Dear Director

Changshu Longte Grinding Ball Co., Ltd
Investigation concerning grinding balls exported from China

We are instructed by our client Changshu Longte Grinding Ball Co., Ltd ("Longte") to make the following comments in response to Statement of Essential Facts No 316 ("SEF 316") as published by the Anti-Dumping Commission ("the Commission") on 21 April 2016.

At the outset, Longte expresses its deep concern and disappointment at the significant revision of Longte’s dumping margin as has now been reported in SEF 316. The positive 12.6% margin represents a dramatic 17.5% swing of Longte’s dumping margin from negative 5.9%, being the margin advised only 10 days earlier when the Commission published Longte’s verification visit report ("the Longte visit report").

In this submission, we intend to address a number of issues regarding the dumping margin determination in SEF 316. These are:

A Substitution of Longte’s actual costs of production in the country of export

B Profit determination

C Other errors in the dumping margin calculation
  1 Incorrect use of data
  2 Calculation of the “conversion factor”
  3 Cost calculation concerning blast furnace gas
  4 Calculation of SG&A
  5 Inclusion of internal profit in the cost of production

A Substitution of Longte’s actual costs of production in the country of export

The single most significant factor contributing to the reversal of Longte’s significant no-dumping margin in its visit report to the significant dumping margin in SEF 316 is the Commission’s determination that:

- a “particular market situation” exists in relation to the grinding ball market in China; and
resultantly, normal value should be based on Longte’s cost to make and sell; and

one of the implications of the alleged particular market situation is that one of those costs, being the cost of grinding bar, should be replaced with an “appropriate competitive market cost[ ] for grinding bar”, based on a non-China benchmark price for steel billet uplifted by a conversion cost.

It is not Longte’s intention to address the “particular market situation” determination in SEF 316 in any detail in this submission. Indeed Longte considers it not possible to do so because SEF 316 does not explain why the alleged GOC involvement in the iron and steel industry, and the alleged “influence” of the GOC, satisfies the considerations under Section 269TAC(2)(a)(ii). Ultimately, all that is said is that “the domestic price for Chinese grinding balls was substantially different to what it would have been in the absence of these interventions by the GOC”. It is patently obvious that the Chinese domestic market for grinding ball would be different in the absence of the GOC and its economic and tax policies. The Australian domestic market for grinding ball would be different if the Australian government and its economic policies suddenly disappeared too. The simple conclusion that there is a “difference” does not answer the question of why Longte’s domestic prices for grinding ball are therefore not “suitable” for normal value comparison purposes.

The Commission’s decision to replace or uplift Longte’s cost of production of grinding bar, purportedly in accordance with Regulation 43 of the Customs (International Obligations) Regulation 2015 (“the Regulation”), is said by the Commission to be part and parcel of the particular market situation finding:

Consideration of whether a situation exists in the relevant market is concerned with the operation of policies and regulations (whether overt or implied) and their potential impact on the suitability of domestic selling prices for normal value purposes. Accordingly, the question to be answered is whether the relevant policies operate in a manner which:

a) leads to a distortion of competitive market conditions in relation to the subject goods such that domestic sales are unsuitable for the purposes of determining normal value; and

b) affects the conditions of commerce related to the production or manufacture of like goods such that the records of exporters cannot be relied upon to reasonably reflect competitive market costs associated with production in accordance with the provisions of subsection 43(2) of the Regulations.

The Commission substituted Longte’s cost of grinding bar with a combination of:

• Latin American FOB billet prices for ASTM A36/A36-08;
• a “ferroalloy uplift” – based on European prices to bring the billet grade from the Commission’s own Latin America FOB billet prices for ASTM A36/A36-09 to the grade of grinding ball exported by Longte; and
• a “conversion factor” based on Longte’s actual cost of converting steel billet to grinding bar,

(collectively, “the grinding bar benchmark”).

The grinding bar benchmark was constructed to meet the following objectives:

The Commission has determined that grinding bar accounts for the vast majority (approximately 80-90 per cent) of the cost to make grinding balls. The Commission considers that, due to the influence of GOC, the costs of grinding bar recorded by exporters in their records do not reasonably reflect competitive market costs.
The Commissioner considers that it is appropriate to substitute the costs relating to grinding bars recorded by exporters with a benchmark grinding bar cost. The Commissioner considers that this approach best removes all the influence of the GOC.

The Commissioner considers that the grinding bar benchmark will also reflect the world benchmark prices which are utilised to produce grinding balls, and as such, the substitution of the benchmark grinding bar costs will accurately reflect, rather than artificially inflating genuine raw material costs.

The Commission remarkably claims that the decision to surrogate a Latin America FOB steel billet price, a European ferroalloy price, and a Chinese conversion factor into the costs of production of a Chinese exporter for normal value calculation purposes is in accordance with WTO authority:

Accordingly, to account for the effects of the GOC’s influence, the Commission has replaced Chinese manufacturers’ grinding bar costs with appropriate competitive market costs for grinding bar. The order of preference to do so below is in accordance with the Commission’s policy which has regard to the principles established in WTO Appellate Body findings as follows:

i. private domestic prices;

ii. import prices; and

iii. external benchmarks.

The Commission’s decision to surrogate Longte’s cost of grinding bar with the Commission’s own grinding bar benchmark is legally problematic in many respects.

No principle has been established in WTO Appellate Body findings for the surrogation of costs in normal value calculation outside the terms of China’s Protocol on Accession to the World Trade Organisation. Australia has legislatively excluded itself from applying, and the Commission does not purport to apply, any provision of that Protocol in SEF 316. We suspect that the “principles” the Commission alleges are those adopted in United States – Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada (commonly referred to as “Softwood Lumber IV”).1 It is, however, self-evident from the title of that report that the subject matter related to alleged subsidies, and more specifically to the determination of “adequacy of remuneration” in a countervailing investigation under the Subsidies and Countervailing Measures Agreement (“the SCM Agreement”). That authority is unrelated to dumping margin calculation.

Further, even in Softwood Lumber IV, the Appellate Body could not have been more clear in stating that whichever benchmark is used – especially if a benchmark derived from a market outside the country of origin is to be considered – it must relate to the “prevailing market conditions for the good or service in question in the country of provision or purchase” in accordance with Article 14(b) of the SCM Agreement. SEF 316 proposes to do exactly the contrary – by finding a benchmark which is as far away from and as irrelevant to the Chinese market as possible, in order to “best remove[ ] all the influences of the GOC”.

We must also remind the Commission of the clear direction under Australian law – which directly implements the same direction as that in the Anti-Dumping Agreement – that the Minister must work out the normal value of the goods in a “particular market situation” circumstance based on:

- the sum of “cost of production or manufacture of the goods in the country of export” and the relevant administrative, selling and general costs (SG&A) and profit, according to Section 269TAC(2)(c) of the Customs Act 1901 (“the Act”); or

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1 WT/DS257/AB/R (19 January 2004)
- third country sales under Section 269TAC(2)(d).

The principal and overarching requirement for normal value calculation in a “particular market situation” scenario is regulated by Section 269TAC(2)(c) and (d). The operation of Regulation 43 is for the purpose of prescribing the “manner” to be adopted, and the “factors” that should be taken into account, in working out the relevant costs described under Section 269TAC(2)(i) and (ii). Such “manner” and “factors” must still comply with the requirement of the Act – that is, Section 269TAC(2)(c) - that the costs of production for the calculation of normal value are those in the country of export.

This requirement has been confirmed and crystallised by the WTO Panel decision in European Union – Anti-Dumping Measures on Biodiesel from Argentina2 (“EU - Biodiesel”). That dispute involved the EU’s decision to resort to a constructed normal value, also due to a finding of a “particular market situation”, in relation to exports from Argentina. In constructing the normal value the EU substituted a FOB price based benchmark cost for soybean into the Argentinian exporter’s costs of production, on the basis that the Argentinian cost of soybean was distorted by various Argentinian Government regulatory measures. The Panel decided that:

- The costs used for constructing normal value under Article 2.2 of the Anti-Dumping Agreement must be based on the cost of production in the country of origin:

  7.256. The text of both Article 2.2 of the Anti-Dumping Agreement and Article VI:1(b)(ii) of the GATT 1994 refer to the “cost of production” in “the country of origin”.

...    

  7.260. ...the European Union acted inconsistently with Article 2.2 of the Anti-Dumping Agreement and Article VI:1(b)(ii) of the GATT 1994 by using a “cost” that was not the cost prevailing “in the country of origin”, namely, Argentina, in the construction of the normal value.

- The costs of production calculated for the purpose of constructing normal value under Article 2.2 and Article.2.2.1.1 of the Anti-Dumping Agreement must be based on the actual costs of the producers.3

It is also noteworthy that the EU – Biodiesel report specifically addresses one aspect of Australia’s third party submission in those proceedings:

391. Along broadly similar lines, Australia and the United States submit that the “particular market situation[s]” referred to in Article 2.2 encompass distortions that could render a producer/exporter’s recorded costs unreasonable as to the cost of production and sale, and thereby justify departing from those recorded costs. However, in our view, Article 2.2 of the Anti-Dumping Agreement only states that a “particular market situation” may necessitate the construction of normal value. It does not address how that construction should be undertaken, which is instead set out in detail in the subparagraphs of Article 2.2. (Australia’s third-party response to Panel question No. 5; United States’ third-party response to Panel question No. 3, para. 11)

The WTO Panel’s finding in EU - Biodiesel is directly relevant to the present investigation, as it establishes that:

- a finding of the existence of a “particular market situation” simply allows the investigation authority to determine the normal value by way of a cost based construction or to base it on

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2 WT/DS473/R (29 March 2016)
3 Ibid, see para 7.233, 7.242, 7.247, 7.248.
an exporter’s third country sales - it does not allow the investigating authority to depart from using the cost records of the relevant exporters;

- the determination of costs can only focus upon whether the records accurately reflect the actual costs incurred by the exporter - it is not open to the investigating authority to disregard the costs recorded by the exporter on the basis that the costs are “artificially low” or “distorted” by comparison to a cost not actually incurred by the exporter;

- in any case, the costs to be used for normal value construction purposes must be the actual costs prevailing in the country of origin.

These findings confirm the already clear language of Section 269TAC(2)(c) of the Act, which requires the constructed normal value to be based on “the cost of production or manufacture of the goods in the country of export”, together with the relevant SG&A and profit.

Accordingly, Longte respectfully urges the Commission to withdraw its proposed approach to surrogate Longte’s cost of production with a Latin American based steel billet price and a European based ferroalloy price. We respectfully request the Commission to bring its decision in line with the legal requirement under the Act and of the relevant WTO reports, and to determine Longte’s normal value in accordance with its actual cost of production – being Longte's cost of production of the goods in the country of export.

As the Commission already knows, based on Longte’s actual cost of production, Longte’s exports of the goods to Australia during the investigation period were not dumped.

B Profit determination

As stated above, it is Longte’s view that the Commission’s decision to construct normal value under Section 269TAC(2)(c) by way of using artificially constructed non-China and certainly non-Longte “benchmark” costs, is plainly wrong and unlawful. Without prejudice to this primary proposition, we consider that the margin calculation for Longte is still flawed.

The first of these flaws relates to the amount of profit adopted by the Commission for normal value construction purposes. SEF 316 purports to calculate an amount of profit for determination of Longte’s normal value as follows:

Longte’s profit on domestic sales which met the original OCOT testing based on Longte’s verified (non-substituted) CTMS

The “original” profit determination was described in the Longte visit report as follows:

In calculating the profit, the verification team has only included domestic sales made in the OCOT.

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2 Section 45(2) of the Customs (International Obligations) Regulation 2015

Regulation 45(2) prescribes the manner by which the Minister should determine the amount of profit to be used in constructing a Section 269TAC(2)(c) based normal value as follows:

The Minister must, if reasonably practicable, work out the amount by using data relating to the production and sale of like goods by the exporter or producer of the goods in the ordinary course of trade.
The Commission proposes to recommend that the Minister work out Longte’s cost of production for the purposes of Section 269TAC(2)(c) by determining an uplifted cost of production, based on a combination of Longte’s own costs and the grinding bar benchmark. If this recommendation remains unchanged – despite everything we have said to the contrary in A above - the Commission must at least adopt a consistent approach and use the same uplifted cost of production in the calculation of the amount of profit under Regulation 45(2).

With respect, we do not see how the Commission can use one cost for the purpose of working out the costs of production, and another for the purpose of working out the profit to be adopted. The legislation at least makes it clear that the Minister must use the financial records of the exporter if they are maintained in accordance with GAAP and “reasonably reflect competitive market costs”. If that is not the case, then the Minister cannot use them. With respect, the Minister cannot use both the “accepted and corrected” costs and the “unaccepted” costs for different purposes in the same calculation.

Longte submits that there is no basis for the inconsistent approach adopted in SEF 316 in this regard. We submit that it does not comply with law and is not an approach that an unbiased, reasonable decision maker could adopt.

Further, the approach adopted in SEF 316 is contradictory to the Commission’s own practice in Report 238, which concerned an investigation regarding deep drawn stainless steel sinks exported from China. In that case the Commission also decided to uplift the Chinese exporters’ costs of production. However the Commission agreed that the correct and reasonable approach was to use the uplifted costs in working out the amount of profit under Regulation 181A (being the predecessor of Regulation 45). The Report states:

Regulation 181A provides that, where reasonably possible, profit for constructed normal values must be worked out using data relating to the production and sale of like goods by the exporter or producer of the goods in the ordinary course of trade.

Accordingly, the Commissioner has calculated a weighted average net profit on like goods sold on the domestic market in the ordinary course of trade, measured as a percentage mark-up on full cost to make and sell, for each Chinese selected exporter.

The ordinary course of trade tests undertaken used the verified cost to make and sell data after performing the abovementioned amendments to the recorded costs incurred in relation to stainless steel raw materials. The Commissioner observes that even when the cost of stainless steel raw materials is uplifted, all three selected exporters achieve profits at not insignificant levels.

This approach is the same to that taken in SEF 238, which took into account submissions on profit reasonableness received from Jiabaolu and Zhuhai Grand prior to the issue of SEF 238 (refer to Section 6.8 of that statement for discussion of these submissions).

It appears to us that one of the key factors considered by the Commission in SEF 238 and Report 238 was that the exporters still achieved a profit when the uplifted costs were used in the ordinary course of trade test. The underlined text in the extract above bears this out.

The same circumstances apply to Longte. This is because, based on Longte’s own analysis using:

- the uplifted costs determined in SEF 316; and
- the original domestic sales profit calculation as used by the Commission,
the Commission would come to the conclusion that Longte still achieved profit from its domestic sales of goods in the ordinary course of trade, being [CONFIDENTIAL TEXT DELETED – number]%.

Longte respectfully requests the Commission to bring its profit calculation in line with its proposed cost of production determination and its own prior administrative practice, and to calculate the amount of profit for Longte’s constructed normal value in a reasonable and unbiased manner.

C Other errors in the dumping margin calculation

Longte would also like to bring to the Commission’s attention a number of mathematical and methodological errors that impact upon its present margin determination. Again, these comments are provided without detracting from Longte’s primary view as stated at A above.

1 Incorrect use of data

Longte’s review of “Confidential Attachment 2c – Dumping Margin” suggests that the Excel spreadsheet formula used to locate the CTMS element of the normal value at column AT of the dumping margin worksheet is not directed at the “CTMS” data (which is supported by the CTMS calculation in Confidential Attachment 2b) in that same spreadsheet. If the data has been aligned correctly with the “CTMS” worksheet, everything else being equal, the dumping margin should read [CONFIDENTIAL TEXT DELETED – number]%.

Longte respectfully requests that this clerical error be corrected.

2 Calculation of the “conversion factor”

SEF 316 applied a “conversion factor” for the purpose of calculating a grinding bar benchmark cost from the Commission’s steel billet benchmark costs. The conversion factor is said to be “the exporter’s actual cost of converting steel billet to grinding bar”. However, in applying that conversion factor, rather than adding the weighted average per unit amount of actual conversion cost to the per unit steel billet costs, the calculation formula applies Longte’s conversion cost as a percentage rate to the benchmark billet cost instead. The effect of this approach is that Longte’s actual amount of conversion costs was also inflated/uplifted. Specifically, Longte’s actual weighted average steel billet to grinding bar conversion costs - as worked out by the Commission - was RMB[CONFIDENTIAL TEXT DELETED – number]. However due to the calculation method adopted in the spreadsheet, the “conversion factor” as applied by the Commission ranged from RMB[CONFIDENTIAL TEXT DELETED – number] to RMB[CONFIDENTIAL TEXT DELETED – number] – which is more than the actual amount of Longte’s conversion costs the Commission intended to use.

Longte respectfully requests that this mathematical error be corrected.

3 Cost calculation concerning blast furnace gas

As stated in the Longte visit report:

4.2.1 Blast furnace gas

Longte’s cost to make included costs for blast furnace gas supplied by Longteng. As the verification team considers it appropriate to collapse Longte and Longteng into a single entity (see section 3.4 above), it follows that the cost of blast furnace gas supplied by Longteng should be excluded. The verification team was able to verify that blast furnace gas revenue was not included as a cost offset for steel bar supplied by Longteng.

Longte notes that the latest cost calculation spreadsheet in SEF 316 omitted the mathematical step for the exclusion of blast furnace gas. Longte respectfully requests that this calculation error be corrected.

Longte respectfully requests that this mathematical error be corrected.
4 Calculation of SG&A

Longte submits that there are two errors in the Commission’s calculation of SG&A costs.

(a) Failure to use Longte’s actual SG&A costs

The first relates to the application of the revenue based SG&A ratio to the Cost to Make (“CTM”) values to arrive at a CTMS. Longte does not dispute the correctness of this methodology itself. Further, Longte notes that so far as SG&A costs are concerned, SEF 316 accepts that “Longte’s actual verified SG&A costs” should be used in the construction of normal value. However this was not done in the margin calculation spreadsheet pertaining to SEF 316. The problem is that the margin calculation spreadsheet uses the uplifted CTM as the denominator for the purpose of working out SG&A and the CTMS, rather than using Longte’s actual SG&A costs. Essentially, due to this incorrect calculation, Longte’s SG&A costs have been inflated by the same percentage as the uplift to its CTM using the grinding bar benchmark.

Longte respectfully requests that this methodological error be corrected.

(b) Incorrect calculation of SG&A ratio for the collapsed entities

The second relates to the calculation of a single SG&A ratio for the collapsed single entity.

The current SG&A ratio is worked out by a simple aggregation of the ratio based on [CONFIDENTIAL TEXT DELETED – details of the SG&A calculation for each entities]. The combined ratio ([(CONFIDENTIAL TEXT DELETED – number)]% is then applied to Longte’s CTM for grinding balls. [CONFIDENTIAL TEXT DELETED – detailed explanation about the SG&A calculation, and comments that the SG&A costs should be attributed correctly]. Accordingly, for the purpose of working out the amount of SG&A costs [CONFIDENTIAL TEXT DELETED – relevant proportion of the SG&A cost] which is attributable to grinding ball, the denominator should be the sum of [CONFIDENTIAL TEXT DELETED – the relevant entities’] revenue – being the total revenue of the collapsed entity. Based on Longte’s re-calculation, this reduces the total SG&A ratio from [(CONFIDENTIAL TEXT DELETED – number)% to (CONFIDENTIAL TEXT DELETED – number)%.

Longte respectfully requests that this methodological error be corrected.

5 Inclusion of internal profit in the cost of production

As acknowledged by the Commission, Longte’s cost of production data contains [CONFIDENTIAL TEXT DELETED – cost element] represents the fully absorbed costs incurred [CONFIDENTIAL TEXT DELETED – entity] and an amount of profit [CONFIDENTIAL TEXT DELETED – entity]. In light of the collapsed entity approach, the profit retained [CONFIDENTIAL TEXT DELETED – entity] is an internal profit within the single entity and therefore should be excluded from the cost calculation.

We refer to the spreadsheet provided to the Commission prior to the publication of the SEF, [CONFIDENTIAL TEXT DELETED – confidential spreadsheet relating to cost of production]. At column P of that spreadsheet, Longte has demonstrated the amount of profit [CONFIDENTIAL TEXT DELETED – as part of the cost element], being RMB[(CONFIDENTIAL TEXT DELETED – number] or a weighted average of [(CONFIDENTIAL TEXT DELETED – number)]% of the total amount of the [(CONFIDENTIAL TEXT DELETED – cost element) during the investigation period.

Accordingly, Longte submits that the amount of profit should be excluded from the cost of production.

Longte respectfully requests that this methodological error be corrected.

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Longte’s dumping margin as stated in SEF 316 is significantly inflated, due to the various legal and clerical issues explained above.

Longte urges the Commission to rectify these errors and to restate the correct margin outcome for Longte – which is that the goods exported by Longte to Australia were not dumped.

Our client continues to offer its full cooperation to the Commission in this investigation. Should the Commission have any further questions, or require any clarifications or further information, please contact us.

Yours sincerely

Charles Zhan
Senior Lawyer