***United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003**. United States, Appellant; European Communities, Appellee; Brazil, India and Mexico, Third Participants. Division: Lockhart, Abi-Saab and Bacchus. **Major Topics Addressed by the Appellate Body: definition of 'subsidy'; continued subsidy or benefit to recipient after privatization; mandatory versus discretionary legislation and challenge of an administrative practice as such.**

1. Abstract

It seems clear in WTO law that only a continuing, or existing, subsidy may give rise to countervailing duties. The main question in this case relates to the type of investigation that is necessary in order to determine the continued existence of a subsidy, after the subsidized entity is privatized. The Appellate Body found a rebuttable presumption that privatization at arm's length and for fair market value extinguishes the benefit of a subsidy. The Appellate Body reversed the panel's finding that a finding of arm's length privatization at fair market value requires a finding that no benefit continues. The Appellate Body also found that an administrative practice, in this case the U.S. method for determining the effect of privatization on a prior subsidy, as such, can be a violation of WTO law.

2. Facts

This case related to a United States statute, 19 U.S.C. § 1677(5)(F) ('Section 1677(5)(F)'), which reads as follows:

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

The European Communities attacked the Department of Commerce methodology pursuant to that statute, alleging that in 12 investigations relating to steel products, each relating to the products of a formerly state-owned enterprise, privatized at an arm's length price, the imposition or maintenance of countervailing duties was based on pre-privatization subsidies. The method of analysis of pre-privatization subsidies examined in this case included eleven instances of the application of the method of analysis addressed

in *U.S.-Lead and Bismuth II*,[1] the 'gamma method,' including original investigations, an administrative review, and sunset reviews, and one instance of the application of a replacement method, known as the 'same person' method. Before the panel, the U.S. conceded that, under *U.S.-Lead and Bismuth II*, the determinations using the gamma method violated the *SCM Agreement*. So the remaining issue related to the use of the same person method.

Under the 'gamma method,' the pre-privatization subsidy is presumed to persist, but is divided between the selling entity and the continuing privatized entity. The 'same person' method involves an analysis, based on several factual parameters, of whether the post-privatization entity is the same legal person as the pre-privatization entity. If it is the same person, the pre-privatization subsidies are found to persist.

The EC also attacked Section 1677(5)(F) on its face.

3. Analysis of Appellate Body Report

This case presented an opportunity to extend the analysis presented in *US – Lead and Bismuth II*. In that case, the panel, and the Appellate Body, found that under the *SCM Agreement*, the U.S. was required to engage in reviews that would determine on a current basis whether the subsidy still existed. Furthermore, the panel and Appellate Body determined that under the facts of that case, the subsidy was extinguished by the privatization.

a. The Effects of Privatization at Arm's Length and for Fair Market Value

In the current case, the panel found that

> [o]nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer.[2]

The U.S. had argued that privatization cannot 'extinguish' the benefit from a financial contribution, and therefore the subsidy, because the legal person continues to exist and is the recipient of the subsidy. The U.S. argued that the panel's approach of understanding the subsidy as somehow flowing to the shareholder of the recipient was flawed.[3] On the other hand, the panel understood privatization as entailing the repayment of the subsidy,

[1] Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, adopted 7 June 2000.
[2] Panel Report, para. 8.1(d).
[3] Indeed, the subsidy might be viewed as flowing to the shareholder of the recipient upon privatization in the same way that it does before privatization—constituting an accretion to the financial value of the subsidized firm—pointing up one of the logical difficulties of subsidies law.

by virtue of the fact that the fair market value paid by the purchaser *to the government* includes the remaining value of the subsidy.[4] Of course, this approach raises the question of whether repayment by a new *shareholder* can effect repayment on behalf of the subsidized entity.

The Appellate Body described the disagreement between the U.S. and the panel as follows:

> Thus, the Panel found that privatization at arm's length and for fair market value will *always* necessarily extinguish the remaining part of a benefit previously existing with the state-owned enterprise. By contrast, the United States argues, on appeal, that a change in ownership, irrespective of the price paid for the transaction, will *never* extinguish the benefit when the state-owned enterprise and the new privatized firm are the *same* legal person.[5]

The Appellate Body examined the meaning of the term 'benefit' and referred to its decision in *Canada-Aircraft*,[6] in which it found that in order to determine the existence of a benefit, it is necessary to compare the circumstances at hand to the marketplace. On this basis, since by definition the marketplace establishes the value of the privatized entity in an arm's length privatization, the comparison leads to a finding that there is no continuing subsidy.

The Appellate Body rejected the U.S. argument that its prior jurisprudence suggested that the recipient of the benefit of a subsidy must be a firm and not its owners. It concludes as follows: 'Hence, contrary to the contention of the United States, it is possible to confer a 'benefit' on a firm by providing a financial contribution to its owners, whether natural or legal persons, possibly holding property by means of shares.' [7] The Appellate Body holds that a subsidy on a firm's owners may benefit the firm itself, and therefore, the repayment of a subsidy by the firm's owners may constitute repayment by the firm itself. On the other hand, the Appellate Body rejected the panel's holding that there is never a basis for distinguishing between the owners and the firm. [8]

The Appellate Body then considered whether the panel is correct that privatization at arm's length and at fair market prices always extinguishes a prior subsidy. Here, the Appellate Body held that it does not always do so—that there are market imperfections, including those caused by government—that result in a failure of the market-determined price to fully assimilate the economic value of the enterprise, including the value of the subsidy previously received. The Appellate Body found that the panel's holding should be understood as a *presumption* that such privatization would extinguish the subsidy, shifting to the investigating authority the burden of proof that the

[4] Panel Report, para. 7.82
[5] Appellate Body Report, para. 95 (emphasis in original).
[6] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.
[7] Appellate Body Report, para. 113.
[8] Appellate Body Report, para. 118.

benefit persists.[9] Here, it is difficult to know precisely what the Appellate Body has in mind, and what type of evidence could be brought to demonstrate market failure. But by positing this possibility, the Appellate Body is able to avoid a direct attack on the U.S. law as written.

b. The 'Same Person' Method

The panel found that the same person method is inconsistent with the *SCM Agreement* because it 'prohibits the examination of the conditions of the privatization-transaction when the privatized producer is not a distinct legal person based on criteria relating mainly to the industrial activities of the producers concerned.' [10] Thus, if the U.S. authorities find that the privatized entity is the 'same person,' they do not inquire into the conditions of the privatization in order to determine whether the benefit of the subsidy continues to exist. The same person method responds to language in the Appellate Body opinion relating to *U.S.-Lead and Steel II*, referring to the fact that the pre-privatization entity and the post-privatization entity were distinct legal entities. The Appellate Body found that the U.S. had taken its statements out of context, and that it had not intended to limit the possibility of extinguishing the subsidy through privatization to circumstances where a new legal entity is established.[11]

Here, it is important to note that the EC attacked the same person method, *as such*. This raises an important question of the scope of application of WTO law: under what circumstances may it apply to an administrative practice *as such*, as opposed to an actual application of that administrative practice. It raises a question of the scope of the WTO law doctrine whereby mandatory rules may be attacked, *as such*, without regard to a specific instance of application. The EC also attacked a particular application of the same person method.

The Appellate Body found the same person approach inconsistent with U.S. obligations under Articles 19.1, 21.2 and 21.3 of the *SCM Agreement*, relating to original investigations, administrative reviews, and sunset reviews, respectively. Therefore, the Appellate Body found that the same person method, *as such*, is inconsistent with the *SCM Agreement.*[12]

c. Consistency of Section 1677(5)(F), as such, with WTO Obligations

The Appellate Body rejected the panel's finding that privatization will necessarily extinguish a prior non-recurring subsidy.[13] In this light, the Appellate Body rejected the panel's conclusion that the Section 1677(5)(F), as such, is inconsistent with the U.S.' WTO obligations. So interestingly, the Appellate Body found enough latitude in the statute to permit compliance with WTO obligations, while finding that the administrative

[9] Appellate Body Report, para. 126.
[10] Panel Report, para. 7.77.
[11] Appellate Body Report, paras. 141-144.
[12] Appellate Body Report, paras. 146-147.
[13] Appellate Body Report, paras. 126-127, 158.

practice, as such, mandated non compliance with WTO obligations, and therefore violated them.

4. Conclusion

This decision extended the Appellate Body's articulation of the effects of privatization on subsidies under the *SCM Agreement*. This jurisprudence raises the interesting question of whether a publicly-held company, the shares of which are continually auctioned to the market, can be understood to retain any general subsidy. To what extent does a subsidy affect pricing?

This decision also addresses the interesting question of whether an administrative practice, as such, may constitute a violation of WTO law.

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