

# Revisiting Cost Analysis Under the Antidumping Law

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## Revisiting Cost Analysis Under the Antidumping Law

### I. Introduction

Seven years ago, two current and one former U.S. Department of Commerce officials wrote a comprehensive review of the treatment of cost of production and constructed value under the U.S. antidumping law.<sup>2</sup> The article reflected the early years of cost of production analysis, a time when the Commerce Department was working out the basic framework for cost of production and constructed value investigations. To contend with the increasing number of cost issues, the Commerce Department established a separate office of accountants to conduct the cost-related aspects of antidumping investigations. Since that time, the Commerce Department has conducted hundreds of sales below cost investigations on products as diverse as minivans, farmed salmon, flat panel displays, and kiwifruit.<sup>3</sup> Cost of production and constructed value issues are among the most contentious aspects of recent antidumping proceedings. The degree of controversy is reflected in the Uruguay Round amendments to Article VI of the General Agreement on Tariffs and Trade (the "GATT Antidumping Code"), which prescribe methods for calculating sales below cost and constructed value with a new-found degree of specificity.<sup>4</sup>

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<sup>2</sup> "Cost Analysis Under the Antidumping Law," Gilbert B. Kaplan, Lynn G. Kamarck, and Marie Parker, George Washington Journal of International Law and Economics, vol. 21, (1988), 357. An earlier version of the paper was presented by the authors at a Practicing Law Institute program held in January 1987.

<sup>3</sup> New Minivans from Japan, 57 Fed. Reg. 21,937 (Dep't. Comm. 1992) (final determination) (hereinafter "Minivans from Japan"); Fresh and Chilled Atlantic Salmon from Norway, 56 Fed. Reg. 7661 (Dep't. Comm. 1991) (final determination) (hereinafter "Salmon from Norway"); High-Information Content Flat Panel Displays and Display Glass from Japan, 56 Fed. Reg. 32376 (Dep't. Comm. 1991) (final determination) (hereinafter "Flat Panel Displays from Japan"); Fresh Kiwifruit from New Zealand, 57 Fed. Reg. 13,695 (Dept. Comm. 1992) (final determination) (hereinafter "Kiwifruit from New Zealand"). Other investigations and annual reviews involving sales below cost investigations are too frequent to mention.

<sup>4</sup> See: Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, (Version of 15 December 1993), MTN/FA II-A1 A-8, 1-26, Office of the United States Trade Representative, U.S. Government Printing Office. (hereinafter "Revised GATT Antidumping Code"). As discussed in more detail below, the Revised GATT Antidumping Code introduces specific instructions on the treatment of highly technical cost

As suggested by the title, the purpose of this paper is to outline the evolution of cost of production and constructed value analysis since the publication of "Cost Analysis under the Antidumping Law," and to provide the reader with some practical advice on current methods of calculating cost of production and constructed value. This paper also highlights the "gray areas" in cost of production analysis, as well as situations where the Revised GATT Antidumping Code may force changes to current Departmental methodology. It does not rehash basic cost of production and constructed value issues; nor does it go over Commerce policies and methods described in the earlier article which have not changed in the intervening years. Indeed, this article should not be viewed as a complete record of all of the recent changes in cost policy pronouncements, as it is based largely upon the direct experience of an active practitioner in the area whose memory is far from perfect.<sup>5</sup>

This paper jointly addresses most issues as they relate to cost of production and constructed value, as there is a great deal of overlap between the two.<sup>6</sup> Explanations are woven into the body of the paper for areas that are treated differently under cost of production and constructed value.

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of production issues, including start-up expenses, the period for calculating costs, definitions of "substantial quantities" and "extended period of time", methods for calculating profit, and the role of generally accepted accounting principles in the country of exportation.

<sup>5</sup> One major area not covered by this paper is cost of production in hyperinflationary economies. The Department's special rules for calculating cost of production in hyperinflationary economies is worthy of a separate paper in itself.

<sup>6</sup> The term "cost of production" in antidumping law refers to the total cost of producing the product sold in the home or third country market(s), and includes material, labor, factory overhead, selling, general and administrative expenses, and packing. Cost of production is used as the basis for determining whether or not home market sales are below cost. 19 U.S.C. § 1677b(b). "Constructed value" is the total cost of producing the product sold in the U.S., except that:

it substitutes home market selling expenses for U.S. selling expenses;

it includes a minimum amount for general and administrative expenses; and,

it includes an amount for profit.

19 U.S.C. § 1677b(e). Constructed value is used as the basis for Foreign Market Value in the event that there are inadequate above-cost sales in the home or third country markets. The Department generally requires consistent treatment of the "cost of production" portion of constructed value and home market/third country cost of production.

## II. The Initiation Threshold

### A. Evidentiary Requirements

Cost of production and constructed value normally only come into play in an antidumping proceeding if there are no viable home or third country markets, or if petitioners successfully allege that home market (or third country)<sup>7</sup> sales are at prices below cost. Before initiating a sales below cost investigation, the Department requires that the petitioner to demonstrate that it has "reasonable grounds to believe or suspect" that home market prices are below cost.<sup>8</sup> All below cost allegations must have an estimate of the foreign company's cost of production and information on home market prices.

In order to persuade the Department to initiate a investigation at the outset of a general antidumping investigation, a petitioner can submit an estimate of the foreign producer's costs based on its own cost of production, adjusted for differences in the costs major inputs in the U.S. and the country of manufacture.<sup>9</sup> The Department has consistently held, however, that Al Tech Specialty Steel Corp. v. United States<sup>10</sup> requires that a successful allegation include company-specific home market prices, even though company-specific prices for every respondent are not required for the initiation of a general antidumping investigation.

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<sup>7</sup> The relevance of home market versus third country prices in cost of production analysis is determined by market viability, under 19 C.F.R. § 353.48. Since home market and third country prices are treated comparably in cost of production analysis, this paper refers only to the home market when discussing the relationship of cost of production or constructed value to sales prices.

<sup>8</sup> 19 U.S.C. § 1677b(b).

<sup>9</sup> 19 C.F.R. § 353.12 (7).

<sup>10</sup> 6 Ct. Int'l Trade 245, 575 F. Supp. 1277 (1983), aff'd on other grounds, 745 F.2d 632 (Fed. Cir. 1984). In that case, the Court of International Trade (at 250) stated:

absent a specific and objective basis for suspecting that a particular foreign firm is engaged in home market sales at prices below its cost of production, section 773(b)'s [19 U.S.C. 1677b(b)] threshold requirement of 'reasonable grounds to believe or suspect' has not been satisfied.

Emphasis in original.

Respondents can do very little to challenge a sales below cost allegation. Prior to initiation of an antidumping investigation, potential respondents are precluded from doing anything at all.<sup>11</sup> After initiation, respondents are limited to rebutting petitioner's arguments with publically-available information (such as public financial statements), or business proprietary information placed on the record prior to Petitioner's allegation.<sup>12</sup> The Department routinely refuses to consider rebuttals of sales below cost allegations based upon business proprietary information submitted specifically by respondent for that purpose. The Department's reason for rejecting newly-introduced business proprietary evidence is that its use would contradict the "reasonable grounds" standard. Moreover, as there is no discovery under antidumping law, respondents are not allowed to "cherry pick" from their own records in order to prevent a full-scale cost of production investigation from going forward.

As the investigation proceeds and more information becomes available, petitioners face changing evidentiary requirements for initiation of a sales below cost investigation. Once a respondent submits home market prices on the record, the petitioner must use these prices as the basis of the sales below cost allegation.<sup>13</sup> Because obtaining company-specific home market prices can be extremely difficult, sales below cost allegations frequently are not made until after petitioner's counsel has had a chance to review the actual home market prices submitted by respondents under Administrative Protective Order. Unless an extension is granted by the Department, the last date on which petitioner can make a sales below cost allegation in an antidumping investigation is 45 days before the scheduled date of the preliminary determination. The deadline for annual reviews is 120 days after the date of publication of the notice of initiation.<sup>14</sup>

After initial questionnaire responses are filed, petitioners may face new difficulties in estimating the cost of producing merchandise sold in the home market. As a general rule, in calculating production costs, petitioners must consider any relevant information submitted by

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<sup>11</sup> 19 C.F.R. § 353.12(1) (Parties to the proceeding (including potential respondents) are barred from formally communicating with the Department of Commerce, except to inquire on case status, until after initiation).

<sup>12</sup> We may not be able to find a cite for this. See case file MMF Sweaters Pet Film

<sup>13</sup> See: Sweaters Wholly or in Chief Weight of Man Made Fiber from the Republic of Korea, 55 Fed. Reg. 32,659 (Dep't. Comm. 1990) (final determination) (hereinafter "MMF Sweaters from Korea"), (The Department requires petitioner in making its sales below cost allegation to use company specific information on the record).

<sup>14</sup> 19 C.F.R. § 353.31(c).



respondents in other contexts, unless there are compelling reasons why it cannot be used.<sup>15</sup> Variable manufacturing costs, for example, frequently are submitted with a price questionnaire response for use as the basis for adjustments for differences in physical characteristics between the products sold in the U.S. and the home market.<sup>16</sup> Once this information is on the record, petitioners must rely on it as the basis for direct manufacturing costs (rather than petitioners' own costs, adjusted for input cost differences), or provide an explanation as to why it is unusable.<sup>17</sup>

With regard to annual reviews, the same general evidentiary requirements hold for initiating sales below cost investigations, except that the Department will automatically initiate a sales below cost investigation if sales below cost were found in the original investigation, or the most recent annual review.<sup>18</sup>

#### B. How Many Sales Must Be Below Cost?

In several proceedings, respondents have challenged petitioners' sales below cost allegations on the grounds that the volume of alleged below cost sales is insufficient to trigger the initiation of a cost of production investigation.<sup>19</sup> In MMF Sweaters from Korea<sup>20</sup>, for example, respondents argued that the Department need not initiate any allegation which showed less than 10 percent of sales below cost, as the Department's standard policy is to

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<sup>15</sup> MMF Sweaters from Korea, 55 Fed. Reg. 32,659.

<sup>16</sup> 19 C.F.R. § 353.57. Although the regulation states that the DIFMER adjustment shall be based on differences in "production costs," in practice the Department limits the adjustment to variable costs of manufacturing. See Certain Internal-Combustion Industrial Forklifts from Japan, 53 Fed. Reg. 12,570 (Dep't. Comm. 1988) (final determination).

<sup>17</sup> Antifriction Bearings and Parts Thereof from the Federal Republic of Germany, 54 Fed. Reg. 19,019 (Dep't. Comm. 1989) (final determination); Certain Residential Doorlocks and Parts Thereof from Taiwan, 54 Fed. Reg. 53, 153 (Dep't. Comm. 1989) (final determination).

<sup>18</sup> See, e.g., Antifriction Bearings (Other than Tapered Roller Bearings) and Parts Thereof From Sweden 58 Fed. Reg. 25,623 (Dep't. Comm. 1993) (preliminary results) (Department initiates cost investigations on SKF's sales of ball bearings and cylindrical roller bearings because it had found sales below cost for both classes or kinds of merchandise in the previous administrative review.)

<sup>19</sup> This issue usually does not find its way to Federal Register notices, as it has been mooted by the briefing stage of the investigation by the Department's finding of some sales below cost.

<sup>20</sup> MMF Sweaters from Korea, 55 Fed. Reg. 32,659.

include below cost sales in antidumping calculations if their volume is under that threshold.<sup>21</sup> The Department, however, rejected this argument and initiated sales below cost investigation against companies for which petitioner's allegations showed less than 10 percent of sales below cost, on the basis that Huffy Corp. v. United States<sup>22</sup> requires only a showing that sales, and not "sales in substantial quantities" are below cost. Considered in conjunction with the Department's application of the sales below cost test on a model-by-model basis,<sup>23</sup> the proportion of total home market sales below cost may not be a good indicator of the extent to which below cost sales are affecting the overall dumping margins, as the volume of home market products actually used to calculate Foreign Market Value could be quite small. Interpreted literally, however, the decision in Huffy Corp. v. United States requires no showing that the alleged below cost sales are likely to have a significant impact on the dumping margins, which suggests that the Department is forced to go through the administratively burdensome cost of production investigation whenever petitioners can show that there is more than one home market sale below cost of production.

### III. General Rules for Calculating Costs

The GATT Antidumping Code and the U.S. antidumping law identify the two basic elements of cost of production and constructed value, namely manufacturing costs (materials, labor, and factory overhead), and selling, general, and administrative expenses.<sup>24</sup> At times, the administering authority and the Courts have suggested that the elements of cost of production are objective, intuitively knowable, and absolute<sup>25</sup>. Much of the discussion that follows, however, illustrates the many gray areas in cost of production analysis. In particular, the choice of methods for allocating costs to specific products and spreading costs

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<sup>21</sup> See Part VIII. B.1. below for a discussion of the "substantial quantities" threshold.

<sup>22</sup> 7 I.T.R.D.(BNA) 2272, 632 F.Supp. 50 (1986).

<sup>23</sup> Discussed in Part VIII. B. 3. below.

<sup>24</sup> See: Revised GATT Dumping Code, Article 2.2.1. Although the elements included in cost of production are not set out under 19 U.S.C. § 1677b(b), there are parallel elements identified under the definition of constructed value as set forth in 19 U.S.C. § 1677b(e).

<sup>25</sup> For example, Ipsco, Inc. v. United States, 13 C.I.T. 402; 714 F. Supp. 1211; (Ct. Int'l. Trade 1989) In rejecting the argument that second grade oil country tubular goods be costed as a by-product, in accordance with GAAP, the Court stated that "[B]oth the statute and ITA regulations set forth specific cost, expense and profit elements which must form the basis of constructed value," suggesting that the statutory definitions of cost are sufficient to address the gray areas in this particular case.

over time can be subjective, and dependent upon underlying assumptions which often have not been based upon empirically observed pricing and cost behavior. The Spartan rules for determining cost of production under the GATT Antidumping Code and U.S. Antidumping Law provides the Commerce Department with great discretion in dealing with the gray areas in cost of production.

## A. Generally Accepted Accounting Principles

### 1. The Gaps in GAAP

The Commerce Department is given very little legislative guidance on the standards or methods to use in the calculation of cost of production or constructed value, except, as stated in the House Report of the 1974 Act, to adhere to "accounting principles generally accepted in the home market of the country of exportation, if [it] is satisfied that such principles reasonably reflect the variable and fixed costs of producing the merchandise."<sup>26</sup>

Generally accepted accounting principles, however, do not provide the Department with adequate guidelines for calculating costs in all cases. They are designed in large part to protect the interests of private investors (and government tax authorities!). Accordingly, the preponderance of specific GAAP pronouncements in most countries focus on the operating results of the enterprise as a whole, and the value of the enterprise at a given moment in time, as expressed through the presentation of assets and liabilities on the balance sheet. Cost of production analysis deals almost exclusively with the income statement portion of a company's financial statement. However, in calculating cost of production, the Department must go well beyond the general statement of profitability as reported on the income statement, to the level of the cost of producing very specific products over a fixed period of time.

### 2. GAAP versus GAAP

Standard Departmental practice is to accept the GAAP of the exporting country, unless it "distorts costs", in which case the Department may rely on U.S. GAAP, or use other methods.<sup>27</sup> This seemingly simple rule, however, implicitly assumes that there are some common standards for measuring "cost of production" for dumping purposes which can be used to determine whether or not the GAAP of a particular country is "reasonable" on a

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<sup>26</sup> H.R. Rep. No. 571, 93d. Cong., 1st Sess. 71 (1973), note 31.

<sup>27</sup> See, e.g., Certain Welded Stainless Steel Pipe from the Republic of Korea, 57 Fed. Reg. 53,693 (Dep't. Comm. 199) (final determination); Ferrosilicon from Venezuela, 58 Fed. Reg. 27,527 (Dep't. Comm. 1993) (final determination); Gray Portland Cement and Clinker from Mexico, 57 Fed. Reg. 25,806 (Dep't. Comm. 1993) (final results); Minivans from Japan, 57 Fed. Reg. 21,947.

particular subject.

The Department's treatment of research and development ("PRD") expenses in Korean antidumping proceedings illustrates the problems encountered in choosing between competing GAAPs and other methods. Korean GAAP allows companies to spread research and development expense over three to five years, to reflect the fact that current R & D expenditures primarily benefit future sales over an extended period.<sup>28</sup> Amortization of R & D costs also is allowed under International Accounting Standard No. 9.<sup>29</sup> Current U.S. GAAP, on the other hand, requires that research and development costs be completely expensed in the year incurred.<sup>30</sup> The arguments for expensing R & D in the year incurred include the uncertainty of matching R & D costs to future sales (both in timing and magnitude), and the fact that R & D typically is a recurring expense for an ongoing concern.

One can easily perceive a certain logic to both positions. How is the Department to determine, therefore, if either U.S. or Korean GAAP treatment of R & D is unreasonable or distortive? In DRAMs from Korea,<sup>31</sup> the Department rejected Korean GAAP in favor of the U.S. approach, and expensed a respondent's R & D in the year incurred. In Pet Film from Korea,<sup>32</sup> the Department rejected the responding company's attempt to restate its R & D expenses in accordance with U.S. GAAP, and instead amortized R & D costs in accordance with Korean GAAP and the company's books.

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<sup>28</sup> See: Polyethylene Terephthalate Film, Sheet, and Strip ("Pet Film") from Korea, 56 Fed. Reg. 16305 (Dep't. Comm. 1991)(final determination) (hereinafter "Pet Film from Korea"); Small Business Telephones from Korea, 54 Fed. Reg. 31980 (Dep't. Comm. 1989)(final determination); Dynamic Random Access Memory Semiconductors of One Megabit and Above From the Republic of Korea, 58 Fed. Reg., 15,472. (Dep't. Comm. 1993) (final determination) (hereinafter "DRAMs from Korea").

<sup>29</sup> See also: EPROMS from Japan, 51 Fed. Reg. 39,682 (Dep't of Comm. 1986) (citing International Accounting Standard #9 as support for its decision to amortize respondent's R & D costs)

<sup>30</sup> "Statement of Financial Accounting Standards No. 2: 'Accounting for Research and Development Costs' ", in Current Text Accounting Standards as of June 1, 1992, 38,847 (Irwin 1992).

<sup>31</sup> 58 Fed. Reg. 15,472.

<sup>32</sup> 56 Fed. Reg. 16,305.

The R & D debate illustrates the gray nature of the period over which to spread costs. In the cases cited above, the Department chose the treatment of R & D as sanctioned by one GAAP over the other on the basis of "reasonableness". However, it is hard for the layman to see what definition of reasonableness would require on the same issue, the use of Korean GAAP in some cases and U.S. GAAP in others. Without some empirical measurement of product cycles and beneficiary products, there is nothing on which to anchor a judgment as to what is "reasonable" method for allocating R&D. A non-empirically based definition of "reasonableness" can easily change from case-to-case, resulting in decisions which appear to be arbitrary.

## B. Relationship to Inventory Values

Faced with a large number of cost investigations covering a multitude of products, the Commerce Department tries to minimize the number of gray areas by relying largely on the company's pre-existing costs. The Commerce Department requires that a company's reported manufacturing costs be anchored in the product-specific manufacturing costs recorded in the official accounting records,<sup>33</sup> for the very good reason that, in the case of public companies, such costs have been subject to review by external auditors. Moreover, (at least for companies undergoing initial investigations), there is no a priori reason to believe that, with respect to the gray areas, official product costs have been skewed in a manner which will reduce cost of production or constructed value calculations.

Product costs usually are found in the company's normal accounting records as the basis for inventory values reported on the balance sheet, and the cost of goods sold reported on the income statement.<sup>34</sup> A recurring problem, however, is that many companies do not calculate manufacturing costs to the degree of specificity required by the Department.<sup>35</sup> In

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<sup>33</sup> Attached as Appendix 1 to this paper is a representative cost of production/constructed value questionnaire. The questionnaire (at 10) explicitly directs the respondent to "rely on your company's cost accounting records to the extent that those records accurately reflect the costs incurred to produce the subject merchandise." The questionnaire (at 9) also asks the respondent to explain in detail all instances where reported costs differ from costs as recorded in the company's cost accounting system and specifically, those used as the basis of finished inventory values.

<sup>34</sup> In most company accounting systems, the same cost of manufacturing is the basis for both finished goods inventory values and the cost of goods sold. For the sake of simplicity, therefore, product costs as they appear in the company's normal accounting records are referred to hereinafter as "inventory values."

<sup>35</sup> See, e.g., Minivans from Japan, 57 Fed. Reg. 21,946-7 (The Department rejected Mazda's aggregate corporate-wide variance taken from its internal financial accounts, and applied individual variance factors.)

the normal course of business, companies often calculate manufacturing costs for a range of products. In an antidumping proceeding, however, the Department requires that respondents define "unique" products to a great degree of specificity, so that it can compare the product-specific costs to the sales prices of the "unique" products.<sup>36</sup> In such cases, companies must rely on pre-existing production or accounting records to reallocate their costs to the more specific products as defined by the Department.<sup>37</sup>

Even in cases where inventory values are calculated to an acceptable level of specificity, respondents must often revise them in order to comply with Departmental reporting requirements. Certain types of costs, such as yearly employee bonuses, may be treated as a general and administrative expense in the company's records, but are considered a direct labor costs by the Department. In making such adjustments, however, respondents must take care to ensure that the reported costs can be reconciled to the company's official inventory values and/or cost of goods sold, as this reconciliation is a standard part of the cost verification.<sup>38</sup>

### C. Related Party Transactions

A common issue in cost of production investigations is the valuation of inputs (materials, machinery, subcomponents, etc.) provided by related parties. At the time "Cost Analysis Under the Antidumping Law" was written, the Department applied the standard five percent test to determine whether or not suppliers were related to producers of the subject merchandise.<sup>39</sup> More recently, the Department has employed a test of majority control to determine whether or not prices charged by related parties can be considered for use in cost

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<sup>36</sup> See: "Cost Analysis Under the Antidumping Law," 378 and fn 115.

Application of the [sales below cost]test on the such or similar merchandise basis often results in fairly narrow product groupings. This determination of cost by reference to such or similar groupings is necessary to determine adequately whether sales are priced above the appropriate costs.

<sup>37</sup> See, e.g., Circular Welded Non-Alloy Steel Pipe from the Republic of Korea, 57 Fed. Reg. 42,951 (Dep't. Comm 1992) (final determination) (hereinafter "Non-Alloy Steel Pipe from Korea") (The Department determined that deviations from normal accounting methodology were necessary in order to comply with Departmental reporting requirements.)

<sup>38</sup> See: Flat Panel Displays from Japan, 56 Fed. Reg. 32,390-1 (The Department uses BIA for mother glass material costs because the submitted numbers could not be reconciled to the company's inventory records.)

<sup>39</sup> See: "Cost Analysis Under the Antidumping Law", 378-379.

of production calculations.<sup>40</sup> If cross-ownership between the respondent and its related supplier exceeds 50 percent, then the Department will use the related supplier's costs as the basis for valuing the inputs. If cross-ownership ownership is less than 50 percent, the Department will use of related party input prices in the cost of production calculation, as long as respondent can demonstrate that those prices are at arm's length.<sup>41</sup>

In calculating constructed value, the Commerce Department will use transfer prices for inputs supplied by related parties, as long as those prices are above the cost of production and are at arm's length.<sup>42</sup>

#### D. Relationship to Difference in Merchandise

In calculations of dumping based upon home market and U.S. prices, the Department adjusts home market prices for costs associated with any physical differences between the products sold in the two markets.<sup>43</sup> The adjustment for physical differences in merchandise (often referred to as the "DIFMER" adjustment) must be based on variable manufacturing costs: materials, direct labor, and variable factory overhead. In cases where both cost of production/constructed value and adjustments for physical difference in merchandise are submitted, the Department requires that respondents use the same methods to calculate the DIFMER adjustment and the variable manufacturing costs.<sup>44</sup>

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<sup>40</sup> See: Appendix 1, 11-12. See also, Aramid Fiber Formed of Poly-Phenylene Terephthalamide From the Netherlands, 59 Fed. Reg. 23,689 (Dep't. Comm. 1994) (final determination); Certain Carbon and Alloy Steel Wire Rod from Canada, 59 Fed. Reg. 18,791 (Dep't. Comm. 1994) (final determination).

<sup>41</sup> See: Minivans from Japan, 57 Fed. Reg. 21,942 (The Department compared related party prices to similar unrelated party prices to determine if the unrelated party prices were at arm's length.)

<sup>42</sup> Appendix 1, 12.

<sup>43</sup> 19 U.S.C. § 1677(a)(4)(C). See also: 19 C.F.R. § 353.57.

<sup>44</sup> Certain Corrosion-Resistant Carbon Steel Flat Products and Certain Cut-to-Length Carbon Steel Plate from Mexico, 58 Fed. Reg. 37,198 (Dep't. Comm. 1993) (final determination) (Because of differences between variable costs in the COP/CV files and those used for the DIFMER adjustment, the Department used the verified variable costs from the COP/CV to calculate DIFMER).

## E. Temporal Matching of Costs to Prices

In every antidumping proceeding, the Department investigates U.S. and home market sales made during a fixed period. In a cost of production investigation, therefore, the Department must decide on the period for calculating costs, so that the appropriate costs are matched to the home market (and possibly) U.S. sales.<sup>45</sup>

If sales are made to order and production requires long lead times, then the actual costs to produce the sales in question may be incurred long after the sale date. On the other hand, if manufacturing occurs first and sales are made from finished good inventory, the product may be sold long after the actual date of production.

Rather than deal with multiple time periods, however, the Department generally matches sales during a discrete period to actual costs incurred over the same period. This method is reasonable as long as the period between manufacture and sale is not overly long, and costs do not vary significantly over that period. In fact, temporal matching is not a major issue in most antidumping investigations.

The temporal matching of prices to costs has only been an issue in cases where either prices or costs are rapidly changing. For high-tech products such as semiconductors, for example, prices and costs decline rapidly after the introduction of a new generation, reflecting rapid increases in yields and production volumes. With respect to hyperinflationary economies, on the other hand, prices and costs may be increasing dramatically, reflecting the generally high levels of inflation in the country of exportation. In such cases, the Department must address two timing issues: First, over what length of time should costs be calculated? And second, what historical period should be used in calculating cost of production and constructed value?

### 1. Length of Period

For investigations, the Department normally calculates direct manufacturing costs over a six month period, reflecting the standard period of investigation. In annual reviews, the Department generally instructs companies to average costs over the review period (which, except for the first annual review, is one year), or, in some cases, over the closest fiscal year. If short-term changes in costs are significant, reflecting, for example seasonal differences or steep learning curves, the Department may require costs to be reported over longer or shorter periods.<sup>46</sup>

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<sup>45</sup> See: "Cost Analysis Under the Antidumping Law, 11,391.

<sup>46</sup> See discussion regarding agricultural products, below. See also Calcium Aluminate Cement, Cement Clinker, and Flux from France, Fed. Reg. 14,136 (Dep't. Comm. 1994)(final determination). (Hereinafter "Calcium Aluminate Cement from France").



The Revised GATT Antidumping Code, stipulates that for purposes of determining if there are significant sales below cost, the normal definition for "extended period of time" (discussed below) shall be one year.<sup>47</sup> To implement this change, the Department in the future may have resort to a one year period of investigation for all proceedings involving sales below cost.

## 2. Lagging the Manufacturing Date Behind the Date of Sale

The appropriate historical time period to use in matching costs to individual prices has been a central issue in semiconductor investigations.<sup>48</sup> In cases in which temporal matching is an issue, the Department fixes the length of the lag between manufacturing and sale as the period between the commencement of manufacturing to withdrawal from finished inventory for sale.<sup>49</sup> If companies calculate part or all of manufacturing costs on an historic (as opposed to present) basis, however, prior period costs will be carried forward into later stages of production. In such cases, the lag should be limited to the average inventory period for finished goods.<sup>50</sup>

### F. Collapsing Unrelated Producers with Exporters

Until recently, in cases where respondents in U.S. antidumping investigations were solely involved in the exportation of the subject merchandise, and were unrelated to the actual producers, the Department used the acquisition price paid by the exporter in the calculation of cost of production.<sup>51</sup> In Salmon from Norway<sup>52</sup>, however, the Department

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(Because of seasonal variances in production, the Department agreed that depreciation and labor should be calculated over an annual average (as opposed to six month) period.)

<sup>47</sup> Article 2, para 2.2.1.1, fn 4.

<sup>48</sup> See, e.g., DRAMs from Korea, 58 Fed. Reg. 15,472-3.

<sup>49</sup> Id., 15,472.

<sup>50</sup> Id., 15,473 (The Department lagged Samsung's submitted costs only to reflect the time spent in inventory, as it found that Samsung's costs accounting system accumulated costs as products flow from stage to stage).

<sup>51</sup> See: Cyanuric Acid and its Chlorinated Derivatives from Japan, 53 Fed. Reg. 46,896 (Dept' Comm 1986) (preliminary determination); Certain Internal Combustion Industrial Forklift Trucks from Japan, 53 Fed. Reg. 12,552 (Dept' Comm. 1988) (final determination); Certain Forged Steel Crankshafts from Japan, 52 Fed. Reg. 36,894 (Dep't. Comm. 1987) (final determination).

<sup>52</sup> 56 Fed. Reg., 7661.

stated that acquisition prices were irrelevant, as the law requires it to look at "the cost of producing the merchandise". Accordingly, in such cases, the Department now requires that respondents that are solely involved in exporting the product gather and submit the actual production costs incurred by its unrelated suppliers for purposes of valuing cost of production and constructed value.<sup>53</sup>

#### IV. Principles of Allocating Manufacturing Costs

The cost of manufacturing is the first of two main components of cost of production. Manufacturing costs generally include those costs which are incurred on the factory floor, or in support of manufacturing operations. Materials, direct labor, and factory overhead are the main elements of manufacturing costs. In most antidumping proceedings, the questions rarely arise as to which elements to include in the cost of manufacturing. Most of the debates on manufacturing costs focus on how they are to be allocated among a company's various products.

##### A. Materials

Materials costs include raw materials, purchased subassemblies or semifinished goods, and all ancillary costs associated with inbound freight, defective materials, scrap, waste, and lost inventories.<sup>54</sup> In the case of products produced in discrete production runs or "batches," (e.g., steel, cement), actual material costs often are assigned in the company's pre-existing accounting system to specific products.<sup>55</sup>

Some companies, on the other hand, will not assign material costs in their existing accounting records to the specific products as defined by the Department. In such cases, the Respondent may have to reallocate material costs to specific products. The use of standard

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<sup>53</sup> Id. See also: Kiwifruit from New Zealand, 57 Fed. Reg. 13,701-2.

<sup>54</sup> See: Appendix 1, 11.

<sup>55</sup> In a few cases, material costs are assigned to specific batches, or "heats" (in the case of steel). This degree of specificity, however, is greater than the Department requires, as it may produce differences in costs between products which, for all practical purposes, are identical. In such cases, the Department requires that the batch specific costs be weight-averaged to arrive at costs per specific product. See, e.g., Circular Welded Non-Alloy Steel Pipe From the Republic of Korea, 57 Fed. Reg. 42,944 (Dep't. Comm. 1992) (final determination)(hereinafter "Non-Alloy Steel Pipe from Korea") (The Department used a single weighted average cost for identical products with reported different costs.) See also: Gray Portland Cement and Clinker from Japan 56 Fed. Reg. 12,156 (Dep't. Comm. 1991) (final determination).

material costs, based upon a bill of materials,<sup>56</sup> is an oft-used and acceptable method of allocating materials costs to individual products.

## B. Direct Labor

Direct labor is "factory or field labor," and includes the wages, salaries, and fringe benefits of all workers employed in the production of the subject merchandise.<sup>57</sup> In some cases companies track actual labor costs by product. In other cases, companies use standards to allocate actual direct labor costs to specific products. Standards may be based on pre-existing analyses of the labor or machine time required to complete the manufacturing process ("time and motion studies").

## C. Factory Overhead

Factory overhead consists of variable and fixed elements. Variable factory overhead includes those costs which vary with manufacturing volume, including energy and consumables. Fixed factory overhead consists of costs which generally do not vary with manufacturing volume, including depreciation of machinery and equipment. Variable and fixed factory overhead that cannot be assigned to particular products often are allocated to individual products using the same method used for direct labor.

### 1. Depreciation

The calculation of depreciation is a frequent issue in cost of production analysis, for the reason that generally accepted accounting principles regarding depreciation vary widely from country-to-country. In most countries, companies cannot expense in the year purchased the full cost of capital equipment if it has a multiple year useful life. The "general" rule for expensing capital equipment in most countries is that the period should reflect the useful life of the capital equipment.<sup>58</sup> Specific depreciation guidelines, however, often are fixed by governments to achieve certain tax or economic development objectives. For example, some countries allow "accelerated depreciation" in order to encourage capital investment.

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<sup>56</sup> A "bill of materials" is a list of all materials incorporated into the production of one unit (piece, ton, meter) of a specific product or model. Most bills of materials have two parts: the amounts of all materials typically used in production or incorporated into the final product; and an average per unit value for every listed material.

<sup>57</sup> Appendix 1, 13.

<sup>58</sup> See, e.g., "Depreciation," Section D40, in Current Text Accounting Standards as of June 1, 1992, 12607. "Generally accepted accounting principles require that this cost be spread over the expected useful life of the [asset] . . . ."

Thus, the depreciation methods used by a company may not reflect the actual economic useful life of its capital equipment. However, since the actual economic useful life of most capital equipment cannot be determined until some date in the future, and is virtually impossible to predict, standard Department policy regarding depreciation is to accept the method used by the company in its normal accounting records, unless the Department finds that the method does not reflect the expected economic useful life of the assets.<sup>59</sup> Deference to the company's normal accounting practices for depreciation is also stipulated in the Revised GATT Antidumping Code.<sup>60</sup>

## 2. Research and Development

Besides the period over which to allocate costs discussed in Part III.A.2. above, the Department has had to struggle with the controversial issue of allocating R & D costs to particular products. Of particular significance in cases involving high technology products is the tying of R & D to products or product lines, another gray area in cost of production analysis.

In allocating R & D costs, the Department must determine two related, but sometimes distinctly separate issues: which product(s) benefits from the R & D, and which product(s) should bear the cost? In the original Japan semiconductor investigations, the Department categorized R & D costs into three different levels: product-specific R & D, product-line R & D, and general corporate R & D.<sup>61</sup> Product-specific R & D was that which could be tied to specific products. The Department determined that such costs should be borne by those

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<sup>59</sup> See: "Cost Analysis Under the Antidumping Law," 384-5:

"In many cases, the Department used the depreciation schedules established by the pertinent country's tax law." See also, Non-Alloy Steel Pipe from Korea, 57 Fed. Reg. 42,952 (The Department rejects restated depreciation and used depreciation as allowed by Korean GAAP and reported in the company's books); Salmon from Norway, 56 Fed. Reg. 7669 (Despite respondent's argument that depreciation recorded in the company's books in no way reflects the economic useful life of the assets, the Department uses depreciation as recorded on the financial statements).

<sup>60</sup> Article 2, para. 2.2.1.1.

<sup>61</sup> Erasable Programmable Read Only Memories (EPROMs) from Japan, 51 FR 28,253 (Dep't. Comm. 1986) (notice of suspension of investigation), and Dynamic Random Access Memory Semiconductors of 256 Kilobits and Above from Japan, 51 FR 28,396 (Dep't. Comm. 1986) (notice of suspension of investigation). A more detailed description of the development of R & D allocation methodology in the Japan semiconductors cases is contained in "Cost Analysis Under the Antidumping Law," 389-90.

products. Product-line R & D included costs which could not be tied to a specific product or generation, but which benefited a broader product line. These costs were allocated over the product line's sales value. Both types of product R & D were treated by the Department as a manufacturing, as opposed to a general cost. Finally, general R & D was that which generally benefited the company's products, such as costs of improving generic manufacturing methods. These costs were treated by the Department as a G & A expense. Thus, the semiconductors methodology assumed that the benefiting product(s) should bear the cost of research and development.

In Flat Panel Displays from Japan,<sup>62</sup> however, the Department decided that, in certain cases, the tying of costs solely to the benefiting products could leave some current R&D costs unabsorbed by current production. For example, under the semiconductors methodology, product-specific R & D on a product which never made it to production during the period of investigation would be unabsorbed over that time frame. To address this problem, the Department modified its R & D allocation methodology as follows: First, it simplified the assignment of R & D by eliminating the two-tier treatment of product R & D. Instead, the Department calculated a "class or kind" R & D ("class or kind" being defined as one of the four primary technologies used to make flat panel displays), and included it in the cost of manufacturing. Second, if the company incurred R & D on a class or kind or merchandise which it did not currently produce, that R & D was allocated to the products currently under production.<sup>63</sup> In other words, the Department determined that current production should bear the cost of all current R & D costs, including that which was scheduled to enter into production in the future.

Later, in DRAMs from Korea,<sup>64</sup> the Department broadened the definition of the products which must absorb R & D costs even further. In that case, the Department determined that the "class or kind" of product under investigation (namely DRAMS of one megabit and above) benefited from R & D spent on other types of semiconductors, and vice versa. Thus, the Department did not tie generation-specific DRAM R & D to specific products, or even DRAM R & D to DRAMS, but instead allocated total semiconductor R & D over total semiconductor production.

The use of different R & D allocation methods for different industries reflects the fact that the identification of the appropriate "beneficiary" and "financier" of current R & D is not a clear-cut issue. The sometimes fuzzy relationship between R & D costs and a particular products has given the Commerce Department a great deal of discretion in the calculation of research and development expenses. The language in the Revised GATT Antidumping Code requiring that the investigating authority consider development cost

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<sup>62</sup> 56 Fed. Reg. 32,386.

<sup>63</sup> Id.

<sup>64</sup> 58 Fed. Reg. 15,472.

allocations "which have been historically utilized by the exporter or producer" arguably places greater reliance on the methods of allocation used by the exporter in the normal course of business.

#### **D. Packing Costs**

Most companies treat packing costs -- materials, labor, and factory overhead -- as manufacturing costs. Reflecting the statutory construction of the constructed value provision, the Commerce Department requires that companies exclude packing costs from the cost of manufacturing.<sup>65</sup> In a few cases, the distinction between "packing" and the subject merchandise is significant. For example, in Calcium Aluminate Cement from France,<sup>66</sup> the inclusion of bagging costs into cost of manufacturing, rather than packing, resulted in no home market products meeting the twenty percent difmer test. In that case, the Department declared bagging costs to be a part of packing, as it was not a defining physical characteristic of the subject merchandise. In general, the Department treats "consumer packing" as part of the subject merchandise and all other shipping materials as "packing".<sup>67</sup>

#### **E. Allocating Costs to Joint Products**

In a number of cases, the Department has addressed the issue of allocating costs to two or more products produced jointly. The two major categories of joint products are by-products and co-products.

##### **1. By-products**

In many manufacturing processes, a limited quantity of second quality merchandise, or by-product, is produced in conjunction with the primary product. A distinguishing feature of by-products are that their sales value is minor in comparison to the sales value of the

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<sup>65</sup> See: Appendix 1, 16-17 (Packing treated as an item separate from the cost of manufacturing) . See also 19 C.F.R. 1677b(e)(Constructed value equal to (A) materials and fabrication; (B) general expenses and profit; and (C) cost of all containers and coverings).

<sup>66</sup> Calcium Aluminate from France, 59 Fed. Reg., 14, 143-4.

<sup>67</sup> Certain Stainless Steel Cooking Ware from Korea, 51 Fed. Reg. 42,873 (Dep't. Comm. 1986) (final determination); Certain Residential Door Locks from Taiwan, 54 Fed. Reg. 53,103 (Dep't. Comm. 1989) (final determination).

prime product.<sup>68</sup> Because of their relative lack of commercial value, by-products are produced unintentionally, as part of the process for manufacturing the intended product. To the extent possible, companies attempt to minimize their production of by-products. In many industries, seconds and defective goods that are sold for separate purposes are examples of by-products, in that they are an inevitable, but unintentional consequence of producing prime, or commercial quality merchandise, and have minor commercial value.

Consistent with standard cost accounting practice<sup>69</sup>, the Commerce Department treats by-products in the same manner as scrap. In calculating the cost of production, total costs are allocated to prime quality products. Any revenues arising from the sale of by-products (or scrap) are used to reduce the total costs allocable to prime production.<sup>70</sup> In this manner, the by-product absorbs costs only up to the amount equal to its ability to generate revenues. Prime products absorb the remaining costs of production.

## 2. Co-products

Two or more products are considered co-products when each individually has more than "minor" commercial value. Common examples include the various products which can be produced from crude oil distillation (e.g., gasoline, fuel oil, aviation fuel, lubricants, chemical feedstocks). In the case of co-products, the Commerce Department requires that costs be allocated in such a manner that all individual products share an appropriate amount of the total cost of production.

A special case of co-products is multiple grades resulting from a unified production process. For many agricultural products (as well as some manufactured goods), the

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<sup>68</sup> See: e.g., Cost Accounting: A Managerial Emphasis, Charles T. Horngren and George Foster (Prentice Hall, 1991) 7th Ed., 527:

A by-product is a product that has a low sales value compared with the sales value of the main or joint product(s).

See also, Advanced Management Accounting, Robert S. Kaplan, (Prentice Hall 1982), 391-2,3.

<sup>69</sup> Horngren and Foster, 540 (By-product revenues are treated as a cost reduction of the main or joint product(s) or as a separate revenue item). See also: Kaplan, 392.

<sup>70</sup> See: Certain Fresh Cut Flowers from Colombia, 52 Fed. Reg. 6,844 (Dep't. Comm. 1987) (final determination) (Total costs are allocated over total export quality flowers sold. Since "culls" are considered by-products, the revenues from their sale are used to offset the cost of producing export quality flowers.) See also: Sebacic Acid From the People's Republic of China 59 Fed. Reg. 568 (Dep't. Comm. 1994) (preliminary determination).

cultivation or manufacturing process will produce multiple grades of the same product. In such cases, there usually is no way to discern differences in grade-by-grade production costs on the basis of physical measurements of manufacturing inputs. Despite their lack of physically measurable production differences in input usage, the different grades often have significantly different commercial values. If a single average cost is compared to grade-by-grade prices, then lower grade products may appear to be below cost of production, even though the producer is selling the mix of products at prices which are well above production costs.<sup>71</sup>

There are two potential ways of neutralizing the mismatch. The first solution is to compare costs to prices for the "mix" of products, and not to prices for individual grades. This solution squares with the reality that the output of the production process is a mix of grades. However, this solution requires that prices be averaged before the sales below cost test, and before calculation of dumping margins based upon constructed value. Traditionally, the Department has been reluctant to average prices for any reason other than calculating Foreign Market Value based upon price. Reflecting this reluctance, the Department generally has not used this approach, except in cases where it has determined that price averaging is appropriate for other reasons.<sup>72</sup>

The second solution is to reallocate the single average costs to the multiple grades, based upon the relative sales value of each. This method is widely discussed in cost accounting texts.<sup>73</sup> The Department however, is reluctant to allocate costs based upon sales value, as by definition it transfers costs from low-priced products to high-priced products.<sup>74</sup> Because the Department ultimately is trying to measure the extent of unfairly low prices in

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<sup>71</sup> Alternatively, the comparison of an average cost to grade-by-grade prices could indicate that high grade sales are above cost, even though overall the producer is losing money.

<sup>72</sup> See, e.g., Certain Fresh Cut Flowers from Colombia 55 Fed. Reg. 20,491 (Dep't. Comm. 1990) (final results) hereinafter "Cut Flowers from Colombia" (Because the product is considered perishable, the Department decides that it is appropriate to use monthly average U.S. prices. In averaging U.S. prices, the Department accepts the use of averages by flower type, without regard to grade.) But see also: Salmon from Norway, 56 Fed. Reg. 7666 (The Department compared a single average cost for all sizes of salmon to individual (grade-specific) prices).

<sup>73</sup> See, e.g., Horngren and Foster, 533.

<sup>74</sup> See also: Horngren and Foster, 533 (For joint cost allocations, physical measures are preferred to sales value methods in rate regulation settings, in cases where the objective is to set a fair selling price, since the use of prices to allocate costs results in circular reasoning).



the U.S., the use of price as an allocation factor could mask dumping.<sup>75</sup> Accordingly, this method has been accepted by the Department only in limited situations.<sup>76</sup>

Thus, finding neither solution wholly acceptable, the Department in many cases has compared a single average cost to grade-by-grade prices.<sup>77</sup>

### 3. Co- or By-?

The definition of a product as a co- or by-product is another gray area which can have a major impact on the outcome of cost of production calculations. One of the earliest cases where this issue arose was in Oil Country Tubular Goods from Canada.<sup>78</sup> Second grade oil country tubular goods ("OCTG"), albeit not as high-priced as prime quality product, had a range of commercial values,<sup>79</sup> and was sold for the same end-uses as "prime" OCTG.<sup>80</sup> The Department decided that OCTG "seconds" were more appropriately treated as co-products, and allocated costs equally to prime and second grade OCTG.

The definitional issue in OCTG from Canada was even further complicated because both the prime and second grade products were subject to investigation. Treatment as a by-product might have allowed second grade OCTG entering the U.S. to avoid dumping duties. In such cases, the implication of treating the "second" product as a by-product is that sales of the comparable product in the home market will never be sold below cost of production, as cost of production is fixed at revenues received for the sale of the by-product. On appeal, the Court of International Trade ruled that if the second grade product were exported to the United States, the Department would have to treat the second grade product as a co-product,

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<sup>75</sup> See: Ipsco, Inc. v. U.S., 13 C.I.T. 402, 714 F. Supp. 1211 (Ct. Int'l Trade 1989); affm'd in part, 965 F.2d 1056 ( Fed. Cir. 1992)(Defendants argued that costs could not be allocated to different products on the basis of value because pricing policies are the subject of the investigation) See also: Kiwifruit from New Zealand, 57 Fed. Reg. 13,704 (The Department rejects respondent's request to reallocate single average costs based on sales value, on the basis that no firm correlation between price and fruit size was established.)

<sup>76</sup> See: PET Film from Korea, 56 Fed. Reg. 16,311.

<sup>77</sup> See: Kiwifruit from New Zealand, 57 Fed. Reg. 13,704; Salmon from Norway, 56 Fed. Reg. 7666

<sup>78</sup> 51 Fed. Reg. 15,029 (Dep't. Comm. 1986) (final determination)

<sup>79</sup> See: 714 F. Supp. 1211, 1215: (The sales value of second grade OCTG relative to prime OCTG ranges from "lower" to "greatly lower.")

<sup>80</sup> 965 F. 2d 1056: (Both prime and second grade OCTG used for the same purpose, namely "down-hole" use in oil and gas wells.)

regardless of its treatment under generally accepted accounting principles.<sup>81</sup> However, in ruling that second product by definition is a co-product, the Court left open the possibility that, by shifting costs from prime to seconds, such treatment could mask dumping margins on prime product, which in many cases is sold in the United States and the home market in far greater volumes.

The Court of Appeals for the Federal Circuit ultimately upheld the Department's treatment of second-grade OCTG as an equally-costed co-product.<sup>82</sup> In subsequent cases, the Department generally has interpreted the Courts' decisions in Ipsco Co. v. the United States to apply to all cases where seconds are included in the scope of investigation, even if there were no U.S. sales of seconds under investigation, and regardless of their value relative to prime products.<sup>83</sup>

## V. Selling, General and Administrative Expenses

Selling, general and administrative expenses or collectively, "S,G & A", are the second major component of cost of production. The responding company's actual S,G & A expenses, allocated to the subject merchandise, are included in the calculations of cost of production and constructed value. However, under current U.S. antidumping law, the S,G & A included in constructed value is subject to a minimum floor of 10 percent of the cost of manufacturing.<sup>84</sup> Because most companies do not allocate S,G, & A costs to individual products in the normal course of business, S, G, & A allocation issues arise in nearly every dumping investigation.

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<sup>81</sup> F. Supp. 1211, 1213 (Treatment of a second product as a by-product is proper under the law only when second products are not subject to investigation.)

<sup>82</sup> 965 F.2d 1056 (Fed. Cir. 1992)

<sup>83</sup> See: Non-Alloy Steel Pipe from Korea, 57 Fed. Reg. 42951; Certain Carbon and Alloy Steel Wire Rod from Canada, 59 Fed. Reg. 18,797 (Dep't. Comm. 1994) (final determination).

<sup>84</sup> 19 U.S.C. § 1677b(e)B). However, Article 2.2.2 of the Revised GATT Antidumping Code has no allowance for the use of a minimum level for "administrative selling or any other costs", but instead requires that costs be based upon "the actual amount incurred and realized by the exporter or producer," or the "weighted average" of all exporters or producers.

## A. Selling Expenses

### 1. Consistency with Reported Price Adjustments

Selling expenses consist of most home market direct selling expenses, or circumstance of sale adjustments (except imputed expenses, discussed below), and all indirect selling costs. The Commerce Department requires that direct and indirect selling expenses reported as part of the cost of production response be equal to the sum of the transaction-specific direct and indirect selling expenses reported as adjustments to price in the computerized file for home market sales.<sup>85</sup>

### 2. Exclusion of Imputed Costs

In calculating the cost of production, however, the Department excludes credit and inventory carrying costs, which normally are reported as selling expenses on home market sales.<sup>86</sup> The Department excludes these expenses on the basis that they are not "actual costs," as defined by generally accepted accounting principles. Although these financing costs are included in the calculation of total, unadjusted constructed value<sup>87</sup>, the Department allows an offset to a company's total interest costs, in order to avoid double counting. The offset normally is calculated by multiplying total interest costs by the ratio of accounts receivable and finished goods inventory to total assets, as reported on the company's financial statements.<sup>88</sup> The assumption behind this method is that the loans which give rise to interest expenses are used to finance the company's total assets which include, besides accounts receivable and inventory, fixed assets, such as capital equipment, buildings, and investments. The ratio, therefore, represents the portion of interest costs being used to finance sales and finished inventory.

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<sup>85</sup> See Appendix 1, 14-15. Selling expenses reported as adjustments to price normally are allocated to individual products based upon sales value. In cost of production calculations, the Department normally uses cost of goods sold as the basis for allocating selling expenses. Thus, the respondent should take care to ensure that the selling expenses reported as price adjustments are properly converted before inclusion in cost of production.

<sup>86</sup> See: Appendix I, 14.

<sup>87</sup> Certain adjustments are made to total unadjusted constructed value prior to calculation of the margin of antidumping. These adjustments are discussed in Part IX.B below.

<sup>88</sup> See: Certain Stainless Steel Butt-Weld Pipe Fittings from Taiwan, 58 Fed. Reg. 28,558 (Dep't. Comm. 1993) (final determination).

### 3. Taxes Based on Income

The Department does not include taxes based upon income in cost of production calculations, as it is viewed as part of profit, and not as a cost to the company.<sup>89</sup>

### 4. Antidumping Related Expenses

The Department will allow respondents to exclude legal and accounting fees specifically related to the antidumping proceeding.<sup>90</sup>

### 5. Other Excluded Costs

In testing for reporting completeness, the Commerce Department routinely asks companies to reconcile the submitted S, G, & A costs to their official financial statements.<sup>91</sup> Companies may include certain categories of costs in S, G, & A in their official accounting records which should be excluded for purposes of reporting cost of production or constructed value. As a general rule, in order to avoid double-counting, any cost which is deducted from gross unit price in the sales below cost calculation should not be included in the cost of production. The most common costs which should not be included in S, G, & A costs are post-sale movement charges (often included in accounts labelled "transportation," or "freight"), which the Department always deducts separately from price in calculating sales below cost.<sup>92</sup> Other costs which may be included in official S, G, & A but which should not be included in reported production costs are discounts, rebates and commissions.

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<sup>89</sup> See, e.g., Flat Panel Displays from Japan 56 Fed. Reg. 32,392. (Japan Enterprise Tax not included in cost of production because it was based on the aggregate profit/loss of the corporation).

<sup>90</sup> See: e.g., Certain Fresh Cut Flowers from Colombia 55 Fed. Reg. 20,491.

<sup>91</sup> See: Appendix 1, 15.

<sup>92</sup> Pursuant to the recent ruling in Ad Hoc Comm. of AZ-NM-TX-FL Producers of Gray Portland Cement v. United States, 13 F.3d.398 (Fed. Cir. 1994), that pre-sale home market freight costs are not included in movement charges, such costs should now be treated as indirect selling expenses, which are included in cost of production.

## B. General and Administrative Expenses

### 1. General Allocation Method

General and administrative ("G&A") expense allocation methods are unique to each company. However, as a general principle, the Department requires respondents to dissect its G & A accounts, and tie them to the appropriate organizational level.<sup>93</sup> In most cases the Department requires that G&A expenses be calculated over the fiscal year that most closely corresponds to the Period of Investigation<sup>94</sup> or Review. The G & A percentages associated with each relevant organizational level are summed to arrive at the total G & A percentage allocable to the subject merchandise. This percentage is then multiplied by the cost of manufacturing of the individual products to arrive at the total G & A costs, per product.

### 2. Calculated at the Operating Level

In cases where actual production takes place at an operating entity which is consolidated into a larger corporate entity, the Department typically requires that G & A costs (excluding interest) be calculated at the operating, rather than the consolidated, level, on the basis that G & A calculated at the operating level provides the most representative measurement of G & A costs incurred in producing the subject merchandise.<sup>95</sup>

### 3. Inclusion of Corporate Overhead

The truly corporate wide general and administrative expenses are those that cannot be tied directly to any one or group of operating entities. Even in cases where G & A costs are calculated at the operating level, the Department will require that a certain amount of G & A

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<sup>93</sup> See: Flat Panel Displays from Japan, 56 Fed. Reg. 32,385 (G & A expenses for Sharp allocated according to the level of organization where they were incurred).

<sup>94</sup> See: e.g., Certain Steel Products from Canada, 58 Fed. Reg. 37,105.

<sup>95</sup> See: Certain Hot-Rolled Carbon Steel Flat Products, Certain Cold-Rolled Carbon Steel Flat Products, Certain Corrosion Resistant Carbon Steel Flat Products from Japan, 58 Fed. Reg. 37,166 (Dep't. Comm. 1993) (final determination)(Department normally calculates G & A based on its unconsolidated operations); Certain Hot-Rolled Carbon Steel Flat Products, Certain Cold-Rolled Carbon Steel Flat Products, Certain Corrosion Resistant Carbon Steel Flat Products, and Certain Cut-to-Length Carbon Steel Plate from France, 58 Fed. Reg. 37125, 37136 (Dep't. Comm. 1993) (hereinafter "Certain Steel Products from France")(In calculating G & A for the subject merchandise, the Department used the expenses of Sollac, the operating company, rather than Usinor, the holding company).

costs incurred by the consolidated corporate entity be allocated to the subject merchandise.<sup>96</sup>

#### 4. Interest

Money is a necessary part of all manufacturing processes. Money is needed to fund capital equipment purchases. Depending upon the cash flow characteristics of the business, money may also be required to fund the purchase of materials and cover payroll until the company has received money from the sale of its products. Money, however, can also be used by the firm for non-manufacturing purposes, such as purely financial investment. Further, it is much harder (but not impossible) to trace the use of money, as opposed to materials or labor, to particular products. Because of its ubiquitousness and its commonality to virtually all production, money, or the cost of it (interest) is a frequent gray area in cost of production investigations.

##### a. Calculation of Total Interest Costs

Unlike G & A expenses, the Department normally calculates interest costs on the basis of the respondent's consolidated financial statements.<sup>97</sup> In calculating total interest costs, the Department includes costs from short-term loans, long-term loans, and bonds in its calculation of interest costs allocable to the subject merchandise.<sup>98</sup> As noted above, however, the Department treats interest costs as a special case when it comes to allocating expenses to the merchandise under investigation. Normally, as noted above, the Department requires that input costs be tied as closely as possible to specific products. Rather than trace the flow of funds and estimate the cash needs of the company's different operating activities, the Department assumes that both the source and uses of financial inputs -- equity, loans and bonds -- are not tied to particular products or their manufacturing and sales operations. Accordingly, the Department allocates corporate-wide financial costs equally over all production.

In rare instances, the Department has recognized that companies may be borrowing to fund completely different lines of business which are wholly unrelated to the business of

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<sup>96</sup> Certain Steel Products from France, 58 Fed. Reg. 37,136 (An allocated amount of Usinor's G & A expenses included in the G & A for Sollac.)

<sup>97</sup> See: MMF Sweaters from Korea, 55 Fed. Reg. 32,659.

<sup>98</sup> See: Certain Hot-Rolled Carbon Steel Flat Products, Certain Cold-Rolled Carbon Steel Flat Products, Certain Corrosion Resistant Carbon Steel Flat Products, and Certain Cut-to-Length Carbon Steel Plate Korea, 58 Fed. Reg. 37,177 (Dep't. Comm. 1993) (final determination) (Department includes an amortized amount of costs associated with bonds in interest costs).

producing the subject merchandise. In MMF Sweaters from Korea,<sup>99</sup> the Department investigated a company, Hanil Synthetic Fiber Co., Ltd. ("Hanil") which manufactured sweaters, but which also had significant investment activities. In that case, the Department allowed Hanil to allocate its total interest costs between the company's investment and manufacturing activities based on the relative amount of earned income.<sup>100</sup>

**b. Offsets to Total Interest Costs.**

Although the Department requires that all interest costs, short-term and long term, be included in cost of production, it allows only corporate interest earned from short-term bank deposits to be used as an offset.<sup>101</sup> The assumption underlying this policy is that long-term income from financial instruments is earned solely from wholly different line of business, namely investment activities. Thus, the Department holds that this type of interest income is not allocable to the subject merchandise.

The Department's policy of summarily excluding all long-term interest income, and dividends or interest earned on short-term non-bank deposits, is at odds with the principle of fungibility which underlies its general method for allocating interest costs. The policy assumes long-term interest income is not fungible; namely, that all long-term interest income, and short-term non-bank deposit revenues, can be tied directly to the company's "investment activities," which is a separate line of business. Such a policy also does not recognize that

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<sup>99</sup> 55 Fed. Reg. 32,659 (Dep't. Comm. 1990) (final determination). This special case of interest allocation is addressed in detail in "Recent Stitches in the Department of Commerce's Cost of Production Analysis: The MMF Sweaters Antidumping Case and Commerce's Treatment of Interest Expense," Mark David Davis and Jeffrey Allen May, George Washington Journal of International Law and Economics, Vol. 25 (1991), 115.

<sup>100</sup> An example of an alternative ruling on the tying of interest to particular activities is found in Minivans from Japan, 57 Fed. Reg. 21,947. In that case, Mazda was unsuccessful in convincing the Department not to consolidate for interest calculation purposes its auto manufacturing operations with its auto financing subsidiary. Mazda claimed that the auto financing subsidiary had very different borrowing requirements than the auto manufacturing side of the company. The Department's decision to use consolidated interest costs, coupled with the decision not to allow an offset for interest earned by the financing subsidiary on its loans to consumers (since this interest was considered to come from long-term investment), effectively saddled the auto operations with the finance subsidiary's cost of borrowing, with no credit for revenues from consumer lending.

<sup>101</sup> See: Appendix 1, 15. See also: MMF Sweaters from Korea, 55 Fed. Reg. 32,659; Non-Alloy Steel Pipe from Korea, 55 Fed. Reg. 42,953 (Dividends on short-term stock investments not allowed as an offset to total interest income). See also: Certain Fresh Cut Flowers from Colombia 55 Fed. Reg. 20,491 [ ] (Dep't. Comm. 1990) (When respondents cannot separate short-and long-term interest, the Department denied the offset).

the source of the deposited or invested funds may be the subject merchandise. For example, a company may have a mature product line, that generates excess cash, or it may float a long-term bond offering to fund a multi-year development project. In the interim, the company may choose to invest the excess cash in long-term instruments (which generally earn a higher rate of return than short-term instruments) or, hold stocks or bonds for a short-term until it needs the money to fund future development.

### c. Allocation to the Subject Merchandise

In nearly every case, the Department has allocated a company's total interest costs to the various types of products on the basis of the relative value of the cost of goods sold.<sup>102</sup> The rationale behind this policy is expressed in "Cost Analysis Under the Antidumping Law:"

In most cases, because the cost of sales includes the current expenses of production and a proportional amount of depreciation for the long-term assets of each product sold during a relevant period, the interest expense is allocated on the basis of the cost of sales.<sup>103</sup>

Stated another way, the cost of sales represents "a reasonable measure of the inputs which need to be financed by the company."<sup>104</sup>

However, in DRAMs from Korea,<sup>105</sup> the Department departed from the long-standing policy and used the relative value of fixed assets as the basis for allocating interest costs. The Department did not explain, however, why the use of one type of assets (fixed assets in this case), to the exclusion of all other types of assets needed for production was a more reasonable allocation basis in this case, other than to state that the subject merchandise employed a disproportionate amount of fixed assets. In essence, the Department deviated from its "money is fungible" principle and tied interest costs solely to the generation of fixed assets. The case is on appeal.

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<sup>102</sup> See: e.g., Certain Hot-Rolled Carbon Steel Flat Products, Certain Cold-Rolled Carbon Steel Flat Products, and Certain Cut-to-Length Carbon Steel Plate from Belgium, 58 Fed. Reg. 37,083 (Dep't. Comm. 1993) (final determination)(hereinafter "Certain Steel Products from Belgium)", Certain Steel Products from Canada 58 Fed. Reg. 37,099; Steel Wire Rope from Korea, 58 Fed. Reg. 11,305 (Dep't. Comm. 1993) (final determination).

<sup>103</sup> "Cost Analysis Under the Antidumping Law," 387.

<sup>104</sup> Id., fn. 177.

<sup>105</sup> 58 Fed. Reg. 15,471-2.



The assumption that all money is fungible arguably is reasonable in most cases, where the capital requirements are proportional to overall cost of sales. It avoids the difficult task of tracing the sources and uses of cash within the responding company. For companies with lines of business which have very different financing needs, however, the policy can create distortions.

## VI. Non-Operating Costs

Although not specifically enumerated in the list of items included in cost of production, non-operating costs are often added in part or in whole to selling, general and administrative costs.

### A. Extraordinary Costs

Extraordinary costs usually arise from acts of God and unforeseen events and give rise to additional, out-of-the-ordinary production costs, or significant losses in production volumes. In both cases, the actual production costs per unit are significantly higher than expected. For the Department to accept a claim that costs associated with acts of God or unforeseen events are extraordinary, the respondent must be able to show that they do not recur.<sup>101</sup> The Department places the burden on the respondent to show that the events are "one-off" in nature or occur very infrequently, and in general, has denied claims for extraordinary expenses.<sup>102</sup>

However, if a company receives an insurance payment to cover unforeseen losses, the Department allows the reimbursement as an offset to total production costs.<sup>103</sup>

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<sup>101</sup> See Certain Steel Products from Belgium, 58 Fed. Reg. 37,088; Porcelain-on-Steel Cooking Ware from Mexico, 58 Fed. Reg. 32,101-2 (Dep't. Comm. 1993) (final results); Steel Wire Rope from Korea, 58 Fed. Reg. 11,035 (Dep't. Comm. 1993) (final determination).

<sup>102</sup> See Salmon from Norway, 56 Fed. Reg. 7671 (Because respondent submitted no evidence regarding the country-wide incidence of the disease in question, the Department denied treatment of costs associated with the disease as extraordinary.). See also: Cut Flowers from Colombia 55 Fed. Reg. 20,491 (The Department denied an adjustment to costs based on expected production, since respondents failed to provide sufficient information on the collapse of the company's water table.)

<sup>103</sup> See Kiwifruit from New Zealand, 57 Fed. Reg. 13,702; Salmon from Norway, 56 Fed. Reg. 7663.

## B. Exchange Rate Gains and Losses

Exchange rate gains or losses occur when companies buy, sell, or borrow in a currency other than the currency of their official accounting records. Gains or losses in foreign exchange transactions will arise because of differences in the timing of posting costs or revenues in a company's books and the corresponding receipt or payment of funds. In the case of purchases, the cost of the input typically will be converted to home currency on the date that the purchase is posted to the company's official accounts payable records. Actual payment for the purchase typically occurs a month (or more) later. At the time it makes the actual foreign currency payment, the company will convert (at least for accounting purposes) some of its home currency to the currency of payment. To the extent that there is a difference between the exchange rate as of the date of posting and the date of payment, a company will have to treat the difference as an exchange rate gain or loss. Thus, exchange rate gains and losses are an inevitable part of production involving either imported inputs or export of finished products.

In calculating cost of production, the Commerce Department requires that exchange rate gains or losses on input purchases be included.<sup>104</sup> The Department's rationale is that exchange rate gains arising from purchases are tied to production, while on the other hand, gains related to sales are in fact a sales-related item. Further, the Department has argued that the use of exchange rate gains or losses on sales would undercut the requirement in 19.C.F.R. § 353.60 that the exchange rate as of the date of sale be used to convert third country sales to U.S. dollars.<sup>105</sup> Given that virtually all exchange rate losses and gains arising from sales are disallowed by the Department as a selling expense,<sup>106</sup> these exchange rate losses and gains are effectively ignored in the calculation of dumping margins. In a hyperinflationary economy, exchange rate gains on sales are a regular, significant occurrence,<sup>107</sup> and thus their exclusion denies companies an adjustment to cost that is a major determinant of the economics of foreign currency transactions.

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<sup>104</sup> See: MMF Sweaters from Korea, 55 Fed. Reg. 32,659.

<sup>105</sup> See: MMF Sweaters from Korea, 55 Fed. Reg., 32,659.

<sup>106</sup> See Antifriction Bearings (Other Than Tapered Roller Bearings) from the FRG, 54 Fed. Reg. 19085 (Dep't. Comm. 1989) (final determination) (Only foreign exchange gains from hedging operations directly tied to the sales under consideration are allowed as a circumstance of sale adjustment)

<sup>107</sup> In a hyperinflationary economy, the rate of depreciation should roughly track the difference between the rate of inflation in the country of exportation and the country of importation. For example, if the inflation differential is running at a rate of 10 percent per month, a company normally will experience a 10 percent exchange rate gain on sales paid for 30 days after shipment.

## VII. Profit

Current U.S. antidumping law requires that constructed value include the greater of: actual profit earned on the sale of the subject merchandise; or, profit equal to 8 percent of the total cost of production (less packing).<sup>108</sup>

### A. The Calculation of Actual Profit

Officially the Department applies a hierarchy in the determining actual profit level, beginning with the company-specific profit on home market sales of the class or kind of merchandise, and ending with industry-wide profit on home market sales of comparable merchandise.<sup>109</sup> In the recent past, the Department usually has calculated actual profit on the products reported as sold in the home market. All of the information used to make the profit calculation on home market sales of the subject merchandise is contained in the computerized listings of home market sales and cost of production submitted by the respondent. It is now standard practice for the Department to compare respondent's calculation of actual profit to the results obtained when comparing reported prices to costs. In its preliminary determination on DRAMs from Korea, the Department rejected the reported costs for two respondents and applied best information available because the responding companies' profit calculations could not be reconciled to the profits calculated from the sales and cost of production computer submissions.<sup>110</sup> Thus, respondents should be careful to calculate reported profit in a manner which is reconcilable to the reported prices and costs.

### B. Future Use of Profit in Constructed Value

Under current law, the Department adds the lesser of actual profit or the eight percent minimum in order to arrive at constructed value.<sup>111</sup> The eight percent minimum profit (the "statutory eight percent") has been a major bone of contention between the United States and many of its trading partners.

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<sup>108</sup> 19 U.S.C. § 1677b(e)(1)(B).

<sup>109</sup> See: "Cost Analysis Under the Antidumping Law," 406.

<sup>110</sup> See: Dynamic Random Access Memory Semiconductors of One Megabit and Above From the Republic of Korea, 57 Fed. Reg. 44,068-9 (Dep't. Comm. 1992 (preliminary determination)).

<sup>111</sup> 19 U.S.C. § 1677b(e)(B)

Reflecting this disenchantment, the revised GATT Antidumping Code describes, in order of preference, the following methods which may be used to calculate profits<sup>112</sup>:

1. actual profit on home market sales made "in the ordinary course of trade" by the producer or exporter of the "like product;"
2. actual profit on home market sales by the producer or exporter of the "same general category" of products;
3. weighted average profit on home market sales of other producers, or exporters of the "like product"; or,
4. any other reasonable method, so long as the resulting amount does not exceed the weighted average profit on home market sales of other producers, or exporters of the "same general category" of products.

As is often the case in issues addressed by the GATT, the language on profit calculation leaves plenty of room for interpretation. For example, the term "sales in the ordinary course of trade" may be interpreted in this context to mean only above cost sales. If so, the "average profit" for constructed value would be limited to the average for above cost sales only. In markets characterized by highly volatile prices, the average profit on above cost sales only could be much higher than the current statutory eight percent. Moreover, there appears to be no specific exception for situations where all producers and exporters in the home market are selling at losses. Such a scenario is conceivable in industries which have high fixed costs and substantial excess capacity. It is highly likely that the final version of the U.S. antidumping legislation will have some provision for some form of "default profit" (such as a country-wide, non-industry specific average) in the event that the whole domestic industry in the exporting country is operating at a loss. How that default profit is calculated and applied, however, is likely to be the subject of lively debate.<sup>113</sup>

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<sup>112</sup> Revised GATT Antidumping Code, Article 2, para 2.2.2

<sup>113</sup> For example, in instances where "other reasonable methods" are used to calculate profit, H.R. 4206 (the "Regula-Mineta bill"), suggests a floor profit "not less than an amount sufficient to cover the cost of capital in the country of exportation." While a percentage reflective of the cost of capital may be a relatively non-objectional measure of a fair operating result for a company, care should be taken to ensure that it is applied to the right base (e.g., the amount of invested capital, and not cost of goods sold).

## VIII. Calculation and Treatment of Sales Below Cost

Upon receipt of a cost of production response, the Department performs a series of tests to determine the impact of this information on the ultimate calculation of dumping margins.

### A. Elements of the Below Cost Comparison

Both home market pricing and cost of production information generally must be submitted in computer readable format.<sup>114</sup> To test for sales below cost, the Commerce Department merges the two groups of information (or "files") together. In order to successfully merge sales and cost data, respondents must be sure that there is a product identifying field which is common to both files, and that the same unit of measurement is used in recording prices and costs in their respective files. The Department compares individual prices of each transaction to the product-specific cost of production and then separately sums the volume of sales where prices are above and below cost of production.

### B. Sales Below Cost: Inclusion, Exclusion, or Use of Constructed Value?

In drafting the sales below cost provision, Congress recognized that some below cost sales were an inevitable part of standard (read "fair") business practices. The U.S. antidumping law states that below cost sales cannot be used as the basis for Foreign Market Value if they occur "over an extended period of time", and "in substantial quantities," and "are not at prices which permit recovery of all costs within a reasonable period of time in the normal course of trade." (emphasis added)<sup>115</sup> The Department's interpretation of these two key phrases has a significant impact on the effect of below cost sales on antidumping calculations.

#### 1. "Substantial Quantities"

The statute does not indicate how "substantial quantities", or "extended period of time" are to be defined. However, the subsequent qualification -- that before exclusion, sales must not be "at prices which permit recovery of all costs within a reasonable period of time in the normal course of trade -- suggests a case-by-case approach. In a high margin industry (such as supercomputers), the definition of "substantial quantities" might be quite low, as virtually all sales in the normal course of trade are above cost. In other industries characterized by volatile pricing, companies may sell large quantities of products below costs

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<sup>114</sup> 19 C.F.R. § 353.31 (e)(3).

<sup>115</sup> 19 U.S.C. § 1677b(b)(2).

in the normal course of trade, and still recover all costs with a much smaller proportion of high-priced sales.

The Commerce Department, however, has opted for a uniform, bright line definition of "substantial quantities." With the exception of agricultural products it deems "highly perishable"<sup>116</sup>, the Department currently considers any quantity over 10 percent to be "substantial".<sup>117</sup> If the volume exceeds 90 percent, then provided that below cost sales have been made over an extended period of time, the Department will exclude all home market sales, above and below cost, from FMV.

In determining if below cost sales should be excluded, the Department does not separately test to determine if the below cost sales prohibit the "recovery of all costs over a reasonable period of time". The burden is placed on the responding company.<sup>118</sup> Moreover, the Department interprets the "recovery of all costs" as requiring a prospective assessment of prices and costs.<sup>119</sup> Despite its apparent problems, the Courts have upheld the Department's application of a uniform threshold for determining "substantial quantities" as within its administrative discretion.<sup>120</sup>

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<sup>116</sup> See: discussion in Part X.A. below.

<sup>117</sup> See: "Cost Analysis Under the Antidumping Law," 394.

<sup>118</sup> See, e.g. Sweaters Wholly or in Chief Weight of Man-Made Fiber from Korea, 59 Fed. Reg. 25,607-8 (Dep't. Comm. 1994 (preliminary results) (As a basis for finding sales below cost, the Department cited the failure of respondents to submit information that its prices would have recovered costs within a reasonable period of time.)

<sup>119</sup> See: Granular Polytetrafluoroethylene Resin from Japan, 58 Fed. Reg. 50,345-6 (Dep't. Comm. 1993) (final results) In that case, respondent's prices during the period of review ("POR") of permitted full recovery of all costs. The Department, however, determined that profitability during the POR was irrelevant, as the Court in Toho Titanium Co v. United States, 657F. Supp. 1280 Ct. Int'l Trade 91987) required a showing that below-cost prices would exceed future costs to such a degree so as to cover past and future losses. Of course, there is the distinct possibility that none of the respondent's projections of future costs would be verifiable, meaning that the Courts and the Department have established an impossible standard.

<sup>120</sup> See: Timken Co. v. United States, 21 Cust B, & Dec. (No. 49) at 51, 673 F. Supp. at 514. The CIT, in noting that 1677b(b) provided very little legislative guidance on defining "substantial," decided that the Department's application of a particular threshold was "perhaps the only practical way of interpreting and administering the statute."

## 2. "Extended Period of Time"

Similarly, a "reasonable period of time" for recovery of all costs will vary from industry to industry. For some industries, such as cement and paper, a combination of high fixed costs, long lead times for capacity increases, and cyclical sales create a long business cycle. Such industries may sell product at losses for many months and even years during the cyclical downturns.

The Department's definition of "extended period of time" has fluctuated in the recent past. At the time "Cost Analysis Under the Antidumping Law" was written, the Department performed no specific test for determining if below cost sales were occurring over an extended period of time.<sup>121</sup> During the early 1990's, the Department began to include a separate extended period of time test in its sales below cost analysis. For products sold in multiple months, "extended period of time" was defined by the Department for investigations as more than one month out of a standard six month period of investigation.<sup>122</sup> That is, the Department excludes below cost home market sales if total below cost sales exceed 10 percent, and there are any individual below cost sales in more than one month during the six month period of investigation, or a minimum of one sixth of the period.<sup>123</sup>

In a few very recent annual review notices, the Department has defined the "extended period of time" to be three months, for a twelve month period of review (one fourth of the time)<sup>124</sup>. In other cases, it has applied a definition of two months.<sup>125</sup>

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<sup>121</sup> See: "Cost Analysis Under the Antidumping Law," 394-5.

<sup>122</sup> See, e.g., Welded Stainless Steel Pipe from Malaysia 59 Fed. Reg. 4024 (Dep't. Comm. 1994) (final determination).

<sup>123</sup> Id. If home market sales are made in only one month, then the Department defines the "extended period of time" as one month.

<sup>124</sup> See: Tapered Roller Bearings and Parts Thereof, Finished and Unfinished, from Japan and Tapered Roller Bearings, Four Inches or Less in Outside Diameter and Components Thereof from Japan, 58 Fed. Reg. 64,729 (Dep't. Comm. 1993) (final results) In that case, the Department stated that it used three months since "three months is commonly used to measure corporate, financial, and economic performance." The three month period was also used in Granular Polytetrafluoroethylene Resin from Japan, 58 Fed. Reg. 44,495 (Dep't. Comm. 1993) (preliminary results); Sweaters Wholly or in Chief Weight of Man Made Fiber from Korea, 59 Fed. Reg. 25,607 (Dep't. Comm. 1994)(preliminary results).

<sup>125</sup> See: Fresh Kiwifruit from New Zealand, 59 Fed. Reg. 23,692 (Dep't Comm. 1994) (preliminary determination)

### 3. Application on a Model-by-Model Basis

The statute is silent on whether the test for "substantial quantities" and "extended period of time" should be applied on the basis of all such or similar home market sales or individual models. However, in citing obsolete models as an example of allowable below cost prices, the legislative history can be construed to suggest an aggregate approach.<sup>126</sup> On a model-by-model basis, sales of obsolete models are highly likely to be below cost in both "substantial quantities" and over "an extended period of time," as currently defined by the Department. Yet Congress noted that although it is "frequently necessary" to sell obsolete or end-of-year merchandise, such below cost sales should not be disregarded.

Until recently, the Department applied the test for "substantial quantities" to all such or similar home market sales.<sup>127</sup> In a number of recent cases, however, the Department has applied the below cost test separately for each home market model. The Department's reasoning is set forth in "Import Administration Policy Bulletin 92/3 ('The 10/90/10 Test for Sales Below Cost of Production')":<sup>128</sup>

If the purpose of the COP provision is to avoid basing FMV on prices below cost (with certain exceptions), the model specific methodology is appropriate, since it focuses on the prices actually used for FMV. In the price-to-price comparison, the prices of models that are not used in the comparison are irrelevant to the determination of FMV.

In some cases, the application of the 10/90/10 test on a model-by-model basis is necessary because cost of production is submitted for less than the complete universe of home market sales.<sup>129</sup> The policy of applying the sales below cost test on a model-by-model basis also eases the Department's administrative burden as it eliminates the need to determine alternative above-cost home market product matches in the event that over 90 percent of sales of the reported home market matching model are below cost.

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<sup>126</sup> S. Rep. No. 1298, 93d Cong. 2d Sess. 173, .41. See also: H. Rep. No. 571, 71,n.31. (expressing a similar intent).

<sup>127</sup> "Cost Analysis Under the Antidumping Law," 377; See also: MMF Sweaters from Korea 55 Fed. Reg. 32,660 (If all sales of a particular model were below cost, but overall below cost sales were between 10 and 90 percent, the Department used the next most similar model as the basis of FMV)

<sup>128</sup> Reprints available in Room B099, U.S. Department of Commerce, Washington, D.C.

<sup>129</sup> Non-Alloy Steel Pipe from Korea, 57 Fed. Reg. 42,497.



Nevertheless, the change is a substantial methodological departure from historical practice. By applying its stringent definitions of "substantial quantities" and "extended period of time," to individual models, the Department excludes from the calculation of Foreign Market Value all but the most sporadic below cost sales. The combined effect of the narrow definitions of "substantial quantities," and "extended period of time", as well as the application of the sales below cost test on a model-by-model" basis arguably skews Foreign Market Value towards the use of constructed value, which is inconsistent with the law's general preference for the use of prices as the basis for FMV.<sup>130</sup>

#### 4. Uruguay Round Revisions to Below Cost Test

The Revised Antidumping Code overturns significant portions of the current Commerce Department sales below cost test. First, the definition of "substantial quantities" is raised to a minimum of 20 percent.<sup>131</sup> Second, the language suggests that the "extended period of time" normally is fixed at one year, and in no case is less than six months.<sup>132</sup> Third, in cases where prices are below costs at the time of sale, but are above average costs for the period of investigation, the sales are considered to provide for the "recovery of all costs within a reasonable period of time."<sup>133</sup> Thus, the Revised GATT Antidumping Code implies that short-term, high start-up costs or "spikes" in costs should not disqualify home market prices as the basis of FMV.

### IX. Calculation of Constructed Value

#### A. Elements of Constructed Value

Under current Department practice, constructed value will be used as the basis of FMV for any particular product sold in the United States if more than 90 percent of the comparable home market product are sold at prices below cost of production. In calculating gross, unadjusted constructed value, the Commerce Department includes the cost of

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<sup>130</sup> 19 U.S.C. § 1677b(a).

<sup>131</sup> See: Article 2, para 2.2.1.1, fn. 5.

<sup>132</sup> See: Article 2, para 2.2.1.1, fn. 4. Note, however that the definition is ambiguous, as the paragraph reads: "within an extended period of time" (emphasis added).

<sup>133</sup> See: Article 2, para 2.2.1.

manufacturing, home market selling expenses,<sup>134</sup> general and administrative costs, and profit.

## B. Adjustments to Constructed Value

When the Commerce Department uses constructed value as the basis for Foreign Market Value, it deducts home market circumstance of sale adjustments.<sup>135</sup> In addition, home market indirect selling expenses are treated in the same manner as standard price dumping calculations.<sup>136</sup> The "net" constructed value is then compared to net U.S. price, calculated in the standard manner. The "net constructed value", which in reality is a surrogate for a "fair" home market price, is equal to the ex-factory cost of producing the U.S. product, plus a reasonable profit for such a product as sold in the home market.

## X. A Notable Exception: Agricultural Products

In formulating policies for calculating cost of production for agricultural products, the Commerce Department has taken into consideration in a number of instances the specific pricing and cost behavior of the industry. Because of perishability, seasonality, and family ownership of their means of production, the Department has recognized that agricultural products raise unique cost calculation issues.

### A. Perishability

The Department has long recognized that in cost of production analysis, perishable agricultural products must be treated differently from non-perishable goods such as steel or cement.<sup>137</sup> With respect to cost of production, the major difference in treatment is in the definition of "substantial quantities."<sup>138</sup> Because of their finite shelf life, the available supply

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<sup>134</sup> Or third country selling expenses, if the home market is not viable.

<sup>135</sup> See: Timken Co. V. United States, 21 Cust. B. & Dec. (No. 49) 31,42, F. Supp. 495, 507 (1987).

<sup>136</sup> See: Aramid Fiber Formed of Poly-Phenylene Terephthalamide From the Netherlands, 59 Fed. Reg. 23,686 (Dep't Comm. 1994) (final determination) (When U.S. prices were compared to CV, the Department deducted third country indirect selling expenses up to the amount of indirect selling expenses incurred on U.S. sales)

<sup>137</sup> See, e.g, Southwest Florida Winter Vegetable Growers Association v. United States, 7 Ct. Int'l Trade 99, 584 F. Supp. 10 (1984).

<sup>138</sup> The other major difference is in the calculation of U.S. price, where the Department has allowed the use of monthly average (as opposed to transaction specific) prices in the calculation of dumping margins for products it deems to be perishable. See: Fresh Cut Flowers from Colombia, 55 Fed. Reg. 20,491.

of perishable products can swing wildly in the normal course of business, thus causing significant price volatility and substantial below cost sales. If the Department determines that the investigated agricultural good is perishable, it will include below cost sales in the calculation of antidumping margins as long as the volume of such sales is less than 50 percent.<sup>139</sup>

A critical issue in recent agricultural cases, therefore, is whether or not the Department deems the product or crop in question to be perishable. In analyzing perishability, the Department has considered two main factors: storage life (both before and after harvest) and further processing potential.<sup>140</sup> If a producer has the flexibility to store the product or further process it into a product which can be stored, then the Department considers perishability to be a non-factor in determining pricing volatility. Thus, if the product can be stored for longer than a few days or weeks, or if it can be processed (frozen, dried, smoked) into a product with a longer shelf life, then the Department will not consider the product to be perishable. For example, in Salmon from Norway, the Department found the product not to be perishable, as salmon farmers could choose to leave the fish in the pen for a certain period of time rather than harvest during a narrow window.<sup>141</sup> Further, the Department also noted that fresh salmon could be processed into frozen salmon, which could be stored for a significant period.<sup>142</sup> Similarly, in Kiwifruit from New Zealand, the Department found this particular fruit not to be perishable, because it had a much longer shelf life than highly perishable products.<sup>143</sup> Current Commerce Department policy is to consider only "highly perishable" products, that is, those with extremely short shelf lives

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<sup>139</sup> See: Southwest Florida Winter Vegetable Growers Association v. United States, 7 Ct. Int'l Trade 99, 584 F. Supp. 495(1987) (upholding the Department's use of a fifty percent "substantial quantities" standard for fresh vegetables). See also: Fall Harvested Round White Potatoes from Canada, 48 Fed. Reg. 51,669 (Dep't. Comm. 1983) (final determination); Fresh Cut Flowers from Colombia 55 Fed. Reg. 20,491.

<sup>140</sup> See: Salmon from Norway, 56 Fed. Reg. 7672-3.

<sup>141</sup> Salmon from Norway, 56 Fed. Reg. 7673.

<sup>142</sup> Id.

<sup>143</sup> 57 Fed. Reg. 13,699-70. As is evidenced in a comparison with Fall-Harvested White Round Potatoes from Canada, 48 Fed. Reg. 51,669 (Dep't. Comm. 1983) (final determination)(hereinafter "White Potatoes from Canada") the Department's finding in Kiwifruit from New Zealand reflects a tightening up on the rules for determining perishability. Both products remain stable in storage over several months, but, at the end of the storage period must be sold for whatever the market will bear, or be destroyed. Further, there is no commercially significant further processing options for kiwifruit farmers. The Department, however, found kiwifruit not to be perishable, even though a few years earlier it had found potatoes to be a perishable product.

(e.g., fresh vegetables and cut flowers) as perishable for cost of production purposes.

## B. Seasonality

### 1. Period for Investigating Costs

In agricultural cases, the Department recognizes that costs must be calculated over the whole growing season, rather than an arbitrary period determined by the filing of a petition. In most cases, the period over which costs are measured is one year.<sup>144</sup>

### 2. Treatment of Pre-production Costs

For many types of agricultural products, producers incur substantial costs prior to beginning of production. Trees, vines, or plants may have to be tended for many years before they begin to produce in commercial volumes. In many countries, growers can expense these costs as they are incurred, rather than amortize them over the productive life of the crop.

Consistent with its treatment of manufactured goods, the Commerce Department generally requires that prior year pre-production costs be accumulated and amortized over the productive life of the bearing plant, regardless of the company's normal accounting treatment of such costs.<sup>145</sup>

An exception to this general rule applies to initial land costs. As land (theoretically) maintains its value and is not a depreciable asset, the Department excludes the cost of purchasing land<sup>146</sup>. However, if a grower has a mortgage on the property or is leasing land, the mortgage or leasing costs are included in cost of production, as it is a recurring expense.<sup>147</sup>

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<sup>144</sup> However, in cases where crops are raised over multiple years, the Department will use a multi-year cost of production period. See: Salmon from Norway 57 Fed. Reg. 7662.

<sup>145</sup> See: Kiwifruit from New Zealand 57 Fed. Reg. 13,703 (the costs of developing a kiwifruit orchard should be recovered during its useful life).

<sup>146</sup> See: Red Raspberries from Canada, 50 Fed. Reg. 19,768 (Dep't. Comm. 1985) (final determination) (Farm land costs are not depreciated, and therefore not a cost of production).

<sup>147</sup> Red Raspberries from Canada, 50 Fed. Reg. 19,768.

### C. Issues Raised by Family Ownership

Family ownership of farms often creates several difficulties in cost of production analysis. First, "personal" costs may be expensed on the farm accounts.<sup>148</sup> The Department allows such costs to be excluded, if the respondent can demonstrate that they are a personal expense.<sup>149</sup>

Second, the valuation of owner labor is often based upon tax considerations. Owner salaries may be set at whatever level is needed to bring to zero net income for the farm operations, in order to avoid double taxation. Consequently, the amount an owner is paid for overseeing the same volume of production may vary wildly from farm-to-farm. In such cases, the Department may substitute an arm's length amount for valuing owner labor.<sup>150</sup> In addition, in some cases, the Department has not assigned a value for unpaid part-time family labor and bookkeeping<sup>151</sup>, while it has assigned a value in other cases.<sup>152</sup>

## XI. Conclusion

A combination of statutory time constraints, limited budgets, different accounting treatment from country-to-country, and the uniqueness of each industry makes the task of investigating cost of production in antidumping proceedings a very difficult one indeed. Department accountants often are required to quickly master the very specific methods of calculating production costs in particular industries, and are given a limited number of days to test for accuracy and reasonableness at verification. Over the past seven years, the Department has gone a long way in establishing general rules and methods for calculating cost of production and constructed value, despite the very adverse conditions under which it must operate. These general rules and methods have enhanced consistency and predictability in cost analysis under the antidumping law.

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<sup>148</sup> A common practice in New Zealand, for example is to expense all mortgage-related interest costs, including the portion related to the family living structure, in the farm accounts. See: Kiwifruit from New Zealand, 57 Fed. Reg. 13,704.

<sup>149</sup> Id.

<sup>150</sup> Kiwifruit from New Zealand, 57 Fed. Reg. 13,704.

<sup>151</sup> White Potatoes from Canada, 48 Fed. Reg. 51,669.

<sup>152</sup> Kiwifruit from New Zealand, 57 Fed. Reg. 13,705.

In the near future, however, the Revised GATT Antidumping Code may force major revisions to parts of current Departmental practice. However, a number of gray areas remain in cost of production analysis. Before international consensus on these areas can be achieved, there should be some empirical analysis undertaken on "normal," or "fair" pricing and cost recovery. The debates over cost of production analysis of the past few years illustrate the difficulties in defining what is "unfair" or "unreasonable" without a reasoned notion of "normal" behavior of companies, in terms of selling below cost. Unless definitions for such concepts as "substantial quantities," "extended period of time," and "recovery of all costs" are grounded in empirical behavior, they will remain controversial. Clearly, the debate over cost of production and constructed value in antidumping law is far from over.

# APPENDIX 1

Section D  
Cost of Production/Constructed Value

I. INTRODUCTION

This section of the antidumping questionnaire covers cost of production ("COP") information for the merchandise sold in the home market/third country and constructed value ("CV") information for the merchandise sold in the U.S. market. Please refer to the cover letter to determine your reporting requirements.

Cost of Production

The COP is the cost for the products sold in the home market/third country that are listed in the product concordance. The COP will be compared to the prices for these products sold in the home market/third country to determine if these prices are above the COP, and, consequently, if these home market sales will be used for purposes of this investigation. In the event that we determine a U. S. model's most appropriate model match to be models sold at prices below the cost of production, we will compare that U. S. model to constructed value.

The COP includes: (1) the cost of manufacturing ("COM") incurred during the period of investigation ("POI"), including materials and fabrication, but not including general and administrative expenses of the company and/or interest expense, for each product sold in the home/third country market, and (2) total general expenses (selling, general, and administrative expenses ("SG&A")), including the following:

- a) direct and indirect selling expenses incurred for the sale of products in the home market/third country,
- b) your company's total general and administrative expenses incurred during the relevant period and a proportional amount of the general and administrative expenses incurred by affiliated entities on your company's behalf, e.g., an allocated share of management costs incurred by the parent company. Any other such corporate expenses, e.g., general research and development ("R&D"), and
- c) total interest expenses of the consolidated group companies for the relevant period.

NOTE: For any sales made below cost in the home



market/third country, provide evidence based on historical data that demonstrates that you made these sales at prices which will permit the recovery of all costs within a reasonable period of time in the normal course of trade.

#### Constructed Value

The CV may be used as the basis for FMV if an insufficient number of your company's home market sales are above the cost of production, or if no comparable sales can be found in the home market/third country.

The constructed value is based on the costs incurred to produce each product sold in the U.S. market, as if it had been sold in the home market.

The CV includes the following cost components:

- (1) the COM incurred during the POI including materials and fabrication, but not general and administrative expenses of the company and/or interest expense, for each product sold in the U.S. market;
- (2) general expenses (selling, general, and administrative expenses (SG&A)), including the following:
  - a) average direct and indirect selling expenses incurred for the sale of the class or kind of merchandise in the home market/third country. Include imputed credit for purchase price transactions, and both imputed credit and inventory carrying costs for ESP transactions;
  - b) your company's total general and administrative expenses for the relevant period and a proportional amount of the general and administrative expenses incurred by affiliated entities on your company's behalf, e.g., an allocated share of management costs incurred by the parent company. Any other such corporate expenses, e.g., general R&D; and
  - c) total interest expenses of the consolidated group companies for the relevant period,
- (3) the profit usually realized from home market/third country sales of the class or kind of merchandise; and
- (4) packing expenses incurred for sales to the United States.

However, pursuant to section 773(e)(1) of the Tariff Act of 1930, as amended (the Tariff Act), general expenses must be at least 10 percent of total materials and fabrication costs. Moreover, profit must be at least 8 percent of the sum of total material and fabrication costs and general expenses.

Reporting Period for Cost of Production/Constructed Value

The COP and the CV should be calculated on a weighted-average basis for the costs incurred during the period of investigation ("POI"). See Appendix 5 of the questionnaire. You must be able to demonstrate that the reported costs reconcile to your company's annual and/or interim financial statements. If you have any questions, please call the Office of Accounting at (202) 377-2210.

Presentation of Cost of Production/Constructed Value

The information requested should be submitted on computer tape or diskette as specified by the cover letter. The product codes must correspond with those used for the U.S. and home market/third country sales sections. Refer to Appendix D-1 and D-2 of this section for a sample reporting format.

The information for each "extra" sold by your company during the POI should be submitted on Lotus diskette. Refer to Appendix D-3 of this section for a sample reporting format.

II. GENERAL

Please provide complete narrative descriptions of the following areas.

A. Corporate Organization

Provide a corporate organization chart specifically identifying the parent company, subsidiaries, factories and all other entities related to your company. Identify those entities from which you obtain materials, research and development services, equipment or any other input or service used to manufacture or sell the subject merchandise. The relationship of your company to the other entities should be determined pursuant to section 773(e)(4) of the Tariff Act. Specify the exact nature of the relationship, including percentage of ownership by your company, your parent company, or any other related entity.

Related parties are defined in the Tariff Act as:

- Members of a family, including brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.
- Any officer or director of any organization and such organization.
- Partners.
- Employer and employees.
- Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting stock or shares of any organization and such organization.
- Two or more persons or organizations directly or indirectly controlling, controlled by, or under common control with, any person or organization.

B. Products and Production Process

Describe the manufacturing process for the product under investigation. Your description should include the following:

1. A general description of the products manufactured by your company. Identify any products manufactured in the same production facilities as the subject merchandise.
2. A complete flowchart of the production cycle, including descriptions of each stage in the process. (When preparing your flowchart, identify the points in the process where one or more production stages comprise a direct cost center.)
3. A description of your company's production facility. If production or any one process takes place at more than one facility, list all facilities and provide brief descriptions of the production activities that take place at the major facilities. State if your company has continuous casting and/or conventional ingot breakdown and the type of furnaces used.
4. Describe the method used by your company to track yields throughout the production process. List all of the stages at which yields are calculated.

Provide an analysis of the overall accumulated yield, the accumulated yield after slab and the accumulated yield for processes after slab to the final product. Include the yield for the following production steps:

- a) Coke

- b) Sinter
- c) Blast Furnace
- d) Conventional Furnace or Arc Furnace (Molten Steel)
- e) Continuous Casting, Conventional Teeming and Ingot Breakdown
- f) Processes
  - 1) Plate through Plate finishing (Cut-to-length)
  - 2) Hot Strip Mill through Hot Finish (Hot Rolled)
  - 3) Hot Strip Mill through Cold Roll Finish (Cold Rolled)
  - 4) Hot Strip Mill through Electro-Galvanizing or Hot-Dipped Galvanizing Process (Corrosion Resistant)
- g) Extras

5. Submit an analysis that separately identifies the weighted-average price (including transportation, etc.) per input unit for the following materials:

- |                                   |             |
|-----------------------------------|-------------|
| a) Coal                           | g) Fluxes   |
| b) Iron Ore                       | h) Zinc     |
| c) Limestone                      | i) Nickel   |
| d) Purchased scrap                | j) Aluminum |
| e) Purchased coke and coke breeze |             |
| f) Alloys                         |             |

If the price of the input varied significantly for different processes, provide the range of each input.

Provide the weighted average prices (including transportation, etc.) per input for the following:

Coke Gas MMBTU  
 Steam MMBTU  
 Electricity MK

### C. Accounting Systems and Policies

1. If you have not already done so in your response to Section A of the Department's questionnaire, please provide a translated copy of the company's audited financial statements, including footnotes and auditor's opinion for all fiscal years covered by the POI.

State whether these practices are in accordance with the GAAP in the country of manufacture. Your description should include all principles which have a significant impact on the cost of the product, including discussions of the following:

- a) Average useful life for each class of production equipment and depreciation method used for each.
  - b) Raw materials, work-in-process and finished goods inventory valuation methods (e.g., first-in, first-out (FIFO), last-in, last-out (LIFO), weighted-average).
  - c) Inventory write-off and write-down methods for raw materials, parts and subassemblies, and finished goods.
  - d) Note any differences in methodologies between financial and cost accounting treatment of product costs, and explain the reasons for such differences.
  - e) Scrap value for scrap used in production. Scrap value for scrap generated at the various stages of production.
  - f) Exchange gains and losses from transactions and from year-end financial statements purposes.
  - g) Revaluation of assets for inflation.
  - h) Accelerated depreciation.
  - i) Capitalization of general expenses and/or interest expense as part of the product inventory costs.
  - j) Expense of idled equipment and/or plant shut-downs, planned or unplanned.
  - k) Closure costs.
  - l) Restructuring costs.
2. Describe the cost accounting system used by your company to record the production costs of the subject merchandise. Your description should be provided in narrative form, supplemented with flow charts as appropriate, and should include, but not

be limited to, the following items:

- a) A general description of the company's cost accounting method as it relates to applying production costs to individual units of the subject merchandise produced (e.g., job order, process costing). State whether the cost accounting system is an integral part of your financial accounting system used for the financial statements.
- b) A description of the company's use of standard or budgeted costs, if applicable, including:
  1. the types of variances recorded under your company's cost accounting system and how they are used as part of its managerial reporting process;
  2. the period for which the variances are calculated and recorded;
  3. the methods used to develop your company's standard costs;
  4. the frequency of standard cost revisions, including the date of the most recent revisions;
  5. the disposition of favorable and unfavorable variances (including underapplied or overapplied overhead) resulting during an operating period (e.g., charge to cost of sales, proration among inventory and cost of sales balances).

NOTE: If your company uses a standard cost system you must use this system in reporting COP/CV. (See Section III.B. of this questionnaire.) All variances between standard and actual costs resulting from manufacturing operations must be allocated for the submission to the subject merchandise produced using a reasonable methodology that does not distort per-unit costs. All direct costs incurred to produce the merchandise should be directly identified with the product, product line costs should be allocated to products manufactured on that line and plant-wide costs should be allocated to products manufactured in that plant. If your company does not allocate in this manner, please call the Office of Accounting (202) 377-2210. You should explain in detail the allocation

method used, as well as any significant or unusual cost variances that occurred during the POI.

- c) A list of the direct cost centers included as part of your company's cost accounting system. Briefly describe the segment of production activity attributed to the listed cost center.
- d) A list of the indirect cost centers included as part of your company's cost accounting system. Briefly describe the indirect costs that are accumulated in each cost center and the method normally used to allocate those accumulated costs to the direct cost centers and to the subject merchandise produced.
- e) A list of all other common production costs that are accumulated and allocated under your company's cost accounting system. Briefly describe the methodology normally used to allocate these costs to the subject merchandise produced.
- f) Methods and bases used to allocate costs among the company's organizational units (e.g., parent company charges to subsidiaries, corporate charges to specific plants, inter-plant allocations).
- g) Methods used to account for scrap used for production and for scrap generated at each stage of production. Specify the difference between usable scrap and loss. Also state the method used to account for rework.
- h) A description of your company's use of its cost accounting system to value the cost of sales and raw materials, work-in-process and finished goods inventories for the audited financial statements. (See Section III.A.2. of this questionnaire for a related question.)
- i) A list of all costs which are valued differently for cost and financial accounting purposes.
- j) State the accounting procedures used to account for the work related to "extras". How is this work valued?

### III. COST OF PRODUCTION AND CONSTRUCTED VALUE SUBMISSION

NOTE: A format for reporting COP and CV has been prepared and is included in Appendix D of this questionnaire section. To the extent possible, you should follow the format as shown.

#### A. Methodology

Describe in detail the methodology used by your company to derive the reported fully absorbed materials, direct labor, overhead, G&A expenses, interest and profit for the subject merchandise.

1. Describe how the submission methodology correlates to the methodologies used in the cost accounting system and financial statements. If the methodologies are not the same, explain in detail any differences and the reasons for such differences.

Describe in detail how your company records the movement of inventory from work-in-process to finished goods to cost of sales. For the product with the highest U.S. sales by value during the POI, prepare a schedule that compares the cost used to record the inventory movements from work-in-process to finished goods to cost of sales to the COM reported in this submission. Explain any differences (e.g., application of monthly or annual variances).

2. Is the reported cost of manufacturing the same as that recorded in your company's finished inventory records? If not, explain any differences.
3. State whether all costs incurred in manufacturing have either been directly charged or allocated to the reported COP/CV figures.
4. State whether any reported cost element was derived using a methodology different from that used for the audited financial statements. If so, provide a detailed explanation of the methodological differences.

#### B. Cost of Manufacturing

The COM, which includes materials and fabrication costs, should be those costs actually incurred by your company for the manufacture of the products, quantified



and valued in accordance with generally accepted accounting principles (GAAP). Any element of cost for which the quantity or value is recorded using a method that does not conform to GAAP should be adjusted to reflect the proper accounting principles before reporting. However, if your company includes a share of the general and administrative expenses and/or interest expense as manufacturing overhead in your accounting system, these costs should be excluded for the submission (the full general and administrative expenses and interest expense for the relevant period should be included in the general expenses).

In responding to this section of the questionnaire, you should rely on your company's cost accounting records to the extent that those records accurately reflect the costs incurred to produce the subject merchandise. If for any reason you do not intend to use these records to prepare your response, you should contact Import Administration's Office of Accounting at (202) 377-2210.

#### Weighted-Average Cost of Manufacturing

If the subject merchandise is manufactured at more than one facility, the reported COM should be the weighted-average manufacturing cost from all facilities. The weighted-average manufacturing cost calculation for the merchandise should be reported separately.

#### Fully Absorbed Costs on the sales unit basis

The costs for the COP must be the fully absorbed costs (e.g. all yield losses incurred during production and down-time costs) on the per-unit sales basis in the home market sales. The costs for the constructed value must be the fully absorbed costs on the per-unit sales basis in the U.S. market.

#### Extras

For each product sold in the U.S. and in the home market the costs of each extra(s) should be separately presented. The cost of the extra should include the materials, variable and fixed overhead.

#### Presentation of the COP/CV

The COP/CV should be presented separately, itemizing major material inputs, variable and fixed overhead, for the following processes:

- a) Coke Oven
- b) Sinter
- c) Blast Furnace
- d) Liquid Steel Furnace
- e) Continuous Casting or  
Conventional Teeming/Ingot Breakdown
- f) Processing from Slab through Finishing e.g.  
Hot Rolled Products, Hot-Strip Mill to  
Finishing, e.g. Pickling, Annealing, etc.
- g) Extras

## 1. Materials

Describe in detail the methodology used to report materials cost. Include a sample calculation for illustrative purposes. Provide the actual, per-unit direct materials costs incurred for manufacture of the product. Material costs should include transportation charges, (including the cost of operating a transportation system if it relates to the product under investigation) duties and other expenses normally associated with obtaining the materials.

- a) Purchases from Unrelated Suppliers - Explain the nature of contractual arrangements with unrelated suppliers. State whether these suppliers or the company itself absorbs the cost of defective materials, parts or components. Materials costs should include the purchase price, transportation charges, duties and all other expenses normally associated with obtaining the materials used in production.

For direct materials, use the actual price and quantity of raw materials used in production during the POI, including losses resulting from defective materials, inventory writedowns and shrinkage.

- b) Purchases from Related Suppliers

Note: In determining the relationship between companies, refer to Section 773(e)(3) of the Tariff Act.

Indicate the nature of your relationships with the suppliers. Explain, in detail,

relationships such as equity ownership, common management, common ownership, debt financing and any other types of assistance from or to the related suppliers.

For the Cost of Production, the actual costs to manufacture the materials obtained from your supplier should be used if the supplier is under common control with your company, directly or indirectly owned more than 50% by your company, or if your company is owned more than 50% by the supplier.

For Constructed Value, the transfer price for material purchases from related companies as defined by Section 773 (e) (4) may be used to value materials inputs. However, the transfer price must be above the COP and must fairly reflect the amount usually realized in sales in the market under consideration. For example, if a market exists for the identical or similar input obtained from your related supplier, the price could be compared to purchases from unrelated suppliers. Please explain how you determined that the transfer price was representative of a fair market price. If purchase prices from third parties for an identical or comparable input cannot be obtained, provide cost of production information for the input. Provide information regarding the percentage of total material costs purchased from unrelated and from related suppliers.

- c) Taxes - Describe any internal taxes or duties incurred on the purchase or disposition of materials that are not remitted or are refunded upon exportation of the merchandise.

For COP, both duties and internal taxes should be included. Do not include value added taxes.

For CV, materials costs should be reported exclusive of any internal taxes in the home market that are applied directly to materials, but that are not collected or are refunded upon exportation of the merchandise produced. Include import duties. Do not include value added taxes.

## 2. Variable Overhead

Describe in detail the methodology used to report variable overhead cost. Include a sample calculation for illustrative purposes. Variable overhead costs include those manufacturing costs that generally vary in total with changes in the amount of goods produced, but do not vary on a per-unit basis. Variable overhead costs may include the fully absorbed costs incurred for direct labor, movement expenses, indirect materials, indirect labor and manufacturing utilities.

Direct labor should include the costs incurred for all production workers, relief workers, inspection/testing workers, and any other workers directly involved in manufacturing the subject merchandise. Direct labor costs should include elements such as base pay, overtime pay, incentive pay, shift differentials, year-end bonuses, and other employee benefits (e.g., vacation, holiday, sick pay, insurance, government required social programs). If the costs of direct labor exceeds 15% of the variable costs, please identify these costs as a separate item.

Direct labor costs should also include the full amount of any payments made for contract labor. Report separately amounts incurred for contract labor. Indicate if the contractors are related to your company (within the meaning of Section 773(e)(4) of the Tariff Act). Describe the production services provided by the labor contractors.

Note that indirect labor, such as that incurred for factory supervisors or production engineers, should be reported as part of factory overhead.

Itemize the expenses included as variable costs.

3. Fixed Overhead

Describe in detail the methodology used to report fixed overhead cost. Include a sample calculation for illustrative purposes. Fixed overhead costs include those manufacturing costs that generally do not vary with the quantity of goods produced at a given level of operations. Fixed overhead costs may include costs incurred for building or equipment rental, depreciation, plant property taxes, and plant security. Any R&D which is specifically related to the subject merchandise

should also be included in the cost of manufacturing. Product R&D included in SG&A on the financial statements should be segregated and allocated to production based on the cost of sales of the subject merchandise.

Please explain if your company incurred any expenses for restructuring and/or rationalization for the product under investigation. If so provide all details of such restructuring and/or rationalization and explain how these costs were allocated to the product.

Itemize the expenses included as fixed costs.

Include expenses related to shut-downs, depreciation on idle machinery, etc.

4. Extras

The cost of manufacturing related to extra processing, finishing, coating, etc. See Appendix D-2 and D-3.

C. Selling, General, and Administrative

1. Selling Expenses

For COP, report both direct and indirect selling expenses incurred for each sale in the home market/third country. These selling expenses should be reconciled with the selling expenses reported in response to Section B of this questionnaire.

Note: Imputed credit and inventory holding costs should not be included in selling expenses reported for COP purposes.

For CV, report the direct and indirect selling expenses associated with the class or kind of merchandise sold in the home market/third country.

Direct and indirect selling expenses (including imputed inventory carrying costs and credit expenses, as necessary) should be reported separately. If the selling expenses were calculated for Section B as a percentage of the sales revenues of the general class or kind of the merchandise, please explain the method used to convert this percentage to a cost of manufacturing of the class or kind of merchandise sold in the

home/third country market for this cost of production calculation. Provide a worksheet showing the calculation of the per-unit direct and indirect expenses.

Itemize the expenses included as selling expenses.

2. General and Administrative ("G&A") Expenses

G&A expenses are those expenses which relate to the activities of the company as a whole rather than to the production process. These would include expenses which are not identified with a particular operation, (e.g., general R&D, G&A expenses of the corporate headquarters). Factory administrative costs, however, are considered to be part of factory overhead. G&A expenses should be allocated on an annual basis based on cost of sales. Provide a worksheet reconciling the SG&A expenses reflected on the consolidated financial statements to the amount of G&A expenses used for your calculation. Present the actual calculation reflecting the percentage which you used for the submission.

3. Other

Include in the submitted costs any other expenses that relate to the general production activity of your company but which may not have been specifically included in the categories described above, (e.g., loss on sale of assets or inventories, and other non-operating income and expense items).

4. Interest Expense

Interest expense should be derived from the total borrowing costs incurred by the consolidated group companies. In calculating your interest expense for COP/CV, include the expense incurred for both long-term and short-term borrowings.. Total interest expense may be reduced by any interest income earned from your company's short-term investments of its working capital. This net interest expense should be allocated among all of the products on an annual basis based on consolidated cost of sales. Please provide a worksheet reconciling the interest expense and interest income reflected on the consolidated financial statements to the amount used for the calculation in your response. Present the actual

calculation which you used for your calculation in the submission.

For CV only

For purchase price sales, the reported net interest expense should be reduced by an amount attributable to financing trade accounts receivable. For exporter's sales price sales, the net interest expense should be reduced by an amount attributable to financing both trade accounts receivable and finished goods inventory. This percentage may be calculated by computing the ratio of accounts receivable and finished goods inventory to total assets, and applying the ratio to the total net interest expense.

Provide a worksheet reconciling the interest expense and interest income reflected on the consolidated financial statements to the amount used for the calculation in your response. Present the actual calculation.

D. Profit (for CV only)

Report the average profit realized on home market/third country sales of the class or kind of merchandise.

NOTE: If your company's profit on home/third country market sales of the class or kind of merchandise was less than 8 percent of the reported sum of the cost of manufacturing plus general expenses for the subject merchandise, then the 8 percent minimum profit figure should be used to derive CV in accordance with section 773(e)(1)(B)(ii) of the Tariff Act. You must, however, include in your submission a calculation showing how you determined that your company's home market/third country sales profit was less than the minimum amount.

E. Packing

For COP, provide all costs of preparing the products for shipment in the home/third country market. This should be the same information provided for packing in response to Section B of this questionnaire.

For CV, provide all costs of preparing the products for shipment to the United States. This should be based on

the same information provided for packing in response to Section C of this questionnaire.

#### IV. PRODUCTION

For the POI, provide the following:

1. Total production of: a) slab, b) billets, and c) blooms,
2. The total slabs used during the POI for production of finished products,
3. The percentage of slab used for the total production of: a) hot-rolled flat products, b) cold-rolled flat products, c) cut-to-length carbon steel plate, and d) certain corrosion-resistant carbon flat products.