



UNC  
SCHOOL OF LAW

NORTH CAROLINA JOURNAL OF  
INTERNATIONAL LAW AND  
COMMERCIAL REGULATION

---

Volume 10 | Number 2

Article 10

---

Spring 1985

# Michelin Tire Corp. v. United States: Fine Tuning the Valuation Process in Countervailing Duty Assessments

David A. Spuria

Follow this and additional works at: <http://scholarship.law.unc.edu/ncilj>



Part of the [Commercial Law Commons](#), and the [International Law Commons](#)

---

## Recommended Citation

David A. Spuria, *Michelin Tire Corp. v. United States: Fine Tuning the Valuation Process in Countervailing Duty Assessments*, 10 N.C. J. INT'L L. & COM. REG. 499 (1985).

Available at: <http://scholarship.law.unc.edu/ncilj/vol10/iss2/10>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Journal of International Law and Commercial Regulation by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

# *Michelin Tire Corp. v. United States: Fine Tuning the Valuation Process in Countervailing Duty Assessments*

## I. Introduction

Countervailing duties<sup>1</sup> (CVD) are imposed on foreign subsidized<sup>2</sup> goods that enter the United States and cause material injury to a United States industry.<sup>3</sup> The purpose of a CVD is to offset the unfair competitive advantage accorded foreign producers that have received foreign government subsidies or incentives.

In every CVD proceeding, it must be determined whether the government funding in question is a countervailable subsidy, and if so, how it should be measured for purposes of imposing a duty. In many cases, the measurement of a subsidy is more problematic than the substantive determination of countervailability.<sup>4</sup> The three-part

---

<sup>1</sup> The term "countervailing duty" is defined as "a special duty levied for the purpose of off-setting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise . . . ." Agreement on Interpretation and Application of Articles VI, XVI, XXIII of the General Agreement on Tariffs and Trade, done April 12, 1979, art. 1, n.4, 31 U.S.T. 513, 530 T.I.A.S. No. 9619, reprinted in H.R. Doc. 153, 96th Cong., 1st Sess., pt. 1 (1979) [hereinafter GATT Subsidies Code].

<sup>2</sup> The term "subsidy" is used interchangeably with "bounty or grant" and includes, but is not limited to:

- (i) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations.
- (ii) The provision of goods or services at preferential rates.
- (iii) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry.
- (iv) The assumption of any costs or expenses of manufacture, production, or distribution.

19 U.S.C. § 1677(5) (1982).

<sup>3</sup> "Material injury" is defined as "harm which is not inconsequential, immaterial, or unimportant." 19 U.S.C. § 1677(7)(A) (1982). "Industry" is defined as "the domestic producers as a whole of a like product, or those producers whose collective output of the like product constitutes a major proportion of the total domestic production of that product." 19 U.S.C. § 1677(4). Under U.S. law, the Commerce Department is authorized to impose countervailing duties on imported merchandise through its own initiative or upon petition by interested parties. If the Commerce Department is persuaded by evidence that a bounty or grant exists, an order to countervail will issue. See generally The Trade Agreements Act of 1979, *infra* note 25; Murphy, *Antidumping and Countervailing Duty Under the Trade Agreements Act of 1979: A Preliminary Analysis*, 14 INT'L LAW. 203 (1980).

<sup>4</sup> For a discussion of the issue of countervailability in the *Michelin* case, see Recent Decisions, *The Michelin Decision: A Possible New Direction for U.S. Countervailing Duty Law*, 6 LAW & POL'Y INT'L BUS. 237 (1974). On countervailability in the recent steel cases, see Barshefsky, Mattice, & Martin, *Government Equity Participation in State-Owned Enterprises: An Analysis of the Carbon Steel Countervailing Duty Cases*, 14 LAW & POL'Y INT'L BUS. 1101 (1983).

judicial review of *Michelin Tire Corp. v. United States*<sup>5</sup> illustrates the problematic nature of many subsidy valuations.

In *Michelin* the Court of International Trade (CIT) rejected several traditional, convenient, Commerce Department<sup>6</sup> valuation techniques in favor of more precise, technical methods of measuring the benefit conferred on the recipient of a subsidy. The court's techniques will sharply increase future CVD assessments, and their underlying analyses will provide much needed guidance in resolving the thorny valuation issue.

## II. Facts and Holdings in *Michelin*

In 1967 Industrial Estates Limited (IEL), an industrial development agency charged with promoting economic development in Nova Scotia, Canada, invited Michelin Tire Corporation<sup>7</sup> to establish manufacturing facilities in the Province. When Michelin decided to establish a steel cord factory and a tire factory in Nova Scotia, various levels of the Canadian Government furnished cash payments, tax credits, and low interest rate loans to Michelin to facilitate the establishment and expansion of the plants in two economically depressed municipalities.<sup>8</sup>

The Canadian Government granted Michelin \$16 million and permitted the company to change its method of recording depreciation on machinery and buildings to a more favorable method for both tax and accounting purposes.<sup>9</sup> At the provincial level, the company received a \$50 million loan at an interest rate of six percent and grants worth \$7.6 million.<sup>10</sup> Locally, Michelin was accorded a reduced property tax on its plant sites.<sup>11</sup>

Exports from the Nova Scotia plants to the United States began

---

For a discussion of the countervailability of the New York subway cars from Canada, see Note, *Railcars from Canada: A Misapplication of the Countervailing Duty Law*, 7 FORDHAM INT'L L.J. 287 (1984).

<sup>5</sup> *Michelin X-Radial Steel Belted Tires from Canada*, 46 Fed. Reg. 48,737 (1981), *aff'd in part, rev'd in part*, *Michelin v. United States*, 2 Ct. Int'l Trade 143 (1981), *reviewed by Michelin Tire Corp v. United States*, 4 Ct. Int'l Trade 252 (1982), *reviewed by Michelin Tire Corp. v. United States*, No. 83-136, slip. op. (Ct. Int'l Trade Dec. 22, 1983).

<sup>6</sup> See *infra* note 16.

<sup>7</sup> Plaintiff and Michelin Canada are subsidiaries of Michelin Investment Holding Company Limited which is a Bermuda corporation that is part of the Michelin group under *Companie Generale des Etablissements Michelin*, the group's corporate parent, headquartered in Clermont-Ferrand, France.

<sup>8</sup> The tire plant was established in Granton and the cord plant in the town of Bridgewater, which donated a plant site to Michelin valued at \$10,000. Recent Decisions, *supra* note 4, at 238-39.

<sup>9</sup> *Id.* at 239. The purpose of the incentives was to provide for the development of economically depressed areas of Canada. *Id.* at n.8.

<sup>10</sup> *Michelin*, 2 Ct. Int'l Trade at 149. The loan took the form of mortgage bonds issued by Michelin and proceeds were used for construction of facilities between 1970-72. *Id.*

<sup>11</sup> *Id.*

in late 1971, and it became obvious that Michelin had established a base from which to penetrate the U.S. market.<sup>12</sup> By 1972, exports from the Canadian plants totaled approximately nine million dollars.<sup>13</sup> Michelin stated that ultimately, the company would deliver seventy-five percent of its Canadian production to the United States.<sup>14</sup>

In 1972 the U.S. Rubber Manufacturers Association<sup>15</sup> filed a CVD complaint with the Treasury Department,<sup>16</sup> questioning whether the incentives afforded Michelin constituted a "bounty or grant" within the meaning of section 303 of the Tariff Act of 1930.<sup>17</sup> The Treasury Department investigated and concluded that the incentives did constitute a "bounty or grant," and countervailing duties were imposed on tires entering the United States after February 7, 1973.<sup>18</sup>

After Michelin's protest of the administrative determination was denied, the company commenced an action in the CIT.<sup>19</sup> The court upheld the administrative finding of a subsidy, but rejected the method chosen to allocate the loan in calculating the duty.<sup>20</sup> The court remanded the issue of loan value to the Secretary of Commerce for redetermination.<sup>21</sup>

When the International Trade Administration of the Commerce Department<sup>22</sup> reported its redetermination to the CIT, the court, in its second review, disapproved of the method used in analyzing the

---

<sup>12</sup> Financial Post, Dec. 19, 1970, at 13, col. 4.

<sup>13</sup> N.Y. Times, Jan. 6, 1973, at 39, col. 5.

<sup>14</sup> Recent Decisions, *supra* note 4, at 239.

<sup>15</sup> The U.S. Rubber Manufacturers Association, an interested party, is a trade association for U.S. tire producers. The Association initially concealed the fact that it was the moving force behind the complaint, but later joined the litigation in an *amicus curiae* brief. *Michelin*, 2 Ct. Int'l Trade at 146.

<sup>16</sup> The Tariff Act of 1930, ch. 497, § 303, 46 Stat. 590, as amended by the Trade Act of 1974, Pub. L. No. 93-618, § 331, 88 Stat. 1978 and the Trade Agreements Act of 1979, Pub. L. No. 96-39, 93 Stat. 144, reprinted in 1979 U.S. CODE CONG. & AD. NEWS 144 (codified as amended in scattered sections of 19 U.S.C. (1982)) [hereinafter the Tariff Act], originally defined the administering agent to be the Secretary of the Treasury, or any other officer of the United States to whom the responsibilities are transferred by law. The Secretary of Commerce [hereinafter Commerce Department] assumed the functions of the Secretary of the Treasury involving 19 U.S.C. § 1303 under Reorg. Plan No. 3 of 1979, § 5(a)(1)(c), 44 Fed. Reg. 69,275, 93 Stat. 1381 (effective Jan. 2, 1980), as provided by § 1-107(a) of Exec. Order No. 12,188, Jan. 2, 1980, 45 Fed. Reg. 993.

<sup>17</sup> Generally, § 303 of the Tariff Act levies a duty upon any foreign manufacturer or producer that received, directly or indirectly, a bounty or grant on goods imported into the United States. 19 U.S.C. § 1303 (1982).

<sup>18</sup> T.D. 73-10, 1973-7 C.B. 11; *Michelin X-Radial Steel Belted Tires from Canada*, 38 Fed. Reg. 1018 (1973).

<sup>19</sup> *Michelin*, 2 Ct. Int'l Trade 143.

<sup>20</sup> *Id.* at 168.

<sup>21</sup> See *supra* note 16.

<sup>22</sup> The International Trade Administration (ITA) is the agency of the Commerce Department charged with administering CVD law. For purposes of this article, reference to the Commerce Department includes the ITA.

financial benefit of the federal grant.<sup>23</sup> The court remanded again, suggesting that the Department implement a valuation method that considers the time-value of money.

In its most recent opinion, the CIT disagreed with the Department's method of valuing money over time, including the discount rate used in the calculation.<sup>24</sup> The court sent the valuation issue back to the administrative level, recommending its own formula and discount rate for measuring the time-value of money.

### III. Legislative and Judicial Guidance in Valuing Subsidies

In response to pleas by domestic industries for protection against unfair foreign competition, Congress enacted the Trade Agreements Act of 1979.<sup>25</sup> The Trade Agreements Act and its legislative history provide meager guidance in valuing subsidies for purposes of imposing duties. While the Act established certain rules governing the calculation of the net subsidy,<sup>26</sup> there is little guidance for calculating the gross subsidy. A report on the Trade Agreements Act by the Senate Committee on Finance states that gross subsidy is the "value of the subsidy provided, or made available, and used."<sup>27</sup> In defining "value of the subsidy," the Report merely states that the measure of a subsidy is its "commercial and competitive benefit" to the recipient.<sup>28</sup> In its review of the Trade Agreements Act, the House Committee on Ways and Means indicated that "reasonable methods of allocating the value of . . . subsidies" may be used.<sup>29</sup> The House Report does not indicate what the "value of subsidies" is or should be.

International CVD law is even less helpful. The GATT Subsidies Code,<sup>30</sup> which is implemented by the Trade Act, provides that signatories to GATT should develop and set forth "the criteria for the calculation of the amount of the subsidy."<sup>31</sup> The signatories, however, have not yet agreed upon the rules governing the calculation of subsidies.<sup>32</sup>

Given this background, it seems the Commerce Department has wide latitude in valuing subsidies for the purpose of assessing duties.

---

<sup>23</sup> *Michelin*, 4 Ct. Int'l Trade at 254.

<sup>24</sup> *Michelin*, No. 83-136, slip. op. at 3.

<sup>25</sup> Pub. L. No. 96-39, 93 Stat. 144 (1979) (codified in scattered sections of 19 U.S.C.).  
*See also supra* note 3.

<sup>26</sup> A net subsidy is derived from subtracting from a gross subsidy, any payments made to qualify for the subsidy, any loss resulting from deferred receipt of the subsidy, and any other charges intended to offset the subsidy received. 19 U.S.C. § 1677(6) (1982).

<sup>27</sup> S. REP. NO. 249, 96th Cong., 1st Sess. 85-86 (1979).

<sup>28</sup> *Id.*

<sup>29</sup> H.R. REP. NO. 317, 96th Cong., 1st Sess. 75 (1979).

<sup>30</sup> GATT Subsidies Code, *supra* note 1.

<sup>31</sup> GATT Subsidies Code, *supra* note 1, art. 4, para. 2, n.2.

<sup>32</sup> Cold-Rolled Carbon Steel Flat-Rolled Products from Argentina, 49 Fed. Reg. 18,006, 18,016 (1984).

Indeed, the Senate Report merely directs that the Department use "reasonable methods" of allocating the value of subsidies.<sup>33</sup> The House Report also suggests the same reasonableness standard.<sup>34</sup>

The judiciary has underscored the Department's freedom and the requirement of reasonableness in interpreting and administering CVD law. In *United States v. Zenith Radio Corp.*<sup>35</sup> the Supreme Court, quoting *Unemployment Compensation Commission v. Aragon*,<sup>36</sup> acknowledged that great deference is given to the interpretation of a statute by the agency charged with its administration. In reviewing an administrative interpretation of a statute, the Court considers only whether, in light of normal aids of statutory construction, the agency's interpretation is "sufficiently reasonable."<sup>37</sup> Moreover, the Court need not find that the construction is the only reasonable one to sustain the agency's application of the statute.<sup>38</sup>

The Commerce Department recognizes that there are alternative methods of calculating the gross value of a particular subsidy.<sup>39</sup> As the principal agency for administering CVD law, the Department has developed methods for valuing various types of subsidies that, in the Department's opinion, best achieve the purpose of CVD law.<sup>40</sup>

#### A. Valuing Direct Grants

The concepts of "benefit to the recipient" and "reasonableness" have long been recognized by administrative agencies in calculating the value of all types of subsidies.<sup>41</sup> For example, the Commerce Department has valued preferential rate loans at the difference between the actual rate paid and the commercial rate that would have been available to the recipient.<sup>42</sup>

---

<sup>33</sup> See S. REP., *supra* note 27, at 86.

<sup>34</sup> See *supra* note 29 and accompanying text. See also H.R. Doc. No. 153, 96th Cong., 1st Sess. 433 (1979).

<sup>35</sup> 437 U.S. 443 (1978). *Zenith* involved the practice of the Japanese Government of waiving commodity taxes on products exported from Japan while taxes were imposed on products that remained in Japan. The Court upheld the Treasury Department's determination that such a practice did not constitute a bounty under § 303 of the Tariff Act, and thus, was not countervailable.

<sup>36</sup> 329 U.S. 143, 153 (1946).

<sup>37</sup> *Zenith*, 437 U.S. at 450.

<sup>38</sup> *Id.*

<sup>39</sup> Cold-Rolled Carbon Steel Flat-Rolled Products from Argentina, 49 Fed. Reg. 18,006, 18,016 (1984).

<sup>40</sup> Subsidies most frequently take the form of grants, loans, loan guarantees, and equity infusion, but may also include tax concessions, environmental programs, disaster relief assistance, research and development assistance, exchange rate benefits, labor subsidies, and forgiveness of debt. For the purpose of this article, only grants, the subsidy at issue in *Michelin*, will be examined. For the valuation of loans, see *infra* note 42 and accompanying text. For discussions on valuing all types of subsidies, see J. PATTON, ANTI-DUMPING AND COUNTERVAILING DUTY LAWS, § 6.02 (Int'l Bus. & Law 3, 1984); Cold-Rolled Carbon Steel Flat-Rolled Steel Products from Argentina, 49 Fed. Reg. at 18,016.

<sup>41</sup> See *supra* note 28 and accompanying text.

<sup>42</sup> Certain Steel Products from Belgium, 47 Fed. Reg. 26,300, 26,308 (1982). See, e.g.,

In most cases, the value of a direct cash grant is simply the amount received. As the Commerce Department described it in the 1984 steel cases, the value of a grant is the "difference between what the company paid for the funds (nothing), and what it would have to pay on the market to receive the funds (the face value of the grant)."<sup>43</sup> This is consistent with the "benefit to the recipient" standard expressed in the legislative history of the Trade Act.<sup>44</sup>

### B. Allocating Benefits over Time

The most complex valuation issues arise when benefits are allocated over the life of an asset or the period of a loan. Prior to the 1982 steel cases, the Commerce Department allocated the face value of subsidies on a straight line basis over the appropriate time period.<sup>45</sup> For example, a loan of ten million dollars payable in ten years would be countervailed at one million dollars per year for ten years.

Determining the appropriate time period over which to allocate benefits proved confusing, however, in light of what the Commerce Department regarded as a legislative mandate to "front load" the benefits. In a 1979 Senate Report<sup>46</sup> on the Trade Agreements Act, Congress gave this example:

For example, allocating a subsidy in equal increments over the anticipated 20-year useful life of capital equipment purchased with the aid of the subsidy would not be reasonable if the capital equipment gave the recipient of the subsidy an immediate significant competi-

---

Polypropylene Film from Mexico, 48 Fed. Reg. 14,421 (1983); Pig Iron from Brazil, 44 Fed. Reg. 67,554 (1979). In *Certain Steel Products from Belgium*, 47 Fed. Reg. 39,304, 39,317-18 (1982) (final determination), the Commerce Department set forth its methodology for ascertaining the commercial interest rate that would have been available to the recipient. The Commerce Department typically constructs a comparable commercial loan at the appropriate market rate (the benchmark) reflecting standard commercial terms. If a comparable commercial loan cannot be constructed, the Department uses a national average commercial interest rate.

Numerous problems arise under such a methodology. For example, differences of opinion may exist regarding "comparable commercial loan" and "national average commercial interest rate." Furthermore, disputes have arisen over the use of a benchmark rate when a history of loan activity for a specific recipient is available. *See, e.g., Pigmentos Y Oxidos v. United States*, 47 Fed. Reg. 54,847 (1983), where a Mexican producer of lead products subject to countervailing duties challenged the use of benchmark rates. Additionally, loans denominated in a currency other than the recipient's present valuation problems. The valuation of preferential rate loans to an uncreditworthy producer poses yet additional considerations. *See generally* J. PATTON, *supra* note 40, § 6.02[3].

<sup>43</sup> *Carbon Steel Products from Mexico*, 49 Fed. Reg. 5142, 5148 (1984).

<sup>44</sup> *See supra* note 28.

<sup>45</sup> *See, e.g., Carbon Steel Products from Brazil*, 47 Fed. Reg. 39,394 (1982); *Steel Products from the United Kingdom*, 47 Fed. Reg. 39,384 (1982); *Carbon Steel Structural Shapes from Luxembourg*, 47 Fed. Reg. 39,364 (1982); *Steel Products from France*, 47 Fed. Reg. 39,332 (1982); *Steel Products from Italy*, 47 Fed. Reg. 39,356 (1982); *Steel Products from the Netherlands*, 47 Fed. Reg. 39,372 (1982). *See also supra* note 42 and accompanying text. When the steel cases were initiated, the second judicial review of *Michelin* was pending.

<sup>46</sup> *See supra* note 27 and accompanying text.

tive benefit compared to what would be the situation without the capital equipment and compared to the competitive benefit the equipment would likely provide in the later stages of its useful life.<sup>47</sup>

Thus, the Department allocated the face value of grants over one-half the useful life of the asset purchased with the grant. It justified this compressed allocation of grants as being in conformity with a "congressional intent to front load the benefit of grants which aid an enterprise in acquiring capital plant and equipment."<sup>48</sup> The Department reasoned that the inherent nature of such grants was to bestow disproportionate benefits in the earlier years when start-up costs are higher, and assets are more productive, efficient, and require less maintenance.<sup>49</sup>

The 1982 steel cases also alerted the Commerce Department to the fact that allocating subsidies on a straight-line basis ignored the fact that money changes value as it moves through time.<sup>50</sup> The Department adopted the "present value of annuity method"<sup>51</sup> and began considering the time-value of money when allocating subsidies over time.<sup>52</sup> The Department explained this procedure when applied to a loan:

[W]e determine the subsidy value of a preferential loan as if the benefits had been bestowed as a lump-sum grant in the year the loan was given. We determine how much less valuable money is today by applying a discount rate . . . . This amount is then allocated evenly over the life of the loan [or the asset acquired].<sup>53</sup>

Present value computations traditionally have been based on a

<sup>47</sup> *Id.* at 86.

<sup>48</sup> *Michelin*, 4 Ct. Int'l Trade at 253.

<sup>49</sup> *Id.* The Commerce Department allocates some small grants over one year regardless of whether a benefit is conferred over time. *Certain Steel Products from Belgium*, 47 Fed. Reg. 26,300, 26,307 (1982).

<sup>50</sup> *Id.*

<sup>51</sup> This technique can be expressed in the formula:

$$PV = x \left[ \frac{1}{(1+r)^0} + \frac{1}{(1+r)^1} + \frac{1}{(1+r)^2} + \dots + \frac{1}{(1+r)^{n-1}} \right]$$

where PV = the grant amount in the year of receipt;  $x$  = the unknown amount of the annual payment;  $r$  = discount rate;  $n$  = number of total years. When applied to a hypothetical \$10,000 grant over ten years, assuming the discount rate is 10%, the amount to be countervailed every year would be \$1,480:

$$(i) 10,000 = \frac{x}{1.1^0} + \frac{x}{1.1^1} + \frac{x}{1.1^2} + \dots + \frac{x}{1.1^9}$$

$$(ii) 10,000 = x/1 + x/1.1 + x/1.21 + x/1.31 + \dots + x/2.36$$

$$(iii) 10,000 = x + .91x + .83x + .75x + \dots + .424x$$

$$(iv) 10,000 = 676x$$

$$(v) 1,480 = x$$

Total amount to be countervailed is \$14,800.

<sup>52</sup> The Commerce Department contends that front loading is still achieved through such allocations. As long as the subsidy is allocated in equal increments over its useful life, it is front loaded because money today is worth more than money tomorrow. *Certain Steel Products from Belgium*, 47 Fed. Reg. 39,304, 39,317 (1982) (final determination).

<sup>53</sup> *Id.* at 39,318.

discount rate represented by the secondary market rate for long-term government debt in the foreign country.<sup>54</sup> Justifying the use of a risk-free bond rate, the Department explained:

When we allocate a subsidy over a number of years, it is not the intention of the Department to comment on nor to judge the riskiness of the project undertaken with the subsidized funds nor to evaluate the riskiness of the company as a whole. Nor do we intend to speculate how a project would have been financed absent government involvement in the provision of funds. Rather, we simply need a financial mechanism to move money through time so as to accurately reflect the benefit the company receives.<sup>55</sup>

Finally, in allocating a subsidy over time, the Department has interpreted both domestic law<sup>56</sup> and international law<sup>57</sup> as imposing a limit on the total amount countervailable. The Trade Act speaks of a duty "equal" to the net amount of the subsidy.<sup>58</sup> Likewise, the GATT Subsidies Code seems to prohibit a signatory from imposing a CVD in excess of the amount of the subsidy found to exist.<sup>59</sup> Thus, a subsidy "cap" provides an upper limit on the total value of the subsidy in calculating the CVD.

#### IV. Analysis of the *Michelin* Decisions

The *Michelin* decisions departed from traditional valuation principles in three major respects.<sup>60</sup> First, the court rejected the Commerce Department's arbitrary half-life approach in favor of allocating grants over the full useful life of the assets acquired. Second, the court disapproved of the Department's use of the annuity method in measuring the value of money over time. Finally, the court called for the use of a more realistic discount rate than the risk-free bond rate that the Department had been using.

##### A. Allocating Grants over Time

The original cash grants accorded *Michelin* were tied to the re-

---

<sup>54</sup> *Id.* at 39,316.

<sup>55</sup> *Id.* at 39,317.

<sup>56</sup> See *supra* note 25 and accompanying text.

<sup>57</sup> See *supra* note 30 and accompanying text.

<sup>58</sup> 19 U.S.C. § 1671(a) (1982).

<sup>59</sup> GATT Subsidies Code, *supra* note 1, art. 4, para. 2.

<sup>60</sup> The court also rejected several minor refinements in valuation offered by the plaintiff to reduce the final duty assessment. Most significantly, the plaintiff urged the court to consider tax savings in the valuation process. The plaintiff contended that the tax deductibility of interest expense would reduce the cost of alternative financing; thus, the benefit of the subsidy should be reduced accordingly. Noting that the plaintiff paid no taxes during the period involved in this case, the court rejected the plaintiff's contention. The court's primary reason was that "secondary effects" should not be considered in such calculations. *Michelin*, No. 83-136, slip op. at 14-15. Yet, it is difficult to distinguish tax implications from the consideration of the time-value of money, which is arguably a "secondary effect" also. Tax consequences are no less ascertainable than a theoretical interest rate that a company may have obtained with alternative financing.

payment of the fifty million dollar loan during the construction of the tire facilities. In 1972 when the facilities were completed, a new loan was negotiated, freeing Michelin from applying the original cash grant to the repayment of the original loan. Thus, the justification for allocating the original grants over the life of the loan no longer existed. In its first review of *Michelin*, the CIT directed that the grants no longer should be linked to the repayment of the loan; rather, the grants should be allocated over the life of the assets acquired—the plant and equipment.<sup>61</sup>

While the court acknowledged that, as a general rule, allocation of grants should take place over the full life of the assets they purchase, it cautioned that the principle is not automatically applied. Because of the possibility that subsidies may have a disproportionately beneficial effect in the earlier years, the court encouraged the Department to consider if the facts in *Michelin* justified shortening the useful life of the assets purchased by the grants.<sup>62</sup>

In its redetermination, the Department concluded that the law required that the grants be allocated over one-half the useful life of the assets acquired.<sup>63</sup> In its second review, the court found that the half-life approach was “arbitrary and not in accordance with the law.”<sup>64</sup> The court had expected the Department to make a factual determination as to whether plaintiff had actually experienced greater benefits in the asset’s early years. Instead the Department arbitrarily applied a “procrustean” half-life approach that was not supported by the facts or the law.<sup>65</sup>

The Senate Report on the Trade Act<sup>66</sup> merely expresses concern that benefits *might* be experienced disproportionately in the early years of an asset’s life. A mandate for the automatic compression or distortion of an asset’s life simply does not exist.<sup>67</sup>

Compression of an asset’s useful life, or front loading, results in a higher annual tariff paid over a shorter period of time. If an asset is in fact more valuable in its early years, a higher tariff in the earlier years is justified to reflect this. If an asset is not more productive earlier, the Department’s arbitrary half-life approach will exact a tax that exceeds the benefit derived from the subsidy. This may result

---

<sup>61</sup> *Michelin*, 2 Ct. Int’l Trade at 168.

<sup>62</sup> Other considerations also existed for the court’s desire to compress the asset lives, thus increasing the yearly duty while shortening the number of years required to pay. For example, Michelin had not disclosed the fact that the grants were no longer tied to the repayment of the \$50 million loan until the court’s second hearing of the case which prevented the Commerce Department from investigating other periods of allocation. *Id.*

<sup>63</sup> *Michelin*, 4 Ct. Int’l Trade at 253. See also notes 46-49 and accompanying text.

<sup>64</sup> *Id.* at 254.

<sup>65</sup> *Id.*

<sup>66</sup> See *supra* note 27 and accompanying text.

<sup>67</sup> The court approved the measurement of the lives of the buildings and equipment to be 40 and 20 years respectively pursuant to IRS depreciation tables.

even when an asset is more valuable earlier, but not twice as valuable as the half-life approach presumes. Overvaluing a benefit clearly violates the well-recognized "benefit to the recipient" standard of measuring subsidies.<sup>68</sup>

*B. Recognition of the Time-Value of Money*

*1. Generally*

In its second decision, the *Michelin* court, struggling with the inequities of the straight-line method of allocating subsidies, recommended the recognition of the time-value of money in valuing grants.<sup>69</sup> The court remanded to the administrative level the determination of the particular method to be used in the case.

Regardless of the particular method chosen to reflect the time-value of money, its consideration always will result in a higher valuation than if a subsidy is valued without considering the time-value of money.<sup>70</sup> The value of the grants in *Michelin*, which did not reflect the time-value of money, would increase when the time-value of money is considered. Thus, the corresponding tariff, which is based on the value of the grant, also would increase.

By its nature, the consideration of the time-value of money is a valuation refinement that will result in higher CVD determinations in the future. Also by its nature, consideration of the time-value of money is a refinement that results in valuing a grant in excess of its face value, which according to the Commerce Department, violates CVD law.<sup>71</sup> The *Michelin* court, however, did not read the law to limit the valuation of a subsidy to its face amount. On the contrary, the court reasoned that the law foresees a process of measurement, and providing for the time-value of money is "in harmony with the law."<sup>72</sup>

In valuing subsidies, the Commerce Department is concerned primarily with using reasonable valuation methods in measuring the benefit of the subsidy to its recipient.<sup>73</sup> In keeping with these legislative directives, the consideration of the time-value of money is a reasonable, generally accepted principle of financial analysis that more accurately measures the benefit of a subsidy to its recipient.<sup>74</sup>

---

<sup>68</sup> See *supra* notes 27 & 46 and accompanying text.

<sup>69</sup> *Michelin*, 4 Ct. Int'l Trade at 255-56. This alternative was suggested in the amicus curiae brief filed by the U.S. Rubber Manufacturers Association.

<sup>70</sup> This presumes that a positive discount rate is used in the time-value of money calculation.

<sup>71</sup> See *supra* notes 56-59 and accompanying text.

<sup>72</sup> *Michelin*, No. 83-136, slip op. at 15-16.

<sup>73</sup> See *supra* notes 26-28 and accompanying text.

<sup>74</sup> *Michelin*, No. 83-136, slip op. at 16.

## 2. *Present Value of an Annuity*

In its latest *Michelin* determination, the Department specifically endorsed the annuity method of measuring the time-value of money.<sup>75</sup> The CIT, in its third and final *Michelin* review, found the use of the annuity method inappropriate for valuing subsidies.<sup>76</sup> Use of the annuity method, as with any method of measuring the time-value of money, would have resulted in a higher valuation of the *Michelin* grants.<sup>77</sup>

Although the annuity method may be reasonable and represents generally accepted principles of financial analysis, its equal installments do not accurately express the benefit received in each year in the same manner in which an enterprise's commercial alternatives would be expressed. As the court noted, it merely equalizes amounts that should be different in each year to reflect a decline in principal.<sup>78</sup> In this respect, the annuity method is inconsistent with the "benefit to the recipient" standard.

The annuity method is most commonly used in calculating standard home mortgage repayment schedules. The technique is easy to understand and apply, and it provides convenient, constant periodic payments for the mortgagor. In a CVD proceeding, however, the Commerce Department should not be concerned with a particular formula's convenience and ease of application in valuing a subsidy. CVD law focuses on the effects of subsidies on beneficiaries. The actual benefit of a grant to its recipient cannot be ignored for the sake of administrative convenience.<sup>79</sup>

## 3. *The Court's Declining-Balance Formula*

In its third and final review, the *Michelin* court recommended its own formula for measuring the time-value of money.<sup>80</sup> Under the formula, the principal amount of the grant is allocated on a straight-line basis over the life of the asset acquired by the grant. Interest expense is then added to that amount, based on the alternative commercial rate that the recipient would have paid on the remaining balance of the principal.<sup>81</sup> This declining-balance method not only

<sup>75</sup> See *supra* notes 50-53 and accompanying text.

<sup>76</sup> *Michelin*, No. 83-136, slip op. at 8.

<sup>77</sup> See *supra* note 69 and accompanying text.

<sup>78</sup> *Michelin*, No. 83-136, slip op. at 9.

<sup>79</sup> Indeed, the Commerce Department concedes that the method facilitates its annual reviews of CVD assessments required under § 751 of the Trade Act. Carbon Steel Products from Mexico, 49 Fed. Reg. 5142, 5149 (1984).

<sup>80</sup> *Michelin*, No. 83-136, slip op. at 14.

<sup>81</sup> The formula is expressed as:

$$B = p/n + r[p - (x - 1)(p/n)]$$

where B = benefit to be countervailed in a given year; p = face amount of the subsidy; n = number of years of the benefit; r = discount rate; x = unknown amount of the annual

achieves some degree of front loading but also maintains a constant correspondence between the actual benefit and the amount to be countervailed.

The use of the declining-balance method will result in a higher valuation of the Michelin grants than would the use of the Commerce Department's annuity method.<sup>82</sup> Higher valuations result in higher tariffs. Although the declining-balance method further aggravates the harsh impact that time-value of money calculations will have on future CVD assessments, the method more accurately measures the benefit of a grant to its recipient. Moreover, by the Commerce Department's own admission, the method is reasonable under the legislative standard of valuing subsidies.<sup>83</sup>

payment. When the court's formula is applied to a hypothetical \$10,000 grant over ten years, assuming the discount rate is 10%, the results are:

Year 1

$$(i) B = \frac{10,000}{10} + .1[10,000 - (1 - 1)1,000]$$

$$(ii) B = 1,000 + 1,000, \text{ or } 2,000$$

Year 2

$$(i) B = \frac{10,000}{10} + .1[10,000 - (2 - 1)1,000]$$

$$(ii) B = 1,000 + 900, \text{ or } 1,900$$

Year 3

$$(i) B = \frac{10,000}{10} + .1[10,000 - (3 - 1)1,000]$$

$$(ii) B = 1,000 + 800, \text{ or } 1,800$$

Year 10

$$(i) B = \frac{10,000}{10} + .1[10,000 - (10 - 1)1,000]$$

$$(ii) B = 1,000 + 100, \text{ or } 1,100$$

<sup>82</sup> The following compares the two methods using a hypothetical \$10,000 grant over ten years, assuming a 10% discount rate:

| <u>Annuity Method</u> | <u>Declining Balance Method</u> |
|-----------------------|---------------------------------|
| Year 1 - 1,480        | Year 1 - 2,000                  |
| Year 2 - 1,480        | Year 2 - 1,900                  |
| Year 3 - 1,480        | Year 3 - 1,800                  |
| Year 4 - 1,480        | Year 4 - 1,700                  |
| Year 5 - 1,480        | Year 5 - 1,600                  |
| Year 6 - 1,480        | Year 6 - 1,500                  |
| Year 7 - 1,480        | Year 7 - 1,400                  |
| Year 8 - 1,480        | Year 8 - 1,300                  |
| Year 9 - 1,480        | Year 9 - 1,200                  |
| Year 10 - 1,480       | Year 10 - 1,100                 |
| Total                 |                                 |
| 14,800                | 15,500                          |

<sup>83</sup> Carbon Steel Products from Mexico, 49 Fed. Reg. 5142, 5149 (1984).

#### 4. *The Discount Rate*

Time-value of money calculations require the use of a discount rate that reflects the company's time preference for money. If a company is indifferent to receiving one hundred dollars today or receiving one hundred and ten dollars next year, its discount rate for the intervening year is ten percent.<sup>84</sup> The third *Michelin* opinion rejected the Commerce Department's use of the rate on long-term Canadian government bonds as the discount rate in measuring the effects of time on money.<sup>85</sup> Instead, the court stated that the more accurate measure of opportunity cost is the commercial rate that the beneficiary would have obtained in the marketplace.<sup>86</sup> In most cases, the alternative financing rate will exceed the rate on long-term government bonds.<sup>87</sup> Thus, the use of the alternative financing rate will result in higher valuations and tariffs than would the use of the risk-free bond rate.

The Commerce Department has explained that the rationale for using the risk-free bond rate was to avoid judging the riskiness of a particular undertaking.<sup>88</sup> The more compelling reason for the use of a ready-calculated risk-free bond rate, however, is to avoid the inconvenience of determining what the alternative rate of financing would have been in each case.<sup>89</sup> In reality, different companies invest in different projects of varying degrees of risk. The point at which a high risk firm will be indifferent to receiving sums in the future (its discount rate), will be higher than a firm that is more adverse to risk. Thus, it is unrealistic to apply the same discount rate to every enterprise. Additionally, if the alternative rate of financing is not used, it is possible that an outright grant—the most complete and generous form of subsidy—will be measured by a looser standard than a preferential interest rate loan.<sup>90</sup>

The refinements in valuation expressed by the *Michelin* court alter three components of the Department's methodology that have been either elided or homogenized for administrative convenience. If a recipient of a grant enjoys greater benefit in the early years of the life of asset purchased by the grant, the Department compresses the

---

<sup>84</sup> *Id.* at 5148.

<sup>85</sup> *Michelin*, No. 83-136, slip op. at 12.

<sup>86</sup> *Id.* The Court deferred to the Commerce Department to determine what the alternative rate of financing would have been. *Id.*

<sup>87</sup> Long-term government bonds are risk free due to the financial stability of governments offering the bonds. Consequently, in a risk versus return analysis, this high degree of safety (low risk) yields relatively low return. Even offerings by the most creditworthy corporations are more risky than government bonds, and such corporations cannot borrow at less than the risk free rate.

<sup>88</sup> See *supra* notes 54-55 and accompanying text.

<sup>89</sup> The Commerce Department considers such determinations to be "speculation." Certain Steel Products from Belgium, 47 Fed. Reg. 39,304, 39,316 (1982).

<sup>90</sup> *Michelin*, No. 83-136, slip op. at 11.

allocation of its benefit to a convenient one-half of the asset's life. Similarly, the Department uses convenient, readily accessible, easy-to-read mortgage tables in valuing money over time. As the discount rate in valuing money over time, the Department uses a foreign government-determined, risk-free bond rate. All these techniques are applied without regard to the actual "benefit to the recipient"—the standard the Department supposedly follows in valuing subsidies.

Since the *Michelin* decisions, the Commerce Department has implemented two of the three refinements called for in the case. For the most part, the Department has abandoned the half-life approach of front loading benefits.<sup>91</sup> It also has changed the discount rate used in time-value calculations from the risk-free bond rate to a company's average weighted cost of capital.<sup>92</sup> The Department continues, however, to use the annuity method of valuing money over time. It cites administrative convenience and flaws in the declining balance method as reasons for the continued use of the annuity method.<sup>93</sup>

## V. Conclusion

Despite the enactment of the Trade Act and subsequent improvements to trade law under the Trade Act,<sup>94</sup> industry dissatisfaction with increasing foreign presence in the United States still exists.<sup>95</sup> Each year thousands of CVD petitions are filed, and hundreds are investigated, challenging imports from every major trading partner of the United States involving nearly every major industry. It is clear, therefore, why the Commerce Department has chosen convenient methods of valuing subsidies. Examining the effects of a subsidy, however, is the very nature of CVD law, and valuing such subsidies is an integral component that cannot be neglected for the sake of administrative convenience. Less accurate duty assessments, for whatever reason, is contrary to CVD law and the needs of U.S. industries that are injured by foreign subsidized merchandise.

The call for refinements in valuation by the *Michelin* court illustrates that, despite the Department's workload, valuing subsidies is as important as the fundamental issue of countervailability, and the process should not be compromised. When CVD law no longer pro-

---

<sup>91</sup> On small grants, the Commerce Department allocates benefits over one year. See *supra* note 49.

<sup>92</sup> Carbon Steel Products from Mexico, 49 Fed. Reg. 5142, 5149 (1984).

<sup>93</sup> *Id.* Under the declining-balance method, the Commerce Department contends that the allocation of one year grants, or small grants that the Department typically allocates over one year, may exceed the face value of the subsidy in violation of the subsidy "cap." See *supra* notes 30-32 and accompanying text. The court dismissed this argument when applied to the use of the time-value of money calculations. See *supra* notes 71-72 and accompanying text.

<sup>94</sup> See Barshefsky, Mattice, & Martin, *supra* note 4.

<sup>95</sup> Indeed, the past session of Congress experienced a flood of protectionist trade reform proposals.

vides U.S. industries with the protection they desire, strict interpretation of valuation principles can provide an added degree of protection. The court has interpreted "reasonable methods of measuring benefit to the recipient" to require the use of methods that most accurately reflect benefit to the recipient. The *Michelin* court's interpretation, refinements, and underlying analyses provide much needed guidance and policy on the issue of valuation.

—DAVID A. SPURIA

