Memorandum
To Our Friends and Clients

WTO Appellate Body Rules Against U.S. “Zeroing” in Anti-Dumping Calculations

In its fourth significant decision against the United States in recent years, the Appellate Body of the World Trade Organization (“WTO”) ruled on August 11, 2004 that a U.S. method of calculating dumping margins in anti-dumping investigations is contrary to the Anti-Dumping Agreement – the Uruguay Round trade agreement which sets out standards for the implementation of the anti-dumping duty law by each of its signatory countries. In particular, the Appellate Body ruled that the U.S. practice of not taking into account, or “zeroing,” non-dumped transactions when calculating aggregate dumping margins is contrary to Article 2.4.2 of the Anti-Dumping Agreement, which requires that the dumping margin calculation include “all comparable … transactions.” In essence, the Appellate Body found that by excluding

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1 The other three U.S. laws held to be contrary to WTO agreements are the Foreign Sales Corporation/ Extraterritorial Income (“FSC/ETI”) corporate income tax exemptions, the Anti-Dumping Act of 1916, and the Continued Dumping and Subsidy Offset Act of 2000 (popularly known as the “Byrd Amendment”). Significant retaliatory tariffs have been imposed by the European Union (“EU”) due to the failure of the United States, until late 2004, to roll back the FSC/ETI exemption, and retaliatory action has been threatened with respect to the other two if the U.S. does not take prompt action to bring itself back within its WTO obligations. The repeal of the Anti-Dumping Act of 1916, a seldom-used provision of the law, was part of the Miscellaneous Tariff Bill passed by Congress on November 19, 2004.

2 The Anti-Dumping Agreement is formally known as the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994. It is an attachment to the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, available at http://www.wto.org/english/docs_e/legal_e/19-adp.pdf, at 145 (Apr. 15, 1994). The U.S., as well as the EU, Canada, Japan and most other major U.S. trading partners have signed the Anti-Dumping Agreement.

non-dumped transactions from the calculation of the weighted average dumping margin in anti-dumping investigations, the U.S. method leads to the finding of dumping margins where none exist, or to the finding of higher dumping margins than actually occurred.

The Appellate Body’s decision is not self-implementing. That is, it will not lead to an immediate elimination of the U.S. anti-dumping duty imposed on softwood lumber from Canada – the case in which the decision was made. Nor will the U.S. immediately stop the application of its practice of zeroing to pending anti-dumping proceedings. Rather, the decision means that the U.S. must, within “a reasonable period of time,” bring its calculation methodology “into conformity with its obligations under the Anti-Dumping Agreement.” If the U.S. does not do so, Canada, the EU and other WTO members whose exports to the U.S. are adversely affected by the practice would be permitted to impose retaliatory tariffs on products exported from the U.S.

The imposition of retaliatory tariffs for zeroing is more than an abstract possibility. In fact, the EU has already imposed retaliatory tariffs amounting to at least $274 million as a result of Appellate Body rulings that the provisions of U.S. tax law permitting the FSC/ETI corporate income tax exemptions provided an illegal subsidy to U.S. manufacturers. The EU tariffs led Congress to approve, and President Bush to sign, an amendment to the tax code which will phase out the offending provisions over the next three years.

The Zeroing Practice at Issue

The particular practice in question in the latest Appellate Body ruling is used when the Department of Commerce (“DOC”), which is the U.S. authority responsible for the determination of whether dumping has occurred, calculates the dumping margin in an anti-dumping investigation by comparing a weighted-average export price to a weighted-average normal value. The extent to which the export price is less than normal value is
the dumping margin, which is the basis for the amount of dumping duty to be imposed on imports of the product manufactured by the foreign producer.

In the calculation of export price and normal value in an anti-dumping investigation, the devil is truly in the details. The governing statute, the DOC’s regulations, and the precedents established in DOC determinations and court decisions provide for countless procedures and adjustments designed to calculate the export price and normal value on a comparable basis. One such procedure involves grouping the product under investigation (which is formally defined as the “subject merchandise” at the initiation of the investigation) into sub-groups typically based on physical characteristics. For example, in the investigation of softwood lumber from Canada, the DOC did not compare the weighted average export price of all softwood lumber sold in the U.S. by a particular Canadian producer to a single weighted average normal value for that producer. Rather, the DOC calculated a weighted-average export price and normal value for each of numerous sub-groups of softwood lumber.8

The practice of “zeroing” has its effect in the DOC’s next step. In order to calculate a single weighted-average margin for each foreign producer, the DOC compares the export price and normal value for each sub-group exported by that producer. If the export price of merchandise in a sub-group is lower than the comparable normal value, the DOC considers that a dumping margin exists for that sub-group. If the export price of that sub-group is higher than the comparable normal value, however, the DOC considers that sub-group as not being dumped, and treats the difference between the two values as zero. The DOC then adds up all the dumping margins resulting from these comparisons (i.e., only the positive dumping margins found for “dumped” sub-groups), and divides the total by the value of all imports (including imports in what it considers to be “non-dumped” sub-groups) in order to calculate a single weighted-average margin for that producer. This process is demonstrated in the following highly simplified example, involving a single foreign producer that exports three sub-groups of lumber from Canada to the U.S.

### WTO Appellate Body Rules Against U.S. “Zeroing” in Anti-Dumping Calculations

<table>
<thead>
<tr>
<th></th>
<th>Normal Value per unit</th>
<th>Export Price per unit</th>
<th>Difference as a % of Normal Value (“Dumping Margin”)</th>
<th>Units Sold in U.S.</th>
<th>Total Value of U.S. Sales</th>
<th>Total Potential Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type A</td>
<td>$1.00</td>
<td>$0.90</td>
<td>($1.00-$0.90)/$1.00 = 10%</td>
<td>111</td>
<td>$100</td>
<td>$10</td>
</tr>
<tr>
<td>Type B</td>
<td>$1.20</td>
<td>$1.14</td>
<td>($1.20-$1.14)/$1.20 = 5%</td>
<td>88</td>
<td>$100</td>
<td>$5</td>
</tr>
<tr>
<td>Type C</td>
<td>$1.00</td>
<td>$1.15</td>
<td>($1.00-$1.15)/$1.00 = -15%</td>
<td>87</td>
<td>$100</td>
<td>-$15</td>
</tr>
</tbody>
</table>

In this example, the DOC “zeroes” the “dumping margin” (i.e., the difference in percentage terms) calculated with respect to the Type C sub-group of softwood lumber and concludes that the weighted average dumping margin with respect to this producer is 5% (i.e., the total potential margin divided by total sales, or $15 divided by $300). Canada, supported by the EU and Japan, argued to the Appellate Body, however, that under the Anti-Dumping Agreement the negative 15% difference on Type C softwood lumber must be included in the calculation, which would yield a weighted average dumping margin of 0% (i.e., $15 plus “negative” $15 equals zero).9

**The Appellate Body Decision**

Arguments before the Appellate Body focused on Article 2.4.2 of the Anti-Dumping Agreement, which provides, in pertinent part, that “the existence of margins of dumping during the investigation phase shall normally be established on the basis of [(among other permissible methods)] a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions.”10

The U.S. supported its zeroing practice with several arguments before the Appellate Body, its main contentions being that:

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9 See id. at 10, 19, 21.
10 See id. at 25 (emphasis added). The Appellate Body’s decision is expressly limited to that comparison methodology, and does not apply to the other two methodologies described in Article 2.4.2. See id. at 28, 37.
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(i) Article 2.4.2 applies to the comparison of the weighted average normal value and export price of each sub-group of the product under investigation, and “all comparable export transactions” are included when such a comparison is made within each sub-group of product;

(ii) Article 2.4.2, and the Anti-Dumping Agreement as a whole, impose no requirement as to how the results of the comparisons made with respect to the sub-groups of the subject merchandise are aggregated into a single weighted average dumping margin applicable to a foreign producer;

(iii) even if Article 2.4.2 applied to such aggregation, it requires by its terms only that “margins of dumping” be included in the aggregation, and so-called “negative margins,” (i.e., transactions in a sub-group of merchandise that is not dumped) need not be included in the aggregation; and

(iv) to offset positive dumping margins with “negative margins” would be to compare non-comparable transactions, since transactions where dumping occurs are not “comparable” to transactions where no dumping occurs.11

The U.S. also argued that, even if the Appellate Body were to conclude that the DOC’s interpretation of Article 2.4.2 were not the most appropriate construction of that provision, the Appellate Body should apply Article 17.6(ii) of the Anti-Dumping Agreement, which states that when a provision of the Agreement is susceptible to more than one permissible interpretation, a Member (such as the U.S.) may act consistently with any such permissible interpretation.12

Essentially adopting positions advanced by Canada, by the EU and Japan as third party participants, and by a majority of the WTO dispute panel (which had ruled against the U.S. on this same issue in April 2004), the Appellate Body rejected the U.S. arguments.

Referring to the basic provisions of the Anti-Dumping Agreement, the Appellate Body concluded that the agreement requires the calculation of a single margin of dumping for the whole (i.e., all sub-groups combined) of each product under investigation.13 In this framework, all transactions involving the product are “comparable,” after appropriate adjustments are made, and must be included in all stages of the calculation. For this

11 See id. at 6-7.
12 See id. at 7.
13 See id. at 33.
reason, the Appellate Body rejected the distinction made by the U.S. between the
calculation of a “dumping margin” for each sub-group of the product, on the one hand
(which the U.S. contended was subject to Article 2.4.2), and the aggregation of all such
positive “dumping margins” into a single dumping margin for the product as a whole, on
the other (which the U.S. contended was not subject to Article 2.4.2).14 Thus, with respect
to the requirement in Article 2.4.2 that “all comparable export transactions” be included,
the Appellate Body concluded:

We fail to see how an investigating authority could properly establish margins of
dumping for the product under investigation as a whole without aggregating all of
the results of the multiple comparisons for all product types. There is no textual
basis under Article 2.4.2 that would justify taking into account the “results” of
only some multiple comparisons in the process of calculating margins of
dumping, while disregarding other “results.”15

The Appellate Body also concluded that Article 17.6(ii) of the Anti-Dumping Agreement
provided no support for the U.S., since there is no permissible interpretation of Article
2.4.2 with which the U.S. methodology would be consistent.16

In addition to its analysis of the text of the Anti-Dumping Agreement, the Appellate Body
found that the U.S. methodology, which excludes certain transactions from the calculation
of the dumping margin, is inconsistent with the framework for an anti-dumping
investigation as a whole.17 For example, in the hypothetical case described above, sales of
softwood lumber Type C would not be included in the calculation of the dumping margin
because, according to the U.S., they did not involve dumping. However, such sales would
be included in the investigation by the International Trade Commission (“ITC”) of whether
U.S. softwood lumber producers have suffered “material injury” due to imports of
softwood lumber from Canada. In fact, if sales of Type C softwood lumber at a unit price of
$1.15 had underpriced sales by U.S. producers, those sales would be a significant factor
(since they constitute one third of this Canadian producer’s sales) in the ITC analysis, even
though the DOC would exclude them from the calculation of the dumping margin. This
inconsistency, in which the Type C imports are excluded from the dumping margin
calculation by DOC but considered as dumped for purposes of determining whether U.S.

14 See id. at 34.
15 Id. (emphasis in original).
16 See id. at 39.
17 See id. at 36.
producers have suffered injury from dumped imports, appeared to play a significant supporting role in the Appellate Body’s analysis.

**Implications of the Appellate Body Decision**

The *U.S. – Softwood Lumber* case is not the first time the Appellate Body has considered the practice of zeroing. In 2001, the Appellate Body rejected virtually the same methodology which had been applied by the EU in an anti-dumping investigation of bed linen from India.\(^\text{18}\)

The position the DOC took in response to *EC – Bed Linen* is instructive in understanding the DOC’s likely position in response to *U.S. – Softwood Lumber*. In response to challenges from Japanese roller bearing producers following the *EC – Bed Linen* case, the DOC had successfully defended its zeroing methodology in the U.S. courts as a reasonable interpretation of the statutory definition of “dumping margin” as “the amount by which the normal value exceeds the export price,”\(^\text{19}\) since the zeroing methodology excludes instances where normal value is less than the export price. The DOC had also argued that since an Appellate Body decision is binding only on the country which is directly subject to it, the *EC – Bed Linen* decision was not binding on the U.S. The Court of Appeals for the Federal Circuit upheld the DOC on each of these points.\(^\text{20}\)

The *U.S. – Softwood Lumber* decision, however, is not only binding on the U.S., it specifically rejects the U.S. position that transactions where normal value is less than the export price can be excluded from the calculation of the overall dumping margin. In doing so, the Appellate Body pointed to the definition of “dumping” in the Anti-Dumping Agreement to conclude that dumping “can … be found to exist only for the product under investigation as a whole, and cannot be found to exist only for a type, model, or category of that product.”\(^\text{21}\) In other words, the Appellate Body has now explicitly ruled that the DOC’s interpretation in the softwood lumber case of the statutory definition of dumping is not reasonable, in light of the requirements of the Anti-Dumping Agreement.

The Appellate Body’s ruling does not apply to all dumping proceedings. First, it is limited by its terms to the use of zeroing when dumping margins are calculated on a weighted


\(^{20}\) See *Timken*, 354 F.3d at 1344.

\(^{21}\) *U.S. – Softwood Lumber* at 33.
average export price to weighted average normal value basis. The DOC commonly uses this method in anti-dumping duty investigations, but typically does not use it in the subsequent administrative reviews of existing anti-dumping duty orders, which are normally conducted on a transaction-to-transaction basis.\(^2\) Thus, the effect of the Appellate Body’s rejection of the DOC’s zeroing methodology, once implemented by DOC, will be most significant at the investigation stage (where no duty is imposed unless the DOC calculates a dumping margin greater than the “\textit{de minimis}” level of 2%). In a close case, therefore, zeroing can make the difference between a \textit{de minimis} margin and no duty, and the imposition of a dumping duty.

\textbf{Conclusion}

The U.S. is now required to bring the DOC’s calculation methodology into line with the Appellate Body’s decision. After initial negotiations between the U.S. and Canada reached an impasse, the WTO appointed an arbitrator who is expected to set, in early 2005, a deadline for the U.S. to comply with the Appellate Body’s decision.\(^2\) It is impossible to predict now what schedule the arbitrator may set.

If the DOC accepts the court’s conclusion in \textit{Timken} that its zeroing methodology is but one “reasonable interpretation” of the statute,\(^2\) the DOC could change its practices through an amendment to its regulations regarding the calculation of the dumping margin. On the other hand, if the DOC adheres to its litigation position that its zeroing methodology is required by the statute, it may be necessary for Congress to pass legislation in order to abolish zeroing. If recent experience is any guide, such a process is likely to take years and involve a number of additional trade-offs. In either case, it is possible that the DOC or Congress may settle on a different methodology which it decides would be consistent with the Anti-Dumping Agreement, while still preserving some of the aspects of zeroing which tend to increase the likelihood of finding higher dumping margins.

If the DOC eventually abandons the use of zeroing in anti-dumping investigations, U.S. companies deciding how to frame a petition for anti-dumping duties where a small margin is likely would face a difficult choice. If the U.S. petitioner frames the scope of the investigation too broadly, it faces the risk of too many transactions with a “negative

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\(^2\) In a transaction-to-transaction comparison, the export price for each U.S. sale is compared to a normal value deemed to be the most appropriate comparison for that sale, according to various procedures applied by the DOC.


\(^2\) See \textit{Timken}, 354 F.3d at 1344.
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dumping margin” – i.e., where the export price in the U.S. is higher than normal value. On the other hand, if the U.S. petitioner focuses the investigation on a more narrowly defined subset of the product that is likely to be sold at dumped prices, the narrower scope may lead the ITC to reject the imposition of a duty because the dumped sales have not caused material injury to the U.S. industry, or, if an anti-dumping duty is eventually imposed, its scope may be too narrow to achieve the petitioner’s goals.

For further information, please call your Fried Frank contact or one of the individuals listed below.

Washington, DC
Jay R. Kraemer 202.639.7060  jay.kraemer@friedfrank.com
Mark Fajfar 202.639.7333  mark.fajfar@friedfrank.com
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Fried, Frank, Harris, Shriver & Jacobson LLP

New York
One New York Plaza
New York, NY 10004
Tel: 212.859.8000
Fax: 212.859.4000

Washington, DC
1001 Pennsylvania Avenue, NW
Washington, DC 20004
Tel: 202.639.7000
Fax: 202.639.7003

Los Angeles
350 South Grand Avenue
Los Angeles, CA 90071
Tel: 213.473.2000
Fax: 213.473.2222

Fried, Frank, Harris, Shriver & Jacobson (London) LLP
99 City Road
London EC1Y 1AX, England
Tel: 44.20.7972.9600
Fax: 44.20.7972.9602

Website
www.friedfrank.com

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