

Delhi Regional AD/CVD Workshop

October 4, 2016

Session 6

The Sufficiency and Ordinary Course of Trade
Tests

5 Percent Test

(*aka*, Home Market Viability)

- Normal value is the price at which the foreign like product is first sold for consumption in the exporting country (*aka* the home market).
- There are exceptions to this approach, one of which involves market viability.

Home Market Viability – Continued

- A market is viable if the aggregate quantity of sales of the foreign like product to affiliated and unaffiliated purchasers in the home market is five percent or more of the aggregate quantity of sales of subject merchandise to unaffiliated buyers in the United States.
- The home market viability analysis is based on aggregate sales quantities and is not conducted on a model-by-model basis.

Home Market Viability – Continued

- If the home market for the foreign like product is not viable, normal value may be based on sales to a viable third-country market (*e.g.*, a country other than the home market), or on constructed value (*e.g.*, a normal value based on cost of production, selling, general and administrative expenses, and profit).
- Presently, where the home market is not viable, Commerce has a preference for calculating normal value based on sales to a viable third-country market, rather than on constructed value.

Home Market Viability - Proposed Regulations

- However, in August 2016, Commerce issued proposed regulations that would invert this preference. *See* 81 FR 58419.
- Under the proposed rules, if the home market is not viable, Commerce would first seek to rely on constructed value.
- Reliance on a viable third-country market as the basis for normal value would drop to the second preference.

Home Market Viability, Propose Regulations - Continued

- Commerce finds there are advantages to a standard that uses constructed value as the default.
- Recent changes in U.S. law require Commerce to request cost information from all dumping respondents at the outset of each proceeding. *See* Trade Preferences Extension Act (TPEA) of 2015.
- As a result, under the proposed regulations, Commerce would have the necessary constructed value data readily available for use in the event the home market is not viable.

Home Market Viability, Propose Regulations - Continued

- Secondly, Commerce views constructed value data as preferable to third country sales because they provides a more appropriate comparison to U.S. prices.
- Third country sales sometimes involve products that are similar, but not identical to U.S. sales, whereas constructed value data reflect the costs associated with the production and sale of the subject merchandise.
- The deadline to submit comments on this revised methodology is September 26, 2016.

Home Market Viability, Propose Regulations - Continued

- There are few instances in which Commerce considers the home market of a respondent not to be viable.
- We conduct the home market viability test prior to the arm's length test and cost of production test.
- We do not perform the home market viability test a second time after application of the arm's length and cost of production tests.

Ordinary Course of Trade

- We base normal value on sales made in the exporting country or third-country market that are in the ordinary course of trade.
- Ordinary course of trade means, “the conditions and practices which, for a reasonable time prior to the exportation of the subject merchandise, have been normal in the trade under consideration with respect to merchandise of the same class or kind.”

Ordinary Course of Trade

- Continued

- We exclude sales outside ordinary course of trade from the calculation of normal value.
- Home market sales to affiliated parties determined to be not at arm's length as well as home market sales that are below the cost of production are considered to be outside the ordinary course of trade.

Sales to Affiliated Parties

- We include home market or third-country affiliated party sales in our analysis only if the respondent's sales are made at arm's length.
- Such sales that are not at arm's length are considered outside the ordinary course of trade.
- To be at arms length, the prices of the affiliated-party transactions must be comparable to the prices at which the respondent sold identical merchandise to unaffiliated parties.

Sales to Affiliated Parties

- Arm's Length Test

- We compare affiliated and unaffiliated prices at the same level of trade.
- We determine the weighted-average price for each product sold to each affiliated party. Similarly, we determine the weighted-average price for each product to the unaffiliated customers.
- For each affiliated customer, we compare the weighted-average price for each product to the weighted-average price of the same product sold to unaffiliated customers. This results in a product-specific arm's length ratios for each affiliated customer.
- Next, for each affiliated customer, the Department weight averages the ratios into a single arm's length ratio.

Sales to Affiliated Parties

- Continued

- To be at arm's length, the overall price ratio of the affiliated customer must be, on average, between 98 percent and 102 percent of prices to unaffiliated customers.
- We reject sales to affiliated parties when they are, on average, less than 98 percent or more than 102 percent of unaffiliated party prices.
- Thus, the arm's length test is ultimately applied to each affiliate and not to individual models sold by that affiliate.
- In situations where sales made through the affiliated party constitute all or a significant percentage of home market sales, the Department calculates normal value based on the "downstream" sales price made by the affiliate to the first unaffiliated party.

Cost of Production Test

- Sales below the cost of production are considered to be outside the ordinary course of trade.
- Sales made below cost of production may be disregarded for calculation of normal value if those sales were: 1) within an extended period of time in substantial quantities, and 2) at prices which do not permit the recovery of all costs within a reasonable period of time.

Cost of Production Test

- Continued

- The extended period of time is normally one year but not less than six months.
- Substantial quantities typically exist if the volume of such sales of a particular product model represent 20 percent or more of the volume of sales of the product model under consideration for the determination of normal value.

Conducting the Cost Test

- The cost of production used for comparison purposes must represent the cost of production of the model of the product under examination, which is sold in the comparison market (*e.g.*, the normal value of the model is compared to the average cost of production of that model for the period).

Conducting the Cost Test - Continued

- Sales prices and cost of production must be on the same basis.
- Normal value normally excludes discounts and rebates, movement charges, direct and indirect selling expenses, and packing expense from the sales prices.
- Cost of production is composed of cost of materials, general and administrative, and interest expenses.
- Thus, the sales prices and the cost of production are on the same basis because both are net of any sales related expenses, movement expenses, and packing expenses.
- When U.S. sales are export price (EP) sales, the cost of production should include actual indirect selling expenses.

Conducting the Cost Test - Continued

- When 20 percent or more by volume of the sales of a product model during the period fail the cost test, Commerce may disregard the below-cost sales of that model from the calculation of normal value.
- The remaining sales of the given product model that passed the cost test are used in the calculation of normal value.
- Where less than 20 percent of the sales of the product model during the period fail the cost test, we do not disregard any below-cost sales of that product model because the below-cost sales were not made in substantial quantities within an extended period of time.

Cost of Production and Particular “Particular Market Situation

- The TPEA of 2015, gives Commerce additional discretion when determining costs of production and constructing normal value in order to calculate an applicable duty rate.
- Under the law, Commerce may find that a sale or transaction is outside of the ordinary course of trade whenever it “determines that the particular market situation prevents a proper comparison with the export price or constructed export price.”

Particular Market Situation - Continued

- Under the new law, if a particular market situation exists such that the cost of materials and fabrication or other processing of any kind does not accurately reflect the cost of production in the ordinary course of trade, Commerce may use another calculation methodology under this subtitle or any other calculation methodology.

Particular Market Situation - Continued

- This provision under the TPEA is still relatively new.
- Thus, Commerce has very little experience in dealing with particular market situations.

Challenges Involving Cost Test

- We conduct our cost test on a model-specific basis.
- Respondents often do not maintain model-specific costs in the ordinary course of business.
- Respondents must create a method by which they allocate costs to the models specified in our dumping questionnaire.
- We must evaluate respondent's cost allocation methodology and trace the allocated costs to the respondent's books and records.

Challenges Involving Cost Test - Continued

- We must examine whether the respondent has engaged in “cost shifting.”
- Cost shifting may occur when respondents utilize an allocation methodology that shifts high costs away from subject models and towards non-subject models, or
- When costs are allocated towards subject models whose normal value is already relatively high, thereby limiting the costs allocated to lower priced models that otherwise might be at risk of failing the cost test.

Challenges Involving the SG&A Calculation

- We divide SG&A, as reported on the respondent's income statement, by the respondent's cost of goods sold to derive an SG&A ratio.
- We multiply the SG&A ratio by the model-specific cost of manufacture to arrive at a model-specific SG&A cost.
- In some countries, the GAAP does not require firms to report SG&A as a separate line item. The same is sometimes true of cost of goods sold.
- In such instances, we must derive a SG&A and cost of goods sold, which can be challenging.

Additional Challenges Involving Cost Test

- Ensuring that normal value and cost of production are on the same basis can be difficult in instances in which there are peculiar selling conditions (*e.g.*, when a product is sold by length and the cost of production is calculated on a per KG basis).
- “One-off” or extraordinary gains can also pose a challenge. Respondents may attempt to allocate these gains to their costs as a means of decreasing the costs used in the cost test.
- Our new policy of conducting the cost test for all market-economy dumping proceedings has increased the workload for our analysts, particularly the analysts in our accounting department.

Other Types of Sales That May Be Found Outside the Ordinary Course of Trade

- Other types of sales or transactions may be outside the ordinary course of trade when they have characteristics that are “not ordinary.”
- Such sales that are deemed “not ordinary” may include:
 - Merchandise produced according to unusual product specifications.
 - Merchandise sold at aberrational prices.
 - Merchandise sold pursuant to unusual terms of sale.

Other “Not Ordinary” Sales – Continued

- Additionally, outside the ordinary course of trade may arise when sales are “extraordinary for the market in question.”
 - Off-quality merchandise or merchandise produced according unusual product specifications (*e.g.*, sample sales, prototypes, “off-spec” sales, or overruns).
 - Merchandise sold at aberrational prices or with abnormally high profits.
 - Merchandise sold pursuant to unusual terms of sale (*e.g.*, sales to employees).

Additional Factors

- Continued

- Ordinary course of trade is an analysis that is limited to home market sales.
- There is no equivalent provision for finding U.S. sales of subject merchandise to be outside the ordinary course of trade.