiveness of principal was countervailable because it was required by the governments as part of a government-led debt reduction package for Saarstahl and because the two governments guaranteed the future liquidity of Saarstahl, thereby implicitly assuring the private banks that the remaining portion of Saarstahl's outstanding loans would be repaid.*" [88]

[86] Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany, 58 FR 6233, 27 January 1993.

[87] 58 FR 6233, 27 January 1993, at 6233-6234.

[88] 58 FR 6233, 27 January 1993, at 6234-6235 (Italics added).

375. The Panel noted that the notice of the DOC's final affirmative determination contained comments by interested parties on the issue of the treatment of debt forgiveness by the private banks and the responses of the DOC to these comments:

"Respondent maintains that the private banks' forgiveness of Saarstahl's debts was a rational commercial decision because, if Saarstahl had filed for bankruptcy, the banks would have lost more money than the forgiven portion of the debt. Respondent further asserts that private banks were not, in any way, coerced by the federal or Saarland governments to forgiven the debt.

Petitioners, on the other hand, argue that private creditors released Saarstahl from its debts as part of a package deal in which the governments agreed that they would continue to assume payments on the guaranteed debt. Without government intervention, the private banks' forgiveness would not have occurred. Therefore, petitioners maintain that the private banks forgiveness in (sic) countervailable, especially since Saarstahl failed to produce documents during verification that, Saarstahl claimed, would have proved otherwise.

DOC Position

The private debt forgiveness was part of a debt reduction package negotiated by the Governments of Germany and Saarland. The governments made the initial approach to private creditors requesting that they forgive Saarstahl's debt. In exchange for the private debt forgiveness, the governments agreed to forgive all of the debt due to them by the company. In addition, the Government of Saarland assured the private banks of Saarstahl's liquidity. Given the governments' extensive role in bringing about the private banks' debt forgiveness and the absence of any documentation to support respondent's claim that the banks' actions were commercially sound, we find the forgiveness to be countervailable.

We also note that we requested additional documents relating to the debt forgiveness which were referred to in Saarstahl's response. These documents were not provided to the Department by the company."[89]

376. The legal question before the Panel was whether, as claimed by the EC, the DOC acted inconsistently with the Agreement by treating the debt forgiveness by private banks in Germany as a subsidy.

377. The Panel considered that the following were the main arguments advanced by the parties on this question.

378. The EC claimed that, in finding that the debt forgiveness by the private banks resulted in a subsidy, the DOC had acted inconsistently with Articles 1 and 4:2 of the Agreement because there was no government involvement in this debt forgiveness such that it could properly be treated as a subsidy under the Agreement. The EC argued on the basis of several textual elements in the Agreement that the term "subsidy" referred to measures of governments and that actions of private parties as such were not subsidies. An action of a private party could result in a subsidy to a third party only if public authorities, directly or indirectly, channelled public funds through a private party to a third party, or if the public authorities compelled or mandated a private party to provide funds to a third party. The EC derived these two criteria from the general proposition that under the Agreement the existence of a financial contribution by a government was a necessary condition of the existence of a subsidy, and from item (c) in

[89] 58 FR 6233, 27 January 1993, at 6235-6236 (Italics added).

the Illustrative List of Export Subsidies. In this latter regard, the EC argued that item (c) stood for the proposition that where, in exceptional cases, a subsidy was provided by a government acting through a private party without there being a financial contribution by the government, the government must mandate the action of that private party. The EC also relied on public international law rules on state responsibility. In the EC's view, by treating the debt forgiveness by the German banks as a subsidy, the DOC had attributed the action of the private banks to the Governments of Germany and Saarland in a manner which was inconsistent with the closely circumscribed conditions under which under public international law actions of private parties could attract state responsibility.[90]

379. The EC submitted that the statement of the DOC that the debt forgiveness by the private banks was *required* by the Governments of Germany and Saarland as part of the debt reduction package[91] did not provide a valid basis for qualifying the debt forgiveness by the private banks as a subsidy. Firstly, the Governments did not, directly or indirectly, provide a financial contribution to the debt forgiveness by the banks. The Governments did not channel funds through the banks to Saarstahl, nor did they provide compensation to the banks for their debt forgiveness to Saarstahl. Secondly, the Governments did not exercise any control over the private banks' activities, nor did they direct or impose a legal obligation upon the banks to provide funds to Saarstahl. Thirdly, even if one accepted the notion of "requirement" as used by the United States, it would still have been the task of the DOC to establish that the banks would not have acted absent the intervention by the Governments. The DOC's reliance on a lack of evidence to the contrary amounted to the use of an unjustifiable presumption. Finally, nothing in the behaviour of the private banks indicated that their assessment of the financial situation of Saarstahl and their motivation in forgiving a portion of the loans was any different from those prevailing at the time of the earlier forgiveness of interest payments on loans. The banks and the Governments acted in parallel to preserve their own, distinct interests. Conscious parallelism between the actions of the banks and the Governments as major creditors, even if the Governments initiated the debt reduction package, was not a sufficient basis to treat the debt forgiveness by the private banks as a subsidy. Thus, in the EC's view, in treating the debt forgiveness by the commercial banks as a subsidy, the DOC incorrectly treated parallel, concerted actions by the Governments and private parties, each acting in their own interests, as involving the indirect bestowal of a subsidy by the Governments.

380. The EC further submitted that the statement of the DOC that the Governments of Germany and Saarland *assured the future liquidity* of Saarstahl[92] was insufficient as a basis for treating the debt forgiveness by the private banks as a countervailable subsidy. Firstly, the assurance of Saarstahl's future liquidity was not enforceable and quantifiable, did not involve a financial contribution by the Governments and did not amount to more than a statement of the common interest which the Governments shared with the banks in ensuring the future commercial viability of Saarstahl. The liquidity assurance did not amount to a loan guarantee and did not represent compensation by the Governments to the banks for the debt forgiveness by the private banks. To characterize this assurance as the equivalent of a loan guarantee (which in any event was an *ex post facto* argument of the United States) was a manifest error of fact. Secondly, if, as argued by the United States, the assurance of Saarstahl's future liquidity by the Governments made the debt reduction package commercially viable for the banks, the United States should have countervailed this assurance of liquidity, rather than the debt forgiveness by the private banks. However, the liquidity assurance was unquantifiable, and involved neither a cost to, nor a contribution by, the Governments, even on a contingent basis.

[90]The EC referred in this respect to the work of the International Law Commission on the codification of the law on state responsibility.

[91]See *supra*, paragraph 374.

[92]Id.

381. The United States submitted that it was permissible under the Agreement to interpret the concept of indirect subsidization as including a situation where a government acted through a private party. Such indirect subsidization occurred when a government action that was more than incidental caused a private party to act in a manner which provided a benefit to a third party. Indirect subsidization could occur regardless of whether the government action was in the form of a direct or indirect financial contribution to the private party and regardless of whether the government action involved legal coercion of the private party to act in a particular manner. Whether or not the private party whose action resulted in a benefit to a third party was motivated by its own commercial interests was irrelevant if it was the government action which made the action of the private party commercially viable. In the case at hand the direct causal relationship between the action of the Governments of Germany and Saarland and the action of the private banks which made it permissible to treat the debt forgiveness by the private banks as a countervailable subsidy resulted from the fact that the Governments initiated the debt reduction plan, approached and negotiated with the banks, and provided the *quid pro quo* in the form of the government debt forgiveness and an assurance of Saarstahl's future liquidity.

382. In support of this position, the United States submitted the following arguments. Firstly, the Agreement offered little guidance on what constituted a countervailable subsidy and left investigating authorities free to apply any reasonable test for determining whether a subsidy existed. Secondly, the Agreement did not require a financial contribution by a government as a necessary condition for the existence of a subsidy. Thirdly, footnote 4 <u>ad</u> Article 1 defined a countervailing duty as a special duty levied for the purpose of offsetting any bounty or subsidy bestowed *directly or indirectly* on the manufacture, production, or export of any product. Nothing in the General Agreement or in the Agreement suggested that a government could not indirectly bestow a countervailable benefit through private parties. Item (c) in the Illustrative List of Export Subsidies supported the view that subsidies could be provided indirectly through government action involving private parties. This item was significant only in that it supported the general proposition that private parties may be involved in the provision of a subsidy and not a specific proposition that such a private action results in a subsidy only if a government mandates that action. Finally, the United States considered that the international law criteria regarding the circumstances under which conduct of private parties could be attributed to a state were not relevant to the issue of whether or not it was lawful under the Agreement to apply a countervailing duty in relation to a benefit bestowed indirectly by a government acting through a third party. In any event, in this case there was government action that served as the basis for the finding of a subsidy. The DOC did not hold the Governments of Germany and Saarland responsible for the actions of the banks; rather, it held these Governments responsible for their own actions.

383. With respect to the EC's criticism of the reference in the final affirmative determination to the debt forgiveness by private banks being *required* by the Governments of Germany and Saarland, the United States made the following points. Firstly, the EC's argument that there was no direct or indirect financial contribution by the Governments was without legal basis in the Agreement. Secondly, the EC's argument that there was no legal compulsion exercised by the Governments rested on a misinterpretation of the statements of the DOC. The DOC used the term "required" only to reflect the fact that the government debt forgiveness was conditional upon the debt forgiveness by the private banks. In addition, as a matter of law, the Agreement did not require that there be such legal compulsion in order for a subsidy to be provided indirectly as a result of a government acting through a private party. Thirdly, the evidence of record indicated that the actions of the Governments (forgiveness of debt and assurance of future liquidity) were a necessary condition for the debt forgiveness by the private banks. As such, the record supported the conclusion that the banks would not have acted absent government intervention. While respondents had the opportunity to provide documentary evidence to the contrary, no such evidence was provided. Any claim that the banks would have acted the same way in the absence of action by the Governments was not only unsupported by the record, but also amounted to a challenge to the weight the DOC chose to give the evidence of record and as such was not a basis for finding a violation of the Agreement.

384. With respect to the EC's criticism of the DOC's reliance on the *liquidity assurance* provided by the Governments of Germany and Saarland, the United States advanced the following counterarguments. Firstly, there was no support in the record for the EC's view that this assurance by the Governments of Saarstahl's future liquidity was nothing more than a statement of intention by the Governments of the common interest they shared with the private banks. Rather, the record supported the view that the liquidity assurance was the price to be paid by the Governments for the debt reduction by the private banks. Secondly, the assurance by the Governments of Saarstahl's liquidity was analogous to a loan guarantee. The fact that, with the guarantee provided by the Governments, the private banks might have perceived the debt forgiveness to have been in their own commercial interests did not detract from the fact that the action of the Governments was a necessary condition for the action of the banks. Thirdly, the key issue with respect to an evaluation of the significance of the liquidity assurance was not the legal nature of this assurance, but the fact that this assurance was perceived by the banks to be of such significant value that they conditioned their forgiveness of debt to Saarstahl on this commitment by the Governments. Fourthly, the statement in Saarstahl's response to the DOC questionnaire that in the case of bankruptcy the banks would have lost more money than the amount of debt forgiveness was not inconsistent with the DOC's finding that the Governments' assurance of liquidity was central for the debt forgiveness to occur. The banks conditioned their debt forgiveness on the Governments' guarantee of liquidity, which essentially eliminated the risk that bankruptcy would deprive the banks of repayment of their remaining loans.

385. As a starting point in its analysis of the EC's claim that the finding of the DOC that debt forgiveness by German private banks was a subsidy was contrary to Articles 1 and 4:2 of the Agreement, the Panel noted that the parties did not disagree that an action of a private party without any government involvement is not a subsidy under the Agreement. The parties also did not disagree that an action of a private party can result in a subsidy within the meaning of the Agreement by reason of government involvement in such action. The parties disagreed, however, on the conditions under which an action of a private party can be treated as a subsidy by reason of the interrelationship between actions of governments and the action of the private party.

386. The Panel recalled that, as explained in the Federal Register notice of the final determination of the DOC, the treatment by the DOC of the debt forgiveness by the private banks as a subsidy rested on considerations regarding the role played by the Governments of Germany and Saarland in procuring this debt forgiveness. In particular, the DOC relied on the following three considerations. Firstly, the Governments initiated the debt reduction package for Saarstahl and made this debt reduction package subject to the condition that the private banks would forgive a portion of the debts owed to them by Saarstahl. Secondly, in exchange of the debt forgiveness by the private banks, the Governments agreed to forgive debts owed to them by Saarstahl and to assure Saarstahl's future liquidity. Thirdly, there was no evidence that the actions of the banks in forgiving debts owed to them by Saarstahl were commercially sound.[93]

387. Accordingly, the question to be decided by the Panel was whether these three factors established a nexus between certain actions of the Governments of Germany and Saarland and the debt forgiveness by the private German banks such that it was permissible under the Agreement to treat this debt forgiveness by the private banks as a subsidy.

388. The Panel began its analysis by examining the provisions of the Agreement relevant to the question of whether, and if so under what conditions, an action by a private party can constitute a subsidy by reason of the relationship between this action and actions of public authorities.

[93] See *supra*, paragraphs 374-375.

389. The Panel considered in this connection the text of footnote 4 to Article 1 of the Agreement:

"The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of off-setting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in Article VI:3 of the General Agreement."

The Panel noted that this footnote does not expressly define the nature of the entities which grant bounties or subsidies. The Panel therefore examined whether other elements in the Agreement provided guidance on this question.

390. The Panel noted that the Preamble of the Agreement recognizes that "subsidies are *used by governments* to promote important objectives of national policy". The Panel also noted the text of footnote 22 ad Article 7:1:

"In this Agreement, the term 'subsidies' shall be deemed to include subsidies granted by any government or any public body within the territory of a signatory. However, it is recognized that for signatories with different federal systems of government, there are different divisions of powers. Such signatories accept nonetheless the international consequences that may arise under this Agreement as a result of the granting of subsidies within their territories."

In Article 8:1, signatories recognize that "subsidies are *used by governments* to promote important objectives of social and economic policy". Article 11:1 provides that:

"Signatories recognize that subsidies other than export subsidies are widely *used as important instruments for the promotion of social and economic policy objectives* and do not intend to restrict the *right of signatories to use such subsidies* to achieve these and other important policy objectives which they consider desirable." (Italics added)

Article 11:3 enumerates various examples of possible forms of subsidies other than certain export subsidies in terms which explicitly indicate that the measures in question are governmental measures. The Panel further noted the consistent reference in other provisions of the Agreement, such as Article 7:1, Article 9, Articles 10:1-3, and Articles 12:1-3, to subsidies "granted" or "maintained" by signatories. Finally, the Panel noted that Article 19:1 refers to "action against a subsidy of another signatory." The Panel therefore considered that, interpreted in light of the object and purpose of the Agreement and in the context of other textual elements in the Agreement, the term "bounty or subsidy" in footnote 4 to Article 1 was to be interpreted to refer to measures of governments or public authorities in the territories of signatories.

391. The Panel then noted that the United States invoked as support for its position that the debt forgiveness by the private banks was properly considered by the DOC to constitute a subsidy, *inter alia*, the reference in footnote 4 to Article 1 to "any bounty or subsidy bestowed directly *or indirectly* upon the manufacture, production or export of any merchandise". According to the United States, in the present case the debt forgiveness by the private banks was a subsidy provided "indirectly" to Saarstahl by the Governments of Germany and Saarland.

392. The Panel considered that, having regard to the ordinary meaning of the term "indirectly", there was no basis to hold that a subsidy could not be said to be provided "indirectly" upon the manufacture, production or export of a product where a government provided assistance to a producer of that product by acting through a third party. Therefore, the Panel considered irrelevant the fact that, as argued by the EC, the word "indirectly" was not specifically intended to address the issue of the provision of subsidies by governments acting through private parties. The Panel noted that the meaning of the term "directly or indirectly" in footnote 4 was not further explained in the Agreement and that there was no interpretative

practice of the signatories with regard to this issue. The Panel also found no relevant interpretative practice of the Contracting Parties to the General Agreement addressing the meaning of the term "directly or indirectly" in Article VI:3 of the General Agreement.

393. In light of the considerations in paragraphs 390 and 392, the Panel was of the view that under the Agreement a subsidy could be considered to be provided indirectly when a government provided assistance to the production, manufacture or export of a product by acting through a third party, on the condition that the relationship between the action of the private party and the government was such that the action of the private party could be qualified as a governmental measure.

394. For the purpose of determining, against the background of the considerations set forth in the preceding paragraphs, whether the debt forgiveness by the private banks could be considered to amount to a subsidy provided indirectly to Saarstahl by the Governments of Germany and Saarland, the Panel took into account the following factual elements.

395. Firstly, the evidence before the Panel indicated that the debt forgiveness by the Governments of Germany and Saarland and their assurance of Saarstahl's future liquidity had been the subject of discussions between the Governments and the private banks and that, in taking these actions, the Governments fulfilled conditions set by the banks for their contribution to the overall debt reduction for Saarstahl. In this regard, the Panel noted that in November 1985 the Governments addressed a letter to the banks requesting them to contribute to the restructuring of Saarstahl by agreeing to forgive a part of the debt owed to them by Saarstahl. In a letter dated 20 February 1986 the banks formulated several conditions of their forgiveness of debt to Saarstahl. One of these conditions was that:

"... the Bund and the Land forgive the loans to ASG with respect to the guarantees provided by the Bund and Land in such a manner that the guaranteed credits will not be charged for long term. In addition, it is expected that in the case of a so-called industrial solution, which would also be available to other companies, the Bund and the land would forever forgive repayment of conditioned investments, contributions and other conditionally-forgiven loans."

A second condition was that:

"the Land will secure the liquidity of ASG within the framework of the means allowed by the EC and secure its finishing operations."

The Panel then noted that in a letter of 4 April 1986 to the banks, the Government of Saarland stated *inter alia*:

"1. The Bund is prepared to forgive 100% of the guaranteed loan (unconditional assumption of the interest payments on the guaranteed loans at maturity; simultaneously relinquishing RVV rights for all past or future payments on capital), if a merger with Dillinger, as the Saarland State Government has formulated, becomes a legally binding reality.

"2. The same applies to the repayable investment payments, operating assistance, and the conditionally released loans. The Land will, as in the past, secure the liquidity of ASG and the subsequent production areas of ASG."

In light of this exchange of letters, the Panel considered that there was sufficient factual evidence indicating that, by fulfilling certain conditions formulated by the banks, the Governments of Germany and Saarland played a decisive role in bringing about the debt forgiveness by the private banks.

396. Secondly, the Panel noted that the evidence before the Panel indicated that the private German banks were driven by their independent assessment of their own commercial interests when they decided to participate in the debt reduction package envisaged by the Governments by forgiving a portion of the debts owed to them by Saarstahl. That the intervention by the Governments played a decisive role in the evaluation by the banks of whether it was in their commercial interest to forgive the debts owed to them by Saarstahl did not detract from the fact that the banks were capable of making an autonomous decision on whether or not to agree to the Governments' request to the banks to forgive a portion of Saarstahl's debt owed to the banks.

397. In sum, the evidence before the Panel indicated that there was coordination between the Governments of Germany and Saarland and the private banks regarding their respective contributions to the restructuring of Saarstahl and that, as a result of negotiations between the Governments and the banks, certain measures taken by the Governments (i.e. the forgiveness of debt owed by Saarstahl to the Governments and a commitment to assure Saarstahl's future liquidity) led to an additional benefit to Saarstahl in the form of debt forgiveness by the private banks. In agreeing to the Governments' request subject to certain conditions, the banks essentially acted in their commercial interest.

398. The Panel was thus presented with the question of whether the Agreement permits a signatory to treat debt forgiveness by private banks as a subsidy provided indirectly by a government acting through the private banks if, as a result of negotiations between a government and private banks initiated by the government, private banks agree to forgive debt owed to them by a firm, subject to the condition that the government provides financial assistance to the firm.

399. In the Panel's view, it might be possible under the Agreement to consider as *direct* subsidies the measures which were taken by the Governments of Germany and Saarland in the context of the overall debt reduction package (i.e. the forgiveness of debt owed to the Governments and the assurance of future liquidity of Saarstahl) and which provided the incentive for the private banks to participate in the debt reduction plan. The Panel noted that the DOC had in fact treated the forgiveness of debt by the Governments as a subsidy.[94] The Panel considered, however, that where a government took measures to assist a firm, which measures arguably constituted *direct* subsidies to a firm, the notion in footnote 4 ad Article 1 of a subsidy provided "indirectly" did not permit a signatory to treat as an indirect subsidy any action of a private party which resulted from the measures taken by the government and which provided an additional benefit to the firm. As noted above, the Panel considered that the Agreement recognized that a subsidy could be provided indirectly when a government acted through a private party as intermediary but that, as an indirect subsidy, the measure in question nevertheless had to be a governmental measure.

400. Without wishing to pronounce itself in general terms on the conditions under which the conduct of a private party could be attributed to a government, the Panel considered that in the present case the mere fact that government intervention played a key role in the assessment by the private banks that it was in their commercial interest to forgive a portion of Saarstahl's debt did not make this debt forgiveness attributable to the Governments of Germany and Saarland as an indirect subsidy. The Panel was of the view that the position taken by the DOC in this case ignored the distinction to be made between a situation in which a subsidy was provided indirectly by a government acting through a third party as intermediary in such a manner that the action of the intermediary could be qualified as a governmental measure, and a situation in which, as a result of negotiations between a government and third parties, a subsidy provided *directly* to a firm by the government led the third parties, acting on the basis of their assessment of their commercial interests, to provide an additional benefit to the firm. In this connection, the Panel noted that in footnote 4 to Article 1 the words "directly or indirectly" refer to the modalities in which a bounty or subsidy was provided, but not to the effects of a subsidy on the conduct of a third party.

[94]See *supra*, paragraph 373.

401. The Panel noted that in the proceedings before the Panel the United States also argued that the subsidy in this case involved both the assurance by the Governments of Saarstahl's future liquidity and the debt forgiveness by the private banks and that the amount of the subsidy was calculated as the amount of the debt forgiveness since the debt forgiveness represented the benefit received from the subsidy.[95] While the assurance of Saarstahl's liquidity by the Governments of Germany and Saarland was analogous to a loan guarantee as an example of an inducement created by a government that produced a benefit to a third party, the benefit arising from the liquidity assurance was different from the benefit arising from a loan guarantee. Therefore, while in the case of a loan guarantee the benefit would not be calculated on the basis of the amount of principal, in the case of the assurance of Saarstahl's future liquidity it was appropriate to calculate the amount of the subsidy as the amount of debt forgiveness.

402. The Panel found nothing in the text of the DOC's determination indicating that the DOC had treated the liquidity assurance provided by the Governments of Germany and Saarland as a subsidy and the debt forgiveness by the private banks as representing the amount of the benefit conferred by that subsidy. The DOC's explanation in its determination clearly indicated that in the DOC's view the debt forgiveness by the private banks as such constituted the subsidy, rather than the liquidity assurance provided by the Governments. Accordingly, the Panel decided that it could not take into consideration the argument of the United States that the debt forgiveness by the private banks represented the amount of the subsidy provided through the assurance by the Governments of Saarstahls' future liquidity.

403. For all the foregoing reasons, the Panel found that, in treating debt forgiveness by private German banks as a subsidy, the DOC had acted inconsistently with Article 1 of the Agreement by imposing a countervailing duty in respect of a practice which did not constitute a "bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise ..." within the meaning of footnote 4 <u>ad</u> Article 1. The Panel considered that, in the absence of a subsidy, the imposition of a countervailing duty was also inconsistent with Article 4:2.

<u>Conclusion</u>

404. The Panel **concluded** that the United States had acted inconsistently with Articles 1 and 4:2 of the Agreement when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from Germany, the DOC found that debt forgiveness by private German banks was a subsidy.

4. **"Pass-through" of subsidies from BSC to UES**

405. The Panel turned its consideration to the request of the EC that the Panel find that the United States had acted inconsistently with Articles 1 and 4.2 of the Agreement when the DOC found in the investigation of imports from the <u>United Kingdom</u> that countervailable subsidies were provided to United Engineering Steels ("UES"), an independent joint venture company formed in 1986 by the then government-owned British Steel Corporation ("BSC") and a privately owned company, Guest, Keen and Nettlefolds ("GKN").

406. The finding contested by the EC appeared in the affirmative final determination made by the DOC in the investigation of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, issued in January 1993.[96]

[95] See *supra*, paragraphs 127-128.

[96] <u>Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom</u>, 58 FR 6237, 27 January 1993.

407. The Panel noted that this determination described in the following terms the formation of UES, the company in relation to which the contested finding was made:

"UES is a joint venture company which was formed in 1986 by the government-owned British Steel Corporation (BSC) and a privately owned company, Guest, Keen & Nettlefolds (GKN). Both BSC and GKN contributed 'productive units' (e.g., steel works, re-rolling mills), accounts receivable, cash, and inventories to the joint venture in return for shares in UES. More specifically, BSC contributed a major portion of its Special Steels Business which produced engineering steels, while GKN contributed its Brymbo Steel Works (Brymbo) and its forgings business. At the time of the formation of UES, BSC was wholly owned by the UK government. However, in 1988, BSC was privatized and now bears the name British Steel plc (BSplc)"[97]

The finding of the DOC that subsidies were provided to UES was based on an examination of whether subsidies originally provided by the Government of the United Kingdom to BSC were "passed through" to UES. In this context, the DOC examined whether subsidies provided to BSC *prior* to the formation of UES in 1986 were "passed through" to UES, and whether subsidies provided to BSC *after* the formation of UES were "passed through" to UES. At issue in the dispute before the Panel was the finding of the DOC that, when UES acquired the Special Steels Business from BSC:

"... a portion of the pre-1986 subsidies provided to BSC passed through to the Special Steels Business at its new 'home', UES."[98]

408. The Panel noted that, while in the determination in this investigation the DOC had taken the position that "a company's sale of 'business' or 'productive unit' does nothing to alter the effect of previously bestowed subsidies", subsequent to this determination the DOC had changed its approach to the question of the effect of a sale of a productive unit on previously bestowed subsidies and had adopted a revised methodology under which the purchase price paid for all or part of a government-owned company can, at least in part, constitute repayment of prior subsidies. In October 1993, pursuant to proceedings in the United States Court of International Trade with respect to the DOC's original determination issued in this case in January 1993, the DOC had issued a remand determination in which it had applied this revised methodology to the sale of the Special Steels Business from BSC to UES.

409. The Panel noted that the parties to the dispute disagreed on whether or not the Panel, in examining the EC's claim, should also take into account this remand determination.

410. In considering this issue, the Panel was guided by its terms of reference which instructed the Panel to:

"... review the facts of the matter referred to the Committee by the EEC in SCM/169 and, in light of such facts, to present to the Committee its findings concerning the rights and obligations of the signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement."[99]

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[97]58 FR 6238

[98]58 FR 6240. The Panel noted that, with respect to subsidies received by BSC after the formation of UES, the DOC found that no "pass through" of those subsidies from BSC to UES occurred.

[99]SCM/173, 3 August 1993.

Document SCM/169, in which the EC requested the establishment of a panel, referred to the Committee on Subsidies and Countervailing Measures a complaint by the EC that definitive countervailing duty determinations issued by the United States in January 1993 were on several specified grounds inconsistent with the obligations of the United States under the Agreement. Thus, "the matter" in which the Committee in June 1993 established a panel under Article 17:3 of the Agreement had been defined in terms of the EC's complaint regarding specific aspects of determinations issued by the United States in January 1993. Other signatories of the Agreement not party to the dispute had decided on the basis of "the matter" as defined in the EC's request in document SCM/169 whether or not to reserve their rights to make a submission to the Panel.

411. In the light of this definition of "the matter" referred to it by the Committee, the Panel decided that it could only examine the EC's claim by reviewing the DOC's finding of a "pass through" of subsidies to UES as set forth in the determination issued by the DOC in January 1993, and that the remand determination made in October 1993 was not properly before it.

412. The Panel considered that the following were the main arguments submitted by the parties with respect to the finding of the DOC in the determination issued in January 1993 that subsidies provided to BSC were passed through to UES.

413. The EC argued that the United States had acted inconsistently with Articles 1 and 4:2 of the Agreement because, in finding that subsidies were passed through from BSC to UES, the DOC had failed to consider on the basis of all relevant factual evidence whether or not UES derived a benefit or competitive advantage from the purchase of the productive assets. In the EC's view, the Preamble and Article 11 of the Agreement, as well as the findings and conclusions of the Pork panel indicated that a benefit must be shown to exist to an entity before that entity could be considered to be subsidized. It followed from footnote 4 to Article 1 that the DOC was required to determine that a subsidy was bestowed on the merchandise produced by UES. The EC was of the view that in the case at hand, the fact that UES had paid a market price for the assets in an arm's length transaction meant that UES did not benefit from the subsidies provided to the previous owner of the assets and thus precluded any possibility of a pass through of those subsidies to UES. A private company which paid market value to purchase an asset from a subsidized state-owned company had no competitive advantage over other companies. The EC thus considered that the DOC's finding that UES was subsidized, on the basis of a pass-through of subsidies from BSC to UES, was not based on fact, but on an unjustified presumption that subsidies "inhere" in assets.

414. The EC rejected the argument of the DOC that its approach to the issue of pass-through was necessary to avoid circumvention of the United States' countervailing duty law. Under the Agreement, there was a clear requirement to determine the existence of a subsidy before the imposition of a countervailing duty. Absent a properly substantiated finding that benefits were conferred upon UES as a result of the purchase of the assets, the anti-circumvention argument provided no valid basis for the imposition of countervailing duties on imports from UES. Moreover, the EC argued that the circumstances of the transaction in which UES had acquired the assets provided no evidence of an intention to circumvent the countervailing duty law of the United States.

415. The United States argued that the most logical manner to conceptualize the issue addressed by the DOC was in terms of the allocation of subsidies between BSC and the productive unit purchased from BSC by UES. The subsidies provided to BSC prior to the formation of UES were untied[100] and were

[100]The Panel noted that in the countervailing duty regulations and practice of the United States a distinction was made between tied and untied subsidies. Subsidies were considered to be tied if the intended use of the subsidy was known to the subsidy giver and so acknowledged prior to or concurrent with the bestowal of the subsidy.

therefore allocable to the production of all of BSC's productive units, including the Special Steels Business. Had BSC simply broken the Special Steels Business off the rest of the company to form a separate corporation, while retaining full ownership, one could not argue that this transaction insulated the Special Steels Business from the subsidies previously received by BSC. Therefore, the mere formation of a new corporate unit using a portion of the assets of a company which previously had received untied subsidies did not mean that a share of the subsidies to the original company was no longer allocable to that unit. According to the United States, the issue before the Panel was whether or not the fact that the productive unit was the subject of an arm's length transaction with another entity changed this result.

416. In this regard, there were according to the United States two distinct questions. Firstly, whether or not the sale of a company, or unit of a company, extinguished all subsidies previously received by the company. Secondly, if the transaction did not automatically extinguish prior subsidies, to what extent, if any, the purchase price nevertheless represented repayment of the subsidies. With regard to the first issue, the DOC had concluded that privatization did not automatically extinguish all previous subsidies. With regard to the second issue, the DOC had not found that any of the purchase price should be considered as repayment of previously received subsidies. The DOC had subsequently changed its position on this second issue. The United States considered that the EC's arguments addressed only the first of these two issues. In this regard, the United States rejected the view that the sale of a government-owned company, if done through a sale at arm's length, necessarily extinguished all previous subsidies received by the company. According to the United States, this view was based on the notion that the amount of the subsidies left in the productive unit was reflected in the purchase price of the unit. Under this approach, the amount of a subsidy in monetary terms actually received by the original company was not a relevant criterion for measuring subsidies. Rather, what mattered was how the subsidies translated into the company's market value. The United States argued that the notion that the Agreement required measurement of subsidies in terms of their resulting competitive or market effects was without support in the Agreement and could lead to absurd results.

417. In its examination of the finding of the DOC of a "pass-through" to UES of a portion of the subsidies provided before 1986 to BSC, the Panel noted that, while the United States presented certain arguments regarding the effects of "privatization" and "corporate restructuring" on previously bestowed subsidies, the issue before the Panel was narrower in scope and involved only the question of the effects of a sale of assets to an independent company in an arms-length transaction.[101] The Panel also noted that, while the EC presented the issue as relating to "sale of assets of a previously subsidized company", the DOC had not conducted its "pass-through" analysis in relation to individual assets but only in relation to the sale of one productive unit, or business unit, the Special Steels Business.

418. The Panel noted that it was undisputed that the subsidies at issue were originally provided to BSC and not to UES. The basic question in dispute was whether or not the DOC had acted inconsistently with the requirements of the Agreement in finding that a portion of certain subsidies received by BSC prior to the formation of UES was "passed through" to UES with the sale of the Special Steels Business from BSC to UES.

419. The Panel noted the fundamentally different approaches underlying the arguments presented by the parties to the dispute. The EC's approach to the question of the existence of a "pass-through" of subsidies from BSC to UES focused on whether UES derived a continuing "benefit" from the previously bestowed subsidies as a result of the purchase by UES of the Special Steels Business. The approach taken by the United States, on the other hand, did not focus on whether UES derived a benefit from the previous subsidies as a result of the purchase of the Special Steels Business, but viewed the issue in terms

[101]The Panel noted that in its determination the DOC specifically found that "... the formation of UES was not simply a corporate restructuring, ..." 58 FR 6237, at 6248.

of whether the sale of the Special Steels Business affected the "allocation" to the Special Steels Business of "untied" subsidies previously bestowed to BSC.

420. The Panel considered that the fundamental legal requirement in light of which the consistency of this "pass through" analysis with the Agreement had to be examined was the rule, reflected *inter alia* in Article 1, footnote 4, that a determination of the existence of a subsidy bestowed on the production of merchandise was a necessary condition for the imposition of a countervailing duty on the importation of that merchandise. Since in this case the merchandise on the importation of which into the United States a countervailing duty was levied was produced by UES, the Panel had to examine whether the DOC had properly found that a subsidy had been bestowed on production of merchandise by UES. This meant that, assuming that the DOC had properly determined that before 1986 subsidies were bestowed on production by BSC, the Panel had to decide whether the DOC's finding that, with the sale of the Special Steels Business to UES a portion of those subsidies was "passed through" to UES, provided a sufficient basis to support a finding that a subsidy was bestowed on the production of merchandise by UES.

421. The Panel noted that the DOC provided the following explanation of its determination regarding the "pass through" to UES of subsidies provided to BSC before the formation of the joint venture:

"Based upon a reconsideration of the preliminary determination and upon reviewing the comments submitted by the interested parties, the Department determines that a company's sale of a 'business' or 'productive unit' does not alter the effect of previously bestowed subsidies. The Department does not examine the impact of subsidies on particular assets or tie the benefit level of subsidies to changes in the company under investigation. Therefore, it follows that when a company sells a productive unit, the sale does nothing to alter the subsidies enjoyed by that productive unit.

The subsidies provided to a company presumably are utilized to finance operations and investments in the entire company, including productive units that are subsequently sold or spun off into joint ventures. Therefore, as the company disposes of its productive entities, these entities take a portion of the benefits with them when they 'travel to their new home.'

The Department has applied this analysis only to a subsidized company's 'business' or 'productive units,' which are sold off. An analysis which would require the Department to examine each individual asset that a company sells would be administratively unfeasible. A subsidized company's sale of a productive unit is a more reasonable basis on which to allocate the pass-through of subsidies.

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

Based on this methodology, the Department considers the portion of BSC's Special Steels Business that was sold to UES a 'productive unit' or business. Accordingly, the Department finds that a portion of the pre-1986 subsidies provided to BSC passed through to the Special Steels Business at its new 'home', UES."[102]

[102] 58 FR 6240.

422. The Panel noted that it was clear from the DOC's determination that the DOC had arrived at its finding of a "pass through" to UES of a portion of subsidies provided to BSC before 1986 without considering the price at which UES had acquired the Special Steels Business. Under the approach of the DOC, the terms of the sale by definition were not a relevant factor in the consideration of a "pass through" of subsidies. The DOC specifically stated that:

"... when a company sells a productive unit, the sale does nothing to alter the subsidies enjoyed by that productive unit."[103]

The Panel therefore had to determine whether under the Agreement a finding that merchandise produced by UES was produced with a productive unit the previous owner of which had been found to be receiving certain subsidies before the formation of UES, without a consideration of the price paid by UES for that productive unit, was a sufficient basis to support a finding that these subsidies were also bestowed on the production of that merchandise by UES.

423. The Panel recalled the argument of the United States in its submissions to the Panel that the issue before the DOC was the appropriate "allocation" of "untied" subsidies between BSC and the Special Steels Business.

424. The Panel was not entirely convinced that this explanation by the United States of the DOC's "pass through" analysis in terms of an "allocation" of "untied" subsidies accurately reflected the approach actually followed by the DOC in its determination. The Panel noted in this respect that in the relevant part of the determination the DOC did not expressly use the term "allocation". While the United States argued before the Panel that the concept of a "pass through" of subsidies was inappropriate in so far as this concept suggested that the subsidy would not normally be allocable to the Special Steels Business, the Panel noted that in the determination the DOC itself consistently described the issue before it in terms of a "pass through" of subsidies from BSC to UES.[104] Furthermore, if, as argued by the United States, a key factor in the analysis by the DOC of the allocation of subsidies between BSC and the Special Steels Business was the DOC's finding that the subsidies provided to BSC were "untied", it was difficult to understand why the DOC did not clearly state that it had found that those subsidies were "untied". Instead, the DOC stated that:

"The subsidies provided to a company presumably are utilized to finance operations and investments in the entire company, including productive units that are subsequently sold or spun off into joint ventures."[105]

A statement of such general nature could not be said to amount to a finding that certain subsidies provided to BSC were "untied" and that it was therefore appropriate to allocate those subsidies to all of BSC's productive units, including the Special Steels Business.

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[103] 58 FR 6240

[104] The issue of subsidization of UES was discussed by the DOC in a section of the determination entitled "Pass-Through of benefits from BSC to UES." The DOC noted that it had "received numerous comments on the issue of whether subsidies provided to BSC prior to the formation of UES were passed through the UES." The DOC determined that "...a portion of the pre-1986 subsidies provided to BSC passed through to the Special Steels Business at its new 'home,' UES." 58 FR 6238 and 6240

[105] 58 FR 6240

425. However, leaving aside the question of whether the argument of the United States regarding the allocation of untied subsidies involved an element of rationalization of the DOC's finding, the Panel considered that even under the "allocation" approach presented by the United States before the Panel the price paid by UES for the Special Steels Business was at least a relevant fact to be taken into consideration. Thus, if the DOC had indeed treated the issue before it as a question of "allocation" of "untied" subsidies, it would still have been necessary for the DOC to examine how the "allocation" of subsidies between BSC and the Special Steels Business was affected by the price paid by UES when it acquired the Special Steels Business. The Panel noted in this respect that the United States had indicated before the Panel that it no longer wished to defend the methodology applied in this case in so far as this methodology failed to take account of the price at which UES had acquired the Special Steels Business.

426. The Panel noted that the parties differed on the question of how the purchase price paid by UES for the Special Steels Business should have been taken into account by the DOC. However, the common element in the approaches of the parties as presented to the Panel was that the purchase price was at least a relevant fact to consider.

427. In view of the above, the Panel found that, as a result of the DOC's failure to take into account the price paid by UES for the productive unit acquired from BSC, the DOC's finding that merchandise produced by UES was produced in a productive unit the previous owner of which had received certain subsidies was not based on a consideration of all relevant facts and was therefore not a sufficient basis to support a finding that a subsidy was bestowed on the production of that merchandise by UES. This finding was without prejudice to the Panel's views on whether or not the existence of a "pass through" of subsidies to UES should be analyzed by focusing on the "benefit" resulting from these subsidies to UES or by examining the appropriate manner of "allocating" those subsidies between BSC and the Special Steels Business. In light of this finding, the Panel did not consider it necessary to pronounce itself on the question of whether, as argued by the EC, the sale of the Special Steels Business at a market price necessarily precluded the possibility of any "pass-through" of previously bestowed subsidies.

428. The Panel then noted that in its determination the DOC had explained its approach to the issue of whether there was a "pass through" of subsidies from BSC to UES *inter alia* by referring to the possibility that an alternative approach might facilitate circumvention of the countervailing duty law. The Panel, however, recalled that the United States took the position before the Panel that it no longer wished to defend the methodology applied by the DOC in the original determination issued in January 1993, in so far as this methodology did not provide for a consideration of the purchase price paid by UES for the Special Steels Business. It therefore appeared to the Panel that the United States did not take the view that the anti-circumvention argument provided a justification for the DOC to find that there was a pass through of subsidies from BSC to UES without considering the price paid by UES for the Special Steels Business.

429. In light of the foregoing considerations, the Panel found that, as a result of the failure of the DOC to take into account in its analysis the price at which UES acquired the Special Steels Business from BSC, the finding of the DOC of a "pass through" of subsidies from BSC to UES was not a sufficient basis to support a finding, required under Article 1 of the Agreement, that a subsidy was bestowed on the production of merchandise by UES. The Panel considered that, in the absence of a sufficient basis for making such a finding, the imposition of countervailing duties was also inconsistent with Article 4:2.

<u>Conclusion</u>

430. The Panel **concluded** that the United States acted inconsistently with Articles 1 and 4:2 of the Agreement when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, the DOC found that production by UES was subsidized as a result of a "pass through" of subsidies from BSC to UES.

5.The findings of the DOC regarding the provision of equity capital by the Governments of France and the United Kingdom

431. The Panel turned its consideration to the request of the EC that the Panel find that the United States had acted inconsistently with its obligations under Articles 1 and 4:2 of the Agreement by reason of the findings of the DOC in the investigations of imports from France and the United Kingdom regarding the provision of equity capital to certain firms by the Government of France and the Government of the United Kingdom.

432. The Panel noted that the EC contested both the findings of the DOC of *the existence of subsidies* resulting from the provision of equity capital to certain firms by the Governments of France and the United Kingdom and the *calculation by the DOC* of *the amount* of subsidization resulting from this provision of equity capital.

433. The Panel first considered the objections of the EC regarding the DOC's findings that equity infusions by the Government of France and by the Government of the United Kingdom constituted subsidies.

5.1 The findings of the DOC that subsidies arose from certain equity infusions

434. The Panel noted the explanation provided by the United States that, under the methodology applied by the DOC, the provision of equity capital by a government is treated as a subsidy if such equity infusion is on terms inconsistent with commercial considerations. Under this approach, if there is a market-determined price for equity purchased directly from a firm, the provision of equity by a government to that firm is a subsidy to the extent the price paid by the government is above that market price. If, however, there is no such market-determined price, the determination of whether or not equity infusion constitutes a subsidy involves an examination of whether the firm in question is "equityworthy". In examining the equityworthiness of a firm, the DOC applies a "reasonable private investor" standard. As formulated in the DOC's Proposed Countervailing Duty Regulations:

> "A firm is equityworthy within the meaning of paragraph (e)(1)(ii) of this section if the Secretary determines that, from the perspective of a reasonable private investor examining the firm at the time the government equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable period of time."[106]

The Proposed Countervailing Duty Regulations of the DOC set forth a number of factors which the DOC may consider, among others, in making this determination.

435. The Panel noted that in the investigation of imports from France, the DOC recalled its finding in a previous countervailing duty determination that Usinor and Sacilor were not equityworthy in 1978 and 1981 and found that Usinor, Sacilor and Usinor Sacilor were unequityworthy during the years 1982 through 1988 and that Usinor Sacilor was equityworthy during 1991.[107] As a result, the DOC determined that certain equity infusions made by the Government of France in 1978, 1981, 1986 and 1988 were inconsistent with commercial considerations.[108]

[106] 54 FR 23365, 31 May 1989, at 23381

[107] 58 FR 6222-6223

[108] 58 FR 6224-6225

436. The Panel further noted that in the investigation of imports from the United Kingdom, the DOC recalled its findings in previous countervailing duty determinations that BSC was unequityworthy between 1977/78 and 1983/84 and found that BSC remained unequityworthy through 1985/86. As a result, the DOC determined that certain equity infusions made by the UK Government in fiscal years 1977/78 through 1985/86 were inconsistent with commercial considerations.[109]

437. The Panel noted that there was no disagreement between the parties that the provision of equity capital by a government does not *per se* constitute a countervailable subsidy and that an examination of the conditions under which the equity infusion takes place is required in order to make a determination on whether or not the equity infusion is a countervailable subsidy. The parties differed, however, on whether in the cases before the Panel the DOC had considered all facts relevant to such a determination.

438. The views of the parties on this question can be recapitulated as follows.

439. The EC claimed that the "reasonable private investor" standard used by the DOC was inconsistent with Article 4:2 in that this standard failed to allow for a consideration of all relevant facts and could thereby lead to a finding of subsidies where no subsidies existed, or to the imposition of countervailing duties in excess of the amount of subsidies. The EC presented two main arguments in support of this claim. Firstly, the "reasonable private investor" standard was not appropriate for government investment because this standard did not take into account that government motives for investment, and therefore investment benchmarks for governments, were different from investment by private individuals. Secondly, even if the "reasonable private investor" standard could be considered appropriate for government investment, the standard was applied by the DOC in a manner which was not consistent with logic and economic reality and did not take into account all relevant facts. In this respect, the EC submitted that (1) the indicators used by the DOC in applying this standard were almost exclusively backward looking and did not, or not sufficiently, take account of any favourable prospects of the firm concerned; and (2) the standard was applied from the perspective of an outside investor and did not take into account the fact that the rational investment decisions of an inside investor might be considerably different from those of an outside investor.

440. In response to the EC's claim, the United States submitted that the DOC's equityworthiness methodology took into account all relevant facts and was rational. The findings of the DOC in the investigations at issue were fact-intensive and reflected a thorough consideration of the record evidence and points raised by the respondents. The DOC had provided a comprehensive explanation of the reasons of its findings. There was no doubt that a reasonable, unprejudiced person, on the basis of the record before the DOC, could have made the findings made by the DOC. The United States submitted that these findings therefore did not violate the Agreement. More specifically, the United States argued that public policy objectives were irrelevant to a determination of whether or not the provision of equity capital by a government was a subsidy. With respect to the EC's argument regarding the inadequate consideration by the DOC of prospective factors, the United States argued that such prospective factors were an explicit element of the DOC's equityworthiness methodology. In the cases at hand, the DOC had considered all evidence of record, including any information on firms' future prospects. Finally, the United States argued that the DOC had specifically addressed the issue of the alleged difference between inside investors and outside investors and had properly concluded that it should not undertake a separate analysis of inside investors and outside investors.

[109] 58 FR 6241-6242

5.1.1 Public policy objectives as a factor to be considered in the analysis of whether the provision of equity capital by a government constitutes a subsidy

441. The Panel first turned to the EC's argument that the "reasonable private investor" standard used by the DOC in determining the equityworthiness of firms failed to allow for a consideration of all relevant facts, and was thereby contrary to Article 4:2, because this standard did not take into account the fact that governments often made investments in pursuance of public policy objectives.

442. The Panel noted the conflicting views of the parties on whether or not public policy objectives are relevant to a determination of whether the provision of equity capital by a government constitutes a subsidy.

443. In the EC's view, the appropriate standard for determining whether the provision of equity capital by a government constituted a subsidy was that of a "reasonable *public* investor". The EC submitted that this standard allowed for a balancing of factors relating to the commercial viability of the equity infusion and the public policy objectives pursued by a government making the equity investment. In this context, public policy objectives should be accounted for by recognizing that, unlike private investors, governments when providing equity capital did not necessarily aim to achieve a maximum return on the equity investment. The EC denied that, as argued by the United States, such a "reasonable public investor" standard was circular and could be used to rationalize any provision of equity capital by a government. The EC submitted in this regard that this standard would not be met if a government made an equity infusion for social reasons only and without any serious chance of breaking even in the long run.

444. In contrast, the United States argued that public policy goals were irrelevant to an examination of the conditions under which the provision of equity capital by a government could be said to constitute a subsidy. The United States considered that the "reasonable public investor" criterion proposed by the EC was without logic in that from the standpoint of a government all subsidies could be said to be "reasonable". The EC was simply proposing an alternative test without explaining why the Agreement required such a test.

445. The Panel noted that, as presented by the EC, the issue before the Panel was whether or not, by not taking into account the different perspectives of public and private investors, the DOC's "reasonable private investor" methodology as applied in the present cases failed to allow for a consideration of all relevant facts and was thereby inconsistent with Article 4:2.

446. The Panel recalled its views on the question of whether Article 4:2, interpreted strictly, could be considered to be the legal basis of obligations of signatories regarding the criteria to be taken into account for the determination of the existence of a subsidy.[110] The Panel also recalled its general observation that, in considering the EC's argument regarding the alleged failure of the DOC to take into account all relevant facts, it was important to bear in mind that this argument could present as evidentiary questions what in fact were questions of interpretation of the Agreement.[111] While the EC phrased its argument on the distinction between public and private investors in terms of an alleged "error of fact" committed by the DOC, the Panel considered that in reality this argument raised a question of interpretation of the Agreement, viz. whether or not in the determination of whether equity infusion by a government constitutes a subsidy the Agreement requires signatories to take account of the public policy objectives pursued by that government. The Panel noted in this regard that the rationale of the EC's argument was potentially applicable to a wide range of forms of government intervention. Governments had different

[110] See supra, paragraphs 348-358.

[111] See *supra*, paragraph 364.

motives than private parties not only when making equity investments in firms but also when providing assistance in other forms. Therefore, the argument of the EC raised the more general question of whether or not, for the purpose of the determination of the existence of a countervailable subsidy, public policy objectives pursued by governments are to be taken into account by investigating authorities.

447. The Panel reviewed the provisions in Part I of the Agreement which governed the application of countervailing duties. The Panel found nothing in these provisions to indicate that policy objectives pursued by a government have to be taken into account by signatories when they conduct an investigation to determine whether or not a particular practice constitutes a countervailable subsidy. None of the provisions in Part I refers to the necessity of a consideration by investigating authorities of policy objectives pursued by an exporting signatory with regard to a particular practice under examination.

448. The Panel further noted that the Agreement refers to objectives of subsidies only in Part II, which, however, does not contain rules for the application of countervailing measures. Objectives of subsidies are referred to in Article 8:1 and more particularly in Article 11:1. According to the latter provision:

"Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable."

Article 11:3 mentions examples of possible forms of subsidies other than export subsidies by means of which the objectives referred to in Article 11:1 might be achieved. One of these examples is "government subscription to, or provision of, equity capital". It follows from Articles 11:1 and 11:3, read together, that the Agreement is not intended to restrict the right of signatories to use subsidies other than export subsidies, including in the form of government subscription to, or provision of, equity, as important instruments for the promotion of social and economic policy objectives. Article 11 thus recognizes the right of signatories to use subsidies other than export subsidies in pursuance of various public policy objectives, but this Article does not provide that such policy objectives are relevant to a determination of whether a particular practice constitutes a subsidy. Under Article 11, the existence of a subsidy and the public policy objectives pursued with that subsidy are separate matters.

449. The Panel's review of the provisions of the Agreement thus indicated that public policy objectives are mentioned only in provisions in Part II of the Agreement, which does not set forth rules for the application of countervailing measures. Moreover, even those provisions in Part II do not treat public policy objectives as a relevant fact for the purpose of determining whether or not a particular practice is a subsidy. The Panel also noted that signatories are not precluded from countervailing subsidies granted in pursuance of public policy objectives mentioned in Part II of the Agreement.

450. On the basis of the considerations above, the Panel was of the view that the Agreement was not to be interpreted as requiring signatories, when conducting an investigation of whether or not the provision of equity capital by a government gives rise to a subsidy, to take into account the public policy objectives pursued by that government in providing the equity capital.

451. In the light of the foregoing considerations, the Panel saw no merit in the argument of the EC that the United States had acted inconsistently with the Agreement when, in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France and the United Kingdom, the DOC did not take public policy objectives of the Governments of France and the United Kingdom into account in evaluating whether certain equity investments made by these Governments were subsidies.

5.1.2 Alleged failure of the DOC to take account of prospective factors

452. The Panel then turned to the argument of the EC that, even assuming *arguendo* that a "reasonable private investor" standard could be appropriate for the evaluation of whether a government equity infusion gives rise to a subsidy, the DOC's application of this standard in the cases at hand did not involve an examination of all relevant facts and was thus contrary to Article 4:2 because the DOC's findings that certain firms were not equityworthy were based only on financial indicators of past performance and did not involve an adequate consideration of evidence before the DOC regarding indicators of the future prospects of these firms.

453. The Panel noted that the dispute between the parties concerning the alleged failure of the DOC to give consideration to indicators of future prospects of the firms in question was of a different nature than the dispute on the appropriateness of a "reasonable private investor" standard *per se*. There was no disagreement that private investors took account of the prospects of a firm in considering whether to make an equity investment in that firm and that a "reasonable private investor" standard as a criterion for evaluating whether government equity infusion was a subsidy had to be applied consistently with that reality. In other words, there was no dispute that the prospects of a firm were a "relevant fact" and that a failure to consider such prospects could call into question the validity of a finding that a reasonable private investor would not have made an equity investment. The issue raised by the EC's argument on prospective factors therefore was more of a factual nature and required the Panel to determine whether or not the findings made by the DOC reflected a proper consideration of an issue the relevance of which was not contested.

454. The Panel noted the following main arguments advanced by the parties on this issue.

455. The EC argued that in the investigation of imports from the United Kingdom, although two studies indicative of BSC's future viability were on record with the DOC, the determination of the DOC contained no discussion of these studies and thus showed that these studies had not been considered at all. The EC argued in this connection that the Panel could base its review of the DOC's finding only on the text of the determination issued by the DOC. With regard to the DOC's finding in the case of the investigation of imports from France, the EC argued that, while there was some discussion in the DOC's determination of a study by McKinsey and Company on future prospects of the firms, the DOC had dismissed this study on the grounds that a "prudent" investor would not have ignored the negative financial indicators. This concept of a "prudent" rather than a "reasonable" investor involved an arbitrary assumption of risk avoidance by private investors and ignored the economic reality that investment was about the provision of risk capital. The EC submitted that the analysis in the McKinsey study focused on issues of interest to a potential investor, contrary to what was argued before the Panel by the United States. Furthermore, the EC argued that the fact that in the French case the DOC had ignored the positive performance of the firm in question since 1987 showed how much the standard applied by the DOC was biased in favour of the use of financial indicators of past performance.

456. The United States argued that in both investigations at issue in this case the DOC had considered evidence on future prospects of the firms and had properly concluded that this evidence was not dispositive. The United States considered that the EC's argument regarding the allegedly inadequate consideration of prospective factors amounted to not more than a disagreement with the weight given by the DOC to the studies predicting an improvement in the firms' performance, as compared with other evidence on the record. As such, this argument was not a basis for finding a violation of provisions of the Agreement.

457. With regard to the finding in the investigation of imports from the United Kingdom that BSC was not equityworthy, the United States argued that the DOC had considered studies on BSC's future prospects, but the DOC had found those studies not to be dispositive in view of the sustained negative

trends in the financial indicators. According to the United States, the DOC's determination properly contained a detailed discussion of the factual information which had enabled the DOC to reach its finding regarding the unequityworthiness of BSC. The studies on the future prospects of BSC had been put on the record in the preliminary phase of the investigation, but in the final phase the respondents themselves had not even focused on these studies as an issue. It was therefore not surprising that the final determination did not explicitly discuss these studies. The United States also argued that, in any event, the Agreement contained no provision requiring that all record information be discussed in a public notice of a determination, and that the issue of what was required under the public notice provisions in Article 2:15 was not within the Panel's terms of reference. In addition, the United States argued that one of the two studies on the prospects of BSC did not focus on how an investor would evaluate whether or not to invest in BSC, but on the future "viability" of the firm, and that another study was a forecast of the United States' market rather than a study of BSC. The latter study had been discussed explicitly by the DOC in a previous determination.[112]

458. With regard to the DOC's finding in the French case that Usinor, Sacilor and Usinor Sacilor were not equityworthy, the United States argued that the DOC had explicitly discussed the McKinsey study referred to by the EC as evidence of the likelihood of an improvement of Usinor Sacilor's performance. The DOC had properly found that this study was not dispositive, in view of the fact that the focus of the analysis in this study was not the focus of a potential investor and in view of the negative recent historical performance of the firm. The United States further submitted that there was no distinction between a "reasonable" and a "prudent" private investor under the DOC's methodology, and the use of the word "prudent" did not involve a presumption of risk avoidance by private investors. Finally, according to the United States the positive performance of a firm subsequent to a government equity infusion was irrelevant to a determination of whether or not a reasonable private investor would have made the equity infusion at the time of the equity investment by the government.

459. The Panel first examined the question of the alleged failure of the DOC to consider evidence on prospective factors in connection with the finding made by the DOC in the investigation of imports from the United Kingdom that BSC was unequityworthy.

460. The Panel noted the DOC's explanation of this finding:

"The Department has previously determined that BSC was unequityworthy between 1977/78 and 1983/84 (See Final Affirmative Countervailing Duty Determination: Stainless Steel Sheet, Strip and Plate from the United Kingdom (Stainless Steel), 48 FR 19048 (April 27, 1983) and Final Results of Countervailing Duty Administrative Review, Stainless Steel Plate from the United Kingdom (Stainless Steel Review), 51 FR 34112 (September 25, 1986)). Petitioners have alleged that BSC remained unequityworthy through 1985/86. For fiscal years 1981/82 through 1985/86, BSC yielded negative returns on assets and equity. Times interest earned and BSC's profit margin were negative for fiscal years 1982/83 through 1984/85. Although BSC reported a profit in 1986, the profit margin on sales was only one percent. Furthermore, no dividends were distributed by BSC between 1977 and 1986.

Based on this information, we find that BSC was unequityworthy from 1977/78 through 1985/86."[113]

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[112] Stainless Steel Plate from the United Kingdom; Final Results of Countervailing Duty Administrative Review, 51 FR 44656 (11 December 1986).

[113] 58 FR 6241. The Panel noted that Final Results of Countervailing Duty Administrative Review in the stainless steel plate case were actually issued in December 1986 and not, as stated in the quoted passage, in September 1986.

461. As explained in this passage, the DOC's conclusion regarding BSC's unequityworthiness was based on (1) findings in previous determinations that BSC was unequityworthy between 1977/78 and 1983/84 and (2) certain financial data which according to the DOC indicated that BSC remained unequityworthy through 1985/86 (negative returns on assets and equity for fiscal years 1981/82 through 1985/86; negative times interest earned and negative profit margins for fiscal years 1982/83 through 1984/85; a profit margin on sales in 1986 of only one percent, and the fact that no dividends were distributed by BSC between 1977 and 1986). In view of this explanation, the Panel considered that, as a factual matter, it could not be contested that the DOC's determination did not expressly discuss the question of the future prospects of BSC as a factor in the DOC's examination of whether BSC was equityworthy.

462. The Panel noted that the EC presented no arguments challenging the factual correctness of the DOC's observations regarding the financial indicators of BSC's negative past financial performance. The EC, however, contended that, since the DOC had not considered information on the record which indicated BSC's future viability, the DOC's conclusion that BSC was not equityworthy was not the result of an examination of all relevant facts. In the EC's view, that the DOC had not considered the issue of BSC's future prospects was evident from the absence of any discussion in the DOC's determination of two studies which according to the EC showed the likelihood of an improvement in BSC's future performance.

463. The Panel noted that the two studies referred to by the EC as indicative of the likely positive future performance of BSC were a study entitled "Data Resources Steel Industry Review" and a report prepared in November 1985 by a consultancy firm for the Commission of the European Communities, entitled "Study of the Viability of the British Steel Corporation". The Panel noted that it was not contested that the two studies mentioned by the EC were indeed part of the DOC's record in this investigation.

464. In its examination of the merits of the EC's argument on the alleged failure of the DOC to consider BSC's future prospects, the Panel was guided by the fundamental consideration that factual findings of investigating authorities in anti-dumping and countervailing duty proceedings need to be accompanied by duly motivated, public statements of reasons such as to make such findings capable of meaningful review in light of relevant requirements of the Agreement. The Panel noted that the importance of such adequately motivated statements of reasons had been discussed in a number of recent panel reports in disputes relating to anti-dumping and countervailing duty determinations.[114] Accordingly, the Panel considered that the pertinent legal question raised by the EC's argument was whether the silence of the DOC's determination on the issue of prospective factors meant that the DOC had failed to provide an adequate statement of reasons in support of its finding that BSC was not equityworthy.

465. The Panel noted that the DOC in its determination had clearly spelled out the factual basis for its finding that BSC was not equityworthy.[115] The question arose, however, whether the Panel should find that the DOC's determination was not supported by an adequate statement of reasons on the grounds that, while the determination specifically identified the financial indicators of BSC's negative performance which in the DOC's view indicated BSC's lack of equityworthiness, the determination did not expressly address the question of BSC's future prospects.

466. The Panel noted in this regard that a previous panel had made the following remarks in connection with the requirement of an "objective examination" in Article 6:1 of the Agreement:

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[114]See e.g. Brazil - Imposition of Provisional and Definitive Countervailing Duties On Milk Powder And Certain Types of Milk From The European Economic Community, Report of the Panel, 27 January 1993, adopted on 28 April 1994, paragraphs 283-285.

[115]*supra*, paragraph 460.

"... a review of whether a determination of material injury was in conformity with this requirement necessitated an examination of whether the investigating authorities had examined all relevant facts before them (including facts which might detract from an affirmative determination) and *whether a reasonable explanation had been provided of how the facts as a whole supported the determination made by the investigating authorities*."[116]

Although this statement pertained specifically to the "objective examination" standard applicable to determinations of injury under Article 6, in the Panel's opinion the rationale of this statement also applied to a review by a panel of a factual finding of the existence of a subsidy. The Panel found that it could properly apply this "objective examination" standard in this context, even though there was no Article in the Agreement specifically setting forth evidentiary standards applicable to a final determination of the existence of a subsidy. In addition to this "objective examination" standard as a substantive requirement, the Panel took into account the requirements of Article 2:15 of the Agreement. Accordingly, the Panel considered that, while it was not the task of a panel to make its own judgement on the relative weight to be accorded to different facts before investigating authorities, it was within the task of a panel to review whether the factual findings made by investigating authorities in a countervailing duty investigation are motivated in such a manner as to make it possible to discern how such findings are the result of an examination of the totality of the evidence before the authorities, including relevant facts which might possibly detract from their findings. In applying this standard, however, the Panel took into account that, as argued by the United States, the Agreement does not require investigating authorities to specifically discuss in a public notice of a determination each piece of evidence examined by investigating authorities.

467. The Panel then recalled that the parties agreed that an evaluation of the likely future performance of a firm was a necessary element in an analysis of whether an equity investment in that firm was commercially rational. Therefore, while the relative weight to be accorded to prospective factors, as compared to indicators of a firm's past performance, obviously depended upon the facts of a particular case, such factors were inherently relevant to a determination of the commercial rationality of an equity investment. It followed that in this case a decision on whether BSC was equityworthy necessarily involved a weighing of information on negative financial indicators against information on BSC's future prospects.

468. For the foregoing reasons, the Panel considered that if, in investigating whether or not BSC was unequityworthy, the DOC examined information on BSC's future prospects, but concluded that information not to be dispositive, it was incumbent upon the DOC to provide adequate reasoning to explain why, in the light of possible shortcomings in this information or in the light of other evidence on the record, this information was not grounds for finding that BSC was equityworthy.

469. The Panel then examined the DOC's determination in light of the above considerations.

470. The Panel noted that, in respect of the period prior to 1984/85, the DOC had explained its conclusion regarding BSC's lack of equityworthiness by referring to findings made in previous determinations. One of those previous determinations related to an administrative review proceeding of a countervailing duty order on stainless steel plate from the United Kingdom, in which the DOC had found that BSC was not equityworthy in the period 10 February 1983-31 March 1984. In this connection, the Panel noted the following comments made in the DOC's final determination in this administrative review on the question of whether BSC was equityworthy:

"Comment 3: BSC claims that the trade journals and market studies that the department considered are too general and cannot by themselves support the conclusion that the

[116] United States - Imposition of Countervailing Duties On Imports of Fresh And Chilled Atlantic Salmon From Norway, Report of the Panel, SCM/153, 4 December 1992, adopted on 28 April 1994, paragraph 258 (Italics added).

company was not equityworthy. The studies used by the Department projected the beginning of an upturn in 1984. Therefore, the Department cannot support the conclusion that no reasonable investor would invest in an industry with potentially favourable long-term returns, and in a dramatically improving company, such as BSC.

Department's Position: We do not base an equityworthy decision on any one item of information or any one financial ratio. We look at a composite of available information. Even if the market studies are too general, they are important to an investor in depicting future trends and in assessing alternative investments.

The studies that BSC cites do project a relative upturn in 1984 for the European Economic Community ("the EC") as a whole. However, the upturn noted for 1984 is relative to the doldrums of 1982 and 1983. While the OECD study projected a small recovery in the EC's steel consumption levels in 1984, it also predicted the worst capacity utilization rate in the world and a continuing downward pressure on prices caused by overcapacity. *The Data Resources, Inc., study noted that the EC Commission had projected a flat world market for the first part of 1984.*

A reasonable investor would consider all this information before making an investment decision. BSC places undue emphasis on financial data available in the latter part of the review period or beyond, and on relatively minor optimistic trends reported in certain trade journals."[117]

These comments indicated that the DOC had expressly addressed the issue of BSC's future prospects in determining that BSC was not equityworthy in 1983-1984, had specifically discussed the studies referred to by BSC, including the "Data Resources Steel Industry Review", and had explained why these studies were no reason to find BSC equityworthy in the period under consideration.

471. The Panel recalled that in the determination in the present case, the DOC had explicitly referred to its determination made in the administrative review conducted in 1986. In the Panel's view, this reference to a previous determination in which the DOC had expressly addressed the study was sufficient to conclude that the DOC had not failed to consider this study, as argued by the EC. The Panel further noted that the EC advanced no arguments to contest the adequacy of the DOC's evaluation of this study in the previous determination.

472. For the reasons set out in paragraphs 470 and 471, the Panel found that, in respect of the DOC's finding that BSC was not equityworthy prior to the period 1984/86, the explanation provided by the DOC was sufficient for the Panel to conclude that this finding resulted from a proper examination of the totality of the evidence before the DOC, including evidence on the record on BSC's future prospects.

473. With respect to the DOC's finding that BSC was not equityworthy in 1984/85 and 1985/86, however, the Panel noted that the DOC's determination did not contain any discussion of the question of BSC's future prospects. This determination did not enable the Panel to discern the reasoning of the DOC in finding that the information on the record on future prospects of BSC did not detract from a finding, based on certain financial indicators, that BSC was not equityworthy.

474. The Panel noted in this connection that the United States submitted that the study which predicted BSC's return to viability in 1987 was prepared from a perspective which differed from that of a potential private investor. The Panel also noted the argument of the United States that the Agreement does not

[117] 51 FR 44656, 11 December 1986 (italics added).

require signatories to specifically discuss in a public notice of a determination each piece of evidence examined by investigating authorities.

475. The Panel did not disagree with this latter argument[118], but considered that this argument was of little relevance to the issue before it because the DOC's determination did not even in general terms indicate that the DOC had found that the information before it with regard to BSC's future prospects was not relevant to its examination of whether or not BSC was equityworthy. The Panel's view regarding the insufficiency of the DOC's reasoning with regard to BSC's future prospects was not based on the absence in the DOC's determination of a detailed discussion of, or reference to, a particular document, but on the fact that the DOC had not even in broad terms explained its evaluation of evidence on BSC's future prospects in the context of its examination of whether BSC was equityworthy. The Panel recalled that previous panel reports had declined to review contested determinations in light of reasons not reflected in a public statement of reasons issued by the investigating authorities at the time of their determination.[119]

476. The Panel, in the light of the preceding considerations, found that the DOC had failed to explain its finding that BSC was unequityworthy in 1984/85 and 1985/86 in a manner sufficient to enable the Panel to discern how this finding was the result of an examination of the totality of the evidence before the DOC, including relevant facts regarding future prospects of BSC which might possibly have detracted from a finding that BSC was not equityworthy.

477. The Panel then considered whether its finding in the preceding paragraph should lead it to conclude that, as argued by the EC, the United States had acted inconsistently with its obligations under Article 4:2 by reason of the finding of the DOC that BSC was not equityworthy during certain years.

478. The Panel considered that the insufficiency of the DOC's explanation of its evaluation of the future prospects of BSC could not be said to be in violation of an obligation which sprang specifically from Article 4:2. The Panel recalled in this regard its observations in section 2 of these findings on the need to interpret Article 4:2 in accordance with its natural meaning and with its specific function in the Agreement. The Panel further recalled its observation in paragraph 354 above regarding the obligation of investigating authorities to properly examine relevant facts and to provide proper reasoning to substantiate their findings. In this connection, the Panel noted, in particular, the requirements of Article 2:15. The Panel also noted that, in finding the explanation of the DOC to be insufficient, it had examined this explanation in light of a standard of an objective examination of the facts in the record, which standard the Panel had derived by analogy with Article 6:1 of the Agreement.

479. In light of its considerations in paragraphs 476-478, the Panel found that the United States had acted inconsistently with Article 1 of the Agreement when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, the DOC found that BSC was not equityworthy during certain years, by reason of the inadequate explanation by the DOC of its evaluation of BSC's future prospects.

480. The Panel then proceeded to examine the issue of the alleged failure of the DOC to take account of prospective factors in connection with the finding of the DOC, in the investigation of imports from France, that Usinor, Sacilor, and Usinor Sacilor were unequityworthy.

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[118]See *supra*, paragraph 466.

[119]See e.g. Korea - Anti-Dumping Duties on Imports of Polyacetal Resins from the United States, Report of the Panel, ADP/92, 2 April 1993, adopted on 26 April 1993, paragraphs 208-213, and Brazil - Imposition of Provisional and Definitive Countervailing Duties on Milk Powder and Certain Types of Milk From The European Economic Community, Report of the Panel, SCM/179, 27 January 1993, adopted on 28 April 1994, paragraphs 282-291

481. The Panel noted the explanation of this finding in the DOC's final affirmative determination:

"Petitioners have alleged that Usinor, Sacilor and Usinor Sacilor were unequityworthy for certain years during the period 1979 through 1991, and, therefore, that equity infusions received during those years were inconsistent with commercial considerations. The Department previously determined that Usinor and Sacilor were unequityworthy for the years 1978 and 1981 in Final Affirmative Countervailing Determinations: Certain Steel products from France, 47 FR 39332 (September 7, 1982) (Certain Steel). Respondents have presented no new evidence in this investigation that contradicts the Department's findings.

Based on the following analysis, we have determined that Usinor, Sacilor and Usinor Sacilor were unequityworthy during the years 1982 through 1988 and that Usinor Sacilor was equityworthy during 1991. Although petitioners' allegation includes 1989 and 1990, there were no infusions in those years.

Throughout the period 1982 to 1987, Usinor, Sacilor, and Usinor Sacilor reported substantial losses. Stockholders' equity was negative in every year except 1986. Accordingly, certain financial indicators, such as rate of return on assets and equity and profit margin on sales, were negative. Therefore, we determine Usinor, Sacilor, and Usinor Sacilor to be unequityworthy in those years.

However, respondents argue that the Department should place its emphasis on indicators of future financial health as would a private investor, not on past indicators. Respondents argue that the 1986 restructuring, which was undertaken in accordance with a study prepared by McKinsey& Co., had a dramatic effect upon Usinor Sacilor's profitability, making it a firm in which it would be reasonable for investors to invest.

We have analyzed the information on the record with respect to the study prepared by McKinsey & Co. We disagree with respondents that, as a result of this study and its projections, we should ignore all past financial indicators when making our equityworthy determination. In our view, a prudent investor would not assess the reasonableness of investing in the newly restructured company without taking into consideration the tremendous financial difficulties of both companies prior to the restructurings or the reasons for those difficulties. For this reason, and absent any positive financial indicators prior to the restructuring, we have continued to find Usinor Sacilor unequityworthy in 1986 and in 1987 and 1988.

(...)

We preliminary determined that Usinor Sacilor was unequityworthy in 1991 based upon a review of the financial data and a summary of an analysis of Usinor Sacilor performed by an independent Swiss consulting firm. We stated that beginning in 1988, the company reported positive rates of return on both assets and equity for the preceding years, although the financial position of the firm weakened yearly. However, since the preliminary determination, the complete Swiss consulting report has been submitted for the record and we have been able to evaluate it. Based on our review of the complete report, we have reevaluated Usinor Sacilor's potential for generating a reasonable rate of return within a reasonable period of time and concluded that Usinor Sacilor was equityworthy during 1991."[120]

[120] 58 FR 6222-6223

482. The above statements made it clear that the DOC had in fact taken into consideration information in a McKinsey study with respect to future prospects of Usinor Sacilor, but had found that, against the background of the negative financial indicators of past performance, this information did not justify a finding that Usinor Sacilor was equityworthy.

483. It appeared to the Panel that the EC did not contest that the McKinsey study had in fact been considered by the DOC, or that the financial indicators which served as the basis for the DOC's findings were factually incorrect. Rather, the EC in essence argued that the DOC had provided an insufficient rationale for dismissing the McKinsey study, which concluded that restructuring would enable Usinor Sacilor to meet certain "viability" criteria established by the Commission of the European Communities. In particular, the EC took the view that in dismissing the McKinsey study the DOC had improperly shifted its standard from a "reasonable" to a "prudent" investor, that the DOC had failed to take into account that the study would have assured any potential investor as to the positive prospects of the firm, and that the DOC had ignored the fact that the positive performance of Usinor Sacilor since 1978 confirmed the predictions in the McKinsey study.

484. The Panel recalled that, in addition to the McKinsey study, predicting an improvement in the health of Usinor Sacilor if certain conditions were met, the facts on the record before the DOC included certain negative past financial indicators, the factual correctness of which had not been contested by the EC. Under these circumstances, the Panel considered that its task was not to make its own evaluation of the significance to be accorded to the McKinsey study in the examination of Usinor Sacilor's equityworthiness, but to determine whether the explanation provided by the DOC of its finding that Usinor Sacilor was unequityworthy enabled the Panel to discern how this finding was the result of an examination of the totality of the evidence before the DOC, including relevant facts regarding the future prospects of Usinor Sacilor which might possibly detract from a finding that Usinor Sacilor was not equityworthy.[121] The Panel recalled that both parties agreed that an examination of prospective factors was relevant to an examination of whether an investment in a firm was commercially rational.

485. The Panel noted that in its determination the DOC addressed the McKinsey study by stating that:

> "We disagree with respondents that, as a result of this study and its projections, we should ignore all past financial indicators when making our equityworthy determination. In our view, a prudent investor would not assess the reasonableness of investing in the newly restructured company without taking into consideration the tremendous financial difficulties of both companies prior to the restructurings or the reasons for those difficulties."[122]

486. The Panel saw no merit in the argument of the EC regarding the shift in the DOC's standard from a "reasonable" private investor to a "prudent" investor. As argued by the United States, "prudence" could well be considered to be an aspect of "reasonableness". The above-quoted statement did not support the EC's view that the DOC relied on an unrealistic concept of risk avoidance on the part of private investors. The Panel therefore considered that the mere fact that the DOC used the concept of a "prudent" investor in its discussion of the McKinsey study was not grounds for holding the DOC's reasoning to be insufficient.

487. The Panel also considered that the issue to be decided by the DOC was not whether the equity infusion by the Government of France had turned out to be in fact a sound investment, but whether a reasonable private investor would have made an investment in Usinor Sacilor at the time the Government

[121] See *supra*, paragraph 466.

[122] 58 FR 6222

of France provided equity capital to Usinor Sacilor. That issue could logically be decided only in light of an evaluation of the circumstances at the time of the equity infusion by the Government of France. Therefore, that the DOC, in discussing the McKinsey study, did not consider the improved performance of Usinor Sacilor since 1987, was not grounds for finding the DOC's reasoning to be insufficient.

488. While the Panel thus did not see merit in some of the arguments advanced by the EC to contest the adequacy of the DOC's explanation of its dismissal of the McKinsey study, the Panel nevertheless considered that the cursory manner in which the DOC addressed the issue of the future prospects of Usinor Sacilor after restructuring did not explain why in the DOC's view the information in this study did not alter the DOC's assessment of whether a "reasonable private investor" would have made an equity investment in Usinor Sacilor. While a prudent private investor would "take into consideration" the financial difficulties of Usinor Sacilor when examining the reasonableness of an investment, such an investor would also "take into consideration" any relevant and credible information on the future prospects of the firm. Therefore, the statement that a prudent investor would have "taken into consideration" Usinor Sacilor's financial difficulties by itself did not explain why the DOC took the view that such an investor would have attached decisive significance to those difficulties. In this regard, the Panel noted that it was not clear that Usinor Sacilor's financial difficulties, and the reasons for those difficulties, prior to restructuring, would not also have been taken into account in the McKinsey study of Usinor Sacilor's future prospects.

489. The Panel observed in this respect that the United States argued before the Panel that there were several factors explaining the DOC's conclusion that the McKinsey study was not of decisive importance, compared with the other facts on the firm's negative past performance. The Panel also noted that the EC argued that the analysis in the McKinsey study was highly relevant to any potential investor.

490. As noted above, the Panel was of the view that it was not its task to make its own judgement regarding the significance of the McKinsey study and the Panel did not wish to suggest that the factors mentioned by the United States might not have been a proper basis for the DOC to conclude that the McKinsey study was not of decisive significance. However, while the Panel did not consider that the DOC was required to discuss such factors in detail in the text of its determination, absent some statement by the DOC indicating in general terms problems with the relevance or credibility of the analysis in the McKinsey study, the Panel could not find that the DOC had provided any rationale in support of its dismissal of the McKinsey study.

491. For the reasons set out in the preceding paragraphs, the Panel found that the DOC had in fact considered information on the record regarding future prospects of Usinor Sacilor, but had failed to provide an explanation sufficient to enable the Panel to discern how the DOC's finding that Usinor Sacilor was unequityworthy was the result of an examination of the facts of record as a whole, including relevant facts regarding the future prospects of Usinor Sacilor which might possibly detract from the finding that Usinor Sacilor was not equityworthy.

492. The Panel recalled its discussion above of the legal consequences of the insufficient explanation provided by the DOC of the reasons for its finding that BSC was not equityworthy during certain years.[123]

493. In light of the foregoing considerations, the Panel found that the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC made a finding that Usinor Sacilor was not equityworthy, by reason of the inadequate explanation by the DOC of its evaluation of Usinor Sacilor's future prospects.

[123]See *supra,* paragraph 478.

5.1.3 Alleged failure of the DOC to take account of different perspectives of inside investors and outside investors

494. The Panel proceeded to examine the argument of the EC that the findings of the DOC that certain firms in France and the United Kingdom were unequityworthy were not based on an examination of all relevant facts, and were thereby inconsistent with Article 4:2, on the grounds that the DOC had evaluated the commercial rationality of the equity investments in question from the perspective of a potential *outside* investor and had ignored that, as owners of the firms, the governments were *inside* investors and guided by a different rationale from that of potential outside investors.

495. The Panel noted the disagreement between the parties on whether a distinction between inside investors and outside investors was relevant to an evaluation of the commercial soundness of an equity investment. The following were the main arguments submitted by the parties on this question.

496. The EC argued that the investment behaviour of an inside investor was guided by a different rationale from the investment behaviour of an outside investor. For an inside investor it could be commercially sound to continue to invest in a company in circumstances in which an outside investor would not do so. Unlike an outside investor, an inside investor would be motivated by the need to protect and recover his existing stake in the company in question. The marginal investment theory referred to by the DOC in one of the two cases before the Panel[124] was based on the concept of opportunity costs and failed to acknowledge the economic reality that inside investors may for some time accept a negative return on their assets as long as over the longer term the net capitalized value of the stream of income from their assets was likely to remain positive. The economic textbooks referred to by the United States in support of the proposition that investments were made on the basis of expected marginal returns ignored the situation of an inside investor in an ailing company. An inside investor was typically faced with a situation in which he could either engage in a costly liquidation of assets, or participate in a restructuring of assets. With liquidation of assets, the inside investor could end up with negative net worth even if he invested in an alternative high-yielding investment. With restructuring, even low-yielding investment in the restructuring of the company would cause his net worth to be positive. Moreover, his past investment would have been saved. Finally, the EC argued that another reason why a distinction was necessary between inside investors and outside investors was that, due to his greater expertise and knowledge about the firm and the market in which the firm operated, the inside investor was better capable than an outside investor to assess the prospects for future profitability of the firm.

497. The United States argued that the arguments of the EC essentially reflected a disagreement over economic theory and did not provide a basis for finding a violation of the Agreement with respect to a matter which was not addressed in the Agreement and which had been analysed by the DOC in a manner which was logical, explained and supported by economic theory. The DOC had expressly addressed the issue of the alleged difference between inside investors and outside investors and had explained that a different standard for inside investors was not warranted because both inside investors and outside investors made investment decisions based on the marginal return expected from an equity infusion. The EC had not provided any support in economic theory for the alleged distinction between rational investment behaviour of inside investors and rational investment behaviour of outside investors. Economic theory supported the proposition that rational investment decisions were made at the margin, without regard to previous investments. The focus of the DOC's analysis was to determine whether the individual investment reflected reasonable commercial considerations, as opposed to whether the behaviour of the particular investor could be explained by reason of the experience or situation of that investor. The marginal return theory on which the DOC's methodology was based was founded on the widely accepted understanding that a rational investor assessed each investment opportunity on its own merits. If the discounted net present value of the expected return from the new investment under consideration was less

[124] 58 FR 6245

than that which would be expected to be earned on an alternative investment, the proposed investment at issue would not be made by a rational investor. The marginal return to an investor was the total return from an increment of investment and included the return to other equity of the investor. Thus, the DOC's equityworthiness methodology included a consideration of the potential return from all assets of a firm, including existing assets.

498. The United States further argued that this marginal rate of return would not be affected by the status of an investor as an inside investor or as outside investor. Whenever it made commercial sense, based on a consideration of this expected marginal return, for an inside investor to make an investment, it would also make commercial sense for an outside investor to make an investment. In this respect, the United States submitted that the real value of past investments was in the potential of the assets procured by such past investments to generate income in the future. Where those assets did not have that potential, there was no past investment that could be "saved" by a new investment. In that situation a rational inside investor would not make a new investment merely to avoid liquidation of such assets. If, however, the income-generating potential of assets procured with past investments, together with the earning power of the new investment, were such that it made commercial sense to make a new investment, it would do so equally for inside investors and for outside investors.

499. In reviewing the merits of the argument of the EC that the DOC had failed to consider as a relevant fact the position of the Governments of France and the United Kingdom as inside investors, the Panel first considered how this question had been addressed by the DOC in the determinations at issue in the dispute before the Panel.

500. In this connection, Panel noted the following comments on this issue in the final affirmative countervailing duty determination in the investigation of certain hot rolled lead and bismuth carbon steel products from the United Kingdom:

"Respondents argue that, in interpreting the commercial considerations standard for purposes of analyzing equity investments, the Department improperly focuses on the company's prospects from the standpoint of an outside investor. According to respondents, it may be commercially justifiable for an inside investor to make continued investments in a loss-making company even if a reasonable outside investor would not have invested in that company. Respondents argue that the statute does not compel the Department to use the outside investor test. Furthermore, from an economic standpoint, respondents argue that an outside investor's decisions are not influenced by the recovery of an existing investment as with an inside investor. Finally, respondents argue that investors and creditors of economically distressed companies routinely decide, on grounds that are economically and financially sound, to invest money or to forbear from taking funds out of the enterprise.

DOC Position: We do not believe that we should have a separate standard for an "inside investor". We believe that, in general, both inside and outside investors make investment decisions at the margin. As we stated in the Final Affirmative Countervailing Duty Determination: Steel Wheels from Brazil, 54 FR 15523 (April 18, 1989) 'a rational investor does not let the value of past investments affect present or future investment decisions. The decision to invest is only dependent on the marginal return expected from each additional equity infusion.'"[125]

[125] 58 FR 6237, 27 January 1993, at 6245.

The Panel noted that there was no discussion of this matter in the DOC's final affirmative determination in the investigation of imports from France. The information before the Panel did not indicate that the question of the treatment of inside investors had been raised in that investigation.

501. The Panel then noted that the arguments of the parties essentially reflected a disagreement over economic analysis of rational investment behaviour. The Panel's task, however, was to determine whether the DOC acted inconsistently with legal requirements of the Agreement by not making a distinction between the perspectives of inside investors and outside investors. In this regard, the Panel considered the following points to be relevant.

502. Firstly, the Panel noted that in the case in which the question of the need for a distinction between inside and outside investors was raised, the DOC had expressly addressed this question and had provided an explanation of why it declined to make this distinction. It was clear from this explanation that the DOC based its rejection of this distinction on the view that rational investors, whether inside or outside, make investment decisions at the margin and do not let the value of past investments affect present or future investments. The Panel therefore considered that there were no grounds to hold that the DOC had failed to provide a reasoned basis for its decision.

503. Secondly, the Panel examined whether the arguments of the EC were a reason to conclude that the explanation provided by the DOC was not adequately supported by rational analysis.

504. In this connection, the Panel noted that the DOC's approach focused on the relative attractiveness of a particular investment and was based on the view that all rational investment decisions involve an evaluation of the expected marginal return on a new investment. According to this position, given that both inside and outside investors, if acting rationally, focus on the marginal return from a new investment, there are no situations in which it will be rational for an inside investor to make an investment, but not for an outside investor. The Panel also noted the criticism of the EC of the marginal investment theory applied by the DOC.

505. The Panel observed that, while the United States had pointed to academic works on financial analysis in support of the marginal investment theory, the EC had not referred to academic literature contesting this approach to the analysis of investment behaviour. The Panel further considered that implicit in the EC's argument that under certain conditions it would be rational for an inside investor to accept a negative return on its assets was the view that a rational inside investor would not evaluate the relative attractiveness of a new investment in a firm in which the investor already owned equity by comparing the expected return on the new investment with the expected return on alternative investment opportunities elsewhere. Thus, a rational inside investor would only look at whether over the longer term the net capitalized value of the stream of income was likely to remain positive, without regard to whether a higher return could be obtained by making an investment elsewhere. However, in the Panel's view, the arguments of the EC provided no basis to hold that economic theory precluded an analysis of rational investment behaviour in terms of an examination of the relative attractiveness of an investment based on a comparison of the discounted net present value of the expected return from the new investment with the return from an alternative investment.

506. The Panel further noted that the DOC's equityworthiness methodology provided for a consideration of potential return from all assets of the firm, including existing assets. Thus, the concept of a marginal return from a new investment included the potential return on equity already owned by an investor. This implied that the potential increased returns from existing assets due to the new investment in a company would be relevant in an assessment of the investment options being considered by reasonable private investors; a consideration of these potential increased returns from existing assets (i.e. the prospects of the company) by investors was included in their assessment of the marginal returns from different investment options. In this regard, the Panel considered that the EC's arguments did not effectively rebut the argument of the United States that the real value of past investments is the

income-generating ability of assets acquired with those investments and that, if it is rational for an inside investor to make a new investment to increase this income-generating ability of such assets, it is also rational for an outside investor to invest in the company.[126]

507. The Panel was aware that there might be circumstances under which inside and outside investors might behave differently because of factors such as differences in the availability of relevant information to inside and outside investors and the presence of barriers to exit and entry. However, the Panel did not consider that the arguments of the EC showed that such factors were relevant under the facts of the cases at hand.

508. In sum, the Panel found that the DOC had expressly addressed the issue of the alleged need to distinguish between inside and outside investors and that the explanation provided by the DOC for its decision not to make such a distinction could not be said to be inadequately supported by rational analysis. The arguments of the EC at best indicated that an alternative approach was possible. The Panel therefore could not find on the basis of these arguments that the DOC, by not making a distinction between inside investors and outside investors, had failed to consider a relevant fact.

509. In the light of the considerations above, the Panel saw no merit in the argument of the EC that the United States acted inconsistently with the Agreement when, in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France and the United Kingdom, the DOC did not make a distinction between the perspectives of inside investors and outside investors in its analysis of whether or not subsidies arose from the provision of equity capital by the Governments of France and the United Kingdom.

Conclusion

510. With regard to the claim of the EC on the findings of the DOC regarding the provision of equity capital to certain firms by the Governments of France and the United Kingdom, the Panel **concluded** that:

(i) the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, the DOC made a finding that BSC was not equityworthy by reason of the inadequate explanation by the DOC of its evaluation of the future prospects of BSC;

(ii) the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC made a finding that Usinor Sacilor was not equityworthy, by reason of the inadequate explanation by the DOC of its evaluation of Usinor Sacilor's future prospects.

The Panel recalled that it had found that the other arguments raised by the EC in support of its claim with regard to these findings were without merit.

5.2. The DOC's calculation of the amount of subsidy in respect of equity infusions by the Governments of France and the United Kingdom

511. Having concluded its review of the issues in dispute between the parties regarding the findings of the DOC of the *existence* of countervailable subsidies in the form of equity infusions by the Government of France and the Government of the United Kingdom, the Panel examined the EC's complaint in respect of the method applied by the DOC for *calculating the amount* of these subsidies.

[126] The Panel noted the example provided by the United States in this context. See Annex 2 to this Report.

512. The Panel noted the argument of the EC that the DOC had failed to take into account all relevant facts and thereby acted inconsistently with Article 4:2 when the DOC calculated the amount of subsidy resulting from equity infusions in firms found to be unequityworthy as grants given in the years in which the equity infusions were made. The EC submitted that the DOC had departed from its previously applied methodology for calculating the amount of subsidies in the case of government equity infusions. The new methodology led to substantially higher rates of countervailing duties than the previous methodology. Regardless of whether a "cost to government" or "benefit to the recipient" approach was taken to the issue of the calculation of the amount of subsidies, the new methodology of the DOC was fundamentally flawed in that it ignored the inherent difference between an equity infusion and a grant. While an equity infusion gave rise to ownership rights and an expectation of a future return on the equity investment on the part of the investor, in the case of a grant there was no such counterpart. The EC considered that, in the calculation of the amount of a subsidy, an equity infusion could be treated as a grant only if the equity were written-off.

513. According to the United States, the DOC's treatment of equity infusions as grants, for purposes of determining the amount of subsidy, was consistent with the "benefit to the recipient" approach to the calculation of the amount of subsidies, an approach which was permissible under the Agreement. If a company was not equityworthy, any equity capital provided to that company was capital the company would not otherwise have achieved and thus benefitted the company in the same manner as a grant. Accordingly, it was permissible to value the amount of the subsidy by treating the equity infusion as a grant. The DOC had changed its previous calculation methodology because it had found that that methodology did not accurately measure the benefit of an equity infusion to the company in which the equity infusion was made. The argument of the EC regarding the ownership rights and expectations of future returns of the provider of the equity capital was based on a "cost to government" approach which was not required by the Agreement. Finally, the United States argued that the argument of the EC that an equity infusion could be treated as a grant only if the equity were written off was of no consequence in the French case because in that case the equity had been written off immediately after the infusions took place.

514. The Panel noted the explanation by the DOC in the determinations at issue of its method for calculating the amount of subsidy with respect to government equity infusions:

"According to section 355.49(e) of the Department's Proposed Regulations, the Department measures the benefit of equity investments in 'unequityworthy' firms by comparing the national average rate of return on equity with the company's rate of return on equity during each year of the allocation period. The difference in these amounts, the so-called rate of return shortfall (RORS), is then multiplied by the amount of the equity investment to determine the countervailable benefit in the given year.

The Department has concluded that the RORS methodology does not provide an accurate measure of the benefits arising from government equity investments in unequityworthy companies. When the Department finds that a company is unequityworthy and, hence, that the government's equity investment is inconsistent with commercial considerations, we are effectively finding that the company could not attract share capital from a reasonable investor. When a company is in such poor financial condition that it cannot attract capital, any capital it receives benefits the company as if it were a grant and no earnings of the company in the subsequent years should be used to offset the benefit.

Moreover, in calculating the company's rate of return, no adjustment is made to eliminate the effect of past or current subsidies. Therefore, those subsidies that increase the company's rate of return serve to reduce the amount of the subsidy arising from government equity investments in subsequent years. In addition, this method does not compensate for the effect of prior year results on equity in subsequent years, thus measuring the rate of return against an equity other than that invested in the transaction in question.

For these reasons, we have determined that equity investments in unequityworthy companies will be treated as grants given in the year of the equity investment. Accordingly, we will value the benefit using the grants methodology described below.

Where a market-determined benchmark price for equity exists, we will continue to use that benchmark to determine whether the government's purchase of equity confers a subsidy and to measure the amount of the subsidy.[127]

515. The parties did not disagree on the simple fact that equity investments and grants are different in that an equity investment gives rise to ownership rights and to an expectation of a future return on the funds invested, but disagreed on whether or not this distinction was relevant to the calculation of the amount of subsidy resulting from an equity infusion.

516. The Panel noted that the Agreement does not provide for specific rules on the calculation of the amount of a subsidy. Footnote 15 ad Article 4:2 calls on the signatories to develop an understanding on that issue, but such an understanding has not been developed. In the absence of such specific rules, the Panel reviewed whether the DOC's method of calculating the amount of a subsidy in the case of government equity infusions by treating the equity infusions as grants received in the year in which the equity infusions were made was based on rational analysis.

517. In this regard, the Panel attached importance to the fact that under the "reasonable private investor" standard applied by the DOC a finding that a company was unequityworthy did not necessarily mean that any investment in that company would yield zero or negative returns.[128] In other words, a finding that a firm was not equityworthy did not mean that the recipient of the equity investment did not have to provide some return on the investment. This anticipation of a future return existed at the time the equity infusion was received by the company. Moreover, the provider of the equity capital, by virtue of its ownership rights, also had other claims on the company. Thus, in the case of bankruptcy, shareholders would be reimbursed to the extent possible.

518. On this basis, the Panel considered that, in calculating the amount of a subsidy resulting from a government equity infusion to an unequityworthy company, equity investment could not logically be treated in the same manner as grants unless the possibility of deriving any future return from the equity investment could be precluded. In the Panel's view, the relevance of this distinction between equity investments and grants in the context of a calculation of the amount of subsidy was not dependent upon a "cost to government" approach, nor was it dependent upon whether the amount of a subsidy was to be determined at the time of the receipt of a subsidy, without regard to subsequent events. Even under an approach focusing on a benefit to the recipient, the anticipation of a return which would have to be provided by the recipient of the equity investment was a factor distinguishing the benefit derived from an equity infusion (at the time the equity investment was made) from the benefit derived from a grant. The Panel therefore considered that the DOC's statement that any capital received by an unequityworthy company benefited that company as if it were a grant lacked a rational basis.

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[127] Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France, 58 FR 6221, 27 January 1993, at 6223, and Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 58 FR 6237, 27 January 1993, at 6241-6242.

[128] See *supra*, paragraph 173.

519. The Panel could find no factual support in the text of the affirmative final determination of the DOC in the French case for the contention of the United States that equity provided by the Government of France had been written off "immediately". The discussion in this determination suggested that, while certain equity infusions had been written off, this had occurred at a later point in time. Thus, with respect to equity infusions arising from the conversion of PACS, FIS bonds and shareholders' advances into common stock, the DOC stated in the determination that:

> "... we have concluded that any benefits to Usinor Sacilor occurred at the point when these instruments were converted to common stock. Because the equity methodology does not recognize the subsequent performance of the company receiving the equity investment and treats the equity investment as a grant, *the later write-off of the equity* is irrelevant."[129]

520. The Panel considered that by calculating the amount of the subsidies resulting from equity infusions by treating these equity infusions as grants, the DOC had calculated countervailing duties in excess of the amount of the subsidy found to exist, contrary to Article 4:2.

Conclusion

521. The Panel, **concluded**, in light of the preceding considerations, that the United States had acted inconsistently with Article 4:2 and had thereby acted inconsistently with Article 1 when, in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France and the United Kingdom, the DOC calculated the amount of subsidy resulting from government equity infusions as if these equity infusions constituted grants.

6. The findings of the DOC regarding loans provided by the Government of France

522. The Panel turned its consideration to the request of the EC that the Panel find that the United States had acted inconsistently with its obligations under Articles 1, 2:15, and 4:2 of the Agreement because of the findings made by the DOC regarding loans by the Government of France to certain firms.

523. The Panel noted that the EC's claim raised two distinct issues. Firstly, the EC argued that the DOC had acted inconsistently with Articles 4:2 and 2:15 in finding that certain firms in France in question were "uncreditworthy" in the years in which the Government of France had provided loans to those firms. Secondly, the EC argued that the DOC had acted inconsistently with Article 4:2 because of the "discount rate" used by the DOC in calculating the amount of the benefits from certain subsidies.

524. The Panel first examined the issues raised by the EC in respect of the DOC's finding that the firms in question were not creditworthy in the years in which loans were provided to those firms by the Government of France.

[129] 58 FR 6221, 27 January 1993, at 6224 (italics added)

6.1 The DOC's findings of subsidies arising from certain loans

525. The Panel noted that, under the methodology applied by the DOC in this investigation, "a loan provided by a government confers a countervailable benefit to the extent that the amount paid by a firm for the government loan is less than what the firm would pay for a benchmark loan."[130] The determination of the appropriate benchmark loan depends upon whether the firm is found to be creditworthy. If a firm is found not to be creditworthy, the benchmark loan will be different from when the firm is found to be creditworthy.

526. The Panel further noted that according to the Proposed Countervailing Duty Regulations of the DOC, a firm will be considered to be uncreditworthy if the DOC determines that:

> "... the firm did not have sufficient revenues or resources to meet its costs and fixed financial obligations in the three years prior to the year in which the firm and the government agreed upon the terms of the loan."[131]

This determination is to be made on a case-by-case basis; the Proposed Countervailing Duty Regulations mention several factors which the DOC may consider in making this determination, among others.

527. The Panel noted that in the case at hand the DOC analyzed whether Usinor, Sacilor and Usinor Sacilor were "uncreditworthy" from 1978 through 1991. The DOC found that Usinor and Sacilor were uncreditworthy during the years 1978 through 1981, that Usinor, Sacilor and Usinor Sacilor were uncreditworthy for the years 1982 through 1989, and that Usinor Sacilor was creditworthy in 1990 and 1991.[132]

528. The parties disagreed on whether the findings of the DOC that certain French firms were uncreditworthy were based on an examination of all relevant facts and on whether the DOC had adequately explained the reasons for these findings.

529. The positions of the parties on these questions can be recapitulated as follows.

530. The EC submitted that, in finding that the firms in question were not creditworthy, the DOC had acted inconsistently with Article 4:2 by failing to consider the future prospects of the firms and the distinct perspective of the French Government as an inside lender. As a result, the DOC's methodology applied in this case could lead to a finding of subsidies where no subsidies existed, or to the imposition of countervailing duties in an amount in excess of the amount of the subsidies. The EC made the following points in this connection. Firstly, the EC argued that the creditworthiness test applied by the DOC was inherently biased against the consideration of prospective factors. While the Proposed Countervailing Duty Regulations of the DOC mentioned prospective factors as an element to be considered in a creditworthiness analysis, the wording of the creditworthiness test in these Proposed Countervailing Duty Regulations made it clear that prospective factors could never be the basis of a determination as to whether or not a firm was creditworthy. In this regard, the EC pointed out that according to these Proposed

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[130]Department of Commerce, International Trade Administration, 19 CFR Part 355, Countervailing Duties; Notice of Proposed Rulemaking and Request for Public Comments, 54 FR 23365, 31 May 1989, at 23380

[131]*Id*. The United States explained before the Panel that this formulation was not an entirely correct reflection of the actual methodology of the DOC. See *supra*, paragraph 234.

[132]58 FR 6221, 27 January 1993, at 6223.

Regulations, the actual determination on creditworthiness could be based only on an assessment as to whether "in the three years prior to the year in which the firm and the government agreed upon the terms of the loan" the firm had sufficient revenues or resources to meet its cost and fixed financial obligations. Secondly, the EC argued that, on the basis of a McKinsey report on the effects of restructuring of Usinor Sacilor and in view of several financial data for the period 1984-1986, it would have been apparent in 1986 to a well-informed lender, and certainly to an inside lender such as the French Government, that the firm's future prospects were good. Thirdly, the EC argued that for an inside lender a firm's ability to service and repay its existing debt was crucial even if various financial indicators were negative and a firm was making losses. Fourthly, the EC argued that the text of the DOC's determination showed that the financial data mentioned by the DOC in support of its finding that Usinor Sacilor was not creditworthy were not sufficient to make a clear case that Usinor Sacilor could not meet its short-term obligations. If, in addition to this fact, the DOC had properly considered the future prospects of the firm and the perspective of the French Government as an inside lender, it could have arrived at a different finding.

531. In support of its argument that the finding of the DOC that certain French firms were uncreditworthy was inconsistent with Article 2:15, the EC argued that the DOC, by stating that it disagreed "that a lender would rely solely on future profitability from restructuring", had misrepresented the argument of the respondents and had failed to provide a properly argued basis for its decision. A properly argued decision under Article 2:15 would have required a weighing of backward-looking and prospective factors in which the prospective factors ought to have received a greater weight than accorded by the DOC. By failing to provide a reasoned analysis weighing up the backward and forward looking factors, the DOC had failed to comply with the requirement of Article 2:15 to provide reasons and basis sufficient to support a finding and to enable a panel to verify whether the requirements of the Agreement had been met.

532. The United States rejected the claim of the EC regarding the failure of the DOC to consider all relevant facts on the following grounds. Firstly, the United States rejected the EC's characterization of the DOC's creditworthiness methodology as giving insufficient attention to information on the future financial position of a firm. Through inadvertence, the DOC's proposed countervailing duty regulations did not correctly represent the test actually applied by the DOC. The United States submitted that in practice the DOC evaluated, whether or not a firm had sufficient revenues and resources to meet its costs and fixed financial obligations not "in", but "based on data from" the three years prior to the year of the loan agreement. Such data included studies on a firm's future financial position. Secondly, the United States argued that in the case at hand, the DOC had sought information on the firm's future prospects and had carefully analyzed a study referred to by respondents on the expected financial position of Usinor Sacilor after restructuring, but had found that the numerous negative indicators outweighed the prospective factors. The mere fact that the DOC did not find the McKinsey study to be probative was no substantive basis for the EC to characterize the DOC's creditworthiness test as not giving true consideration to future-oriented factors. There was no basis in the Agreement for the EC's argument that the DOC should have given more weight to this study. Thirdly, the United States argued that the DOC's conclusion regarding Usinor Sacilor's difficulties in meeting its short-term obligations was appropriate in light of the information before the DOC. Fourthly, the United States argued that the economic analysis of lending behaviour was similar to that of investment behaviour. Because rational lenders would base their lending decisions on expected marginal returns, there was no basis for a distinction between inside lenders and outside lenders in an examination of whether or not a firm was creditworthy.

533. With respect to the argument of the EC that the DOC had failed to provide adequate reasons, the United States argued that the DOC's determination showed that the DOC had carefully analyzed and explained its creditworthiness test and the significance of the McKinsey study. Because the DOC had fully addressed the McKinsey study in the context of its equityworthiness analysis, the DOC had not repeated that discussion in the context of its creditworthiness analysis. The DOC's statement quoted by the EC was made during the course of a lengthy discussion on creditworthiness, and viewed in that context the DOC's statement clearly showed that the DOC reasonably found that the predictions of the McKinsey study did not outweigh the accumulated mass of negative evidence.

534. The Panel noted the DOC's explanation of the factual basis of its findings that certain French firms were uncreditworthy during certain years:

"We have analyzed whether Usinor, Sacilor and Usinor Sacilor were uncreditworthy from 1978 through 1991.

Based on our analysis of Usinor's and Sacilor's financial statements, their debt-to-equity ratios indicate that the companies were highly leveraged during 1979 through 1981. In addition, the current and quick ratios indicate low levels of liquidity available to pay debts. Moreover, Usinor Sacilor reported net losses for each of these years. Therefore, although we cannot analyze the companies' actual experience in meeting their debt obligations because no information was provided on this point, the above indicators lead us to conclude that the companies would have had difficulty making interest and principal payments. Given this, we continue to determine that Usinor and Sacilor were uncreditworthy during the years 1978 through 1981.

To determine the creditworthiness of Usinor, Sacilor, and Usinor Sacilor during the period 1982 through 1991, we have evaluated certain liquidity and debt ratios, i.e., current and quick, times interest earned, long-term debt, and debt-to-equity on a consolidated basis. For the period 1979 through 1987, the company consistently incurred substantial losses. The interest coverage ratios were negative and the liquidity ratios indicated that the company may have had difficulty in meeting its short-term obligations. Although Usinor Sacilor reported a profit in 1988, as a result of our analysis, we determine that Usinor, Sacilor, and Usinor Sacilor were uncreditworthy for the years 1982 through 1989.

Respondents have argued that when determining the creditworthiness of a company, the Department must consider the extent to which the company was able to obtain loans from the private sources without government assistance or guarantees. Respondents argue that Usinor and Sacilor, in fact, had obtained such loans since 1978. However, respondents have provided no information with respect to the nature of the loans from private sources nor whether Usinor, Sacilor, or Usinor Sacilor were able to obtain this private debt without government assistance and/or guarantees. Therefore, we have not considered the extent of Usinor Sacilor's private borrowings in determining whether Usinor Sacilor was creditworthy.

Respondents have further argued that the 1986 restructuring greatly improved Usinor Sacilor's outlook, making it a better risk for lenders as well as for investors. In contrast, petitioners maintain that Usinor Sacilor's return to profitability should be ignored because it was primarily the result of subsidies provided in 1986 and 1988.

With respect to respondent's arguments, we disagree that a lender would rely solely on future profitability resulting from restructuring. With respect to petitioner's arguments regarding the past subsidies received by Usinor Sacilor, past practice and our regulations do not allow us to consider the effect of past subsidies when making a determination as to whether a firm is creditworthy, as is set forth in 355.44(b)(6)(iii) of the Department's Proposed Regulations.

Our review of the financial statements and certain ratios for the years 1990 through 1991, as well as the prior three years, indicates that Usinor Sacilor was able to generate sufficient cash flow to meet its current and long-term obligations. Therefore, we continue to determine that Usinor Sacilor was creditworthy during these years."[133]

535. The Panel considered that this explanation made it clear that the DOC had based its findings on the financial statements of the firms under consideration. With respect to the period 1979 through 1981, these statements indicated that (1) the firms were highly leveraged, as indicated by the debt-to-equity ratios, (2) the firms disposed of a low level of liquidity available to pay debts, as indicated by the current and quick ratios, and (3) there were net losses for each of these years. With respect to the period 1982-1989, the DOC based its finding on (1) substantial losses incurred consistently from 1979 through 1987, (2) negative interest coverage ratios, and (3) the difficulty which the firm might have had in meeting its short-term obligations, as indicated by certain liquidity ratios. The DOC's statement further made it clear that the DOC took the view that the alleged improvement in Usinor Sacilor's outlook as a result of the restructuring in 1986 did not provide a reason to alter its assessment that the firms were uncreditworthy, based on its analysis of the financial statements.

536. The Panel noted that, although the focus of the claim of the EC was on the alleged failure of the DOC to consider prospective factors and the different perspectives of inside lenders and outside lenders, the EC advanced one argument which was distinguishable from the issue of whether or not the DOC had considered information on prospective factors and had considered the status of the French Government as an inside lender. The EC argued that the DOC's statement that the firm "may have had difficulty in meeting its short-term obligations" showed that the financial statements relied upon by the DOC did not provide a sufficient basis to support the finding of uncreditworthiness. Before addressing the arguments of the EC regarding the DOC's failure to consider prospective factors and to consider the status of the French Government as an inside lender, the Panel examined whether or not this argument of the EC was a grounds for finding that the DOC's statements on the negative indicators from the firm's financial statements were not adequately supported by fact.

537. With regard to the EC's criticism of the DOC's statement that "the company may have had difficulty in meeting its short-term obligations", the Panel recalled the context of this statement:

"For the period 1979 through 1987, the company consistently incurred substantial losses. The interest coverage ratios were negative and the liquidity ratios indicated that the company may have had difficulty in meeting its short-term obligations. Although Usinor Sacilor reported a profit in 1988, as a result of our analysis, we determine that Usinor, Sacilor and Usinor Sacilor were uncreditworthy for the years 1982 through 1989."[134]

This passage indicated that the difficulty the company might have had in meeting its short-term obligations, as indicated by the liquidity ratios, was only one factor in the DOC's analysis, in addition to the substantial losses and negative interest coverage ratios. Furthermore, the Panel noted that the DOC was not analyzing the actual experience of the company in meeting its financial obligations, but was assessing the company's ability to meet its financial obligations. In the Panel's view, the use of the word "may" could reflect the fact that the DOC conducted its creditworthiness analysis on the basis of the firm's financial statements rather than on the basis of data on actual borrowing. The Panel noted in this connection that the EC did no contest that, as argued by the United States, data on actual borrowing by the firm had been requested by the DOC, but not provided by the respondents. For these reasons, the Panel considered that the phrase " the company may have had difficulty in meeting its short-term obligations" was no grounds to find that, as argued by the EC, the financial ratios relied upon by the DOC could not support the DOC's finding of uncreditworthiness.

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[133] 58 FR 6223

[134] 58 FR 6223

538. The Panel then considered the argument of the EC that, in finding that Usinor Sacilor was not creditworthy, the DOC had failed to consider information on the future prospects of the firm.

539. The Panel first addressed the more general argument of the EC that the DOC's creditworthiness test, as formulated in the DOC's Proposed Countervailing Duty Regulations, by definition prevented the DOC from properly taking into account information on prospective factors when determining whether a firm was uncreditworthy.

540. The Panel noted that this argument of the EC was based solely on the fact that the DOC's Proposed Countervailing Duty Regulations provided for a determination that a firm was not creditworthy if the DOC determined that the firm did not have sufficient revenues or resources to meet its costs and fixed financial obligations "<u>in</u>" the three years prior to the year of the loan agreement. The Panel was of the view that, taken literally, there was indeed arguably a contradiction between the wording of this test and the inclusion, among the factors to be considered by the DOC, of "Evidence of a firm's future financial position, such as market studies, country and industry economic forecasts, and project and loan appraisals."[135] The Panel noted, however, that the United States had pointed out that the words "in the three years ..." reflected a drafting error and did not accurately describe the test actually applied by the DOC. The Panel further noted that this formulation appeared in what were proposed, not final regulations, and that this formulation was not mentioned by the DOC in the determination at issue before the Panel. For these reasons, the Panel considered as unfounded the EC's argument that the wording of the creditworthiness test in the proposed countervailing duty regulations of the DOC by itself showed that the DOC's creditworthiness methodology was inherently biased against prospective factors.

541. The Panel then examined the arguments of the EC as to the allegedly insufficient consideration given by the DOC to prospective factors as they related to the specific facts of the case before the Panel.

542. The Panel noted that the DOC's finding that certain firms were uncreditworthy related to the period 1978-1989. The prospective factors which in the EC's view were not adequately accounted for by the DOC appeared to relate mostly to the anticipated effects of Usinor Sacilor's restructuring in 1986. It therefore appeared to the Panel that the EC was not contesting the DOC's finding of uncreditworthiness for the whole of the period 1978-1989.

543. The Panel noted that, in support of its argument that the DOC had failed to consider the future prospects of Usinor Sacilor in its creditworthiness analysis, the EC referred to certain developments in Usinor Sacilor's financial position over the period 1984-1986 and to a McKinsey study on the future prospects of Usinor Sacilor after restructuring.

544. The Panel first examined the points made by the EC with respect to the alleged improvement in Usinor Sacilor's financial position during the period 1984-1986.

545. After reviewing the data mentioned by the EC (the increase of gross margins as a percentage of sales from 1985 to 1986, the decline of interest expenses as a percentage of sales during 1984-1986, and the increase of earnings before interest, taxes and depreciation from 1984 to 1986), the Panel was of the view that these data need not be in contradiction with the finding of the DOC that the firm incurred substantial losses, that interest coverage ratios were negative and that the liquidity ratios indicated that the firm may have had difficulty in meeting its short-term obligations. For example, the earnings before interest, taxes and depreciation (EBITD) did not compare these earnings to the interest expenses borne by the firm. As such, an increase in the EBITD did not preclude a finding that the firm was not able to

[135] 54 FR 23365, 31 May 1989, at 23380.

meet its (long-term) obligations based on the "times interest earned" measure used by the DOC, or a finding that certain other financial indicators were not favourable.[136] The Panel further noted that , while the EC argued that the information on these indicators had been provided by respondents to the DOC, there was no evidence available to the Panel indicating that the respondents had referred to these indicators in connection with the DOC's creditworthiness analysis. According to the DOC's final determination, respondents raised the increased EBITD in the context of the DOC's equityworthiness analysis.[137] The Panel therefore considered that the data mentioned by the EC on the improvement in Usinor Sacilor's financial condition in the period 1984-1986 did not mean that the DOC erred when it concluded from the firm's financial statements that the firm was not creditworthy.

546. The Panel then examined the argument of the EC that the DOC had failed to consider information in a McKinsey study indicating an improvement of Usinor Sacilor's position after restructuring. The Panel noted that it was not contested that this study was on the DOC's record in this investigation.

547. In the Panel's opinion, the mere existence of evidence in the record suggesting an improvement in Usinor Sacilor's performance following restructuring was not sufficient to hold that the DOC erred when it found, on the basis of financial statements, that Usinor Sacilor was uncreditworthy. The information before the DOC included, in addition to this McKinsey study on Usinor Sacilor's future prospects, the negative past financial indicators discussed by the DOC in its determination. Consistent with its approach to similar issues in connection with the DOC's finding that certain firms were not equityworthy[138], the Panel considered that its task was not to make its own evaluation of the significance to be accorded to the McKinsey study in the context of an examination of whether or not Usinor Sacilor was creditworthy, but to determine whether the explanation provided by the DOC of its finding that this firm was not creditworthy enabled the Panel to discern how this finding was the result of the totality of the evidence before the DOC, including information on relevant facts which might possibly detract from a finding of uncreditworthiness. The Panel noted in this connection that the parties agreed that an examination of a firm's creditworthiness necessitated an examination of the future prospects of the firm, among other factors. Therefore, a decision on whether or not in this case Usinor Sacilor was creditworthy necessarily involved a weighing of information on negative financial indicators against information on Usinor Sacilor's future prospects.

548. The Panel noted that, as reflected in the DOC's determination, the French respondents argued that:

".. the 1986 restructuring greatly improved Usinor Sacilor's outlook, making it a better risk for lenders as well as for investors."

In response to this argument, the DOC observed:

"With respect to respondent's arguments, we disagree that a lender would rely solely on future profitability resulting from restructuring."[139]

549. The Panel considered that, even if it were correct that a lender would not rely solely on future profitability, this statement of the DOC did not explain how in the circumstances at hand the DOC had

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[136]The "times interest earned" measure is the ratio of a firm's EBIT to that firm's interest obligations.

[137]58 FR 6222

[138]See *supra*, paragraph 466.

[139]58 FR 6223

found that the specific information before it on the likelihood of an improvement in Usinor Sacilor's condition did not preclude a finding, based on the past financial indicators, that Usinor Sacilor was not creditworthy. In the Panel's view, the DOC's statement was at such a level of generality as to make it unlikely that prospective factors could ever outweigh negative past financial indicators in a determination of whether or not a firm was creditworthy. A categorical statement that a lender would not rely solely on future profitability could be made in every case, irrespective of the degree of credibility of the evidence on prospective factors. Contrary to what was argued by the United States before the Panel, the Panel failed to see how the DOC's statement, when viewed in the context of the DOC's earlier statements on the negative financial indicators, "clearly showed that the DOC reasonably found that the predictions of the McKinsey study did not outweigh the accumulated mass of negative evidence."[140] While the Panel did not consider that the DOC was required to discuss the McKinsey study in detail in its determination, absent some statement by the DOC indicating in general terms problems with the relevance or credibility of the analysis in the McKinsey study, the Panel could not find that the DOC had provided any rationale in support of its dismissal of this study. With regard to the argument of the United States that the McKinsey study had already been addressed in the DOC's equityworthiness analysis, the Panel recalled its finding above regarding the insufficient explanation by the DOC of its examination of that study.[141]

550. For the reasons set out in the preceding paragraphs, the Panel found that, while in its examination of Usinor Sacilor's creditworthiness the DOC might in fact have considered information on the record on Usinor Sacilor's future prospects, the DOC had failed to provide an explanation of its finding that Usinor Sacilor was not creditworthy sufficient to enable the Panel to discern how this finding was the result of an examination of the totality of the evidence before the DOC, including information on Usinor Sacilor's future prospects which might possibly have detracted from a finding that Usinor Sacilor was not creditworthy.

551. The Panel recalled its discussion above of the legal consequences of the insufficient explanation provided by the DOC of its finding that BSC was not equityworthy during certain years.[142]

552. In the light of the considerations in the preceding paragraphs, the Panel found that the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC found that Usinor Sacilor was not creditworthy, by reason of the insufficient explanation offered by the DOC of its evaluation of Usinor Sacilor's future prospects.

553. The Panel then addressed the argument of the EC that the DOC had failed to take into account as a relevant fact the status of the French Government as an inside lender.

554. The Panel noted that, as in the case of the dispute on the DOC's equityworthiness analysis, the parties differed on whether or not a distinction between inside and outside lenders should be made when assessing the creditworthiness of a firm.

555. The Panel noted that the issue of the allegedly special status of inside lenders was not expressly addressed in the DOC's determination. There was also no indication in the information before the Panel that the French respondents had raised this issue during the proceedings before the DOC.

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[140]*Supra,* paragraph 234

[141]*supra,* paragraph 488-490.

[142]See *supra,* paragraph 478.

556. The Panel recalled its view in section 5.1.3 of these findings that the DOC's approach to the analysis of rational investment behaviour, which did not make a distinction between inside investors and outside investors, could not be considered to be without a logical basis. The Panel noted that the arguments of the EC in support of its contention that in analyzing whether a firm was creditworthy a distinction was necessary between inside lenders and outside lenders were similar to the arguments of the EC in support of its view that in analyzing whether a firm was equityworthy a distinction needed to be made between inside investors and outside investors. The Panel therefore found no basis in the arguments of the EC warranting a different conclusion with respect to the alleged need to distinguish between inside lenders and outside lenders for purposes of an examination of whether a firm is creditworthy.

557. In the light of the considerations in the preceding paragraphs, the Panel found that there was no merit in the argument of the EC that the United States had acted inconsistently with the Agreement when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC did not take account of the status of the French Government as an inside lender in determining that certain French firms were not creditworthy.

Conclusion

558. The Panel **concluded** that the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC found that Usinor Sacilor was not creditworthy, by reason of the insufficient explanation offered by the DOC of its evaluation of Usinor Sacilor's future prospects.

6.2 Discount rate used by the DOC in the calculation of benefits from certain subsidies

559. The Panel then considered the request of the EC that the Panel find that the imposition by the United States of definitive countervailing duties on imports of certain hot rolled lead and bismuth carbon steel products from France was inconsistent with Article 4:2 of the Agreement by reason of the "discount rate" selected by the DOC for the purpose of calculating the benefits from certain subsidies.

560. The Panel noted that the discount rate contested by the EC was used by the DOC in (1) allocating over time the benefits of certain (non-recurring) grants and equity infusions in accordance with the "declining balance" methodology set forth in section 355.49 (b) (i) of the DOC's proposed countervailing duty regulations;[143] (2) determining whether certain loans to French firms found to be uncreditworthy were countervailable subsidies; and (3) allocating over time the benefits from such loans in accordance with the long-term loan methodology described in section 355.49 (c)(1) of the DOC's proposed countervailing duty regulations.[144]

561. In the present case, the DOC calculated this discount rate as the sum of a lending rate reported by the IMF plus a risk premium. The reasons for the calculation of the discount rate on this basis were stated in a section of the DOC's final affirmative determination which described the DOC's allocation methodology with respect to non-recurrent grants and equity infusions:

"The benefit from each of the grant programs discussed below was calculated using the declining balance methodology described in the Department's Proposed Regulations (see section 355.49(b)(3)) and used in prior investigations (see e.g. Salmon from Norway). For the discount rate used in these calculations, we used the lending rates published in the International Monetary Fund's International Financial Statistics because Usinor Sacilor

[143] 54 FR 23365, 31 May 1989, at 23384

[144] *Ibid.*, at 23384-23385

did not report its actual cost for long-term, fixed rate debt. Since Usinor Sacilor was uncreditworthy in the years in which all grants were approved we have used the highest annual interest rate reported in the IMF publication and have added a risk premium to the benchmark interest rate in accordance with section 355.44(b)(6)(iv) of the Proposed Regulations."[145]

562. The "Comments" section of the determination contained observations by petitioners and respondents on the issue of the choice of the appropriate discount rate:

"Petitioners agree with the Department's selection of the highest long-term annual interest rate in France as reported in the International Monetary Fund's (IMF) International Financial Statistics for the years 1982 through 1989, when the Department found Usinor, Sacilor, and Usinor Sacilor uncreditworthy. However, petitioners disagree with the Department's use of the private bond rate in determining the discount rate for the years 1978 and 1981, years in which the Department also found Usinor and Sacilor to be uncreditworthy.

Petitioners contend that the chart supplied by the GOF providing the TMO private bond rates described as 'Average and highest long-term fixed interest rates' fails to reference the OECD publications from which the rates were taken, or provide information on their terms and conditions. Petitioners further contend that the Department determined at verification that INSEE calculates the TMO rates based on 'medium-term and long-term issues' in France. These rates are used by banks as the basis for medium-to-long-term lending and the banks will typically 'add a few percentage points to the TMO rate to determine the final lending rate'. Petitioners maintain that no information was provided on how this spread is calculated, or what the spread would be for uncreditworthy companies. Therefore, petitioners argue that these rates are not the highest interest rates available in France. Petitioners argue that the Department should use, as best information available, the highest long-term interest rate as reported by the IMF in 1978 and 1981, plus a risk premium.

Respondents argue that in addition to assessing a risk premium based on the Department's uncreditworthiness determination, the Department's use of the short-term consumer overdraft rate reported in the IMF's International Financial Statistics was in error. Respondents maintain that this rate is inappropriate in two ways. First, the use of a short-term overdraft rate was inappropriate given the Department's stated preference for using a long-term rate. Second, OECD rates are used in France not the IMF rates. Respondents also state that the Department's comments in the GOF verification report regarding the TMO-OECD rates were not accurate. According to respondents, the banking official quoted in the report actually testified that the TMO was at least a week old, if not a month old, and was used as a benchmark. The actual rate of lending would depend on the credit market's conditions on that day and on the particular borrower, and thus, the rate could be higher or lower than the average TMO for the preceding week.

DOC Position

We agree with petitioners that we used an incorrect discount rate for the years 1978 and 1981 in our preliminary determination. For purposes of this final determination, we have used the lending rate provided in the IMF's International Financial Statistics to construct the discount rate for all years in which we have found Usinor Sacilor to be uncreditworthy.

[145]58 FR 6221, 27 January 1993, at 6224

We disagree with respondents that this is a short-term rate. In most cases, it applies to loans with maturity greater than one year and, hence, is consistent with the Department's methodology because we consider loans with a maturity in excess of one-year to be long-term loans.

We note that, as discussed above in the 'Long-term Loans from FDES' section, when we have determined that Usinor Sacilor was creditworthy during a particular year, we have used for the discount rate the rate indicated in the OECD publication provided by respondents for that year."[146]

563. As explained above, the discount rate used by the DOC consisted of two components: the lending rate taken by the DOC from an IMF publication and a risk premium added to this lending rate to reflect the DOC's finding that Usinor Sacilor was uncreditworthy during certain years. While most of the arguments of the EC addressed the DOC's reliance upon the IMF lending rate, the EC also contested the addition of a risk premium to this lending rate.

564. The Panel considered that the following were the main arguments advanced by the parties with respect to the discount rate applied by the DOC in this investigation.

565. The EC submitted that, as a result of the unreasonable recourse by the DOC to the IMF lending rate as the basis for the calculation of the discount rate, countervailing duties had been levied in excess of the amount of the subsidies, contrary to Article 4:2. In support of this contention, the EC argued in particular that the IMF rate was inappropriate because this rate represented the highest rate permitted under any circumstances for lending in France and was generally used for very short term lending. Moreover, the IMF rate included elements of consumer credit. For these reasons, this rate was not appropriate as a benchmark rate for long-term loans to industry. The DOC had failed to take any steps to seek clarification from the IMF as to the nature of the transactions to which the rate reported by the IMF applied. The EC further argued that the TMO-OECD rate provided by the French respondents during the DOC's investigation was the best published rate usable by the DOC as a benchmark for long-term corporate lending in France. Therefore, there was no basis for the DOC to rely on the IMF lending rate as "best information available".

566. The EC contested the addition by the DOC of a risk premium to the lending rate on the grounds that such a risk premium was not consistent with the normal practice of banks and was calculated by the DOC in an arbitrary manner which did not take into account the realities of the financial markets in question.

567. The United States argued that, in choosing the IMF lending rate as the basis for the discount rate, the DOC had acted consistently with the provisions of Article 2:9 regarding the conditions under which authorities may make findings on the basis of "the facts available". The DOC had sought information for purposes of determining an adequate discount rate for companies posing a serious credit risk, but such information was not provided by the respondents. The TMO-OECD rate provided by the French respondents was a private bond rate and the respondents had not been able to explain the relationship between this rate and the rate actually charged in France for loans to companies posing a credit risk. Under these circumstances, the DOC was entitled to use other information and make a finding on the basis of the facts available. The IMF rate was appropriate in that, among the information on the record, it came closest to the highest commonly available rate for private sector loans of one year or more duration. There was no information on the record to support the contention of the EC that the IMF rate was in general applied to very short-term transactions. While the respondents during the investigation had

[146]*Ibid*., at 6231-6232

alleged that this IMF rate included elements of consumer credit, they had not provided any evidence to support that contention.

568. The United States rejected the argument of the EC that the addition of a risk premium to the IMF lending rate was arbitrary. The addition of such a premium was appropriate in order to take into account that an uncreditworthy firm would not be able to obtain loans at commonly available interest rates. The methodology used by the DOC in the calculation of this risk premium had been adequately explained by the DOC on previous occasions. By determining the risk premium as a percentage of the prime interest in a country, the DOC directly accounted for the realities of the financial markets concerned.

569. As an initial matter, the Panel observed that the arguments presented by the EC in this context were limited to the factual basis upon which the DOC had calculated the specific discount rate used in its investigation of imports from France. The Panel noted that in the context of another claim the EC submitted that the use by the DOC of a discount rate for purposes of allocating subsidies over time was *per se* inconsistent with the Agreement. The Panel's findings on that issue are set forth below in section 9.

570. The Panel addressed successively the use by the DOC of a lending rate reported by the IMF and the addition by the DOC of a risk premium to that lending rate.

6.2.1<u>The use by the DOC of the IMF lending rate as the basis for the calculation of the discount rate</u>

571. The Panel noted that in the notice of the final affirmative determination issued in this case the DOC explained its choice of the IMF lending rate[147] by mentioning the failure of the French respondents to provide certain information. The Panel further noted the argument presented to it by the United States that resort to the IMF rate was justified under the provisions of Article 2:9 because the French respondents had not provided information on the highest annual long-term fixed interest rates commonly available in France. Against this background, the Panel considered that the question to be decided by it was whether in using this IMF rate the DOC acted inconsistently with Article 2:9, which addresses the situation in which interested signatories or interested parties do not provide necessary information during the course of an investigation.

572. The Panel noted that Article 2:9 provides:

> "In cases in which any interested party or signatory refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final findings (footnote omitted), affirmative or negative, may be made on the basis of the facts available."

In order for the Panel to be able to determine whether the DOC acted inconsistently with Article 2:9 in using the IMF lending rate, it was first necessary to examine whether the DOC in this case was faced with a situation "in which any interested party or signatory refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation." This required the Panel to determine what was in this case the "necessary information" within the meaning of Article 2:9 which the French respondents allegedly had failed to provide.

573. The Panel noted in this regard that in the public notice of the final affirmative determination issued in this case the DOC explained its reliance on "the facts available"in part as follows:

[147]*supra*, paragraph 561.

"... we used the lending rates published in the International Monetary Fund's International Financial Statistics *because Usinor Sacilor did not report its actual cost for long-term, fixed-rate debt.*"[148]

Thus, the DOC expressly mentioned the failure of an individual French firm to report that firm's long-term, fixed-rate debt. The statement did not indicate that the DOC resorted to the use of "the facts available" because the Government of France had not provided information on the highest long-term interest rates commonly available in France.

574. The Panel then noted that in the discussion in the Comments section of the DOC's final affirmative determination the DOC stated its agreement with the argument of the petitioners that the DOC should use the IMF lending rate for all years in which Usinor Sacilor was not creditworthy.[149] In support of this argument, the petitioners submitted that the TMO-OECD rates provided by the Government of France were "not the highest rates available in France".[150] It could therefore be inferred from the DOC's agreement with this argument that the DOC was of the view that the use of data other than the data provided by the French respondents was justified because information provided by the Government of France was not information on "the highest rates available in France".

575. The Panel considered that an individual firm's "actual cost for long-term fixed rate debt" and "the highest interest rates commonly available" in a country were clearly distinct concepts. The Panel noted that these concepts were used in different contexts by the DOC in its methodology for determining whether the provision of a loan to certain firms by a government is a subsidy.[151] The Panel therefore found that there was a logical inconsistency in the reasoning offered by the DOC when explaining why it considered the information provided by the French respondents to be inadequate. On the one hand, the DOC expressly stated that "... Usinor Sacilor did not report its actual cost for long-term, fixed- rate debt", while, on the other hand, the DOC, by agreeing to the argument of the petitioners, implicitly indicated that the reason for the resort to the use of "the facts available" was that the Government of France had not provided information on "the highest interest rates available in France".

576. In light of the considerations above, the Panel was of the view that the determination of the DOC did not enable the Panel to decide what was the "necessary information" not provided in this investigation which required the DOC to use data other than the data reported by the French respondents as "facts available" within the meaning of Article 2:9.

577. The Panel noted the argument of the United States that the DOC's reliance on "the facts available" within the meaning of Article 2:9 was due to the failure of French respondents to provide the highest long-term fixed interest rates commonly available in France. The Panel considered that, apart from not being stated expressly in the DOC's determination, this rationale was in contradiction with the DOC's reference to Usinor Sacilor's failure to report the cost of its long-term, fixed-rate debt. The Panel considered that, if it were to review the facts of the case in order to determine whether this argument of the United States justified the DOC's reliance on "the facts available," this would amount to allowing a signatory to correct *ex post facto* an inadequate statement of reasons. The Panel noted that several

[148]58 FR 6224, italics added

[149]58 FR 6232

[150]58 FR 6231, Comment 11.

[151]cf. sections 355.44(b)(4)(i) and 355.44(b)(6)(iv) of the Proposed Countervailing Duty Regulations of the DOC.

previous panels had declined to accept arguments based on reasons not properly reflected in a statement of reasons.

578. On the basis of the foregoing considerations, the Panel found that the DOC had provided an insufficient explanation of why the DOC relied on "the facts available" in determining the basis for the calculation of the discount rate.

579. The Panel noted that the IMF lending rate was significantly higher than the rate reported by the French respondents. The Panel considered that, absent a sufficient explanation by the DOC of the reasons for relying on "the facts available", the DOC had calculated countervailing duties which exceeded the amount of the subsidy found to exist, contrary to Article 4:2.

580. In light of the considerations in the preceding paragraphs, the Panel found that the United States acted inconsistently with Article 4:2 and thereby acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC provided an insufficient explanation for relying on "the facts available" within the meaning of Article 2:9 in determining the basis for the calculation of the discount rate.

6.2.2 Inclusion of a risk premium in the discount rate

581. The Panel then addressed the EC's argument that the DOC acted inconsistently with Article 4:2 by including a risk premium in the discount rate.

582. The Panel noted that it appeared from the explanation given by the DOC in its determination that the DOC added a risk premium because it had found Usinor Sacilor not to be creditworthy in the years in question.

583. The Panel noted that Article 4:2 was silent on the precise method for calculating the amount of a subsidy and that the signatories to the Agreement had not been able to reach an understanding, envisaged in footnote 15 to Article 4:2, on the issue of the calculation of the amount of a subsidy.

584. The Panel found that there was a logical basis for the view that a risk premium appropriately reflected the benefit arising from a loan to a firm which posed a special credit risk. The Panel further noted that the DOC calculated this risk premium as a percentage of the prime interest rate in the country under investigation. It could therefore not be said that, as argued by the EC, this premium was not based on any reality in the financial markets concerned. With respect to the DOC's practice of calculating the risk premium as 12 per cent of the prime interest rate, the Panel noted that the DOC had explained the reasons for this method of calculation in a determination issued in 1984.

585. In the light of the foregoing considerations, the Panel found that there was no merit in the argument of the EC that the United States had acted inconsistently with Article 4:2 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC included a risk premium in the discount rate used by the DOC for purposes of calculating the benefits resulting from certain subsidies.

Conclusion

586. The Panel **concluded** that the United States had acted inconsistently with Article 4:2, and had thereby acted inconsistently with Article 1 by reason of the discount rate used by the DOC for the purpose of calculating the benefits resulting from certain subsidies in the countervailing duty investigation of certain hot-rolled lead and bismuth carbon steel products from France, in so far as the DOC had provided an insufficient explanation for relying on "the facts available" within the meaning of Article 2:9 in determining the basis for the calculation of this discount rate.

7. Allocation of subsidies to domestic production

587. The Panel then turned its consideration to the request of the EC that the Panel find that the United States acted inconsistently with Articles 1 and 4:2 of the Agreement and with Article VI:3 of the General Agreement when in the final affirmative determination in the investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France[152] the DOC allocated subsidies provided to Usinor Sacilor exclusively over domestic production in France, rather than over Usinor Sacilors 's world-wide production.

588. In the final affirmative determination, the DOC discussed the question of the appropriate allocation of subsidies between domestic and foreign production of Usinor Sacilor. The DOC noted that it had not previously addressed the question

"... whether, in calculating subsidy rates for a holding company with both domestic and foreign subsidiaries engaged in the production of products, where the subsidies are domestic subsidies and are not tied to a particular product or market, we should include in the sales denominator total world-wide sales, including sales attributable to foreign production, or only sales attributable to domestic production."

The DOC determined that in this case the sales denominator should include only sales attributable to domestic production.

589. After noting the opposing views of respondents and petitioners, the DOC provided the following explanation of its analysis of this question:

"At this time, we are not prepared to conclude automatically, as respondents seeks, that otherwise untied domestic subsidies to a holding company with both domestic and foreign subsidiaries engaged in the production of products benefit not only domestic production but also foreign production, with the result that we would include sales attributable to both domestic production and foreign production in the sales denominator. We also are not prepared to conclude, solely on the basis of petitioners' legal arguments, that the subsidies benefit only domestic production.

Rather, as our starting point, we considered whether the subsidies at issue here were tied to domestic production, and we determined that they were. In making this determination, consistent with our existing methodology, we examined whether the subsidies were bestowed specifically to benefit domestic production. See Final Affirmative Countervailing Duty Determinations; Certain Steel Products from Belgium, 47 FR 39304 (Sept.7, 1982) (Appendix 2). On the record before us, after reviewing the programs from which the subsidies at issue arose, and after considering the GOF's contemporaneous controlling ownership position in Usinor Sacilor, we concluded that the GOF was seeking to promote domestic social policy and domestic economic activities and therefore to encourage domestic production.

Next, we attempted to allocate, in a reasonable manner, the subsidies at issue to the products that they benefited, i.e. the products as to which those subsidies provided incentives to produce and sell. Consistent with our approach to subsidies tied to a product or market, we believe that it is reasonable to allocate the benefits of the subsidies at issue, which we

[152] Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from France, 58 FR 6221, 27 January 1993.

have determined are tied to domestic production, fully to domestic production. We also believe that it is reasonable not to allocate those benefits to foreign production. See Proposed Regulations, *supra;*Appendix 2, *supra.* See generally Industrial Nitrocellulose from France; Final Results of Countervailing Duty Administrative Review, 52 FR 833 (Jan. 9 1987) (Industrial Nitrocellulose). Accordingly, we determined that we would allocate the benefits of the subsidies at issue fully to domestic production and that we would not allocate those benefits also to foreign production, unless we had a 'clear reason to believe' that the benefits encouraged foreign production. See Industrial Nitrocellulose, *supra.*

In this case we do not have adequate evidence to give us a clear reason to believe that the benefits of the subsidies at issue encourage foreign production. We therefore allocated the benefits fully to domestic production, and we accordingly included in the sales denominator only sales attributable to domestic production.[153]

590. From this explanation, it appeared to the Panel that the DOC's decision to include only sales attributable to domestic production in the sales denominator resulted from an analysis which involved two steps. Firstly, the DOC examined whether the subsidies were *tied to domestic production.* Secondly, having found that the subsidies were tied to domestic production, the DOC decided to *allocate* those subsidies exclusively to domestic production because (1) the DOC believed that it was reasonable to allocate benefits of subsidies tied to domestic production only to domestic production, and (2) there was no adequate evidence giving a clear reason to believe that the benefits of the subsidies encouraged foreign production.

591. The Panel considered that the following were the main points made by the parties in support of their respective positions on the allocation by the DOC of certain subsidies exclusively over Usinor Sacilor's production in France.

592. In support of its claim that the DOC's action violated Article 4:2 of the Agreement, the EC submitted two basic arguments. Firstly, by ignoring the nature of the subsidies the DOC had improperly allocated the subsidies only to domestic production in France, which had resulted in the imposition of a countervailing duty in excess of the amount of the subsidy found to exist. The DOC had failed to take into account that a subsidy provided in the form of an equity infusion into a holding company of a multinational firm by its very nature could only benefit the recipient company as a whole. This had been acknowledged by the DOC in its Proposed Countervailing Duty Regulations in which it treated subsidies arising from equity infusions as untied subsidies. The DOC's conclusion in the present case that the subsidies in question were tied to domestic production was without a rational basis and unsupported by evidence. Secondly, by taking the position that the subsidies should be allocated exclusively to French domestic production, unless there was adequate evidence providing a clear reason to believe that the benefits at issue benefitted foreign production, the DOC had relied on an impermissible presumption, contrary to the requirement to make a finding based on an examination of all relevant facts. The factors mentioned by the DOC (the nature of the programmes from which the alleged subsidies arose, the contemporaneous controlling ownership position of the French Government and the intention of the Government of France to promote domestic social policy and domestic economic activities and therefore to encourage domestic production) did not support the presumption that the subsidies were tied to domestic production in France. The presumption established by the DOC was in practice irrebuttable in a substantive sense, because of the nature of the subsidies in question. The presumption was also irrebuttable in a more procedural sense because the issue of whether or not the subsidies should be allocated to domestic production was raised at a stage in the investigation at which the parties no longer could submit factual information.

[153]58 FR 6221 (27 January 1993) at 6230-6231

593. The EC rejected the argument of the United States that the finding of the DOC that the subsidies at issue were tied to domestic production was based on a factual analysis. The EC considered in this regard that what was argued by the United States before the Panel did not correspond to the reasoning of the DOC in the text of the final determination issued in this case. What the United States referred to as a factual decision was at best a disguise for a presumption. The factual material referred to by the United States as support for this argument was not discussed in the DOC's determination. Therefore, had the DOC indeed relied on this factual material, it would have committed a procedural error by failing to articulate the factual basis of its finding, as it was required to do under Article 2:15. In any event, this material was inadequate as factual support for a finding that the subsidies at issue were limited to domestic production in France. The course of the investigation also showed that the DOC had not made a finding based on an examination of all relevant facts. Thus, the DOC's questionnaires contained no questions addressing the issue of the appropriate allocation of subsidies over domestic or total world-wide production.

594. The United States argued that the "tying" approach followed by the DOC in the French case was a reasonable approach for dealing with government subsidies provided to firms with multinational production and that the EC had not challenged this approach as such. The characterization by the EC of the tying finding of the DOC as being based on a presumption rested on a misunderstanding of the DOC's analysis. The DOC had first determined whether the subsidies at issue were tied to domestic production. This determination resulted from a factual analysis and was amply supported by the facts on record. The factors supporting this determination were adequately explained by the DOC in the public notice of its determination. After making this determination, the DOC had addressed the issue of the allocation of the subsidies found to be tied to domestic production. At this stage of its analysis, the DOC had permitted the respondents to submit evidence showing that, though the subsidies at issue were tied to domestic production, the subsidies actually would have encouraged foreign production. To the extent this second part of the analysis could be interpreted to involve a presumption, it did not detract from the main part of the analysis, i.e. the factual part. The United States considered that in essence, the EC's challenge amounted to a request that the Panel reweigh the evidence before the DOC on the highly factual question of whether the subsidies were tied to domestic production. However, a mere disagreement as regards the weight to be accorded to factual evidence was not a basis for a finding of a violation of the Agreement.

595. With respect to the argument of the EC that the subsidies in question were in the form of equity infusions and therefore by definition could only benefit the firm as a whole, the United States submitted that not all these subsidies arose from equity infusions. To the extent the subsidies resulted from equity infusions, the DOC had explained that its product-tying regulations applied in a domestic context did not contemplate a situation in which the respondent was a holding company with foreign subsidiaries engaged in the production of a product. In the case of a multinational firm, there were sound reasons for not automatically applying these product-tying regulations. It was therefore appropriate not to assume that, because the subsidies were the result of equity infusions they should automatically be allocated over the total world-wide production of Usinor Sacilor, but to treat this instead as a factual question. The argument of the EC based on the nature of the subsidies as equity infusions ignored the information on record which showed that the aims and goals of the subsidy programmes at issue were to advance the fortunes of the steel industry in France and that the French Government, through its position of ownership was in a position to make these aims and goals a reality.

596. The United States further argued that, while the issue of whether the subsidies should be allocated only to domestic production in France had been raised only in November 1992, the initial questionnaires issued by the DOC sought all information that would have been relevant to the tying question. The French respondents had availed themselves of the opportunity to brief this issue at length.

597. The Panel concluded from the arguments summarized in the preceding paragraphs that the key issues on which the parties differed with respect to the DOC's decision to allocate subsidies only to domestic production in France were:

(i)whether the DOC had failed to take into account that the subsidies in question arose from equity infusions and therefore benefitted the firm as a whole;

(ii)whether the DOC's analysis rested on a presumption, rather than on a factual analysis;

(iii)whether the factors mentioned by the DOC in its determination adequately supported the DOC's decision to allocate subsidies only to domestic production in France; and

(iv)whether interested parties had been afforded an adequate opportunity to submit evidence.

598. The Panel noted that, while the first three questions involved substantive issues of a legal and factual nature, the fourth question raised the issue of whether or not the DOC, by not providing the respondents an opportunity to submit factual evidence, had made a procedural error when it allocated the subsidies in question over domestic production of Usinor Sacilor in France.

599. The Panel considered that if, as argued by the EC, the respondents in this investigation had not been provided an adequate opportunity to submit relevant evidence on the question of whether or not the subsidies should be allocated over domestic production only, this by itself would render the DOC's action inconsistent with the Agreement. Thus, irrespective of whether or not the Agreement permitted a signatory to presume that subsidies granted by other signatories benefitted only domestic production in the territory of other signatories, and irrespective of the nature of the factual evidence relied upon in this case by the DOC as support for its statement that the subsidies were tied to domestic production, if interested parties had not been allowed to submit factual information on this matter due process requirements such as those in Article 2:5 would preclude the Panel from finding that statement to be in accordance with the Agreement. Likewise, for the Panel to be able to find that the DOC acted not inconsistently with the Agreement when it relied on the absence of evidence giving the DOC a clear reason to believe that the subsidies actually encouraged foreign production, there would, at a minimum, have to have been adequate opportunities for interested parties to submit relevant factual information on whether the subsidies actually benefitted foreign production. Absent such opportunities, the DOC's approach would be inconsistent with procedural requirements of the Agreement, even if the DOC's approach did not rest on an impermissible presumption.

600. The Panel therefore decided that it should first address the argument of the EC that the respondents in this investigation had not been afforded an adequate opportunity to submit factual information relevant to the issue of whether or not the subsidies should be allocated over domestic production only.

601. In examining whether the parties to the investigation had been provided an adequate opportunity to submit evidence with regard to the issue of whether subsidies should be allocated only over domestic production, the Panel noted that in the preliminary determination issued in September 1992[154] the DOC had allocated the subsidies in question over Usinor Sacilor's total world-wide production without discussing this matter. There was no indication in this preliminary determination that the DOC was giving further consideration to this issue. The Panel further noted that the petitioners raised the issue of whether the subsidies should be allocated only to domestic production in November 1992, at a point in time at which under the countervailing duty procedures of the United States the parties to the investigation could still present arguments, but could no longer submit factual evidence.

[154] 57 FR 42977, 17 September 1992.

602. The Panel noted the argument of the United States that the DOC had permitted the respondents to submit evidence showing that, even though the subsidies at issue were tied to domestic production, the subsidies actually would have encouraged foreign production.

603. The Panel considered that this contention was contradicted by the actual course of the investigation. Although the French respondents in December 1992 submitted a brief arguing against the allocation of subsidies to domestic production only, at that time the respondents procedurally were precluded from placing further facts on the record of the investigation. Therefore, while the respondents had been allowed to submit arguments, they had not been afforded an opportunity to submit any factual information on this matter.

604. The Panel then noted the argument of the United States that the DOC's initial questionnaire sought all information relevant to the question of whether the subsidies were tied to domestic production. The United States referred in this regard specifically to Appendix 1 to section 2 of the questionnaire.

605. The Panel reviewed this Appendix and found no specific questions as to whether particular programmes were designed to benefit only domestic operations or both domestic and foreign operations of the companies in question. The Panel noted the argument of the United States that the information sought in this Appendix on the nature of the subsidy programme, the government policy behind the programme and the eligibility criteria was precisely the type of information relevant to the factual tying determination made by the DOC. The Panel, however, failed to see how the questions in this Appendix would have alerted the respondents to the need to indicate whether a particular programme also benefitted foreign operations, particularly when according to the information before the Panel the question of the appropriate allocation of subsidies over Usinor Sacilor's production was raised for the first time only in November 1992. The Panel recalled in this context that the DOC itself in the preliminary determination had allocated subsidies over production of Usinor Sacilor in both France and Germany.

606. For the above reasons, the Panel was of the view that the information before it did not demonstrate that the parties to the investigation had been afforded an adequate opportunity to provide factual information relevant to whether the subsidies actually benefitted foreign production.

607. The Panel considered that it would be inconsistent with essential requirements of due process, as reflected, *inter alia*, in Article 2:5 of the Agreement, for the Panel to hold that, notwithstanding this absence of an adequate opportunity for interested parties to submit factual evidence, the decision of the DOC to allocate subsidies exclusively over domestic production was in accordance with the Agreement. The Panel considered in this regard that the requirement in Article 2:5 that interested parties be given an opportunity to present in writing their "views" had to be interpreted as implying a requirement to provide an opportunity for interested parties to submit factual information in support of those views.

608. In light of the considerations in the preceding paragraph, the Panel did not find it necessary to examine other questions disputed by the parties in respect of the DOC's decision to allocate subsidies exclusively to domestic production in France.

<u>Conclusion</u>

609. The Panel **concluded** that the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC allocated subsidies provided to Usinor Sacilor to domestic production only without providing the respondents in this investigation an adequate opportunity to provide relevant evidence on this matter.

8. **Allocation of certain subsidies over an average useful life of assets of 15 years**

610. The Panel proceeded to examine the request of the EC that the Panel find that in the three countervailing duty investigations at issue in these proceedings the United States had acted inconsistently with Articles 1 and 4:2 of the Agreement, Article VI:3 of the General Agreement and with the Guidelines on amortization and depreciation adopted by the Committee on Subsidies and Countervailing Measures in April 1985[155] when the DOC allocated certain subsidies over an average useful life of assets of 15 years.

611. The Panel noted that in these investigations the DOC explained the use of a period of 15 years for the allocation of certain subsidies by stating that this period was "reflective of the average useful life of assets in the steel industry".[156] The DOC referred in this connection to section 355.49 (b)(3) of its Proposed Countervailing Duty Regulations, which provide for allocation of certain subsidies over "the average useful life of a firm's renewable assets (equipment), as set forth in the U.S. Internal Revenue Service's 1977 Class Life Asset Depreciation Range System".[157] The Panel noted that the choice by the DOC of a 15 year allocation period was contested by the respondents in the investigations concerning imports from France and the United Kingdom, but that there was no discussion of this matter in the notice of the final determination with respect to imports from Germany.

612. The Panel noted that the use of the average useful life of assets as the basis for the determination of the time-period for the allocation of the subsidies in question was not disputed by the parties, but that the parties disagreed on whether the DOC acted inconsistently with the Agreement by determining that a period of 15 years was reflective of the average useful life of assets.

613. The Panel considered that the following were the main arguments of the parties on this question.

614. The EC submitted that the Guidelines on amortization and depreciation established rules for the allocation of subsidies over time for purposes of calculating the amount of countervailing duties. Where subsidies were allocated over a period of time not in conformity with these Guidelines, a violation of Article 4:2 occurred because either a countervailing duty was imposed in excess of the amount of the subsidy (when the period was too short) or a countervailing duty was imposed when no subsidy should have been found to exist in the period under consideration (when the allocation period was too long). The application by the DOC in the present cases of a 15 year allocation period was inconsistent with the general rule in paragraph 3.2 of the Guidelines on amortization and depreciation that, when determining the average useful life of an asset (or group of assets) for the purposes of allocating subsidies over time, an investigating authority should select a reasonable period for the firms being investigated. The natural meaning of these terms implied that the period chosen had to reflect the economic and commercial realities of the individual firms being investigated. Contrary to this firm-specific analysis envisaged by the Guidelines, the 15 year period applied by the DOC in the present cases was not based on any examination of the depreciation of assets in the individual firms under investigation. This period was used by the DOC

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[155]BISD 32S/154

[156]Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from France, 58 FR 6221 (27 January 1993) at 6223-6224; Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from Germany, 58 FR 6233(27 January 1993) at 6233; Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom, 58 FR 6237 (27 January 1993) at 6242.

[157]Countervailing Duties; Notice of Proposed Rulemaking and Request for Public Comments, 54 FR 23365, 31 May 1989 at 23384.

only for reasons of administrative convenience. It was based on an outdated study, conducted for income tax policy purposes, of depreciation of assets of steel producers in the United States. Several decisions of courts in the United States had found that the application of this period in countervailing duty investigations was arbitrary and thereby inconsistent with the countervailing duty legislation of the United States. Even if this study were relevant to the current experience of steel producers in the United States and in other countries (*quod non*), the use of the 15 year period was still contrary to paragraph 3.2 of the Guidelines which required a firm-specific, rather than an industry-wide analysis. It was incompatible with the duty to investigate under Article 2:1 of the Agreement to hold that, absent evidence that equipment used in foreign countries was different from equipment used in the United States steel industry, the DOC could rely on the average useful life of assets in the United States steel industry.

615. The EC further argued that, contrary to what was required by the last sentence of paragraph 2 of the Guidelines and by Article 2:15 of the Agreement, in the present cases the DOC had failed to provide an adequate explanation of the reasons for the application of the 15 year period. While the respondents in the investigations of imports from France and the United Kingdom had raised objections against the use of the 15 year period, the DOC had failed to give any reasons for its rejection of these objections.

616. The United States argued that the DOC's use in the present cases of an allocation period based on the average life of assets of firms in the steel industry was entirely consistent with the Guidelines on amortization and depreciation. The reference in paragraph 3.2 of the Guidelines to "a reasonable period for the firms being investigated" did not require a firm-specific test and allowed for an industry-wide test. The 15 year allocation period used by the DOC reflected the average commercial life of assets in the steel industry. The period was based on a thorough study of the steel industry which had been updated. While the study did not include steel producing firms in the EC, it was inconceivable that those firms, which were large and well-established producers, had fundamentally different experience with regard to the depreciation of assets. The DOC had consistently used the 15 year allocation period in steel countervailing duty investigations since the early 1980's. The DOC had begun to apply this period before the adoption of the Guidelines on amortization and depreciation. The United States would not have agreed to the adoption of these Guidelines had the Guidelines been inconsistent with that practice of the DOC. There was no indication that at the time of the adoption of the Guidelines any other signatory considered that the use of a 15 year allocation period in investigations of steel products was inconsistent with the Guidelines.

617. The United States further argued that in the investigation of imports from France the evidence on the record showed that 15 years was a reasonable estimate of the depreciation of steel assets. In the investigation of imports from the United Kingdom the respondent had actually conceded that 15 years was a reasonable estimate of the depreciation of steel industry assets. In the German case the respondents had not questioned the use of the 15 year period as an estimate of the depreciation of assets. With regard to the court decisions mentioned by the EC, the United States submitted that whether the DOC complied with domestic law of the United States was not before this Panel. In any event, the reasoning of the courts in these decisions did not support the EC claim with regard to the choice of the 15 year period in the cases at issue in the dispute before the Panel. Finally, the United States argued that the DOC's use of a 15 year allocation period in investigations involving the steel industry was not new and that the underlying rationale of this practice was well-known. The argument of the EC that the DOC had failed to provide adequate reasons in support of the use of this period was based on an erroneous interpretation of the Guidelines as envisaging the need for a company specific analysis of the average useful life of assets of the individual firms in question.

618. The Panel recalled that neither Article 4:2 nor any other provision in the Agreement set forth specific rules with respect to the allocation of subsidies over time. The Panel noted that most arguments advanced by the parties on the DOC's use of a 15 year allocation period as reflective of the average useful life of assets were not based on the text of particular provisions of the Agreement, but on the text of the Guidelines on amortization and depreciation, adopted by the Committee on Subsidies and Countervailing

Measures in April 1985. The Panel considered that these Guidelines were relevant to its examination of the issue before it as an understanding adopted by the signatories to the Agreement on what were allowable reasonable methods for determining the appropriate time-period for the allocation of subsidies.[158]

619. The Panel noted that the Guidelines on amortization and depreciation deal with the determination of the appropriate time-period for the allocation of subsidies arising from loans and grants. Paragraph 2 of these Guidelines provides that "[T]he guidelines in paragraphs 3,4 and 5 below list reasonable alternatives for the amortization and depreciation of subsidies arising from loans and grants." In the case of loans, the Guidelines provide for a determination of the allocation time-period on the basis of the duration of the loan[159] or, alternatively, on the basis of the life of assets.[160] In the case of grants, the Guidelines provide for a determination of the period of allocation on the basis of the average life of assets owned by the firm (or, if appropriate a division of the firm)[161] or, alternatively, (1) where the grant is used for the acquisition of assets needed to produce a particular product or group of products designated by the granting authority, on the basis of a period of time reflecting the life of the assets so used[162], or (2) where the grant is not used for the acquisition of physical assets used in the production of a particular product or group of products, on the basis of a reasonable period reflecting the average commercial life of assets.[163]

620. The Panel further noted that paragraph 3 of the Guidelines contains two general provisions applicable to those cases in which the time-period for the allocation of subsidies is determined on the basis of the average useful life of an asset or group of assets:

"3.1 The investigating authorities may endeavour to minimize the impact of differences in book-keeping methods on subsidy amounts found; and
3.2 The investigating authority should select a reasonable period for the firms being investigated."

621. Finally, the Panel noted that the last sentence of paragraph 2 of the Guidelines provides:

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[158]The Panel noted that at the time of the adoption of the Guidelines the chairman of the Committee on Subsidies and Countervailing Measures had stated that:

"... these Guidelines did not add new obligations nor did they detract from the existing obligations under the Code for they constituted an understanding on the manner in which signatories intended to calculate the amount of certain subsidies."

See document SCM/M/27, paragraph 79.

[159]Guidelines, paragraph 4.1.

[160]Guidelines, paragraph 4.2. Under paragraph 4.2.1, where a subsidized loan is used for the acquisition of physical assets used in the production of a particular product or group of products, the subsidy can be allocated over "a period of time reflecting the life of the physical assets used in such production." Under paragraph 4.2.2., where a subsidized loan is not used for the acquisition of physical assets used in the production of a particular product or group of products designated by the authority providing the loan, the subsidy can be allocated over "a reasonable period reflecting the average commercial life of assets."

[161]Guidelines, paragraph 5.1

[162]Guidelines, paragraph 5.2.1.

[163]Guidelines, paragraph 5.2.2.

"It is understood that the rationale for the method chosen by the authorities should be explained fully to all interested parties and an opportunity be provided to comment on its reasonableness."

622. The Panel noted the divergent views of the parties on the question of whether a determination of the average useful life of assets, for purposes of allocating subsidies over time, should be made on a company-specific basis. These conflicting views resulted in particular from different interpretations of the statement in paragraph 3.2 of the Guidelines on amortization and depreciation that investigating authorities should select "*a reasonable period for the firms being investigated*." While the EC argued that this expression implied the need for an analysis of the life of assets of the individual firms under investigation, the United States argued that this expression permitted the use of an industry-wide standard for the average useful life of assets of firms in a given industry.

623. The Panel noted that the provisions in the Guidelines which were relevant to its examination of the application in the present cases by the DOC of a 15 year period for the average useful life of assets were sub-paragraph 5.2.2 and paragraph 3.2 of the Guidelines. The Panel noted that sub-paragraph 5.2.2. refers to "the average commercial life of assets" without indicating that these assets must be the assets of the specific firms under investigation. With regard to paragraph 3.2, the Panel considered that, interpreted in accordance with its natural meaning, the term "the firms being investigated" referred to the specific firms under investigation in a particular case and that accordingly paragraph 3.2 contemplates the choice of a period of the average useful life of assets which was reasonable for those specific firms. However, in the Panel's view there was a significant difference between the statement in paragraph 3.2 that, for the purpose of determining the average useful life of assets over which subsidies are to be allocated, the investigating authority should select "a reasonable period for the firms being investigated" and a statement that the investigating authority should determine this average useful life of assets on the basis of an analysis of the life of assets of the specific firms under investigation. The notion of "a reasonable period for the firms being investigated" would be redundant if the only acceptable approach was to take a period based on an analysis of the life of assets of the individual firms under investigation. In that case, the signatories could have simply stated that the average useful life of the assets should be determined on the basis of an analysis of the experience of the individual firms under investigation. In addition, paragraph 3.2 should be read in conjunction with paragraph 3.1 under which signatories were allowed to "endeavour to minimize the impact of differences in book-keeping methods on subsidy amounts found". Therefore, the Panel considered that paragraph 3.2 of the Guidelines meant that the period of the average useful life of assets should be reasonable for the specific firms under investigation, but that this could not be interpreted to imply that the selection of this period necessarily had to result from an examination of the actual average useful life of the assets of those firms.

624. Thus, the Panel did not agree with the argument of the EC that sub-paragraph 5.2.2. of the Guidelines, which referred to the "average commercial life of assets", interpreted in conjunction with paragraph 3.2, was to be interpreted as referring to the average commercial life of assets of the specific firms being investigated. In the Panel's view, sub-paragraph 5.2.2, read together with paragraph 3.2, did not mean anything other than that the period of "the average commercial life of assets" should be "a reasonable period for the firms being investigated".

625. Based on the above interpretation of sub-paragraph 5.2.2. and paragraph 3.2 of the Guidelines on amortization and depreciation, the Panel considered that the mere fact that in the present cases the DOC had not determined the length of the allocation period on the basis of a company-specific analysis of the average useful life of assets of the firms in question was not by itself a sufficient grounds to find that the DOC had failed to use "a reasonable period for the firms being investigated" within the meaning of paragraph 3.2 of the Guidelines.

626. The Panel considered that it was not necessarily inconsistent with the above interpretation of the notion of "a reasonable period for the firms being investigated" for a signatory to apply a standard period for

the average useful life of assets in a given industry, provided that such standard period was not established on an arbitrary basis and that it be applied with a degree of flexibility so as not to prevent an investigating authority from taking into account evidence calling into question the reasonableness of that period under the circumstances of a given case. In this connection, the Panel noted in particular the disagreement between the parties as to whether the study which formed the basis for the DOC's application of a 15 year allocation period in investigations involving steel producing firms was relevant to the current experience of the European steel industry. While the Panel was not entirely convinced by some of the arguments presented in this context by the United States, the Panel considered that the issue before it was not the DOC's practice in general, but the use of a 15 year allocation period in the three specific cases before the Panel. Rather than pronouncing itself in general terms on the DOC's practice, the Panel therefore proceeded to examine whether or not, in light of the facts of the cases before it, the DOC's use of a 15 year allocation period could be considered to be inconsistent with the reference in paragraph 3.2 of the Guidelines to "a reasonable period for the firms being investigated".

627. The Panel recalled that in the public notices of the affirmative final determinations issued in these investigations, the DOC indicated that it used a 15 year period for the allocation of certain subsidies on the grounds that this period was reflective of the average useful life of assets in the steel industry, as set forth in the IRS 1977 Class Life Asset Depreciation Range System.

628. The Panel noted that in the investigation of imports from France the respondents had raised several arguments in favour of the use of a 10 year allocation period instead of the standard 15 year allocation period. The respondents argued in particular that in this case the 15 year period based on the IRS depreciation tables did not correctly reflect the average useful life of assets. The respondents pointed out that the IRS tables were outdated and argued that, if the DOC did not wish to use a 10 year allocation period, it should determine the allocation period on the basis of the most recent estimate available on Usinor Sacilor's average useful life of assets. In support, the respondents referred to data verified by the DOC on the average useful life of assets in 1991:

"Respondents argue that a 10-year period for allocating subsidies over time would provide greater relief to U.S. industry by heightening the impact of any subsidy determination, while assuring that foreign producers are not penalized for subsidies received so far in the past that they no longer confer any tangible benefit. Respondents also argue that the application of a 10-year period would be particularly appropriate in this case, given that the U.S. steel industry negotiated for and received 10 years of extraordinary import relief in exchange for withdrawing countervailing duty petitions addressing some of the very same programs at issue here.

Respondents argue that countervailing subsidies granted prior to the signing of the voluntary restraint agreement is inconsistent with the principle recognized in the Subsidies Code that only one form of relief should be permitted to remedy the effects of a particular subsidy in the domestic market of the importing country.

In addition, respondents argue that even if the Department continues to allocate benefits based upon the average useful life of assets as a reasonable measure of the duration of the benefit to a firm's overall activity, its use of a 15-year period based on 1977 depreciation tables of the Internal Revenue service (IRS) covering renewal of physical assets (i.e. equipment) does not reflect the facts of this case. Moreover, it would perpetuate a dated guideline and ignore the reality of any possible commercial and competitive benefit involved. Rather, respondents argue, the most accurate estimate of the average useful life is the most recent estimate available, i.e. the 1991 Usinor Sacilor figures verified by the Department.

Petitioners disagree with respondents' proposal to use the average useful life of Usinor Sacilor's assets because it is based in the year of review only and bears no relation to the company's experience in the years in which the grants were actually received or other years in which the subsidies benefited the firm. In addition, petitioners dispute respondents' claim that the IRS tables are superseded and outdated. Petitioners contend that the IRS tables continue to provide a consistent and predictable standard for allocating grants to steelmaking operations."

The DOC response to these comments was:

"While the Department has indicated its willingness to consider a ten-year allocation period generally (see the Preamble to the Proposed Regulations), nothing that the parties have argued leads us to conclude that we should depart from the 15-year standard for this investigation. Therefore, we have continued to use the 15-year allocation period based on the 1977 IRS depreciation table, as amended in 1985, covering renewable assets for steel."[164]

629. The Panel found itself unable to discern from this statement of the DOC what were the reasons for the DOC's dismissal of the repondents' argument that a 15 year period for the average useful life of assets was not appropriate in this case. There was nothing in the DOC's determination explaining how the DOC had responded to the argument of the respondents that the IRS tables were outdated. The Panel noted that, in support of this argument, the respondents referred to a statement by the DOC in the preamble of the proposed countervailing duty regulations issued in May 1989:

"Although the IRS tables provide consistency and predictability, the Department is concerned that those tables are dated."[165]

Moreover, while the United States argued before the Panel that data drawn directly from the annual statements of the French companies at issue supported the use of a 15 year period for the average useful life of assets, it could not be inferred from the above-quoted statement that the reason for the DOC's rejection of the respondents' argument was that Usinor Sacilor's own data actually supported the use of a 15 year period. Indeed, the statement provided no explanation of the DOC's position with reference to evidence of record. In the Panel's view, if the DOC considered the data provided by the respondent to support a shorter allocation period and rejected it on the grounds that there was other, more pertinent, data which provided support for the use of the 15 year period, it was incumbent upon the DOC to explain its rejection of this argument by reference to such other data. This would have necessitated an explanation of whether the average useful life of assets was to be determined on the basis of data for the period under investigation or on the basis of average data for a longer period.[166] A statement that "nothing that the parties have argued leads us to believe that we should depart from the 15 year standard for this investigation" was not sufficient in this respect.

630. Since it did not appear from the statement of reasons by the DOC that the DOC had actually relied upon data on Usinor Sacilor's asset life in deciding to use the 15 year allocation period, the Panel did not pronounce itself on whether, as argued by the United States, data before the DOC provided

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[164] 58 FR 6221, 27 January 1993, at 6230.

[165] Countervailing Duties; Notice of Proposed Rulemaking and Request for Public Comments, 54 FR 23365, 31 May 1989, at 23377.

[166] The Panel noted that the respondents had submitted arguments against the determination of average useful life of assets on the basis of average data for the period 1978-1991.

factual support for the use of a 15 year allocation period. It was not the task of the Panel to provide a possible rationale for a finding of an investigating authority when the investigating authority did not itself mention that rationale in its statement of reasons.

631. The Panel recalled that the question before it was whether the DOC, by using a 15 year allocation period for the average useful life of assets, had chosen a period which was reasonable for the firms being investigated. As noted above, the DOC was presented with two arguments raising issues which were clearly relevant to an assessment of whether in this case a 15 year period for the average useful life of assets was reasonable for the firms being investigated. While the Agreement did not require investigating authorities of signatories to address in a public notice of a determination all arguments raised by parties in an investigation, in this case the DOC's failure to provide an adequately reasoned response to these arguments meant that the DOC's use of this period was not supported by sufficient reasoning for the Panel to conclude that the DOC had used a period which was reasonable for the firms being investigated.

632. In the light of the considerations above, the Panel found that the DOC's reasoning was insufficient for the Panel to conclude that a 15 year period for the average useful life of assets was reasonable for the firms being investigated. As a result, the Panel was unable to find that the DOC had not calculated countervailing duties in an amount not exceeding the amount of the subsidy found to exist, as required by Article 4:2.

633. In the light of the considerations in the preceding paragraphs, the Panel found that the United States acted inconsistently with Article 4:2 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC failed to provide a sufficient explanation of the reasons for the use of a period of 15 years as reflective of the average useful life of assets.

634. The Panel then examined the DOC's use of a 15 year allocation period as reflective of the average useful life of assets in its investigation of lead and bismuth carbon steel products from the United Kingdom.

635. The discussion in the Federal Register notice of the DOC's final determination indicated that in this case the respondents challenged the use of a 15 year period for the allocation of subsidies on the grounds that the average useful life of assets was not an appropriate criterion for the determination of the period of time for the allocation of subsidies:

"According to respondents, the CIT has twice rejected the Department's use of average service life of industry assets as a measure of the duration of subsidy benefits. Respondents argue that, consistent with practice in other areas, the Department should determine the duration of benefits by reference to the weighted average maturity of the respondent company's total indebtedness or, alternatively, to an appropriate industry average.

Petitioners argue that because the period over which a subsidy confers benefits may be equally long whether used for capital investment or other purposes, the Department's longstanding policy of using a 15-year amortization period for all non-recurring subsidies in steel cases is appropriate and should be continued.

With respect to subsidies that support capital investment, Congress explicitly intended that countervailing duties be imposed over a period that would coincide with the period during which the subsidy benefits the recipient (...) Petitioners note that the Department, the CIT, and the Court of Appeals for the Federal Circuit have agreed that subsidies for general corporate purposes may provide as important a benefit , over as long a period, as a subsidy for capital investment (...) Therefore petitioners state that the Department's long-held policy of amortizing all non-recurring subsidies over a 15-year period in steel cases should be continued.

In response to these comments, the DOC stated:

"While the Department has indicated its willingness to consider a ten-year allocation period generally (see the Preamble to the Proposed Regulations), nothing that the parties have argued leads us to conclude that we should depart the (sic) 15-year standard. Therefore, we have continued to use the 15-year allocation period based on the 1977 IRS depreciation table, as amended in 1985, covering renewable assets for steel."[167]

636. The Panel noted that these objections raised by the respondents were significantly different from the claim of the EC presented before the Panel. The EC's claim was that a 15 year period for the average useful life of assets in this case was not "a reasonable period for the firms being investigated" because this period was not based on a company-specific examination of the life of assets. The respondents in this investigation, however, contested that the average useful life of assets was an appropriate criterion for determining the length of the allocation period, but did not argue that 15 years was not a factually correct estimate of the average useful life of the assets used by the respondents. While the EC's argument was expressly based on the Guidelines on amortization and depreciation, the argument of the respondents was without basis in these Guidelines, which specifically allowed for the use of the average useful life of assets as a criterion to determine the length of the allocation period for certain subsidies.

637. It thus appeared to the Panel that, unlike the investigation of imports from France, in the investigation of imports from the United Kingdom there was no information or argument before the DOC calling into question that a 15 year period as reflective of the average useful life of assets was a reasonable period for the firms being investigated.

638. The Panel noted that, according to the United States, the use of a 15 year period for the average useful life of assets was supported by the evidence of record because in a submission to the DOC the respondents had actually agreed that a period of 15 years appropriately reflected the average useful life of assets used by the respondents. The Panel further noted the objection of the EC that this argument of the United States amounted to an inadmissible *ex post facto* rationalization of the DOC's decision. According to the EC, the DOC's determination failed to substantiate the use of the 15 year period with reference to a company-specific analysis. In the EC's view, the DOC more generally in these cases had failed to meet the procedural requirement to articulate the reasons for rejecting arguments against the use of the 15 year amortization period. The Guidelines on amortization and depreciation required an investigating authority to deal with the merits of each challenge to a practice, no matter how long-standing that practice might be.

639. The Panel noted that it was factually correct that the DOC's determination did not discuss the reasons for the use of the 15 year allocation period with reference to specific data for the companies under investigation. However, the Panel also noted that the EC had provided no evidence showing that the United States was factually incorrect in stating that the respondents had actually agreed that a period of 15 years accurately reflected the average useful life of assets used by the respondents. Accordingly, the Panel was of the opinion that the DOC's reasoning in this case would have benefited from a statement that the use of a 15 year period was supported by company specific data before it, but that the lack of such a statement did not warrant a finding that the DOC had provided insufficient reasoning to support the use in this case of a 15 year period for the average useful life of assets.

640. As regards the argument of the EC that the DOC had failed to give reasons for the rejection of arguments against the use of the 15 year period, the Panel recalled that the DOC was not presented with any arguments or information calling into question the reasonableness of the 15 year period for the

[167] 58 FR 6245, 27 January 1993, at 6245.

average useful life of assets. It could therefore not be said that the DOC had infringed the procedural requirement referred to by the EC to give reasons for the rejection of arguments against the use of a 15 year period for the average useful life of assets.

641. For the foregoing reasons, the Panel found that there was no merit in the claim of the EC that the United States had acted inconsistently with the requirements of Article 4:2 of the Agreement when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, the DOC used a period of 15 years as reflective of the average useful life of assets.

642. The Panel noted that in the affirmative final countervailing duty determination of the DOC in the investigation of imports from Germany there was no discussion of the issue of the use of a 15 year period for the average useful life of assets.

643. The Panel noted that, while the EC contested the use by the DOC of a 15 year allocation period in this case on the grounds that the DOC had failed to conduct a company-specific analysis of the average useful life of assets of the firms under investigation, the EC did not present any factual evidence pertaining to the depreciation of assets of the German firms in question which would have called into question the reasonableness of a 15 year period for the average useful life of assets for those firms. The information before the Panel indicated that the respondents in this investigation had not questioned the use of this period. The EC did not argue, and the information before the Panel did not show, that the respondents in this investigation had not been provided an opportunity to comment on the reasonableness of the DOC's allocation methodology, as envisaged in paragraph 2 of the Guidelines on amortization and depreciation.

644. Under these circumstances the Panel found, in light of its interpretation of paragraph 3.2 of the Guidelines on amortization and depreciation, that the arguments and information before it did not constitute a grounds to find that the 15 year allocation period used by the DOC in the investigation of imports from Germany was not "a reasonable period for the firms being investigated".

645. The Panel accordingly found that there was no merit in the claim of the EC that the United States had acted inconsistently with Article 4:2 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from Germany, the DOC used a 15 year period for the average useful life of assets.

Conclusions

646. The Panel **concluded** that the United States had acted inconsistently with Article 4:2 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC failed to provide a sufficient explanation of the reasons for the use of a period of 15 years as reflective of the average useful life of assets. The Panel also **concluded** that the United States had not acted inconsistently with Article 4:2 when the DOC allocated subsidies over an average useful life of assets of 15 years in the countervailing duty investigations of imports of hot-rolled lead and bismuth carbon steel products from the United Kingdom and Germany.

9. Use of a declining balance methodology in the allocation of certain subsidies over time

647. The Panel turned its consideration to the request of the EC that the Panel find that the United States acted inconsistently with its obligations under Articles 1 and 4:2 of the Agreement and with Article VI:3 of the General Agreement because of the "declining balance" methodology applied by the DOC for allocating certain subsidies over time. The EC raised this claim with respect to the final affirmative countervailing duty determinations made by the DOC in each of the three investigations at issue in the dispute before the Panel.

648. The Panel noted that the "declining balance" methodology used by the DOC in these investigations and objected to by the EC was applied by the DOC as part of the process of allocation of certain subsidies[168] over time. This allocation process involved three steps.[169] Firstly, the determination of the amount of the subsidy; secondly, the determination of a discount rate, and thirdly, the construction of a benefit stream. The term "declining balance methodology" in a strict sense refers to the formula applied by the DOC with regard to the construction of this benefit stream. This formula calculates the amount countervailed in a given year as a function of the face amount of the subsidy, the length of time over which the subsidy is allocated, the discount rate chosen by the DOC and the year of allocation:[170]

$$Ak = \frac{y/n+[y-(y/n)(k-1)]d}{1+d}$$

Where

Ak = the amount countervailed in year k

y = the face value of the grant

n = the number of years over which the grant is allocated (which under the DOC's methodology is the average useful life of a firm's renewable physical assets)

d = the discount rate, and

k = the year of allocation, where the year of receipt of the grant =1 and $1 \leq k \leq n$

This formula is termed a declining balance formula because it assigns a greater percentage of the subsidy to the earlier years in the allocation period and a steadily declining percentage to the later years.

649. The Panel considered that the following were the main points made by the parties with respect to the EC's claim that the DOC's declining balance methodology was inconsistent with Article 4:2 of the Agreement and with Article VI:3 of the General Agreement.

650. The EC argued that the DOC's declining balance methodology was contrary to Article 4:2 of the Agreement and Article VI:3 of the General Agreement because this methodology resulted in the imposition of a countervailing duty in excess of the amount of the subsidy "found to exist" or "determined to have been granted". The EC argued that the amount of subsidy "found to exist" or "determined to have been granted" was the face amount of a subsidy. Accordingly, where a subsidy was provided in the form of a grant and the grant was allocated over time, Article 4:2 of the Agreement and Article VI:3 of the General Agreement prohibited the imposition of a countervailing duty in excess of the portion of the face amount of the grant allocated to the year under investigation. According to the EC, the DOC's declining balance methodology was inconsistent with this prohibition because the discount rate used under this methodology resulted in the addition of an extra amount to the portion of the face amount of the grant allocated to a given year. The use of a discount rate to calculate the value of money over time might be appropriate in other contexts, but the use of this technique to allocate a subsidy over time resulted in the imposition of a countervailing duty in excess of the amount of the subsidy granted and was thereby contrary

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[168] non-recurring grants and certain equity infusions.

[169] See Countervailing Duties; Notice of Proposed Rulemaking and request for Public Comments, 54 FR 23365 (31 May 1989) at 23384.

[170] Id.

to the plain meaning of the text of Article 4:2. A linear reparation of the face amount of the subsidy would be in conformity with this provision.

651. The EC rejected the argument of the United States that, because money received at present was worth more than the same amount of money received over a future period, countervailing the face value of a subsidy over a period would offset less than the full amount of the subsidy. In the EC's view, the fundamental problem with this analysis was that a subsidy in the form of a grant did not involve money received in the future. The receiving company typically spent the grant immediately. Amortization of such a subsidy over a number of years was permissible under the Guidelines on amortization and depreciation adopted by the Committee on Subsidies and Countervailing Measures[171], but the Guidelines did not authorize, and Article 4:2 clearly prohibited, the addition to the face amount of a grant of an amount representing the net present value of a totally hypothetical income stream. The EC argued that where grants were not spent immediately, but were invested in the purchase of assets which depreciated over time, the net present value methodology created a benefit which did not in fact exist. When a producer used a grant to purchase assets, the subsidy benefits should not exceed the depreciation costs incurred on the assets in any given year. The DOC's declining balance methodology conflicted with this requirement. Finally, the EC also objected to the declining balance methodology on the grounds that under this methodology there was no linkage between the DOC's amortization schedule and the real-world usage of the subsidy and on the grounds that the discount rate was often selected arbitrarily.

652. The United States argued that the methodology used by the DOC in the present cases with regard to the allocation of certain subsidies over time was not inconsistent with the Agreement or with the General Agreement. Article 4:2 only provided that the amount of the countervailing duty was not to exceed the amount of the subsidy found to exist, but did not specify how the amount of the subsidy was to be calculated; neither did the General Agreement or the Guidelines on amortization and depreciation. Absent specific rules on the calculation of the amount of a subsidy, the Agreement permitted signatories to use any reasonable methodology. The United States considered that the EC's arguments did not relate to the declining balance methodology as such, but to the issue of the use of the net present value concept. The United States argued that the concept of net present value was widely recognized in economic and financial analysis to account for the time value of money. It was generally understood that the real value of an amount of money received today was greater than the same nominal amount of money received at a later date because the nominal amount received today included the benefit of the opportunity to put the money to use. Once it was accepted that subsidies could be allocated over time, it followed that adjustments to the nominal value of benefits for time-related considerations could and should be made. According to the United States, countervailing the face value of a subsidy over the period of allocation would offset less than the full amount of the subsidy, since 100 pounds received today was worth more than 10 pounds received in each of the next ten years. The use of a discount rate in the allocation of subsidies over time ensured that the net present value of the sum of the allocated amounts equalled the full amount of the subsidy found to exist. As such, the use of a discount rate in the allocation of subsidies did not lead to the imposition of a countervailing duty in an amount in excess of the amount of the subsidy found to exist and was not inconsistent with Article 4:2 of the Agreement or with Article VI:3 of the General Agreement.

653. The Panel noted that there was no disagreement among the parties that certain subsidies should be allocated over time. While the Agreement did not specifically provide for an allocation of subsidies over time, the signatories of the Agreement had adopted Guidelines on amortization and depreciation which expressly provided that "[C]ertain subsidies exist which should be spread over time."[172] The Panel also noted that the EC did not contest that the subsidies at issue in the cases before the Panel should be allocated over time.

[171]BISD 32S/154

[172]BISD 32S/154

654. The Panel considered that, interpreted narrowly, the unique characteristic of the declining balance method of allocation of subsidies was that it resulted in declining amounts of countervailing duty over the successive years in the period over which the subsidies were allocated. It was possible, however, to envisage allocation methods using a discount rate reflecting the net present value concept which would result in annual amounts which would not decline over time. Any such method would also be precluded by the interpretation of Article 4:2 advanced by the EC in so far as the use of a discount rate in the allocation of subsidies over time meant that the sum of the nominal amounts allocated to each year of the period over which the subsidies were allocated would necessarily exceed the amount of the face value of the subsidies. The Panel also noted that, if a discount rate was not applied, i.e. the discount rate was zero in the formula used by the DOC in its declining balance methodology, the subsidy allocated each year according to that formula would meet the criterion of linear reparation suggested by the EC.

655. In view of the above, the Panel considered that the basic legal question issue before it was not whether or not it was inconsistent with the Agreement to apply the declining balance methodology narrowly interpreted (i.e. as a method under which the amounts allocated to successive years decline over the period over which the subsidies are allocated), but whether it was inconsistent with the Agreement to apply a discount rate in the allocation of subsidies over time to take account of the time value of money, irrespective of whether or not a straight line or declining balance method of amortization was followed.

656. The Panel examined this legal question by considering what were the implications for the allocation of subsidies over time of the requirement in Article 4:2 that:

"No countervailing duty shall be levied (footnote omitted) on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. (footnote omitted)"

657. The Panel observed that when a subsidy was allocated over time, the maximum amount of the countervailing duty which a signatory was permitted to levy under Article 4:2 was determined by the amount of subsidy properly allocated to the period under consideration. This raised the question of how in such cases the notion of "the amount of the subsidy found to exist" in Article 4:2 limited the amount of subsidy to be allocated to the period under consideration.

658. It followed from the arguments of the parties that there was no disagreement that "the amount of the subsidy found to exist" imposed one fundamental requirement with regard to the determination of the amount of a subsidy allocated to a particular time period: both parties agreed that the sum of the amounts allocated to different years in the period over which a subsidy was allocated must not exceed "the amount of the subsidy found to exist". The EC, however, interpreted this to mean that there must be identity between the face value of the subsidy and the sum of the *nominal* amounts of the subsidy allocated to different years in the period over which the subsidy was allocated. The United States, in contrast, interpreted this to mean that there must be identity between the face value of the subsidy in the year in which it was provided and the *real or present value* of the sum of the nominal amounts of the subsidy allocated to different years of the period over which the subsidy was allocated. This latter approach necessarily led to an allocation whereby the sum of the nominal amounts of the subsidy allocated to different years of the period over which the subsidy was allocated exceeded the nominal amount of the subsidy (or grant).

659. In light of these conflicting arguments, the Panel had to decide whether or not Article 4:2 was to be interpreted as precluding the application of a technique of allocating subsidies over time whereby the present value, rather than the nominal value, of the sum of the nominal amounts allocated to different years in the period over which the subsidies were allocated was equated with "the amount of the subsidy found to exist".

660. With regard to the meaning of the expression "the amount of the subsidy found to exist" in Article 4:2, the Panel noted that the normal meaning of the word "amount" was defined as "be equivalent in total value, quantity, significance, etc.", "full value, significance, etc.".[173] Thus, the natural meaning of this expression indicated that a signatory could not allocate a subsidy over time in such a manner that the countervailing duty levied as a result of this allocation exceeded the value, significance or quantity of the subsidy found to exist.

661. In the Panel's view, because value could be affected by time, it could not be said that when a signatory allocated a subsidy over time and in so doing used the net present value concept to ensure that the present value of the amounts of the subsidy allocated over time equalled the subsidy found to exist, the countervailing duty imposed as a result of such allocation was necessarily in excess of the value, significance or quantity of the subsidy found to exist. The key question in this regard was whether or not the time element involved in the allocation of a subsidy provided a rational basis to apply the concept of the time value of money in determining the equality between the amounts allocated over time and the value, significance or quantity of the subsidy found to exist.

662. The Panel recalled the conflicting views of the parties on this question. The United States argued that, because of the time value of money, when a subsidy was allocated over time by dividing the nominal amount of the subsidy over the number of years in the allocation period, the real value of the sum of the nominal amounts allocated to different years would not be equivalent to the amount of the subsidy found to exist. This argument rested on the view that the real value of an amount of money received today was greater than the real value of the same nominal amount received at a later day. The EC contested the relevance of the concept of the time value of money to the allocation of subsidies, mainly on the grounds that a subsidy in the form of a grant did not actually involve money received over time.

663. With respect to this difference of views between the parties on the applicability of the time value of money concept in connection with the allocation of subsidies, the Panel noted that paragraph 5.1 of the Guidelines on amortization and depreciation stated:

> "The investigating authorities may attempt to determine a reasonable period based on the average life of assets owned by the firm or, if appropriate, a division of the firm. (The Committee recognizes that this latter determination will depend in part upon the terms of the grant and the corporate structure of the recipient of the grant.) The rationale for this approach is that while *the benefit of a grant (that is, elimination of financial obligations the recipient company would otherwise incur)* has no exact correlation to the life of any assets purchased with the grant, allocating the grant over the average life of renewable physical assets is one generally practical, fair, and consistent method of allocation."[174]

Given the express statement by the signatories that "the benefit of a grant" consisted of the "elimination of financial obligations the recipient company would otherwise incur", the Panel considered that such benefit could be conceptualized, for instance, in terms of a loan on which the repayment of principal and interest was waived. In that case, the benefit arising from the grant could be considered to amount to the waived repayment obligations. The repayment obligations which the recipient of a grant would have incurred absent the grant would have existed during a period of time. The Panel therefore considered that, if the "benefit of a grant" was the "elimination of financial obligations the recipient company would otherwise incur", it could not be said to be illogical to allocate the benefit of the grant in a manner which took into account the time element of financial obligations which the recipient of the grant would have incurred absent the grant.

[173] See The Concise Oxford Dictionary of Current English (sixth edition, 1976) p.32.

[174] BISD 32S/154, at 155-156 (Italics added)

664. In view of the above, the Panel considered that the EC's argument that grants were typically spent immediately and did not involve a future income stream did not mean that it was a logical error to apply the concept of the time value of money to the allocation of such a grant.

665. In this connection, the Panel also saw no merit in the argument of the EC that when a grant was used to purchase assets, the application of the concept of the time value of money was inappropriate because it would lead to the calculation of a benefit for a given year which exceeded the depreciation costs incurred on those assets in that year. The Panel recalled the statement in paragraph 5.1 of the Guidelines on amortization and depreciation that "the benefit of a grant" was the "elimination of financial obligations the recipient company would otherwise incur" and that this benefit had "no exact correlation to the life of any assets purchased with the grant". It followed that the Guidelines did not establish a relationship between the amount of the benefit of a grant and the depreciation of assets purchased with that grant. In light of this statement, the Panel found that there was no basis for the view that, as a matter of law, subsidies were to be allocated in such a manner that the amount allocated to a given year did not exceed the depreciation costs incurred in that year with respect to assets purchased with those subsidies.

666. The Panel recalled its observation in paragraph 661 above that the ordinary meaning of the term "the amount of the subsidy found to exist" in Article 4:2 did not necessarily preclude the use of a net present value concept, and that the key question was whether or not there was a rational basis for applying that concept to the process of allocating subsidies over time. As discussed in paragraph 663, the Panel considered that the notion of the benefit of a grant, interpreted as the elimination of financial obligations which the recipient of the grant would otherwise incur, indicated that the time value of money concept was not irrelevant to the allocation of subsidies over time, notwithstanding the argument of the EC that a subsidy in the form of a grant did not actually involve the receipt of money over time by the subsidy's beneficiary. Thus, the Panel considered that, if a subsidy were allocated over time by dividing the face amount of the subsidy over the number of years in the allocation period, the concept of the time value of money provided a rational basis to argue that the sum of the nominal amounts allocated to different years was not equivalent in value, quantity or significance to the amount of the subsidy found to exist. The Panel further recalled its views in paragraph 665 with respect to the EC's argument concerning the relationship between the allocation of a subsidy and the depreciation of assets purchased with that subsidy.

667. Accordingly, in the light of the considerations in paragraphs 660-666, the Panel found that a method for allocating a subsidy over time which ensured the equality between the present value of the nominal amounts allocated to different years in the period over which a subsidy was allocated and "the amount of the subsidy found to exist" was not inconsistent with the requirement in Article 4:2 that a countervailing duty not exceed "the amount of the subsidy found to exist", interpreted in accordance with the ordinary meaning of this expression.

668. The Panel then noted the argument of the EC that the Guidelines on amortization and depreciation[175] allowed for the allocation of subsidies over time, but did not allow for the application of the time value of money concept to such allocation.

669. The Panel noted that the introductory paragraph of the Guidelines stated that, where subsidies were to be allocated over time, "... the investigating authority should determine the appropriate time-period, *and decide how much of the subsidy should be allocated to each time-period*."[176] A review of these Guidelines indicated that they addressed exclusively the issue of the determination of the relevant period of time over which certain subsidies were to be allocated, but did not expressly address the question of how,

[175] BISD 32S/154

[176] Italics added by the Panel

after this period was chosen, the amount to be allocated to a particular year within this period was to be determined. To the extent the Guidelines were implicitly relevant to the question of whether the time value of money concept could be used in determining the amount to be countervailed in a given year, the Panel recalled its observations in paragraph 663 on the implications of the statement in paragraph 5.1 of the Guidelines that the "benefit of a grant" was the "elimination of financial obligations the recipient company would otherwise incur".

670. Based on the above considerations regarding the text of Article 4:2 and the Guidelines on amortization and depreciation, the Panel was of the view that Article 4:2 was to be interpreted as not precluding the allocation of subsidies over time in a manner which took into account the time value of money. It followed that the use by the DOC in the present cases of a discount rate in the allocation of subsidies over time was not *per se* contrary to Article 4:2 of the Agreement.

671. The Panel then noted that as support for its claim the EC also invoked the first sentence of Article VI:3 of the General Agreement. The Panel noted that while Article 4:2 prohibited the levying of a countervailing duty "in excess of the amount of the subsidy found to exist," Article VI:3 of the General Agreement prohibited the levying of a countervailing duty "in excess of an amount equal to the estimated bounty or subsidy determined to have been granted ...". The Panel was of the view that its considerations above with respect to the meaning of the phrase "the amount of the subsidy found to exist" in Article 4:2 were also applicable to the interpretation of the phrase "an amount equal to the estimated bounty or subsidy determined to have been granted" in Article VI:3 of the General Agreement.

672. The Panel noted the EC's argument that, in addition to legal shortcomings, the DOC's use of a discount rate was unsound on economic grounds because of the absence of any linkage between the DOC's amortization schedule and the real-world usage of a subsidy, and because of the often arbitrary manner in which the DOC selected the discount rate.

673. With regard to the first of these arguments, it was not clear to the Panel whether the EC's argument was that the allocation period used by the DOC was not reflective of the life of assets used by the firms under investigation, or that the DOC's methodology failed to relate the "benefit stream" to the manner in which a subsidy was actually used by the recipient. In so far as this argument could be interpreted as relating to the length of time of the allocation period used by the DOC, the Panel referred to its findings in the previous section of this Report with respect to the EC's claim that in the present cases the DOC erred by allocating subsidies over a standard 15 year period for the average useful life of assets in the steel industry. In so far as this argument could be interpreted to mean that the DOC should have used a methodology under which the "benefit stream" was determined as a function of the actual use of a subsidy, the Panel recalled that the Guidelines on amortization and depreciation suggested that the benefit of a grant could be considered to be the elimination of financial obligations the recipient company would otherwise incur.[177] Therefore, the Panel could not find that the DOC committed a legal error by not determining the "benefit stream" as a function of the actual use of the subsidy.

[177]The Panel noted in this respect that the amortization schedule which resulted from the application of the DOC's declining balance methodology could be said to be the conceptual equivalent of a loan

(footnote continued)

repayment schedule, with y/n in the formula being the linear amortization of principal. The Panel noted that y/n each year (i.e. the conceptual equivalent of the repayment of principal) was the same as the linear reparation suggested by the EC as one possible way in which the amount of subsidy could be allocated under Article 4:2. The other part of the declining balance formula could be conceptualized as the repayment of interest on the principal amount that was yet to be repaid.

674. With regard to the EC's argument that the discount rate used by the DOC in applying its declining balance methodology was often selected in an arbitrary manner, the Panel wished to underline that its conclusion in this section of its Report was only that the use of a discount rate in the allocation of subsidies over time was not *per se* inconsistent with the Agreement. This did not imply that in a particular case the countervailing duty calculated with this methodology could not be overstated as a result of errors in the choice of the parameters used in the application of this methodology. The Panel referred in this connection to section 6 of its findings of this Report.

675. In light of all the foregoing considerations, the Panel **concluded** that the United States did not act inconsistently with its obligations under Article 4:2 of the Agreement when the DOC applied a declining balance methodology in the allocation of certain subsidies over time in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France, Germany and the United Kingdom.

VI. CONCLUSIONS

676. The Panel recalled its conclusions that:

(i) the United States had not acted inconsistently with Article 4:2 when the DOC allocated subsidies over an average useful life of assets of 15 years in the countervailing duty investigations of imports of hot-rolled lead and bismuth carbon steel products from the United Kingdom and Germany (paragraph 646); and

(ii) the United States had not acted inconsistently with Article 4:2 when the DOC applied a "declining balance" methodology for purposes of allocating certain subsidies over time in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France, Germany and the United Kingdom (paragraph 675).

677. The Panel also recalled that it had found that:

(i) the United States had not acted inconsistently with the Agreement when the DOC did not take into account public policy objectives in determining whether subsidies resulted from the provision of equity capital by the Governments of France and the United Kingdom (paragraph 451);

(ii) the United States had not acted inconsistently with the Agreement when the DOC did not distinguish between the perspectives of inside investors and outside investors in determining whether subsidies resulted from the provision of equity capital by the Governments of France and the United Kingdom (paragraph 509);

(iii) the United States had not acted inconsistently with the Agreement when the DOC did not distinguish between the perspectives of inside lenders and outside lenders in determining whether subsidies resulted from loans provided by the Government of France (paragraph 557);

(iv) the United States had not acted inconsistently with Article 4:2 of the Agreement when the DOC included a risk premium in the discount rate applied by the DOC for purposes of calculating the benefits from certain subsidies (paragraph 585);

678. The Panel then recalled its conclusions that:

(i) the United States had acted inconsistently with Articles 1 and 4:2 when the DOC found, in the investigation of certain hot-rolled lead and bismuth carbon steel products from Germany that debt forgiveness by private banks was a subsidy (paragraph 404);

(ii)the United States had acted inconsistently with Articles 1 and 4:2 when the DOC found, in the countervailing duty investigation of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, that a "pass through" of subsidies occurred with the sale of a productive unit from BSC to UES (paragraph 430);

(iii)the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from the United Kingdom, the DOC made a finding that BSC was not equityworthy during certain years, by reason of the inadequate explanation by the DOC of its evaluation of BSC's future prospects (paragraph 510);

(iv)the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC made a finding that Usinor Sacilor was not equityworthy, by reason of the inadequate explanation by the DOC of its evaluation of Usinor Sacilor's future prospects (paragraph 510);

(v)the United States had acted inconsistently with Article 4:2 and had thereby acted inconsistently with Article 1 when the DOC calculated the amount of subsidies arising from equity infusions as if these equity infusions were grants in the countervailing duty investigations of imports of certain hot-rolled lead and bismuth carbon steel products from France and the United Kingdom (paragraph 521);

(vi)the United States had acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC made a finding that Usinor Sacilor was not creditworthy, by reason of the inadequate explanation by the DOC of its evaluation of Usinor Sacilor's future prospects (paragraph 558);

(vii)the United States had acted inconsistently with Article 4:2 and had thereby acted inconsistently with Article 1, by reason of the insufficient explanation provided by the DOC for the reasons of the DOC's reliance on the "facts available" within the meaning of Article 2:9 in determining the basis for the calculation of the discount rate applied by the DOC in the investigation of imports from France (paragraph 586);

(viii)the United States had acted inconsistently with Article 1, when the DOC allocated subsidies over domestic production only without providing the respondents an adequate opportunity to provide relevant evidence in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France (paragraph 609); and

(ix)the United States had acted inconsistently with Article 4:2 and had thereby acted inconsistently with Article 1 when, in the countervailing duty investigation of imports of certain hot-rolled lead and bismuth carbon steel products from France, the DOC failed to provide a sufficient explanation of the reasons for the use of 15 years as reflective of the average useful life of assets (paragraph 646).

The Panel **concluded** that to this extent the imposition by the United States of countervailing duties on imports of certain hot-rolled lead and bismuth carbon steel products from France, Germany and the United Kingdom was inconsistent with the obligations of the United States under the Agreement.

679. The Panel recommends that the Committee request the United States to bring its measures into conformity with its obligations under the Agreement.

Annex 1

EXCERPTS FROM DOCs PROPOSED REGULATIONS RELATING TO COUNTERVAILING DUTIES – §§ 355.44-355.49

§ 355.44 Existence of a countervailable benefit.

(a) Grants. In the case of a program providing a grant, a countervailable benefit exists in the amount of the grant.

(b)(1) Loans. A loan provided by a government confers a countervailable benefit to the extent that the amount paid by a firm for the government loan is less than what the firm would pay for a benchmark loan.

(2) In making the comparison required under paragraph (b)(1) of this section, the Secretary will take into account any deferral of principal repayments or interest payments on a government loan. Unless such deferral is a normal or customary lending practice in the country in question, the deferral of principal repayments or interest payments provides a countervailable benefit to the extent that the deferral results in a total loan repayment that is less than the repayment would have been in the absence of the deferral.

(3)(i) In the case of a short-term loan provided by a government, the Secretary will use as a benchmark the average interest rate for an alternative source of short-term financing in the country in question. In determining this benchmark, the Secretary normally will rely upon the predominant source of short-term financing in the country in question. Where there is no single, predominant source of short-term financing, the Secretary may use a benchmark composed of the interest rates for two or more sources of short-term financing in the country in question, weighted, wherever possible, according to the value of financing from each source.

(ii) For purposes of paragraph (b)(3)(i) of this section, "predominant" means that type of short-term financing the total value of which is greater than or equal to 50 percent of the total value of short-term financing, in local currency, in the relevant country.

(iii) For purposes of paragraph (b)(3)(i) of this section, unless short-term interest rates in the country in question have fluctuated significantly during the year in question, the Secretary will calculate a single, annual average benchmark interest rate.

(4) In the case of a long-term loan provided by a government for which the interest rate is fixed, the Secretary will use as a benchmark the following, in order of preference:

(i) The interest rate on a fixed-rate, long-term loan taken out in the same year by the firm receiving the government loan;

(ii) The interest rate on a fixed-rate debt obligation issued in the same year by the firm receiving the government loan;

(iii) The interest rate on a variable-rate, long-term loan taken out in the same year by the firm receiving the government loan;

(iv) The national average long-term fixed interest rate in the country in question;

(v) The national long-term variable interest rate in the country in question; or

(vi) A short-term benchmark rate determined in accordance with paragraph (b)(3) of this section.

(5) In the case of a long-term loan provided by a government for which the interest rate is variable, the Secretary will use as a benchmark the following, in order of preference:

(i) The interest rate on a variable-rate, long-term loan taken out in the same year by the firm receiving the government loan;

(ii) the interest rate on a fixed-rate, long-term loan taken out in the same year by the firm receiving the government loan;

(iii) The interest rate on a fixed-rate debt obligation issued in the same year by the firm receiving the government loan;

(iv) The national average long-term variable interest rate in the country in question;

(v) The national average long-term fixed interest rate in the country in question; or

(vi) A short-term benchmark rate determined in accordance with paragraph (b)(3) of this section.

(6)(i) The Secretary will deem a firm to be uncreditworthy if the Secretary determines that the firm did not have sufficient revenues or resources to meet its costs and fixed financial obligations in the three years prior to the year in which the firm and the government agreed upon the terms of the loan. The Secretary will determine creditworthiness on a case-by-case basis, and may examine, among other factors, the following:

(A) The receipt by a firm of comparable long-term commercial loans;

(B) The present and past financial health of a firm, as reflected in various financial indicators calculated from the firm's financial statements and accounts;

(C) A firm's recent past and present ability to meet its costs and fixed financial obligations with its cash flow; and

(D) Evidence of a firm's future financial position, such as market studies, country and industry economic forecasts, and project and loan appraisals.

Normally, the receipt by a firm of comparable long-term commercial loans, provided without an explicit government guarantee, shall constitute dispositive evidence that the firm is creditworthy.

(ii) The Secretary normally will not consider the creditworthiness of a firm absent a specific allegation by the petitioner which is supported by information establishing a reasonable basis to believe or suspect that the firm is uncreditworthy.

(iii) In making a determination under paragraph (b)(6)(i), the Secretary will ignore countervailable subsidies that currently benefit the firm or that benefited the firm in the past.

(iv) Notwithstanding paragraph (b)(4) of this section, if the Secretary deems a firm to be uncreditworthy pursuant to paragraph (b)(6)(i) of this section, the Secretary will calculate the benchmark interest rate for a long-term government loan by taking the sum of 12 percent of the prime interest rate in the country in question and:

(A) If the government loan has a fixed interest rate, in order of preference:

(1) The highest long-term fixed interest rate commonly available to firms in the country in question;

(2) The highest long-term variable interest rate commonly available to firms in the country in question; or

(3) The short-term benchmark interest rate determined in accordance with paragraph (b)(3) of this section; or

(B) If the government loan has a variable interest rate, in order of preference:

(1) The highest long-term variable interest rate commonly available to firms in the country in question;

(2) The highest long-term fixed interest rate commonly available to firms in the country in question; or

(3) The short-term benchmark interest rate determined in accordance with paragraph (b)(3) of this section.

(v) In determining whether a short-term loan provided by a government confers a countervailable benefit, the creditworthiness of a firm will be irrelevant.

(7) In identifying a benchmark under paragraph (b) of this section, the Secretary will attempt to use, where possible, a nongovernment source of financing. Where necessary, however, the Secretary may use loans made available under one or more government programs, provided that any such program is not deemed to be selective within the meaning of § 355.43.

(8) In comparing a government loan with a benchmark loan under paragraph (b) of this section, the Secretary will compare the effective interest rate of the government loan with the effective interest rate of the benchmark loan. Where the Secretary cannot quantify the effective rate, either with respect to the government loan or the benchmark loan, the Secretary will compare the nominal interest rate of the government loan with the nominal interest rate of the benchmark loan. Only as a last resort will the Secretary compare a nominal interest rate with an effective interest rate in establishing the interest rate differential.

(9) Notwithstanding § 355.41(b), the Secretary will not consider a loan provided by a government-owned bank, per se, to be a loan provided by the government, and the Secretary will not investigate a loan from a government-owned bank absent a specific allegation which is supported by information establishing a reasonable basis to believe or suspect that:

(i) The government-owned bank provided the loan at the direction of the government or with funds provided by the government, and

(ii) The terms of the loan were inconsistent with commercial considerations.

(c)(1) Loan guarantees. In the case of an explicit guarantee by a government of a loan to a firm, a countervailable benefit exists to the extent the Secretary determines that:

(i) The price or fee paid by the firm for the government guarantee is less than the price the firm would have paid for a comparable commercial guarantee, or

(ii) The amount paid by the firm for the guaranteed loan is less than what the firm would have paid for benchmark financing pursuant to paragraph (b) of this section.

(2) The explicit guarantee by a government of a loan to a firm shall not confer a countervailable benefit if the government is a principal owner or majority shareholder of the firm and it is a normal commercial

practice in the country in question for owners or shareholders to provide loan guarantees on comparable terms to their firms.

(d)(1) Export insurance. The provision by a government of export insurance confers a countervailable benefit to the extent the Secretary determines that the premium rates charged are manifestly inadequate to cover the long-term operating costs and losses of the program over the past five years, up to and including the year in question. In determining whether premium rates are manifestly inadequate, the Secretary will determine whether there is a substantial gap between premiums charged and costs and losses incurred under the program, and will take into account income from other insurance programs operated by the entity in question.

(2) Where the Secretary determines that the premium rates charged are manifestly inadequate, the Secretary will calculate the amount of the countervailable benefit by calculating the excess of the amount received by a firm over the amount of premiums paid by the firm.

(e)(1) Equity. The provision of equity by a government to a firm confers a countervailable benefit to the extent the Secretary determines that:

(i) The market-determined price for equity purchased directly from the firm is less than the price paid by the government for the same form of equity purchased directly from the firm; or

(ii) In the event that there is no market-determined price, the firm is not equityworthy and there is a rate of return shortfall within the meaning of § 355.49(e).

(2) A firm is equityworthy within the meaning of paragraph (e)(1)(ii) of this section if the Secretary determines that, from the perspective of a reasonable private investor examining the firm at the time the government equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable period of time. In making this determination, the Secretary may examine the following factors, among others:

(i) Current and past indicators of a firm's financial health calculated from that firm's statements and accounts, adjusted, if appropriate, to conform to generally accepted accounting principles;

(ii) Future financial prospects of the firm, including market studies, economic forecasts, and project or loan appraisals;

(iii) Rates of return on equity in the three years prior to the government equity infusion; and

(iv) Equity investment in the firm by private investors.

(3) The Secretary will not investigate an equity infusion in a firm absent a specific allegation by the petitioner which is supported by information establishing a reasonable basis to believe or suspect that a firm has received an equity infusion which provides a countervailable benefit within the meaning of paragraph (e)(1) of this section.

(4) In making a determination under paragraph (e)(2) of this section, the Secretary will ignore countervailable subsidies that currently benefit the firm or benefited the firm in the past.

(f)(1) Provision of goods or services at preferential rates. The provision by a government of a good or service pursuant to a domestic program confers a countervailable benefit to the extent the Secretary determines that the price charged by the government for the good or service is less than the benchmark price, which normally will be the nonselective prices the government charges to the same or other users of the good or service within the same political jurisdiction.

(2) Where the Secretary determines that there is no benchmark price under paragraph (f)(1) which is not selective within the meaning of § 355.43, the Secretary will determine the existence of a countervailable benefit based upon, in order of preference, the following alternative benchmarks:

(i) The price, adjusted for any cost differences, the government charges for a good or service which is similar or related to the good or service in question, provided that the similar or related good or service and its price is not selective within the meaning of § 355.43;

(ii) The price charged by other sellers to buyers within the same political jurisdiction for an identical good or service;

(iii) The government's cost of providing the good or service; or

(iv) The price paid for the identical good or service outside of the political jurisdiction in question.

(g)(1) Internal transport and freight charges for export shipments. Where a government provides internal transport and freight services pursuant to an export program, a countervailable benefit exists to the extent the Secretary determines that the charges paid by a firm for transport or freight with respectto goods destined for export are less than what the firm would have paid if the goods were destined for domestic consumption.

(2) For purposes of paragraph (g)(1), a countervailable benefit does not exist where the Secretary determines that:

(i) Any difference in charges is the result of an arm's length transaction between the supplier and the user of the transport or freight service; or

(ii) The difference in charges is commercially justified.

(h) Price preferences for inputs used in the production of goods for export. The delivery by a government of imported or domestic products for use in the production of exported goods confers a countervailable benefit to the extent the Secretary determines that the terms or conditions are more favorable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, and if such terms or conditions are more favorable than those commercially available on world markets to their exporters.

(i)(1) Taxes and import charges. A countervailable benefit exists to the extent the Secretary determines that the taxes paid by a firm are less than the taxes it otherwise would have paid in the absence of a program providing for:

(i) A full or partial exemption, remission, or deferral of a direct tax or social welfare charge; or

(ii) A reduction in the base used to calculate a direct tax or social welfare charge.

(2) A countervailable benefit exists to the extent the Secretary determines that the taxes or import charges paid by a firm are less than the taxes it otherwise would have paid in the absence of a domestic program providing for the full or partial exemption, remission, or deferral of an indirect tax or import charge.

(3) The exemption or remission upon export of indirect taxes not in excess of those levied with respect to the production and distribution of like products when sold for domestic consumption shall not confer a countervailable benefit.

(4)(i) The exemption, remission, deferral or drawback of prior stage cumulative indirect taxes on goods or services used in the production of exported products in excess of the exemption, remission, deferral or drawback of like prior stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption shall confer a countervailable benefit; provided that the nonexcessive exemption, remission, deferral, or drawback of prior stage cumulative indirect taxes or import charges levied on goods that are physically incorporated, making normal allowances for waste (but not taxes or import charges on services, catalysts, and other items not so incorporated), in the exported product shall not confer a countervailable benefit.

(ii) Notwithstanding paragraph (d)(4)(i), in the case of a program purporting to rebate prior stage cumulative indirect taxes and/or import charges, or in the case of a program providing for a fixed rate of duty drawback, the entire amount of the rebate or drawback shall confer a countervailable benefit, unless the Secretary determines that:

(A) The program operates for the purpose of rebating prior stage cumulative indirect taxes and/or import charges;

(B) The government accurately ascertained the level of the rebate or fixed duty drawback; and

(C) The government reexamines its schedules periodically.

(j) Worker assistance. The provision by a government of financial assistance to workers confers a countervailable benefit to the extent that such assistance relieves a firm of an obligation which it normally would incur.

(k) Forgiveness of debt. The assumption or forgiveness by a government of an outstanding debt obligation of a firm confers a countervailable benefit equal to the outstanding principal and accrued unpaid interest at the time of the assumption or forgiveness. Where a government receives shares in a firm in return for eliminating or reducing a firm's debt obligation, the Secretary shall determine the existence of a countervailable benefit in accordance with the provisions of paragraph (e) of this section.

(l) Research and development assistance. Notwithstanding any other provision of this section, assistance provided by a government to a firm in order to finance research and development does not confer a countervailable benefit where the Secretary determines that the results of such research and development have been, or will be, made available to the public, including competitors of the firm in the United States.

(m) General export promotion. Notwithstanding any other provision of this section, export promotion activities of a government shall not confer a countervailable benefit where the Secretary determines that such activities consist of general informational activities which do not promote particular products over others.

(n) Programs with varying levels of benefits. Notwithstanding any other provision of this section, where a government program provides varying levels of benefits with different eligibility criteria, and one or more of such levels is not selective within the meaning of § 355.43, a countervailable benefit exists to the extent that a firm receives benefits under the program which are more favorable than the most favorable, nonselective level of benefits available under the program. The preceding sentence shall apply only to the extent the Secretary determines that the firm would have been eligible for the nonselective benefits under the program.

(o)(1) Transnational benefits. Notwithstanding any other provision of this section, a countervailable benefit does not exist to the extent the Secretary determines that funding for a benefit is provided by a government other than the government of the country in which the merchandise is produced or from which the merchandise is exported, or by an international lending or development institution.

(2) Notwithstanding paragraph (o)(1) of this section, if the members (or other participating entities) of an international consortium that is engaged in the production of a class or kind of merchandise subject to a countervailing duty proceeding receive countervailable subsidies from their respective home countries to assist, permit, or otherwise enable their participation in that consortium through production or manufacturing operations in their respective home countries, then the Secretary will cumulate all such benefits, as well as benefits provided directly to the international consortium, in determining any countervailing duty upon such merchandise.

§ 355.45 Upstream Subsidies.

(a) In general. The term upstream subsidy means any domestic countervailable subsidy provided by the government of a country that:

(1) Is paid or bestowed by that government with respect to an input product which is used in the production in that country of the merchandise;

(2) In the judgment of the Secretary bestows a competitive benefit on the merchandise; and

(3) Has a significant effect on the cost of producing the merchandise. For purposes of this paragraph, an association of two or more foreign countries, political subdivisions, dependent territories, or possessions of foreign countries organized into a customs union outside the United States shall be treated as being one country if the subsidy is provided by the customs union.

(b) Threshold determination. Before investigating the existence of an upstream subsidy, the Secretary must have a reasonable basis to believe or suspect that all of the following elements exist:

(1) A domestic countervailable subsidy is provided with respect to an input product;

(2) One of the following conditions exists:

(i) The supplier of the input product controls the producer of the merchandise, the producer controls the supplier, or the supplier and the producer are both controlled by a third person;

(ii) The price for the input product is lower than the price that the producer otherwise would pay for the input product in obtaining it from an unsubsidized seller in an arm's length transaction; or

(iii) The government sets the price of the input product so as to guarantee that the benefit provided with respect to the input product is passed through to producers of the merchandise; and

(3) The ad valorem subsidy rate on the input product multiplied by the proportion of the total production costs of the merchandise accounted for by the input product is equal to, or greater than, one percent.

For purposes of paragraph (b)(2)(i) of this section, the Secretary will not consider common government ownership to constitute control.

(c) Input product. For purposes of this section, the term "input product" means any product used in the production of the merchandise.

(d) Competitive benefit. In evaluating whether a competitive benefit exists pursuant to paragraph (a)(2) of this section, the Secretary will determine whether the price for the input product is lower than:

(1) The price which the producer of the merchandise otherwise would pay for the input product, produced in the same country, in obtaining it from another unsubsidized seller in an arm's length transaction; or

(2) A world market price for the input product.

For purposes of paragraph (d)(1) of this section, where the Secretary has determined in a previous proceeding that a domestic countervailable subsidy is paid or bestowed on the input product which is used for comparison, the Secretary may, where appropriate, adjust the price which the producer of the merchandise otherwise would pay for the input product to reflect the effects of the subsidy.

(e) Significant effect. For purposes of evaluating whether a significant effect exists pursuant to paragraph (a)(3) of this section, the Secretary will multiply the ad valorem subsidy rate on the input product by the proportion of the total production costs of the merchandise accounted for by the input product. If the input subsidy so allocated to the merchandise exceeds five percent, the Secretary will presume the existence of a significant effect. If the input subsidy so allocated to the merchandise is less than one percent, the Secretary will presume the absence of a significant effect. If the input subsidy so allocated to the merchandise is between one and five percent, there shall be no presumption. A party may rebut these presumptions by presenting information which demonstrates that subsidies on the input products will have a significant effect on the competitiveness of the merchandise. In assessing such information, the Secretary will consider the extent to which factors other than price, such as quality differences, are important determinants of demand for the merchandise.

(f) Inclusion of upstream subsidy. If the Secretary determines that an upstream subsidy is being or has been paid or bestowed, the Secretary will include in the amount of any countervailing duty imposed on the merchandise an amount equal to the amount of the competitive benefit determined pursuant to paragraph (d) of this section; except that in no event shall the amount so included be greater than the amount of subsidization determined with respect to the input product.

(g) Processed agricultural products. Notwithstanding any other provision of this section, the Secretary will deem domestic countervailable subsidies found to be provided to either producers or processors of a raw agricultural product to be provided to the manufacture, production, or exportation of the processed agricultural product where the Secretary determines that:

(1) The demand for the prior-stage product is substantially dependent on the demand for the latter-stage product, and

(2) The processing operation adds only limited value to the raw commodity.

§ 355.46 Offsets.

(a) General rule. In calculating a countervailable benefit, the Secretary may subtract from the gross benefit, the amount of:

(1) Any application fee, deposit, or similar payment paid in order to qualify for, or to receive, the benefit;

(2) Any loss in the value of the benefit resulting from its deferred receipt, if the deferral is mandated by government order; and

(3) Export taxes, duties, or other charges levied on the export of the merchandise to the United States specifically intended to offset the benefit received.

(b) Tax effects of countervailable benefits. In calculating the amount of a countervailable benefit, the Secretary will ignore the secondary tax consequences of the benefit.

§ 355.47 Allocation of countervailable benefits to a product or market and calculation of ad valorem subsidy.

(a) Benefits tied to a particular product. Where the Secretary determines that a countervailable benefit is tied to the production or sale of a particular product or products, the Secretary will allocate the benefit solely to that product or products. If the Secretary determines that a countervailable benefit is tied to a product other than the merchandise, the Secretary will not find a countervailable subsidy on the merchandise. If the product or products to which the benefit is tied include the merchandise, the Secretary will calculate the ad valorem subsidy rate as follows:

(1) In the case of a domestic program, the Secretary will divide the benefit by a firm's total sales of the product or products to which the benefit is tied; or

(2) In the case of an export program, the Secretary will divide the benefit by a firm's total exports of the product or products to which the benefit is tied.

(b) Benefits tied to sales to a particular market. Where the Secretary determines that a countervailable benefit is tied to the sale of products to a market other than the United States, the Secretary will not find a countervailable subsidy on the merchandise. Where a benefit is tied, or can be tied, to exports to the United States, the Secretary will calculate the ad valorem subsidy rate by dividing the benefit by:

(1) The firm's total exports to the United States; or

(2) If the benefit also is tied to exports of a particular product or products, by the firm's total exports to the United States of the product or products to which the benefit is tied.

(c)(1) Untied benefits. Where the Secretary determines that a countervailable benefit is not tied to the production or sale of a particular product or products, or is not tied to the sale of products to a particular market, the Secretary will allocate the benefit to all products produced by a firm, in the case of a domestic program, or to all products exported by a firm, in the case of an export program. The Secretary will calculate the ad valorem subsidy rate as follows:

(i) In the case of a domestic program, the Secretary will divide the benefit by a firm's total sales; or

(ii) In the case of an export program, the Secretary will divide the benefit by a firm's total exports.

(2) For purposes of paragraph (c)(1) of this section, the Secretary will treat equity infusions as untied benefits.

§ 355.48 Timing of receipt of countervailable benefits.

(a) General rule. Ordinarily, the Secretary will deem a countervailable benefit to be received at the time that there is a cash flow effect on the firm receiving the benefit. The cash flow and economic effect of a benefit normally occurs when a firm experiences a difference in cash flows, either in the payments it receives or the outlays it makes, as a result of its receipt of the benefit.

(b) Particular types of benefits. For purposes of paragraph (a) of this section, the Secretary ordinarily will deem the cash flow effect to occur as follows:

(1) In the case of a grant or equity infusion, at the time a firm receives the grant or equity infusion;

(2) In the case of the provision of a good or service, at the time a firm pays, or in the absence of payment would have paid, for the good or service;

(3) In the case of a loan, at the time a firm is due to make a payment on the loan;

(4) In the case of a direct tax benefit (other than a tax certificate described in paragraph (b)(5) of this section), at the time a firm can calculate the amount of the benefit, which normally will be the time at which the firm files its tax return;

(5) In the case of a tax certificate used to pay direct taxes, indirect taxes, or import charges, at the time a firm receives the certificate;

(6) In the case of an exemption of an indirect tax or import charge, at the time a firm otherwise would be required to pay the indirect tax or import charge; and

(7) Notwithstanding any other provision of paragraph (b) of this section, in the case of an export benefit provided as a percentage of the value of the exported merchandise (such as a cash payment or an overrebate of indirect taxes), on the date of export.

(c) Exception. In unusual circumstances, the Secretary may deem a benefit to be received at a time other than a time prescribed by paragraphs (a) and (b). Where the Secretary departs from the methodology set forth in paragraphs (a) and (b), the Secretary will explain the reasons therefor.

§ 355.49 Allocation of countervailable benefits over time.

(a)(1) General rule. In valuing a countervailable benefit, depending upon the nature of the benefit in question, the Secretary will either expense the entire amount of the benefit in a single year, allocate the benefit over two or more years, or calculate an annual benefit for two or more years.

(2) The Secretary will expense recurring countervailable benefits in the year of receipt.

(3) The Secretary will allocate the following nonrecurring countervailable benefits over two or more years:

(i) Grants and equity infusions found to confer a countervailable benefit pursuant to § 355.44(e)(1)(i) where the total amount of grants or equity infusions received under a particular program during a year is:

(A) In the case of grants or equity infusions provided pursuant to a domestic program, equal to or greater than 0.50 percent of all sales of the firm in question during the same year; or

(B) In the case of grants provided pursuant to an export program, equal to or greater than 0.50 percent of the export sales of the firm in question during the same year; and

(ii) Long-term loans where the interest rates on both the government loan and the benchmark loan are long-term fixed rates.

(4) The Secretary will calculate annual benefits for long-term loans and equity infusions other than those types of loans and equity infusions referred to in paragraph (a)(3) of this section.

(b)(1) Process for allocating grants and certain equity infusions over time. In allocating over time the benefit from a nonrecurring grant or an equity infusion described in § 355.44(e)(1)(i), the Secretary will use the following three-step process:

(i) Determine the amount of the countervailable benefit pursuant to § 355.44;

(ii) Assign a discount rate; and

(iii) Construct a benefit stream.

(2) For purposes of paragraph (b)(1)(ii) of this section, the Secretary will use as a discount rate the following, in order of preference:

(i) The cost of long-term, fixed-rate debt of the firm in question, excluding loans found to confer a countervailable subsidy;

(ii) The average cost of long-term, fixed-rate debt in the country in question; or

(iii) A rate which the Secretary considers to be most appropriate. 52

The Secretary will select a discount rate based upon data for the year in which the government and the firm agreed on the terms for receiving the grant or equity infusion.

(3) For purposes of paragraph (b)(1)(iii) of this section, the Secretary will use the following formula in determining the benefit stream:

$$A_k = \frac{y/n + [y - \{y/n\} \quad \{k-1\}]\ d}{1 + d}$$

Where

A_k = the amount countervailed in year k,

y = the face value of the grant,

n = the average useful life of a firm's renewable physical assets (equipment), as set forth in the U.S. Internal Revenue Service's 1977 Class Life Asset Depreciation Range System (Rev. Proc. 77-10, 1977-1, C.B. 548 (RR-38),

d = the discount rate, and

k = the year of allocation, where the year of receipt = 1 and $1 \leq k \leq n$.

(c)(1) Process for allocating certain long-term loans over time. In allocating over time the benefit from a long-term loan described in paragraph (a)(3)(ii) of this section, the Secretary will use the following three-step process:

(i) Determine the grant equivalent for the loan by calculating the present value, in the year the loan is received, of the difference between the amount that the firm is to pay under the government loan and the amount that the firm would have paid under the benchmark loan;

(ii) Assign a discount rate; and

(iii) Construct a benefit stream.

(2) For purposes of paragraph (c)(1)(i) of this section, the Secretary will use the following formula in calculating the grant equivalent of the loan:

$$\sum_{n=o}^{k} \frac{X_n}{(1+d)^n}$$

Where

n = year in the life of the loan,

d = the discount rate,

x = difference between amount paid under government loan and benchmark loan, and

k = the last year in the life of the loan and $k \geq n \geq 0$.

In no event, however, will the grant equivalent calculated under this paragraph exceed the face value of the loan principal.

(3) For purposes of paragraph (c)(1)(ii) of this section, the Secretary will use as a discount rate the benchmark interest rate for the loan in question determined pursuant to § 355.44(b).

(4) For purposes of paragraph (c)(1)(iii) of this section, the Secretary will use the following formula in determining the benefit stream:

$A_k = y/n + [y - \{y/n\} \{k-2\}]d$

Where

A_k = the amount countervailed in year k,

y = the grant equivalent,

n = the number of years in the life of the loan,

d = the discount rate, and

k = the year of allocation, where the year of receipt=1 and $2 \leq k \leq n+1$.

(d)(1) Process for calculating annual benefit attributable to other long-term loans. In the case of long-term loans other than loans described in paragraph (a)(3)(ii) of this section, for each year the loan is outstanding the Secretary will determine the amount of the benefit attributable to a particular year by calculating the difference between what the firm paid during the year under the government loan and what the firm would have paid during the year under the benchmark loan ("loan differential").

(2) In determining the number of years in which a long-term loan potentially confers a countervailable benefit under paragraph (d)(1) of this section, the Secretary will use the number of years in the loan.

(3) In no event may the amount calculated under paragraph (d)(1) of this section exceed the amount the Secretary would have calculated if the Secretary had treated the loan principal as a grant and calculated the annual benefit pursuant to paragraph (b) of this section.

(e)(1) Equity infusions. Where a firm receives an equity infusion and the Secretary finds the firm to be unequityworthy at the time of the infusion pursuant to § 355.44(e)(1)(ii), the Secretary will determine the amount of the countervailable benefit, if any, conferred in a year by multiplying the difference between the firm's rate of return on equity and the national average rate of return on equity for firms in the country in question ("rate of return shortfall") by the total amount of the equity infusion. The Secretary will use the rates of return for the year in question. If the firm paid dividends to the government during the year, the Secretary will subtract the amount of such dividends from any countervailable benefit found, provided that such dividends are not included in the firm's rate of return.

(2) In determining the number of years in which an equity infusion potentially confers a countervailable benefit under paragraph (e)(1) of this section, the Secretary will use the average useful life of a firm's renewable physical assets (equipment), as set forth in the U.S. Internal Revenue Service's 1977 Class Life Asset Depreciation Range System (Rev. Proc. 77-10, 1977-1, C.B. 548 (RR-38)).

(3) In no event may the amount calculated under paragraph (e)(1) of this section exceed the amount that the Secretary would have calculated if the Secretary had treated the amount of the equity infusion as a grant and calculated the annual benefit pursuant to paragraph (b) of this section.

(f) Contingent liability interest-free loans. Where a government provides a long-term, interest-free loan, the obligation for repayment of which is contingent upon subsequent events, the Secretary will treat any balance on the loan outstanding during a year as an interest-free, short-term loan, will determine the amount of the countervailable benefit for the review period in accordance with the provisions of § 355.44(b)(3), and will expense such benefit to the year in question.

(g) Forgiven loans. Where during a year a government forgives all or part of a loan, the Secretary will treat the forgiven amount as a grant and will expense or allocate it in accordance with the provisions of this section.

(h) Other benefits. In the case of benefits not covered by any other provision of this section, the Secretary will value the benefit in accordance with the underlying principles of this section.

Annex 2

The following simplified example assumes the unlikely case in which a subsequent investment can have a significant effect on the income-generating ability of previously acquired assets, an assumption on which the EC's arguments rely entirely. Even with this assumption, the example illustrates how an investment that is commercially reasonable for an existing owner will be similarly reasonable for other investors.

A small widget company is started though an equity infusion from its sole owner of 100 pounds, which is used to purchase a machine that makes widgets. When functioning, the machine can produce 10 pounds of profit per year, a 10 per cent return. The rate of return the owner could obtain by investing elsewhere (the "market rate of return") is also 10 per cent.

After the machine is installed, however, it is discovered that the machine cannot be operated unless an additional 50 pounds is invested. (This could result from, for example, the need to install a new ignition switch or the need to comply with new environmental regulations.) In effect, this is now an "ailing company" and the existing owner hopes to "save" the past investment.

The two pertinent questions are: (1) does the sole owner make another equity infusion of 50 pounds?; and (2) would a new investor make the investment?

The existing owner faces the following choices:

-<u>With</u> the new 50 pound infusion, the machine can be operated and will earn 10 pounds annually.

-<u>Without</u> the infusion, the current owner will earn 0 pounds per year from the company, but 5 pounds per year by investing the 50 pounds elsewhere (recall that the market rate of return is 10 per cent), for a total of 5 pounds.

Clearly, the sole owner would make the additional 50 pound infusion because the return on this marginal investment is 10 pounds per year - better than the 5 pounds that can be earned elsewhere.

The second question is whether a new investor would provide the 50 pounds infusion. Recall the discussion in the text above that the value of previous investments is their ability to generate income in the future. As a result of the machine's inability to function without further expenditure, the value of the owner's original investment has been effectively reduced. This reality will affect the price the new owner will charge a new investor for purchasing a stake in the company - or, since the present example involves a fixed amount of investment (50 pounds), the size of the stake in the company the owner will offer the new investor. Acting rationally, the owner and new investor would negotiate so that the new investor obtained 50 per cent ownership, which would result in the following returns for each:

-the <u>new</u> owner would earn 5 pounds (half the company's 10 pound profit) on the 50 pound investment - the same return it would make if it invested elsewhere at the 10 per cent market rate of return.

-The <u>existing</u> owner would also earn 5 pounds (the other half of the company's 10 pound profit) from the company, but would earn an additional 5 pounds from investing 50 pounds (the amount saved by not having to invest it in the company) elsewhere at the market return of 10 per cent. Total return: 10 pounds.

Thus, a new investor would indeed make the same investment as the existing owner; moreover, the existing owner and new investor would earn the same amounts (10 and 5 pounds, respectively) whether the existing owner invested in the company or a new investor did.

Of course, one could use different figures for the market rate of return, earning potential of the machine, or amount of additional investment required. Although altered figures would change the terms of the deal struck between the new investor and existing owner, it would not change the fundamental principle: where it makes commercial sense for an existing owner to invest, it will also make sense for a new owner to do so.

The same holds true where it is not consistent with commercial considerations for an existing owner to invest. In the scenario described above, this would occur if the profit the company could expect from the additional 50 pound investment was less than 5 pounds, as that would be below the 10 per cent market rate of return.