MAYER | BROWN

April 15, 2019

Legal Update

WTO Panel Finds "Zeroing" Permitted to Unmask Targeted Dumping

On April 9, 2019, the Report of the World Trade Organization ("WTO") Panel ("Panel") in *United States – Anti-Dumping Measures Applying Differential Pricing Methodology to Softwood Lumber from Canada*[1] was published. This dispute concerned US anti-dumping measures applying the differential pricing methodology ("DPM") to softwood lumber products from Canada. The key issue in this dispute is whether Article 2.4.2 of the Anti-Dumping Agreement permits "zeroing" (i.e., no offset for non-dumped sales) in calculating dumping margins, when the DPM employs the weighted-average-to-transaction ("W-T") method to address "targeted dumping." Departing from the WTO Appellate Body's ("Appellate Body") previous decision, the Panel finds that Article 2.4.2 permits zeroing under the DPM to the extent that this methodology is limited to US sales raising targeted dumping concerns.

Background on the Dispute

Under US law, dumping occurs when "normal value," typically a foreign producer's home market prices, is higher than such producer's prices for the same or similar goods when sold to the United States (hereinafter referred to as "US price"). There are other ways to calculate normal value in certain circumstances (e.g., third-country sales prices, certain "cost plus" methodology), and numerous deductions and adjustments may be made to ensure an "apples-to-apples" comparison. However, the key principle for calculating dumping margins remains the same—a comparison between normal value and US price.

Article 2.4.2 of the Anti-Dumping Agreement addresses the specific methodology to be used when comparing normal value to export price (in this case, the US price). It provides:

first sentence

Subject to the provisions governing fair comparison in paragraph 4 [i.e. Article 2.4], the existence of margins of dumping during the investigation phase shall normally be established on the basis of a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions or by a comparison of normal value and export prices on a transaction-to-transaction basis.

A normal value established on a weighted average basis may be compared to prices of individual export transactions if the authorities find a pattern of export prices which differ significantly among different purchasers, regions or time periods, and if an explanation is provided as to why such differences cannot be taken into account appropriately by the use of a weighted average-to-weighted average or transaction-to-transaction comparison.[2]

second sentence

In summary, Article 2.4.2 sets out three different methods to determine the dumping margin of a foreign producer or exporter. The first sentence provides two methods to be used as default. The first is based on comparing averages: the weighted average normal value is compared with the weighted average export price (the "W-W" method). The second is based on comparing normal value and export prices both on a transaction-specific basis (the "T-T" method). The second sentence sets out the third method. Under this method, the weighted average normal value is compared to prices of individual export transactions (the W-T method). These three methods for the calculation of dumping margin are reflected in US law.[3]

The purpose of the second sentence of Article 2.4.2 is to address dumping targeted to certain purchasers, to certain regions and in certain time periods (collectively, "targeted dumping"). The theory is that the W-T method will be able to uncover targeted dumping behavior, which would otherwise be masked under the first two methods. The W-T method is used as an exception rather than the norm and only permitted when the conditions in the second sentence are met. These conditions are referred to as the "pattern clause" (a pattern of significant export price variations) and the "explanation clause" (an explanation as to why the first two methods would disguise targeted dumping). The United States applies the DPM to decide whether targeted dumping has occurred within the meaning of the second sentence of Article 2.4.2 and, if the answer is in the affirmative, the W-T method will be used to determine the dumping margin of the foreign producer or export.[4]

On November 28, 2017, Canada initiated the dispute to challenge the use of DPM by the United States Department of Commerce ("USDOC") to impose anti-dumping measures on Canadian softwood lumber products. The following aspects of the DPM were at issue:

1. The USDOC aggregated the export transactions to purchasers, regions *and* time periods to identify a single pattern of significant US price variations;
2. Both export transactions that were significantly higher priced and those which were significantly lower priced than other sales were included in the pattern; and
3. In calculating the dumping margin, individual transactions that were higher priced than the relevant weighted average normal value were "zeroed" (i.e., the comparison result was set to zero) when applying the W-T methodology.

Based on the 2016 WTO Appellate Body decision in *US – Washing Machines*, Canada argued that the first two aspects of the DPM were inconsistent with the "pattern clause" in the second sentence of Article 2.4.2 and the third aspect, "zeroing," was inconsistent with the second sentence of Article 2.4.2, as well as Article 2.4 of the Anti-Dumping Agreement.

The United States argued that *US – Washing Machines* was wrongly decided and asked the Panel to depart from the Appellate Body's decision.

Panel Findings

INTERPRETATION OF PATTERN CLAUSE

As a condition for the use of W-T methodology, the pattern clause in the second sentence of Article 2.4.2 requires the investigating authority to find a specific "pattern" of export price variations. The Panel holds that export prices must form "a regular and intelligible form or sequence discernable in certain actions or situations" in order to form "a pattern." In addition, export prices must "differ significantly" among different purchasers, regions or time periods to satisfy the pattern clause.[5]

Furthermore, the Panel finds that the use of the preposition "among" shows that an investigating authority may not compare prices between, say, purchasers and regions, because these two categories are not of the same type. Instead, the comparisons must be made within categories of the same type, i.e., comparing export prices between "different purchasers, or different regions, or different time periods."[6] As a result, the Panel decides that in general, comparison results could potentially indicate one or more patterns of targeted dumping (e.g., a pattern across different purchasers as well as a pattern across different regions). However, it is impermissible to establish a pattern, as the USDOC did in this case, by aggregating export price variations across all three categories to find a *single* pattern of export prices that differ significantly among different purchasers, regions *and* time periods. It finds the USDOC acted inconsistently with the second sentence of Article 2.4.2 on this issue.[7]

Next, the Panel discusses whether "a pattern" can include export prices to purchasers, regions or time periods that differ significantly because they are significantly *higher*. The Appellate Body in *US – Washing Machine* decided the issue in the negative. The Panel *disagrees* with that view. It reasons that targeted dumping is masked when significantly lower export prices are masked by significantly higher prices in other transactions of the same type. Therefore, an investigating authority ought to be able to use a methodology that deals with significantly higher-priced sales as well as significantly lower-priced ones. The Panel also holds that prices falling within a pattern need not differ in the same way, i.e., it need not comprise of only lower- or higher-priced export sales. It therefore finds that Canada has failed to establish inconsistency in this respect.[8]

WHETHER "ZEROING" IS PROHIBITED UNDER W-T METHODOLOGY

Turning to the "zeroing" issue, the Panel first acknowledges that "[t]he panels in *US – Washing Machines* and *US – Anti-Dumping Methodologies (China)* and the Appellate Body in *US – Washing Machines* [have] concluded that the second sentence of Article 2.4.2 does not permit the use of zeroing under the W-T methodology."[9] Nevertheless, the Panel eventually reaches the opposite conclusion through its own reasoning. The Panel reaffirms prior WTO panel and Appellate Body decisions that the application of the W-T methodology must be limited to "pattern transactions" (i.e., transactions showing targeted dumping).[10] However, it *disagrees* with the Appellate Body's findings in *US – Washing Machines* on the treatment of non-pattern transactions, when the dumping margin is determined pursuant to the second sentence of Article 2.4.2. The Appellate Body found in *US – Washing Machines* that non-pattern sales must be excluded from the margin calculation when the second sentence of Article 2.4.2 applies.[11] In contrast, the Panel interprets the second sentence differently, finding that the prices of all export transactions (including non-pattern sales) must be taken into account, in order to "properly assess the pricing behavior of a foreign producer or exporter" and accurately measure "the magnitude of

dumping."[12] In essence, the Panel finds that under the second sentence of Article 2.4.2, the dumping margin should be calculated using a mixed methodology whereby the W-T methodology is applied to pattern transactions and the W-W methodology is applied to non-pattern transactions.[13]

The Panel's own interpretation of the second sentence of Article 2.4.2 is significant. It is the premise for the Panel's acceptance of the US argument that if zeroing is prohibited in all cases, the dumping margin calculated using the mixed methodology will always be "mathematically equivalent" to applying the default W-W methodology to all export transactions, provided that the weighted average normal values used under the W-W and W-T methodologies are the same.[14] The Panel further reasons that this mathematical equivalence means that the W-T methodology would be unable to unmask targeted dumping, rendering the second sentence inutile. To avoid this result, the Panel finds that the second sentence of Article 2.4.2 does not prohibit zeroing under the W-T methodology provided that it is limited to pattern transactions.[15] Finally, the Panel finds that Canada has not established that the United States acted inconsistently with the "fair comparison" obligation of Article 2.4, because all of Canada's arguments depend on the position that the second sentence of Article 2.4.2 prohibits zeroing.[16]

Importance of the Findings

The Panel Report in *US – Differential Pricing Methodology* is important for two key reasons. First, it marks the first time that the United States has prevailed on the issue of "zeroing" in a long line of WTO cases challenging the practice under different methodologies and circumstances.[17] Second, the Panel itself acknowledges that its conclusions differed from those of the panel and the Appellate Body in *US – Washing Machines*, as well as the panel in *US – Anti-Dumping Methodologies (China)*. In its view, this is the result of its objective assessment of the facts, and the applicability of and conformity with, the relevant covered agreements. It notes that it has carefully considered these reports of the panels and the Appellate Body and found convincing or cogent reasons for its disagreement with the prior conclusions.[18] In commending the Panel Report, the United States reiterates its position that the Appellate Body has engaged in judicial overreach in its legal interpretations, effectively "legislating from the bench," and that Appellate Body reports should not be made *de facto* binding precedent on future panels.[19] The merits of the US concerns and the manner in which it has chosen to address them are subject to ongoing debate. Therefore, the Panel Report is relevant both to a highly contentious issue, i.e., whether "zeroing" is permitted under the Anti-Dumping Agreement (at least in some cases), as well as the closely watched debate over Appellate Body reform. It remains to be seen whether any future panel will again depart from Appellate Body findings that it finds erroneous or unpersuasive.

The Panel report may be appealed within 60 days by either of the parties.

For more information about the topics raised in this Legal Update, please reach out to the author, Duane W. Layton or Jing Zhang, or a regional contact:

EUROPE CONTACTS

Paulette Vander Schueren
+32 2 551 5950
pvanderschueren@mayerbrown.com

Nikolay Mizulin
+32 2 551 5967
nmizulin@mayerbrown.com

US CONTACTS

Duane W. Layton
+1 202 263 3811
dlayton@mayerbrown.com

Jing Zhang
+1 202 263 3385
jzhang@mayerbrown.com

BRAZIL CONTACT

Eduardo Molan Gaban
+55 11 2504 4639
egaban@mayerbrown.com

Endnotes

[1] Panel Report, *United States – Anti-Dumping Measures Applying Differential Pricing Methodology to Softwood Lumber from Canada*, WT/DS534/R, circulated April 9, 2019 (the "Panel Report" or "*US – Differential Pricing Methodology*").
[2] Article 2.4.2, Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the "Anti-Dumping Agreement").
[3] *See* 19 CFR § 351.414.
[4] Panel Report, para. 7.22-7.29.
[5] Panel Report, para. 7.39.
[6] Panel Report, para. 7.43.
[7] Panel Report, paras. 7.44-7.49.
[8] Panel Report, paras. 7.57-7.66.
[9] Panel Report, para. 7.68.
[10] Panel Report, para. 7.84.
[11] Panel Report, para. 7.91.
[12] Panel Report, para. 7.90.
[13] Panel Report, para. 7.99.
[14] Panel Report, para. 7.100.
[15] Panel Report, para. 7.106.
[16] Panel Report, para. 7.111.
[17] *See, e.g.*, Appellate Body Report, *United States – Certain methodologies and Their Application to Anti-Dumping Proceedings Involving China*, WT/DS471/AB/R and Add.1, adopted 22 May 2017; Appellate Body Report, *United States – Anti-Dumping and Countervailing Measures on Large Residential Washers from Korea*, WT/DS464/AB/R and Add.1, adopted 26 September 2016; Appellate Body Report, *United States – Laws, Regulations and Methodology for Calculating Dumping Margins ("Zeroing")*, WT/DS294/AB/R, adopted 9 May 2006.
[18] Panel Report, para. 7.107.
[19] Press Release, Office of the US Trade Representative, *United States Prevails on "Zeroing" Again: WTO Panel Rejects Flawed Appellate Body Findings* (Apr. 9, 2019), available at https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/april/united-states-prevails-%E2%80%9Czeroing%E2%80%9D.