

**Non-Confidential**

**Memo**

**Shihlin Electric & Engineering Corp (SEEC)**

**Submission on Visit Report and Revised Dumping Margin**

19 May 2014

**1. Background**

On 28 April 2014 the Australian Anti-Dumping Commission (**Commission**) forwarded a draft confidential visit report and revised dumping margin for review by SEEC for accuracy and to identify confidential information in the visit report.

SEEC has reviewed the visit report and the revised dumping margin calculation and has a number of concerns with both the visit report and the revised dumping margin.

In relation to the visit report changes to it have been marked-up and, in addition, confidential information has been highlighted.

In relation to the revised dumping margin, SEEC has prepared a further revision of the dumping margin calculation to correct what it considers to be certain errors with the Commission's calculation. This calculation is confidential but, if accepted, would result in a dumping margin of less than 5%.

The purpose of this memo is to set out SEEC's concerns with the visit report and the Commission's dumping margin calculation.

**2. Dumping Margin Calculation**

**2.1 Methodology**

The Commission's preferred method for calculating a dumping margin in this investigation is to:

- calculate a constructed normal value using the cost to make (**CTM**) of power transformers exported to Australia and to add to that CTM the exporter's domestic general selling and administrative expenses (**SGA**) and domestic profit on sales of like goods;
- this constructed normal value is then compared to the export price of the power transformer to determine a dumping margin; and
- the dumping margins for all power transformers are added together and divided by the number of power transformers exported to Australia during the period of investigation (**POI**) to derive an average product margin.

In addition, in calculating a dumping margin for SEEC, the Commission has calculated a deductive export price using the price at which SeA sold power transformers to its Australian customers as the starting point. This because it considers that the transactions between SEEC and SeA were not at arms length.

SEEC's concern with the Commission's approach is not with the methodology itself. Rather it is concerned with:

- certain deductions made by the Commission in calculating the deductive export price; and
- the margin of profit for SEEC that the Commission has used in calculating the constructed normal value.

The reasons for these concerns are set out below.

## **2.2 Export Price - Warranty and Similar Cost Deductions**

In calculating the deductive export price for SeA, the Commission has deducted certain warranty claim expenses. These warranty claim expenses are unrelated to, and do not affect, the price at which power transformers were sold to Australian customers. This is true of any warranty claim against any supplier of products. As such warranty claims are not price-related, they should not have been deducted from the export price.

## **2.3 Export Price - Reimbursements by SEEC for warranty and similar costs**

[Confidential submission about alternative approach to be taken to certain reimbursements from SEEC to SeA]

## **2.4 Export Price - Deduction of a Profit Margin for SeA**

As outlined in SEEC's submissions on the PAD, which were provided to the Commission on 9 December 2013 (page 4-5) and in its further letter to the Commission of 20 December 2013 (page 3-4), SEEC disagrees with approach taken by the Commission to SeA's profit when calculating its deductive export price. In particular, SEEC disagrees with the Commission's decision to deduct a [ ]% profit margin from the price at which SeA sold power transformers to its Australian customers.

SEEC seeks to make two points about this.

First, SEEC submits that the Commission should not make a deduction for a notional profit.

Article 2.3 of the Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (**ADA**) allows investigating authorities to construct an export price based on the price at which an associated importer on-sold the goods under investigation. Article 2.4 of the ADA then provides that:

*"In the cases referred to in paragraph 3, allowances for costs, including duties and taxes, incurred between importation and resale, and **for profits accruing**, should also be made"* (emphasis added).

While the ADA allows an adjustment for accrued profits in calculating a deductive export price, it does not allow investigating authorities to [confidential]. This is particularly so in view of the specific requirement in Article 2.4 of the ADA that only "profits **accruing**" should be adjusted to the deductive export price.

Accordingly, the Commission, in calculating a deductive export price, should only deduct the actual profit made by SeA on transactions during the POI. SEEC respectfully submits that the Commission's approach appears to be inconsistent with the ADA.

Secondly, without prejudice to that argument, even if a deduction of a reasonable profit for SeA may be made when calculating a deductive export price for SEEC, for the reasons set out below the Commission's determination of a % profit margin for that purpose is arbitrary and unreasonable.

In the visit reports for SeA (page 13) and for SEEC (page 21), the Commission notes that the source of the [ ]% profit margin allocated to SeA by the Commission was advice from SeA and SEEC to the Commission that a % profit on Australian sales was "expected". That is, it was the "intent" or "expectation" of SeA and SEEC that they would achieve a profit margin of [ ]% on sales in Australia.

It is SEEC's position that in calculating a deductive export price, the Commission should, and is obliged, to deduct actual profits obtained in sales by SeA in sales to its Australian customers, as opposed to notional profits.

## 2.5 **Normal Value - Profit Margin in the Constructed Normal Value**

As outlined in SEEC's submissions on the preliminary affirmative determination (**PAD**), which were provided to the Commission on 9 December 2013 (see pages 6-8), and in its further submission of 20 December 2013 (see pages 4-5), SEEC maintains that the profit ratio for domestic sales to [customer] should be used in calculating the constructed normal value for SEEC.

As the Commission recognized in the visit report, there are two types of customers in the Taiwanese domestic market, namely, utility customers and non-utility customers. In relation to utility customers, the visit report correctly observes that in sales to utility customers prices were negotiated through a public tender process:-

*"During the investigation period SEEC sold power transformers to the following utility companies:[Australian customers]. Prices were negotiated through a **public tender process**. SeA submitted examples of tender documents in its importer questionnaire." (emphasis added) (page 14 of the visit report).*

In the case of sales to utilities in Taiwan, the visit report notes:

*"Sales to the utility sector are also by tender which must be published on the government's website and are open only to the qualified vendors **which will include both domestic and foreign producers**." (emphasis added) (page 28).*

As to the non-utility market, the visit report observes "*sales to this sector are **generally confined to the three local producers** being SEEC, Fortune and Tatung.*" (emphasis added).

These differences in the processes for awarding and negotiating contracts between utility and non-utility customers, together with other differences, were identified in SEEC's submissions of 9 and 20 December 2013. The Commission has now observed that such differences render SEEC's domestic sales to non-utility customers as not comparable to its sales to Australian utility customers.

In the visit report, the Commission calculates profit ratios for sales to [customer] and for all domestic sales and the difference in the margin of profit is readily observable. Those differences amount to different “levels of trade”, or at least represent “other differences which are also demonstrated to affect price comparability” (Article 2.4 of the ADA).

In summary, the Commission has recognized that:

- the process for awarding contracts (and therefore pricing) is different as between utility customers and non-utility customers;
- the processes in Taiwan and Australia for awarding contracts by utility customers are the same or similar; and
- SEEC's sales to Australia have been to utility customers.

The result of those factors is that the profit margins earned by SEEC on domestic sales to non-utility customers, if used in the calculation of SEEC's constructed normal value, distort that normal value, and preclude a like-for-like comparison with the deductive export price.

Just as different levels of trade can affect prices, sales into different markets or sub-markets also can affect prices and, consequently, profits. This is self-evident here. Either only sales to [customer] should be used in determining a margin of profit, so as to ensure a like-for-like comparison with the deductive export price or, alternatively, a downwards adjustment should be made to the constructed normal value under s.269TAC(9) of the *Customs Act 1901* to ensure a fair comparison. This also is mandated by Article 2.4 of the ADA.

Accordingly, SEEC requests that the Commission reconsider the view expressed on page 33 of the visit report, and that in the calculation of the constructed normal value for SEEC, the Commission use the profit margin earned on utility sales in Taiwan, which sales are comparable to SEEC's export sales to Australia, or, alternatively, make a downward adjustment to the constructed normal value of [ ]% to ensure a fair comparison.

Finally, the Commission has chosen to use as a profit margin the profit margin reported in SEEC's exporter questionnaire for all profitable domestic sales, apparently on the basis that the non-profitable domestic sales were not sales in the ordinary course of trade (section 8.5 of the visit report). In accordance with the relevant provisions of the *Customs Act 1901*, sales at a loss can only be assessed as not being in the ordinary course of trade if:

- they constitute more than 20% of sales over the POI; and
- it is unlikely that SEEC would have been able to recover the costs of the goods sold at a loss within a reasonable period.

It is not apparent that the Commission has formed the view that either of those facts is the case. If it has not, then we respectfully submit that the non-profitable domestic sales cannot, using the Commission's approach under regulation 181A(2) of the Customs Regulations, be excluded for the purposes of calculating the profit margin to be used in the normal value calculation.

### 3. Visit Report

#### 3.1 *Number of Power Transformers Exported to Australia*

The number of power transformers exported to Australia during the POI was XX, not XX.

As explained in SEEC's submission dated 20 December 2013, the reason for this apparent discrepancy was because Order no XX covered one main body (product code XX) and one part (product code XX). The main body and the part were counted separately in the sales ledger and as a result there appeared to be XX transformers sold. However, in Confidential Exhibit B-4 the main body and part of the power transformer were combined, so that the true number of power transformers exported to Australia was presented.

#### 3.2 *Upward Cost Reconciliation*

On page 23 of the visit report the Commission made the following statement:

*"The inability to properly verify costs upwards to financial statements was not a result of SEEC impeding to the verification process or due to a lack of cooperation on the company's behalf. It appeared to us that the difficulties were caused by the lack of a proper financial reporting system capable of storing, identifying and reporting relevant information in a format easy to manipulate and interrogate."*

SEEC does not consider that the inability to reconcile certain costs upwards to financial statements was due to a "lack of proper financial reporting". As the Commission is aware and has verified, SEEC's accounting records were complete and accurate.

The difficulty in reconciling SEEC's cost to make and sell (CTMS) in Confidential Exhibits G4 and G5 to the annual income statement and the operating cost statement was due to timing issues.

The production of a power transformer can take anywhere from six months to over a year. Once produced, the power transformer is tested, transferred to site, installed and then commissioned, all of which can take several months after the power transformer has been produced. Accordingly, the total cost of production, including transport, installation and commissioning of a power transformer typically will cover more than one of SEEC's financial periods.

The total cost of production, transport, installation and commissioning of a power transformer has been reported in Confidential Exhibits G4 and G5, which data is taken from SEEC's job order system, despite the fact that the costs have been incurred over more than one reporting period.

However, each annual income statement and operating cost statement will reflect costs incurred in the relevant financial period only. This has given rise to the difficulty in reconciling the cost data in Confidential Exhibits G4 and G5 to SEEC's annual income statement and operating cost statement.

Potential solutions to this problem are:

- in SEEC's Access cost report, a division-wide cost can be filtered out by year and the resulting data should match the data in the divisional operating cost statement; or
- to filter out costs for all job orders relating to a power transformer reported in Confidential Exhibits G4 and G5 across several years and the resulting data should match the costs reported in Confidential Exhibits G4 and G5.

In short, it is possible to reconcile the costs reported in Confidential Exhibits G4 and G5 upwards to the annual income statement and operating cost statement once timing differences have been addressed.

### 3.3 **Verification of Weighted Average Costs**

During the verification visit the Commission expressed some concern with SEEC's use of standard costs in its costing system and proposed that SEEC revise its costs to a weighted average cost, as this would facilitate upwards verification. The Commission advised that if SEEC provided such weighted average costs and subject to reviewing them, the Commission would consider a second verification visit to verify those costs.

At page 32 of the visit report the Commission made the following statement:-

*"Whilst the calculation of a normal value is subject to further consideration of SEEC's proposal for **further verification of revised costs to be submitted by the company**, we have made the following preliminary findings with regards to adjustments."*

The revised weighted average costs have been provided to the Commission, as the Commission acknowledges in the visit report. Preparation of these costs involved SEEC dedicating substantial resources and personnel to the task, which involved thousands of calculations and checking and re-checking to ensure accuracy.

However, in the visit report the Commission noted that revised weighted average costs were similar to the standard costs that SEEC reported in its response to the exporter questionnaire and, because of that, a second verification was not warranted. In the absence of verifying the weighted average costs provided by SEEC, the Commission considered such costs and the standard costs originally reported could not be treated as reliable and could not be used in calculating the constructed normal value.

In SEEC's submission the similarity between the weighted average costs and the standard costs has the effect that the weighted average costs corroborate the standard costs as being accurate and reliable. Had they been materially different then there could be concerns with the accuracy and reliability of the standard costs without explanation as to why they were differences.

If the Commission needs to verify the weighted average costs provided to it by SEEC, SEEC would welcome the Commission undertaking such a verification at its factory.