

# SUFFICIENCY AND ORDINARY COURSE OF TRADE TEST



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# OUTLINE OF THE PRESENTATION

- Application of 5% Sufficiency Test
- Type of sales outside OCT
- When are sales outside the OCT by reason of cost?
- Basis to perform the OCT test: product as a whole or model by model
- Sequence of the OCT and 5% Sufficiency Test

# Legal basis of the tests

## Article 2.1 of ADA

- ▶ “...if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.”

## Article 2.2 of ADA

- ▶ “When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of the sales in the domestic market of the exporting country, such sales do not permit a proper comparison,....”

## Footnote-2

- ▶ “Sales of the like product destined for consumption in the domestic market of the exporting country shall normally be considered a sufficient quantity for the determination of the normal value if such sales constitute 5 per cent or more of the sales of the product under consideration to the importing Member, provided that a lower ratio should be acceptable where the evidence demonstrates that domestic sales at such lower ratio are nonetheless of sufficient magnitude to provide for a proper comparison.”
- ▶ Does not refer to OCT

# Jurisprudence

- ▶ In *US – Hot-Rolled Steel*, the Appellate Body considered that “[t]he text of Article 2.1 expressly imposes four conditions on sales transactions in order that they may be used to calculate normal value:
  - ▶ first, the sale must be ‘in the ordinary course of trade’;
  - ▶ second, it must be of the ‘like product’;
  - ▶ third, the product must be ‘destined for consumption in the exporting country’;
  - ▶ fourth, the price must be ‘comparable’.

# Sequence of the OCT and Sufficiency test

- The language of the Agreement and footnote implies that Sufficiency test needs to be applied first to see if there is sufficient domestic sales to proceed further;
- Authority first applies 5% sufficiency test to domestic sales before applying OCT test
  - Applied to all sales, Not Limited to OCT sales
- There are instances where domestic sales less than 5% export sales have been considered
  - Provided Sufficient Volume available to allow price comparability
- Sufficiency test does not appear to apply to Third Country Sales method- Language of Footnote

# OCT Test

Authority considers two types of domestic sales as not being in the Ordinary Course of Trade

- ▶ Sales between related parties (provided the prices significantly vary)
- ▶ Below-cost sales (if the sales do not recover costs plus SGA over the POI)

# Ordinary Course of Trade Test (Related party sales)

**The Appellate Body in US — Hot-Rolled Steel, when looking into the meaning of “sales in the ordinary course of trade” held that Article 2.2.1 sets forth a method for determining whether sales between *any* two parties are ‘in the ordinary course of trade’; it does *not* address the more specific issue of transactions between affiliated parties.**

In transactions between such parties, the affiliation itself may signal that *sales above cost, but below the usual market price*, might not be in the ordinary course of trade. Such transactions may, therefore, be the subject of special scrutiny by the investigating authorities.”



# AB- US — Hot-Rolled Steel Ruling - Even-handed approach

“...If a Member elects to adopt general rules to prevent distortion of normal value through sales between affiliates, those rules must reflect, even-handedly, the fact that both high and low-priced sales between affiliates might not be ‘in the ordinary course of trade’ ...”

# Authority's Practice

## Relationship Test

- ▶ Extent of Control
  - ▶ Cross ownership
  - ▶ Management Control
  - ▶ Onus on the exporter to prove that relationship does not affect price
- ▶ Related Transactions will be analysed to see whether
  - ▶ Price is the sole consideration of sales
  - ▶ Price is not affected due to any factor other than market forces of demand and supply
  - ▶ Special and favored buyer (relationship)
  - ▶ Extra commercial consideration (compensatory arrangements), if any.

# Related Party Sales Authority's Practice

- ▶ If the prices to related parties and unrelated parties differ significantly (either lower or higher)
  - ▶ the related party sales will be ignored; or
  - ▶ Selling price of the related buyer to first independent buyer will be the basis of determination, subject to adjustments
  - ▶ If there is no clear pattern all sales will be considered
- ▶ In a situation where the entire domestic sales are to related parties the Authority would ignore those sales because of absence of any means of comparison for determination of true market price.

# Ordinary Course of Trade Test (Below Cost Sales)

The Panel in EC — Salmon (Norway) held that

“....Article 2.2.1 establishes a methodology for determining when below-cost sales may be treated as outside of the ordinary course of trade by reason of price. Pursuant to this methodology, below cost sales may be found to be outside of the ordinary course of trade, and thereby disregarded from the calculation of normal value, when three conditions are satisfied:

The below-cost sales must be made:

- (i) within an extended period of time;
- (ii) in substantial quantities; and
- (iii) at prices which do not provide for the recovery of all costs within a reasonable period of time.”

# Authority's Practice

- ▶ Authority would first work out the Cost of Production plus SGA for the like product in the home market.
  - ▶ Always calls for Cost data
- ▶ Cost computation for each PCN/models separately, if such a comparison is warranted
  - ▶ When Costs are uniform across various PCNs/Models single cost may be determined.
- ▶ Cost may be determined on monthly basis if a monthly comparison methodology is called for
  - ▶ When the cost and prices shows significant monthly variations due to various factors (raw material price volatility etc.)

# OCT Test- Authority's Practice

- ▶ OCT test is applied at Model/PCN level
- ▶ OCT may also be applied for the product as a whole, if such a comparison is warranted
- ▶ Weighted Average Cost – Weighted average Price comparison
  - ▶ At Model or Product level as the case may be
  - ▶ If the weighted average selling price over the POI is above the weighted average of the cost of production plus SGA during the same period the domestic sales are treated as being in the ordinary course of trade

# 80-20 Test

- ▶ If the loss making sales are less than 20% of the eligible domestic sales all eligible domestic sales are considered for determination of Normal Value
- ▶ If profit making sales are more than 20% but less than 80% of eligible domestic sales only all profitable domestic sales are considered for determination of Normal Value
- ▶ If profit making sales are less than 20% of eligible domestic sales, domestic sales are disregarded for determination of Normal Value
- ▶ 5% sufficiency test is not re-applied after OCT test

# Determination of Costs for OCT Test

- ▶ Normally determined on the basis of records kept by the exporter or producers under investigation,
  - ▶ provided such records are in accordance with GAPP of the exporting country and such records reasonably reflect the cost associated with production and sale of article under consideration
- ▶ All available evidence of the proper allocation of costs are considered
  - ▶ Provided such allocations has been historically utilized by the producer/exporter, in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditure and other development costs
- ▶ Appropriate adjustments for those non-recurring items of cost which benefits in subsequent years, if not done.
- ▶ Adjustments allowed for cost associated with start up operation



# Challenges in Cost Determination

- ▶ Cost information is invariably called in prescribed format in all cases
- ▶ Challenges in determination in case of multi-product Companies and Integrated Production units
  - ▶ Accounting Standards
  - ▶ Allocation of Costs
  - ▶ Allocation of SGA
  - ▶ Difference in accounting periods and Investigation periods

Thank You

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