

70 FR 7243, February 11, 2005

A-351-826  
ADR 08/01/2002 – 07/31/2003  
AD/CVD Operations Office 7: HMK  
PUBLIC DOCUMENT

February 4, 2005

MEMORANDUM FOR: Joseph A. Spetrini  
Acting Assistant Secretary  
for Import Administration

FROM: Barbara E. Tillman  
Acting Deputy Assistant Secretary  
for Import Administration

SUBJECT: Issues and Decision Memorandum for the Eighth Administrative  
Review of Small Diameter Circular Seamless Carbon and Alloy Steel  
Standard, Line and Pressure Pipe from Brazil; Final Results of  
Antidumping Duty Administrative Review

### **Summary**

We have analyzed the case and rebuttal briefs of interested parties in the administrative review of the antidumping duty order on small diameter circular seamless carbon and alloy steel standard, line and pressure pipe from Brazil (A-351-826) for the period 8/1/2002 - 7/31/2003. As a result of our analysis, we have made changes to the margin calculation as discussed below. We recommend that you approve the positions we have developed in the "Discussion of the Issues" section of this memorandum. Below is the complete list of the issues in this review for which we received comments and rebuttal comments by parties:

1. Product Matching to Similar Merchandise
2. CEP Offset
3. Interest Rate
4. Credit Expenses
5. Inventory Carrying Costs
6. Reversal of Bad Debt Expense
7. Adjustment to Cost of Manufacturing
8. G&A Expense Ratio
9. Clerical Errors:
  - a. Home Market Interest Revenue
  - b. U.S. Packing Expense

c. Home Market Inland Insurance

## **Background**

On September 7, 2004, we published in the *Federal Register* the preliminary results of this administrative review. *See Small Diameter Circular Seamless Carbon and Alloy Steel Standard, Line and Pressure Pipe from Brazil; Preliminary Results of Antidumping Duty Administrative Review*, 69 FR 54125 (“*Preliminary Results*”). The period of review (POR) is August 1, 2002, through July 31, 2003.

This review covers sales of small diameter circular seamless carbon and alloy steel standard, line and pressure pipe made by one manufacturer/exporter, V&M do Brasil S.A. (“VMB”). We invited parties to comment on our preliminary results. We received case briefs from VMB and United States Steel Corporation (“petitioner”) on October 7, 2004. We received rebuttal briefs from the same parties on October 14, 2004.

In the preliminary results of this review, we made a preliminary determination that VMB was the successor-in-interest to Mannesmann, S.A., the former corporate name of the company involved in the original investigation, and therefore, subject to the current antidumping duty order. *See Preliminary Results*. No comments, nor any additional factual information, pertaining to this issue were received from the parties. As a result, we continue to find that VMB is the successor to Mannesmann, S.A.

## **Discussion of the Issues**

### *Comment 1. Product Matching to Similar Merchandise*

#### **Respondent**

Noting that when U.S. sales cannot be compared to identical home market sales, the Department of Commerce (“the Department”) compares the U.S. sales to the most similar home market sales based on product characteristics reflecting complete technical specifications, VMB contends that for the preliminary results, the numeric weighting values the Department assigned to the product specification characteristics are contrary to the Department’s normal practice, and thus caused erroneous matches. VMB points out that the Department assigned a weight of 1 to the home market multiple-specification product coded as 14, which is identical to the specification of the U.S. sales, and a weight of 2 to the single-specification product coded as 3 in VMB’s response. VMB claims that the record in this case, including the Department’s verification findings, clearly demonstrates that multiple specification Code 14 is most similar to triple-specification Code 13, rather than to single-specification Code 3. As the basis for this argument, VMB cites differences in chemical composition, dimensional tolerances, and testing requirements. VMB argues that the record in this case clearly demonstrates that, in contrast to the Code 3 product, Code 13 pipe has the same chemical composition as Code 14, as well as identical

dimensional and pipe end tolerances, testing requirements, and applications. VMB contends that both Code 13 and 14 pipe are subject to stricter pipe-end dimensional tolerances and hydrostatic testing requirements, but that Code 3 pipe does not have to meet either requirement. Further, VMB claims that unlike Code 13 and 14 products that can be used for multiple applications, including critical oil and gas applications and high temperature service, Code 3 is a high temperature service specification not suitable for other uses, such as oil and gas pipelines.

### **Petitioner**

The petitioner argues that the Department properly determined that the single-specification product coded as 3 is the most similar product to the merchandise sold in the United States, but argues that the Department should have treated the double-specification home market product coded in the response as 15 as equally similar to the pipe sold in the United States as the product coded as 13, because seamless pipes that meet the requirements of the more exacting dual specifications coded as 15 necessarily meet the requirements of the triple-specification merchandise coded as 13 that includes a redundant specification for standard pipe.

### **Respondent Rebuttal**

In rebuttal, VMB argues that the petitioner's challenge to the model-match methodology is untimely, and that there is no justification for revising the hierarchy at this stage. Further, VMB argues that there are distinct physical differences between the two products and that certain products classified as Code 15 cannot be classified as Code 13 because they exceed the maximum manganese limit. VMB cites section 771(16)(B) of the Tariff Act of 1930, as amended ("the Act") as requiring the Department's model-match methodology to account for end-use and commercial value in determining the most similar match to the subject merchandise. VMB points out that the Department's final determination in the original investigation stated:

... the generally accepted definition of standard, line and pressure seamless pipes is based largely on end use, and that end use is implicit in the description of the subject merchandise. Thus, end use must be considered a significant defining characteristic of the subject merchandise.<sup>1</sup>

### **Petitioner Rebuttal**

The petitioner points to the Department's finding at verification that products meeting the multiple specification are produced to meet the strictest requirements of any of the specifications and grades.<sup>2</sup> Further, the petitioner argues that in determining the applications of seamless pipe, the most important

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<sup>1</sup>*Small Diameter Circular Seamless Carbon and Alloy Steel, Standard, Line and Pressure Pipe From Brazil*, 60 F.R. 31960, 31962 (June 19, 1995).

<sup>2</sup>Memorandum from Helen M. Kramer and Patrick Edwards to the File Regarding Verification of Home Market and U.S. Sales Information Submitted by Vallourec & Mannesmann (V&M) do Brasil, S.A. (May 26, 2004) at 11 (Public Version) (Sales Verif. Report).

requirements are the mechanical properties of the pipe, *i.e.*, the tensile strength and yield strength. As defined in steel industry manuals, a pipe's tensile strength measures its resistance to internal burst or catastrophic failure under pressure, and the yield strength of a pipe measures its resistance to yielding or bulging under pressure.<sup>3</sup> According to the petitioner, these properties necessarily determine the possible applications for which seamless pipe products may be used and the comparability of such products to one another. The petitioner points out that although VMB acknowledges the importance of applications in determining the comparability of pipe products, it has failed to address the mechanical properties of the specifications at issue. The petitioner contends that an examination of these properties conclusively shows that the Code 3 product is more similar to the Code 14 product sold in the United States than the Code 13 product. The petitioner points out that the Code 3 product sold in the home market had an identical minimum tensile strength and a nearly identical minimum yield strength to the Code 14 product sold in the United States. In contrast, the Code 13 product sold in the home market was produced to a lower grade, and had lower minimum tensile and yield strengths than both the Code 14 and the Code 3 products sold by VMB.

The petitioner argues that VMB overstates and mischaracterizes the differences between Code 3 and Code 13 pipe. For example, VMB contends that the dimensional tolerances of Code 3 pipe are "looser." However, according to the petitioner, Code 3 pipe has exactly the same negative outside diameter and wall thickness tolerances as Code 13 and Code 14 pipe. The petitioner disputes VMB's contention that Code 3 pipe has no positive wall thickness tolerance requirement, explaining that a producer cannot increase the wall thickness of its products more than the weight tolerance allows. Furthermore, the petitioner argues that the weight tolerance for Code 3 products necessarily imposes strict restrictions on the wall thickness, and consequently, imposes strict restrictions on the outside diameter tolerances.

The petitioner points out that ASTM A 106 requires a hydrostatic test in all instances except when specified by the purchaser,<sup>4</sup> as well as bending and flattening tests, disputing VMB's assertion that Code 3 pipe has different testing requirements than Code 13 and Code 14 pipe. The petitioner concludes that considering both the fundamentally important mechanical properties of tensile strength and yield strength, as well as the less significant requirements for seamless pipe VMB relied upon, Code 3 pipe is clearly more similar to the Code 14 pipe than the Code 13 triple-stenciled pipe sold by VMB in the home market. Accordingly, where it is not possible to compare the Code 14 pipe sold in the United States to the identical product sold in the home market, the petitioner argues that the Department should continue to treat the Code 3 pipe as the next most similar product.

#### **Department's Position:**

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<sup>3</sup>See *The Making, Shaping and Treating of Steel* at 1403; *AISI Steel Products Manual* at 23.

<sup>4</sup>VMB Supplemental Questionnaire Response on Matching Criteria at Exhibit 3 (ASTM A106 Specification, p. 31 (SSQR3-248)) (Public Version).

We agree with the petitioner. As explained by VMB officials at verification, in the U.S. market it is increasingly common for distributors to order pipe that conforms to multiple specifications and grades of steel for maximum flexibility in filling orders by end-users while controlling inventory levels. In contrast, in the Brazilian market, this trend is in very early stages and it was not possible to find contemporaneous sales that were identical matches to all the U.S. sales produced to the multiple specifications. Further, as agreed by both parties, when the customer orders a product to meet multiple specifications and grades in order to be suitable for a variety of applications, the strictest requirements of any of the standards must be satisfied. For the multiple-specification product, the strictest requirements are determined by the minimum tensile strength of 70,000 psi and minimum silicon content of 0.10 percent for killed steel required for high temperature applications, and the minimum yield strength of 42,000 psi required for oil and gas pipelines using Grade X42 steel. Code 3 pipe is the only other pipe that has a minimum tensile strength of 70,000 psi. In addition, its minimum yield strength of 40,000 psi is the closest to the multiple-specification requirement of any of the alternative products. Furthermore, VMB's order confirmation for the U.S. sales states that all items are to be produced to the physical properties of the specification and grade coded as 3. *See Sales Verification Exhibit 31, page 10.* The home market products coded as 13 and 15 were produced using a lower grade of steel that has a minimum tensile strength of only 60,000 psi and minimum yield strength of only 35,000 psi. Thus, the Department continues to believe that the most similar home market pipe to the pipe sold in the United States is that coded as 3 in the model match. This product has higher performance requirements than the products coded as 13 and 15.

We disagree with VMB's claim that the petitioner's comments are not timely, as these comments are argument and not new information, and point out that if we were to agree with VMB's illogical contention, we would have to reject VMB's comments on the weights assigned in the model match as well. Further, we agree with the petitioner that for the final results, we should assign equal weight to Codes 13 and 15 as both are equally similar to the U.S. product. We find that VMB has overstated the significance of the third specification included in the product coded as 13 in the model match, which is a lower performance specification for general applications such as sprinkler systems in buildings. A product that meets the stricter performance requirements of the other two specifications that are included in both Codes 13 and 15 for high temperature and oil and gas pipeline applications would necessarily exceed the requirements for the third specification. Therefore, the dual specification product coded as 15 that includes the higher performance requirements is the functional equivalent of the triple-specification product coded as 13, and we agree that we should assign equal weight to them in the model-match hierarchy.

*Comment 2. CEP Offset*

**Petitioner**

The petitioner argues that VMB has failed to meet its burden to establish its entitlement to a constructed export price (CEP) offset and that the Department should deny VMB's claim for such an adjustment in the final results. Citing section 773(a)(7)(B) of the Act, the Statement of Administrative Action for the

Uruguay Round Agreements Act (SAA) and the Department's regulations, the petitioner argues that the burden is on the respondent to demonstrate that "normal value is established at a level of trade which constitutes a more advanced stage of distribution than the level of trade of the constructed export price" and that a CEP offset is warranted.

The petitioner points out that in its Section B response at B-29, VMB stated that its CEP sales are made at the same level of trade (LOT) as home market sales to distributors, and that its CEP sales "should be compared to home market distributor prices." Further, the petitioner notes that in its Section C response at C-20, VMB stated that it assigned a LOT code of "1" to all CEP sales and this "is identical to the level of trade code assigned to home market sales to distributors." The petitioner concludes that by VMB's own admission its CEP sales and its home market sales to distributors are at the same LOT, and that accordingly, the Department should match such sales at the same LOT (*i.e.*, LOTH 1 and LOTU 1) and should deny VMB's request for a CEP offset.

The petitioner claims that this conclusion is further supported by the fact that VMB has reported the same level of indirect selling expenses (ISE) for sales in both markets, and that while this is not dispositive, the Department has considered the levels of selling expenses incurred for different groups of sales to be relevant to a determination of the respective LOTs of those sales, citing *Professional Electric Cutting Tools From Japan; Final Results of Antidumping Duty Administrative Review*, 63 FR 6891, 6895 (February 11, 1998). The petitioner argues that in the instant case, the fact that there is no difference in the selling expenses incurred for home market and CEP sales once again shows that those sales are made at the same LOT.

The petitioner argues that VMB's statements demonstrate that the level of selling functions performed for its home market sales to distributors is relatively limited and, therefore, is comparable to its CEP sales. The petitioner cites VMB's statements in its Supplemental Questionnaire Response (SQR) dated February 9, 2004, at 1 and 3, that home market distributors have a long tradition of buying from VMB, that the distributors already know VMB and its products very well, and that this "makes the selling task much easier" for VMB. The petitioner also cites VMB's statements at verification, where VMB reiterated that "there are inherent differences between distributors and end-users" and that "VMB does not provide services to distributors." See Sales Verif. Report at 12 (Public Version).

The petitioner argues that although the Department found in the preliminary results that there are differences in the number of selling functions performed for home market sales to distributors and for CEP sales, this is not sufficient to find that they are at different LOTs. The petitioner cites the Department's finding in *Notice of Final Determination of Sales at Less Than Fair Value: Emulsion Styrene-Butadiene Rubber From Mexico*, 64 FR 14872, 14877 (March 29, 1999) (*Rubber from Mexico*), that "a substantial difference in selling functions, *inter alia*, must exist in order for the Department to find a different LOT; a difference in the number of selling functions alone is not sufficient."

### **Respondent's Rebuttal**

In rebuttal, VMB argues that the petitioner's assertion that VMB failed to demonstrate its entitlement to a CEP offset is fundamentally flawed, ignores the Department's clear findings at verification, and overlooks crucial record evidence. VMB points out that the Department's verifiers held detailed discussions with VMB officials regarding selling functions and services VMB offers to different classes and groups of customers in both the U.S. and home markets, and that based on its verification findings, the examination of VMB's responses, and detailed analysis of the issue, the Department concluded that "the selling functions for the reported channels of distribution" in the home market "are sufficiently similar to consider them as one LOT in the home market."<sup>5</sup>

VMB admits that it erred in comparing its home market distributor sales to sales in the United States to unaffiliated customers, stating that this is readily apparent in Exhibit A-11 of its December 8, 2003, Section A response, where it included selling functions performed by its U.S. affiliate, Vallourec & Mannesmann Tubes Corporation (VMC), for the unaffiliated U.S. customer.<sup>6</sup> However, VMB argues, the evidence on the record clearly indicates that the selling functions VMB performs for the sale to VMC include sales forecasting, order processing, delivery and warranties, while in contrast, when selling in the home market, VMB performs sales forecasting, planning and promotion, order processing, general selling functions performed by VMB personnel, provision for warranties, sales and marketing support, research, advertising, and after sales services. *See Prelim Sales Analysis Memo.* at 2 and 3. Furthermore, VMB argues, there is no question that its home market LOT is further in the chain of distribution, as many sales are to distributors that may go through unaffiliated warehouses. *See id.* at 3.

VMB counters the petitioner's argument that the U.S. and home market LOTs must be identical because VMB reported the same ISE ratios in both markets, explaining that in those instances where domestic and export sales are handled from the same office, a company's records do not account for ISE separately by market. VMB explains that it does not book those expenses by market such that it can calculate market-specific ISE.

VMB agrees with the Department's conclusion in *Rubber from Mexico*, cited by the petitioner, that differences in the number of selling functions alone do not warrant determination of separate LOTs. In the instant case, however, VMB contends that in accordance with its long-standing policy, the Department clearly considered more than just differences in selling functions in its analysis. VMB cites

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<sup>5</sup> Analysis Memorandum for the Preliminary Results of Administrative Review of Small Diameter Circular Seamless Pipe from Brazil: V & M do Brasil, S.A., August 30, 2004 ("Prelim Sales Analysis Memo."), at 3.

<sup>6</sup> *See* Response to Section A of the Department's Questionnaire, December 9, 2003, at A-12 and Exhibit A-11; Prelim Sales Analysis Memo. at 3 (where the Department notes VMB's inclusion of selling functions performed by both VMB and VMC).

the Sales Verif. Report at 12 and the Prelim Sales Analysis Memo. at 2 - 4 as demonstrating that the Department examined all aspects of VMB's sales processes and practices in making its determination, and that it weighed the relative importance of each of VMB's reported selling functions, the chain of distribution in each market, the different classes and groups of customers, pricing differences, differences in marketing stages or channels of distribution, and designated customer categories.

Disputing the Department's preliminary finding that the record information on differences in selling functions in the home market is insufficient to support a LOT distinction between distributors and end-users, VMB agrees with the petitioner that there are two LOTs in the home market. VMB points out that it offers lower prices to distributors because they purchase in larger volumes than end-users. VMB cites the Sales Verif. Report in support of its claim that it also acts like a service center for end-users in that it provides a variety of services such as cutting, beveling, and further processing. *See* Sales Verif. Rep. at 12. However, VMB points out that even if the Department reverses its preliminary results determination and finds two home market LOTs, the record evidence unequivocally demonstrates that neither home market LOT is identical to the CEP LOT. VMB argues that whether there is a single LOT or two separate LOTs becomes a moot point, because under either home market LOT scenario, the record evidence clearly demonstrates that the home market sales are at a distinctly different LOT and at a more advanced stage in the chain of distribution than the U.S. CEP LOT. Accordingly, the Department does not have record information to allow it to examine a pattern in price differences between the U.S. and home market LOTs and does not have the data available to calculate an appropriate LOT adjustment to normal value (NV). Thus, VMB concludes, no matter the scenario, in accordance with Section 773(a)(7)(B) of the Act, a CEP offset adjustment is appropriate and must be made.

**Department's Position:**

We agree in part with VMB. Pursuant to 19 CFR 351.412(f), the Department may determine that sales in the two markets were not made at the same LOT, and that it is not possible to determine whether the difference affects price comparability. In making our determination, we did not rely on the erroneous comparisons the respondent made in its initial responses to the Department's questionnaire, but instead relied on the responses to our supplemental questionnaire dated January 16, 2004, regarding selling functions relevant to LOT. In its response of February 9, 2004, VMB stated that it provided a number of selling functions exclusively for end-user customers.

The subject of providing further processing services to end-users, such as cutting, slitting and galvanizing, was not discussed in any of VMB's questionnaire responses. However, in the Section A response dated December 8, 2003, VMB provided a schematic for the home market sales process at A-060 that shows some sales passing through a service center where further processing occurs before delivery to an end-user. The claim that VMB provides substantial in-house and subcontracted further processing services was first specifically raised at the sales verification. As the record provides no substantive information to support this claim, such as invoices for these services, and the verifiers



considered it to be new information submitted past the deadline, we have disregarded it in conducting our LOT analysis.

In the same response, VMB stated that to maintain close ties with traditional customers, particularly distributors, it will often share with a distributor the expenses incurred in connection with the inauguration of a new sales office. In addition, VMB stated that it sometimes covers expenses incurred in connection with booth installation at trade fairs and expositions in which it is interested in participating, and sometimes will share advertising expenses with distributors. Further, VMB stated that it performs market research based on information supplied by its distributors, and shares the results of its analysis with them.

VMB neglected to include in its discussion of LOT the warehousing services provided to certain customers. The schematic in the Section A response referred to above indicates that warehousing is provided to both distributors and end-users. However, VMB's home market sales listing shows that warehousing was provided rarely to end-users, and in a substantial number of sales to distributors.

We note also that VMB did not distinguish between sales to distributors and end-users by including the LOTH/LOTU fields in its sales listings, as implied by its narrative responses, but distinguished between these sales in the field for channel of distribution (CHANNELH/U).

In regard to selling functions performed for sales to its U.S. affiliate, which determines the LOT for the CEP sales, in the February 9, 2004, response VMB explained that its parent company, V&M Europe, makes sales in the United States through V&M Corporation (VMC), which is responsible for negotiations, planning and customer service. Further, VMB stated that all U.S. sales are made to order within normal terms for planning, production and delivery. At verification, the VMB official responsible for export sales explained that the extent of the services VMB provides to VMC is essentially delivery. *See Sales Verif. Report at 12.*

As the petitioner recognizes, the fact that VMB reported the same ISE ratios in both the U.S. and home markets is not dispositive. Indeed, as VMB points out, its accounting system does not distinguish between expenses incurred for domestic and export sales. Furthermore, we have reviewed VMB's methodology of calculating ISE and have—for reasons unrelated to LOT—revised it for these final results. *See below under Comment 6.*

Pursuant to section 351.412 (f) of the Department's regulations, we grant a CEP offset only when NV is compared to CEP, NV is determined at a more advanced LOT than the CEP LOT, and despite the fact that the respondent has cooperated to the best of its ability, the data available do not provide an appropriate basis to determine whether the difference in LOT affects price comparability.

We have carefully weighed the evidence on the record and the interested parties' arguments, and conclude that there are indeed two LOTs in the home market, as both sides claim. The selling functions

performed for end-users are different, more numerous and generally at a more intense level than those performed for distributors, except for warehousing. However, the record is clear that VMB provides substantially fewer and less significant services to its U.S. affiliate, VMC, than to home market distributors. Furthermore, with regard to VMB's reporting incongruities, the Department finds that, despite these discrepancies, VMB cooperated to the best of its ability and that its neglecting to provide certain information pertaining to its selling functions did not hinder or compromise our analysis of LOT or the CEP offset, nor the granting thereof. Accordingly, we find that VMB's home market sales to distributors are at a more advanced stage of marketing than its CEP sales and that there is no LOT in the home market corresponding to the LOT of the CEP sales. As there is no basis for calculating a LOT adjustment based on the price differences between sales at different LOTs in the home market, the requirements for granting a CEP offset are met.

### *Comment 3. Interest Rate*

#### **Petitioner**

The petitioner disputes the Department's finding at the sales verification that VMB had one short-term bank loan in Brazilian reais during the POR (Sales Verif. Report at 6 (Public Version)), and points out that VMB stated in its Section B questionnaire response that it had no short-term bank loans denominated in reais, and therefore used the published Special Clearance and Custody System (SELIC) rate to calculate its home market credit expenses and inventory carrying costs. The petitioner argues that the loan in question was not denominated in reais, and that the Department should use the SELIC rate of 22.57 percent originally reported by VMB to calculate home market credit expenses and inventory carrying costs in the final results.

#### **Respondent**

In rebuttal, VMB argues that the Department's findings in its Sales Verif. Report that the loan reflected a "bank loan contract for a loan in reais" were based on its review of the loan, the documentation presented, and discussions with VMB, and leave no room for interpretation or doubt. VMB urges the Department to continue to rely on the short-term borrowing rate it calculated based on this loan and not to revise VMB's home market inventory carrying cost and credit expenses.

#### **Department's Position**

We agree in part with the petitioner. In reviewing Sales Verif. Exhibit 21, we find that the loan in question was paid off before the beginning of the POR and there were no reais-denominated short-term loans during the POR. Therefore, for the final results, we will use the SELIC rate VMB reported to calculate home market inventory carrying cost and credit expenses. In the Issues and Decision Memorandum for the Administrative Review of Silicon Metal from Brazil - 7/1/1999 through 6/30/2000; Final Results, 67 FR 6488 (February 12, 2002) (Silicon Metal) at Comment 1, the Department found that the SELIC interest rate is the primary interest rate of the Brazilian economy. It is based on the purchase and sale of public debt securities registered in the SELIC system. The SELIC

rate is published daily, in annualized form, and represents the weighted average of rates at which public sector securities were traded.

#### *Comment 4. Credit Expenses*

##### **Petitioner**

The petitioner argues that the Department should not have included indirect taxes in the calculation of VMB's home market imputed credit expenses, citing past practice as noted in *Silicon Metal* at Comment 31, and *Notice of Final Determination of Sales at Less Than Fair Value: Certain Hot-Rolled Flat-Rolled Carbon-Quality Steel Products From Brazil*, 64 FR 38756, 38773 (July 19, 1999) (*Hot-Rolled Final Determination*). VMB did not comment on this issue.

##### **Department's Position**

We agree with the petitioner. In the preliminary results, we inadvertently omitted the subtraction of indirect taxes in our recalculation of VMB's imputed credit expenses. In *Hot-Rolled Final Determination*, the Department stated: "It is the Department's practice not to impute credit expenses related to VAT payments."

#### *Comment 5. Inventory Carrying Costs*

##### **Petitioner**

The petitioner contends that the Department improperly calculated VMB's inventory carrying costs (ICC) based on home market price rather than manufacturing cost, contrary to its normal practice, citing the Issues and Decision Memorandum for the Final Determination in the Antidumping Duty Investigation of Steel Concrete Reinforcing Bars from the Republic of Korea, 66 FR 33526 (June 22, 2001). The petitioner points out that ICC are intended to measure the opportunity cost of carrying merchandise in inventory, which is measured by the total cost of manufacture of that merchandise, rather than by the number of days that merchandise sits in inventory before it is sold (*i.e.*, the turnover calculation).

##### **Respondent**

In rebuttal, VMB argues that the methodology it used to calculate its ICC is appropriate, and that the Department's practice does not require that ICC always be based upon a respondent's total cost of manufacture. VMB points out that the Department recognizes that a respondent's ICC calculation methodology may warrant the use of gross price rather than total costs of manufacturing, citing the *Glossary of Antidumping Terms*, which accompanies the Department's antidumping duty questionnaire at the Appendices, where the Department has defined inventory-carrying costs as follows:

Inventory carrying costs are the interest expenses incurred (or interest revenue foregone) between the time the merchandise leaves the production line at the factory to the time the goods are shipped to the first unaffiliated customer. The Department normally calculates these costs by applying the firm's annual short-term borrowing rate in the currency of the country where the merchandise is held, prorated by the number of days between leaving the production line and shipment to the customer, to the unit cost or price.

According to VMB, the Department recognizes that ICC may be applied to unit price or cost, depending on the method by which a respondent's records allow it to derive inventory turnover most accurately (*e.g.*, the number of days in inventory). VMB contends that the petitioner's assertion that the turnover calculation is not relevant and, no matter the method, the total cost of manufacture is always the appropriate basis, ignores a fundamental reporting requirement that all expense ratios be applied on the identical basis upon which they are calculated. If a respondent's inventory turnover calculation is based on sales rather than production, the formula must be applied against per-unit gross price to ensure accuracy. VMB acknowledges that in most instances respondents calculate the number of days in inventory using the value of inventory, and that, because inventory is typically valued at finished cost, the total cost of manufacturing is the appropriate basis for the calculation of reported per-unit inventory carrying costs. VMB cites the Department's Sales Verif. Report at 19, where the verifiers stated:

The formula VMB used to allocate inventory carrying costs is based on GRSUPRH, as the turnover calculation is based on sales invoices issued, rather than production.

VMB argues that the fact that price is the proper basis for its ICC calculations is so obvious that the Department took steps to refine the calculation even more by taking into account complementary invoices and billing adjustments. VMB concludes that the Department's home market ICC calculation in its preliminary results was accurate, appropriate, and based on record evidence, and that the Department should not revise its calculations for the final results.

**Department's Position:**

We agree with VMB. Although the Department's preferred ICC methodology is based on cost, we recognize that a respondent's accounting system used in the ordinary course of business may not readily yield the necessary information. Therefore, we allow the alternative methodology based on sales turnover and gross unit price, as long as it is reasonable and calculated on a consistent basis. For example, in *Light-Walled Rectangular Pipe and Tube from Mexico: Notice of Final Determination of Sales at Less Than Fair Value*, 69 FR 53677, 53679 (September 2, 2004), the Department noted that it revised the formula used in the calculation of ICC for respondent, Perfiles y Herrajes LM, by revising the number of days in inventory and deducting certain discounts from the gross unit price. Furthermore, we note that the petitioner did not raise this issue in its comments dated January 14, 2004, on VMB's Section B and C responses, and that the record lacks information on the

monthly cost of goods sold necessary to calculate ICC using the method suggested by the petitioner. We will continue to use the methodology used by VMB in its ICC calculation.

#### *Comment 6. Reversal of Bad Debt Expense*

##### **Petitioner**

The petitioner argues that the Department should exclude the reversal of bad debt expense from the general and administrative (G&A) and the indirect selling expense (ISE) rate calculations. The petitioner claims that the reversal of bad debt expense results only if bad debt expenses from the prior period are recovered or deemed recoverable. The petitioner asserts that it is the Department's established practice to exclude prior period items such as reversal of bad debt expense from both the G&A and ISE calculations. The petitioner cites *Circular Welded Non-Alloy Steel Pipe from the Republic of Korea; Final Results of Antidumping Administrative Review*, 66 FR 18747 (April 11, 2001) (*Non-Alloy Steel Pipe from Korea*) and accompanying Issues and Decision Memorandum at comment 11; and *Notice of Final Determination of Sales at Less Than Fair Value: Carbon and Certain Alloy Steel Wire Rod From Canada*, 67 FR 55782 (August 30, 2002) (*Alloy Steel Wire Rod from Canada*) and accompanying Issue and Decision Memorandum at comments 12 and 29 as supporting precedents. Thus, the petitioner argues that the Department should not only exclude the reversal of bad debt expense from the G&A expense rate calculation, but also from the ISE rate calculation for the final results.

##### **Respondent**

In rebuttal, VMB argues that the Department should continue to include the reversal of bad debt expense as an offset to ISE as in the preliminary results. VMB contends that VMB's auditors treated the reversal of bad debt expense in its financial statements as a change in accounting estimates which must be included in the current period (*i.e.*, not as a prior period adjustment). According to VMB, such accounting treatment is supported by both U.S. generally accepted accounting principles (GAAP) and international accounting standards (IAS). Thus, VMB maintains that the Department should continue to include this item as an offset to indirect selling expenses for the final results.

##### **Department's Position**

We agree with the petitioner. The Department's practice is to include the respondent's provision for bad debt in ISE. This provision is a company's estimate based on its prior experience with non-payment by customers. As there is no reason to believe the actual bad debt expense will be any higher or lower than the estimated expense, this estimate should not be lowered due to a correction or adjustment to previous years' write-offs. Thus, for the final results we have not used VMB's reversal of prior years' bad debt to offset either the bad debt in the ISE or G&A expenses.

Furthermore, as explained in more detail in the Memorandum to the File from Helen M. Kramer dated February 4, 2005, regarding the Analysis of the Final Results for the Eighth Administrative Review of

Small Diameter Circular Seamless Carbon and Alloy Steel Standard, Line and Pressure Pipe from Brazil (Final Analysis Memo), we have further revised the calculation of ISE to take into account VMB's provision for bad debt and an expense omitted from its reported ISE. In addition, for the final results we have allocated ISE in proportion to home market and export sales, and calculated separate ISE ratios for domestic and export sales.

*Comment 7. Adjustment to Cost of Manufacturing*

**Petitioner**

The petitioner notes that VMB used a correction factor (*i.e.*, INDCOR) to capture the cost difference between its financial and cost accounting systems in the reported costs, and argues that the Department's revision to INDCOR in the preliminary results to exclude costs related to non-subject products is incorrect because the numerator and the denominator used in the calculation are not on the same basis. The petitioner argues that for the final results, the Department should not adjust the INDCOR factor used by VMB.

**Respondent**

VMB argues that there is no error in the Department's methodology of calculating the revised INDCOR and that the Department should continue to use the revised INDCOR in the final results. According to VMB, the Department properly identified the portions of the cost adjustment attributable to subject and non-subject merchandise and equally attributable to both subject and non-subject merchandise. VMB claims that using the original INDCOR overstates the reported costs because it includes costs attributable to only non-subject merchandise. Thus, VMB maintains that the Department should continue to apply its adjustment to INDCOR for the final results.

**Department's Position**

We agree with the petitioner that the numerator and the denominator used to calculate the revised INDCOR for the preliminary results were not on a consistent basis. However, we disagree with the petitioner's conclusion that we should use the INDCOR originally calculated by VMB, because it included amounts that were specifically attributable only to non-subject merchandise. During verification, we reviewed the amounts that made up the numerator of the INDCOR. We were able to identify some of the costs as directly attributable to subject merchandise or directly attributable to non-subject merchandise. However, some of the costs were not identifiable with either subject or non-subject merchandise. For the final results, the Department calculated a two-part INDCOR. For INDCOR part one, we allocated the costs identifiable to all subject merchandise over the cost of goods sold ("COGS") of subject merchandise. For part two, we allocated the costs that were unidentifiable as either subject merchandise or non-subject merchandise over the COGS of all products. We did not include the amount identifiable as non-subject in the revised costs. *See* Memorandum from Ji Young Oh to Neal M. Halper on the Cost of Production and Constructed Value Calculation Adjustments for the Final Results, dated February 4, 2005.

#### *Comment 8. G&A Expense Ratio*

##### **Petitioner**

The petitioner argues that three income and credit balance non-operating items should be excluded from the G&A expense ratio calculation for the final results. The petitioner asserts that the first item is related to income earned from investment activities and that it is the Department's practice to exclude these types of items from the G&A expenses.<sup>7</sup> The second item is the reversal of depreciation expense, which the petitioners claim is related to a prior period and that it is the Department's practice to exclude prior period items from the G&A expense.<sup>8</sup> The petitioners contend that the last item is also related to fixed assets in a prior period that should be excluded from G&A expense.

##### **Respondent**

VMB argues that the reversal of depreciation expense and the fixed asset item should be included in the G&A expense rate calculation. VMB asserts that its auditors classified the depreciation expense adjustment as a change in accounting estimates and not a prior period adjustment. VMB argues that according to section 773(f)(1)(A) of the Act, the Department shall calculate a respondent's costs "based on the records of the exporter or producer of the merchandise, if such records are kept in accordance with the GAAP..." VMB claims that the depreciation expense adjustment was in accordance with GAAP and that there is no basis for excluding this item from the G&A expense rate calculation. VMB states that the fixed asset item is not a prior period expense. VMB argues that write off of fixed assets, just like gains and losses on the disposition of fixed assets, should be included by the Department in the G&A expenses.<sup>9</sup>

##### **Department's Position:**

We agree with the petitioner that the income earned from an investment activity should be excluded from the G&A expense ratio calculation. It is the Department's practice to exclude the gains and losses

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<sup>7</sup>See *Stainless Steel Wire Rod from the Republic of Korea: Final Results of Antidumping Duty Administrative Review*, 69 FR 19153 (April 12, 2004) and accompanying Issues and Decision Memorandum at comment 8 (Stainless Steel Wire Rod from Korea); and *Notice of Final Determination of Sales at Less Than Fair Value: Carbon and Certain Alloy Steel Wire Rod From Canada*, 67 FR 55782 (August 30, 2002) and accompanying Issue and Decision Memorandum at comments 12 (Alloy Steel Wire Rod from Canada).

<sup>8</sup>See *Circular Welded Non-Alloy Steel Pipe from the Republic of Korea; Final Results of Antidumping Administrative Review*, 66 FR 18747 (April 11, 2001) and accompanying Issues and Decision Memorandum at comment 11 (Non-Alloy Steel Pipe from Korea); and Alloy Steel Wire Rod from Canada at comments 12 and 29.

<sup>9</sup>See *Notice of Final Determination of Sales at Less Than Fair Value: Stainless Steel Sheet and Strip in Coils From Japan*, 64 FR 30573, 30590 (June 8, 1999) (SSSS Coils from Japan).

associated with a company's investment activities from the G&A expense. *See Notice of Final Determination of Sales at Less Than Fair Value: Certain Cold-Rolled Carbon Steel Flat Products From Taiwan*, 67 FR 62104 (October 3, 2002) and accompanying Issues and Decision Memorandum at comment 6 (the gain from short-term investment was excluded from the G&A expense ratio calculation). Therefore, we excluded the investment income from the G&A expense ratio calculation for the final results.

We reviewed the record evidence and noted that the depreciation expense item is the correction of an error from a prior period. *See* Verification Report on the Cost of Production and Constructed Value Data Submitted by V&M do Brasil S.A. from Ji Young Oh to Neal M. Halper, dated August 30, 2004, at page 21. In this case, because the correction does not relate to expenses incurred during the POR, it is not appropriate to reduce the current period's costs to correct an error made in the depreciation expense recognized in prior periods. *See Certain Steel Concrete Reinforcing Bars From Turkey; Final Results, Rescission of Antidumping Duty Administrative Review in Part, and Determination Not To Revoke in Part*, 67 FR 64731 (November 8, 2004) and accompanying Issues and Decision Memorandum at comment 20 (the Department did not include the prior period items in the G&A rate expense ratio calculation).

In accordance with the Act, the Department will rely on a company's books and records to calculate COP if they are kept in accordance with the GAAP of the exporting country and reasonably reflect the costs associated with the production and sale of the merchandise. *See* Section 773(f)(1)(A) of the Act. However, we find that including the reversal of depreciation expense in the G&A calculation would distort the reported POR production cost. This is, we do not consider it appropriate to reduce the cost of producing subject merchandise during the POR by the amount which depreciation expense was misreported in prior years. *See Notice of Final Determination of Sales at Less Than Fair Value: Structural Steel Beams From South Korea*, 65 FR 41437 (July 5, 2000) and the accompanying Issues and Decision Memorandum at comment 26. Thus, we excluded the prior period correction of depreciation expense from the G&A expense ratio calculation for the final results.

We agree with VMB that the fixed asset item should be included in the G&A expense ratio calculation. We reviewed the record evidence and noted that this item relates to the routine sale of fixed assets. We note that, generally, disposition of fixed assets is a routine and normal part of ongoing operations for a manufacturing company. Accordingly, any resulting gains or losses are normally included as part of the G&A expense ratio calculation. *See Notice of Final Determination of Sales at Less Than Fair Value: Certain Frozen and Canned Warmwater Shrimp from Brazil*, 69 FR 76910 (December 23, 2004) and accompanying Issues and Decision Memorandum at comment 8. Thus, we have included this item in the G&A expense ratio calculation for the final results.

*Comment 9. Clerical Errors*

## **Respondent**



VMB notes that when deriving the field INTREV1H to calculate home market interest revenue in its home market sales SAS program, the Department inadvertently used the wrong number of decimal places for six client codes. The petitioner agreed that these errors should be corrected for the final results.

### **Petitioner**

The petitioner notes that in the preliminary results, the Department multiplied the U.S. packing expense (PACKU) by the exchange rate (EXRATE) twice in the margin calculation SAS program. The petitioner also points out that in applying a verification correction to the calculation of insurance on home market inland freight, the Department incorrectly applied the deduction of insurance to all home market sales, instead of only to those sales for which a separate insurance expense was actually incurred. VMB did not comment on these issues.

### **Department's Position**

We agree that these were errors and have corrected the calculations for the final results. *See* the Final Analysis Memo.

### **Recommendation**

Based on our analysis of the comments received, we recommend adopting all of the above positions and adjusting the margin calculation accordingly. If these recommendations are accepted, we will publish the final results of the review and the final weighted-average dumping margin for VMB in the *Federal Register*.

AGREE \_\_\_\_\_ DISAGREE \_\_\_\_\_

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Joseph A. Spetrini  
Acting Assistant Secretary  
for Import Administration

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Date