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ARTICLE

U.S. Trade Preferences Extension Act (TPEA) of 2015 Could Lead to Increased Use of "Particular Market Situation" in Calculating Normal Value in Anti-Dumping Cases

Matthew R. Nicely & Brian Gatta

At the end of 2016, China's Protocol of Accession (POA) to the World Trade Organization (WTO) will require a change in the way WTO members calculate normal value in anti-dumping (AD) proceedings involving China.[1] *Although no organ of the U.S. government has officially acknowledged that Paragraph 15 of China's POA will require the U.S. Department of Commerce (USDOC) to abandon its current non-market economy (NME) surrogate value method for calculating normal value for Chinese respondents post-2016, there is no question that some change in practice must take place in order to comply with the expiration of a key provision of that Paragraph that occurs effective December 12, 2016. Ultimately, it is quite possible that the WTO Dispute Settlement Body (DSB) will interpret the provision as requiring that members subject China to the "default" rules set forth in Article 2 of the WTO Anti-Dumping Agreement (ADA). What remains a mystery, however, is just what those default rules permit in terms of the flexibility afforded to investigating authorities in dealing with economies like China, where the state's role in the economy remains pervasive, even if to a lesser degree than it was in the past. It will also be interesting to watch how these new rules might be applied to traditionally market economies (MEs) whose governments, although not formerly communist, may be sufficiently involved in a particular market to also justify application of Article 2 in a manner that, to date, has not been widely adopted by USDOC or any other investigating authorities.*

These inquiries are not merely the idle musings of the authors, but draw on action already taken by the U.S. Congress and the European Commission. In amendments to its AD laws, known as the Trade Preferences Extension Act (TPEA), passed during the summer of 2015 as part of granting the Obama Administration Trade Promotion Authority,[2] *the U.S. Congress added language that expands USDOC's discretion to treat certain transactions as outside the ordinary course of trade (OCOT). Although no legislative history accompanied these amendments, they appear, at least in part, tailored to a post-NME normal value calculation paradigm, in which a respondent's costs can be disregarded and replaced with an alternative that may well approximate the NME methodology that China hoped would be eliminated as a result Article 15 of its POA. Meanwhile, the European Commission has adopted a practice that uses similar tools—so far only for MEs—where a respondent's transactions are deemed outside the OCOT. Together, the new U.S. law and recent European action both suggest a movement toward more flexible rejection of AD respondents' own data and replacement with data that look eerily similar to NME surrogate methodologies—for respondents in any country. But, stay tuned, as these efforts are currently under WTO review, and one dispute settlement panel has indicated that Europe's practice may have gone too far.*

1 U.S. NME TREATMENT

1.1 Current Practice

As of this writing, in early 2016, the United States still treats China and other devoutly communist countries (like Vietnam) as non-market economies (NMEs) in its anti-dumping (AD) cases, one effect of which is to calculate normal value (NV) using an abnormal methodology. In market economy (ME) cases, U.S. Department of Commerce (USDOC) uses the respondent's own home market price to arrive at normal value—or, under certain circumstances, the respondent's third country export price or a constructed value (CV) based on the respondent's own costs. In NME cases, USDOC does not trust the respondent's home market prices or its costs due to the influence of the state; and, rather than use third country export prices, it instead constructs normal value based on the respondent's "factors of production" to which it applies costs incurred in a similarly situated "surrogate" ME

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1 Paragraph 15(d) of the Accession of the People's Republic of China to the World Trade Organization.

2 Pub. L. No. 114-27. *See Annex 1* for a side-by-side comparison of the relevant altered provisions.

Global Trade and Customs Journal, Volume 11, Issue 5

(specifically, a market that is at a comparable level of development that also produces similar merchandise to the product being investigated). This practice of replacing home market prices and costs with values constructed from surrogate values is the key element of USDOC's AD practice against China, the result of which is to produce dumping margins that have no relation to the actual level of cross-market price discrimination that the AD instrument is designed to measure.

If the U.S. is forced to abandon this practice, which is specifically permitted under Article 15 of China's Protocol of Accession (POA) at least until December 12, 2016, it is assumed that USDOC, urged on by petitioners, will look for ways to justifiably reject Chinese respondents' own prices and costs and replace them with higher values found elsewhere, thereby driving up the dumping margin.

1.2 Outside the Ordinary Course of Trade" and "Particular Market Situation" – Old and New.

Article 2.2 of the World Trade Organization's (WTO) Anti-Dumping Agreement (ADA) permits an investigating authority to disregard a respondent's home market sales if they are outside the ordinary course of trade (OCOT) due to "particular market situation" (PMS) and to replace those sales with third country sales or CV. Article 2.2.1.1 then goes on to say a respondent's own cost records should be used in calculating CV, "provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration."

U.S. law, before passage of the Trade Preferences Extension Act (TPEA), already contemplated the possible rejection of a respondent's own sales and costs in calculating normal value. USDOC's traditional practice has been to first determine whether home market sales are outside OCOT where the examination was generally focused on the nature of *sales* (i.e., the terms of sale),[3] rather than costs. *If* sales are determined to be outside OCOT, then home market sales would be replaced with sales to a third country unless, among other potential impediments, USDOC found a "PMS". Up to now, however, the PMS provision has been very rarely used as a justification to resort to CV, in part because, while the statute did not define PMS, the Statement of Administrative Action (SAA) accompanying the implementing legislation for the WTO Agreements suggests that the scope of the term is relatively narrow. Assuming that neither home market nor third country sales were eligible for use, a CV based on a producer's costs of production could be resorted to, but with very strict limitations on the circumstances in which actual costs could be discarded or adjusted—generally, only those in which the producers' recorded costs do not reflect reality as a result of improper cost accounting.

While the TPEA amendments do not announce USDOC's post-2016 intentions vis-à-vis China, the nature and timing of these amendments, along with the U.S. support in a WTO dispute of a particular practice employed by the EU (discussed below), suggest that the U.S. plans to test the outer boundary of WTO law transforming its current NV methodology into something that could, in practice, serve to closely mirror the current NME methodology.

With respect to the question of whether CV may be resorted to as a threshold question, one TPEA amendment radically expands the scope of the "outside OCOT" concept by adding to it situations in which there is a PMS. This change might not be considered to be too meaningful if read in isolation and in light of USDOC's traditionally narrow interpretation of "PMS," but another amendment appears to radically expand the notion of PMS by establishing in an implied manner that a "particular market situation exists [when] the *cost of materials and fabrication or other processing of any kind* does not *accurately reflect* the cost of production in the ordinary course of trade".[4] The amended definition of CV makes clear that, when there is such a PMS, USDOC may replace the producer's actual cost using "any other calculation methodology," which on its face does not exclude reference to a surrogate country value.

The upshot of the foregoing is that, whereas OCOT and PMS were previously treated in U.S. law as distinct concepts and played separate roles in the NV order of operations, they have now been merged such that the identification of a PMS can serve both as a *means* to resort to CV in the first place, *as well as* a basis on which to ignore producers' actual costs in the calculation of CV. If the definition of PMS remained as narrow as it had been in the past, this new means by which to resort to CV might not matter all that much in practice, but the expansion of the definition of PMS is the other key establishing the bridge between the old practice and what may turn out to be an "NME-lite" practice aimed at China and other traditionally NMEs.

What might the notion of an "accurate reflection" of the cost of production in the OCOT mean? If the concept were limited to an "accurate recording" of the costs—in the sense of the relationship between producer's books and

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[3] For example, off-quality merchandise and related party transactions.

[4] We say in an implied manner because PMS does not appear in the "definitions" section of the AD law, but the scope of the concept is nevertheless expanded through the reformed definition of "constructed value".

its “true” cost of production—then the amendment containing that language might not matter much at all insofar as a producer could “control its own destiny” through its accounting procedures. Unfortunately for Chinese producers in particular and probably also some ME respondents, this is likely *not* what the term will be interpreted as meaning. Rather, it will likely be interpreted as referring to, in addition to the old accounting questions, the relationship between “actual costs” incurred and “undistorted” costs, where “distortions” might have nothing to do with accounting and can be established by reference to factors completely outside the control of the producer.

2 European Commission PMS Practice

As evidence for this proposition, consider that the NV portion of the EU’s AD law[5] contains language similar to the amended U.S. law, providing that, in the CV context, costs will be adjusted unless “the records reasonably reflect the costs associated with the production and sale of the product under consideration.” Like the amended U.S. law, the EU law does not require or otherwise even imply that records be deemed as not “reasonably reflecting” costs when those costs are “distorted” by, e.g., the state’s role in the market for the input concerned, but the EU has interpreted it that way. Further, the EU General Court has blessed the practice, which is currently the subject of three separate WTO challenges.[6]

In the AD case that Argentina is currently challenging at the WTO (DS473), the EU resorted to CV on the basis of there being a PMS, allegedly caused by an export tax “distorting” the domestic price of the most significant cost of production of the exported product, and proceeded to inflate NV by replacing the input cost with the “international” market price for the input concerned, resulting in some of the dumping margins increasing from ~20% to ~50%. While the parties have been forced to cling to generally irrelevant dicta in past WTO panel reports interpreting Article 2.2 and 2.2.1.1 of the ADA, the question of whether “distortion” to input prices caused by some exogenous factor may permit resort to “surrogate country” cost replacement was a novelty in WTO law before Argentina’s challenge. Importantly, for the purposes of this discussion, the United States submitted a third party submission specifically supporting the EU’s practice and its flexible interpretation of Article 2.2.1.1.[7]

Ultimately, the WTO dispute boils down to whether the scope of the cost-rejection provisions of the ADA are limited to the relationship between the producer’s recorded costs and *how those costs should have been recorded*, on one the hand, or whether those provisions extend to the relationship between a producer’s recorded costs and what *those costs would or should have been* but for some measure of “distortion”.

So far, the case is not going well for the EU. On March 29, 2016, the WTO panel in DS473 ruled that the EU acted inconsistently with Article 2.2.1.1 when it replaced the Argentine biodiesel respondents’ own soybean costs with an international value. The panel also found the EU’s action to violate Article 2.2, because the EU did not calculate cost of production based on the respondent’s own accounting records. While the panel acknowledged the ability of an investigating authority to find under Article 2.2.1.1 that a respondent’s records do not “reasonably reflect” the costs associated with production and sale of a product, it made clear that the EU misunderstood the relevant question. “The object of the comparison is to establish whether the records reasonably reflect the costs *actually* incurred, and not whether they reasonably reflect some hypothetical costs that might have been incurred under a different set of conditions or circumstances and which the investigating authority considers more reasonable than the costs actually incurred.” (Para 7.242.) As such, the panel did not find sufficient the EU’s explanation that the soybean costs needed to be replaced because they were lower than international prices due to the distortion caused by the export restraint. For the panel, it was not enough that input prices in Argentina were lower than international prices; rather, any cost used as a substitute would still need to reflect costs “prevailing in the country of origin.” Depending on how the Appellate Body reacts to the panel’s decision, this case could impose a limitation on how the United States may use its new legislation with regard to PMS.

3 Implications for China and other current NMEs

If the U.S. adopts a version of the current EU practice, and if USDOC’s countervailing duty practice against China

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[5] Council Regulation (EC) No 1225/2009 of Nov. 30, 2009.

[6] DS473 *European Union — Anti-Dumping Measures on Biodiesel from Argentina*; DS480 *European Union — Anti-Dumping Measures on Biodiesel from Indonesia;* and DS494 *European Union — Cost Adjustment Methodologies and Certain Anti-Dumping Measures on Imports from Russia — (Second complaint* replacing DS474*)*.

[7] “Article 2.2.1.1 allows for investigating authorities to ensure that the calculation of [CV] takes account of a government tax scheme (such as that adopted by Argentina) that may render recorded costs unreasonable”. *See* para. 24 of the U.S. third party submission in DS473.

serves as any indication,[8] there may be little to no limit on the extent to which Chinese respondents' recorded costs of production will be considered to not meet the threshold for "accurate reflection"[9] of costs of production in the OCOT. This would in turn entail the existence of a PMS permitting resort to a surrogate country value for the cost of production concerned. In that sense, the extent to which an adaptation of the EU's practice turns into a quasi-NME practice as it relates to China in particular post-2016 will be in large part a function of the threshold for establishing what constitutes "accuracy" in the context of the relationship between recorded costs of production costs in the OCOT.

At a bare minimum, we would expect that all of the inputs (all steel, land, electricity and even interest expenses) deemed so distorted so as to meet the standard for resort to "out of country benchmarking" in the China countervailing duty CVD context would fail to meet the "accurate reflection" threshold in the AD context. So too will inputs subject to "export restraints" and other measures that are considered to distort prices while not necessarily being countervailable due to lack of a "financial contribution" by the government. Indeed, without being constrained by the standards set for finding governmental "distortion" in the CVD context, or, for that matter, any of the other elements needed to establish a countervailable subsidy,[10] there is little limit to what costs of production a motivated and imaginative USDOC might consider as meeting the threshold for cost-rejection in post-2016 China cases.

At the most extreme end, and as a means to most closely bring the new "Article 2-based" AD practice in line with the current "Paragraph 15-based" NME practice, USDOC could even attempt to assign some measure of relevance to the "macroeconomic" situation of the country of a producer under investigation when coming to a determination as to whether any given cost of production is "accurately reflected" in a producer's records. By adopting such a practice, USDOC could conceivably achieve results that leave China uniquely vulnerable to abuse by application of the practice, while being able to claim—as it is able to in the CVD context in which reference to China's planning documents leave most of its economy vulnerable to subsidy allegations—that the applicable law is facially neutral and therefore does not impermissibly discriminate against China.

All of this, however, depends heavily on how the Appellate Body interprets Article 2.2.1.1 in the ongoing challenges to the EU's reliance on that provision to justify resort to out-of-country costs when distortions are found in the country of origin.

4 Implications for traditional MES

The fact that Europe's current use of PMS as a means to reject input cost data have occurred entirely with respect to MEs demonstrates that this new policy will not be reserved for China and other NMEs. In fact, one would expect the policy to apply equally to all MEs in order, in part, to counter the argument that the law is being applied in a manner that would offend most favored nation (MFN) obligations.[11]

In fact, in at least one U.S. case the petitioners have set forth the argument that the South Korean government's alleged subsidization of an upstream steel input requires USDOC to use a surrogate country alternative to the respondent's own costs for that input in calculating CV in the AD investigation.[12] According to that petitioner, "[t]he new legislation concerning "particular market situations" requires the {USDOC} to consider any {PMS} that prevents proper comparisons with U.S. sale prices". So, to the extent that there is a subsidy finding concerning the input in question, the petitioner claims this means "the vast majority of [the exporting producer's] cost of production is distorted through subsidization," which in turn "would qualify as a particular market situation…. Consequently, the Department would have to

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8 For the purposes of calculating program-specific CVD rates resulting from allegations of input subsidization in particular, USDOC considers vast swaths of the Chinese economy to be "distorted," and uses those findings as a justification to ignore actual input prices and instead refer to a third country benchmarks, much as it does in AD investigations against NMEs.

9 The new U.S. law requires that costs "*accurately reflect* the cost of production in the ordinary course of trade", whereas Art. 2.2.1.1 of the ADA requires that costs "*reasonably* reflect the costs associated with the production and sale of the product under consideration". The EU standard also uses "reasonably reflect," as opposed to "accurately reflect," suggesting that the U.S. standard could more easily permit rejection of costs.

10 For example, financial contribution, receipt of a benefit, specificity and action taken by a government (either directly through a public body or via the direction or entrustment of a private entity).

11 Indeed, this all may be a case of history repeating itself to some extent. In the CVD context, the WTO-compatibility of the "out of country benchmarking" practice that is essentially the *sine qua non* of both the U.S. and EU's anti-subsidy practice against China was first established by the WTO Appellate Body report in *US — Softwood Lumber IV* (2004) (DS257). In that case, the Appellate Body permitted the use of out of country benchmarks to countervail input subsidies granted to Canadian lumber producers, and since then the vast majority of the instances of out of country benchmarking have been used to counteract governmental "distortions" in the Chinese economy. Just as that nominally ME case paved the way for a practice particularly suited to use against NMEs, so too does it seem that an Appellate Body decision in the current EU-Argentina WTO case could, in establishing whether Art. 2.2.1.1 of the ADA permits surrogate country use in principle, quietly go a long way in determining China's fate in AD cases from 2016 and beyond.

12 *See* Letter from Maverick Tube Corporation to the Department of Commerce re*: Certain Oil Country Tubular Goods from the Republic of Korea – Information and Comments Requiring Immediate Action*, p. 2–3 (Nov. 25, 2015).

completely disregard the HRC prices in Korea and instead value HRC using a surrogate price."[13]

That particular investigation may prove to be a poor test case for how USDOC plans to interpret the relevant amendments to the TPEA because, among other reasons, the alleged distortion of the input in question had not even been established yet (the subsidization allegedly causing the distortion was later determined to be *de minimis*).[14] Nevertheless, the petitioner's argument demonstrates that the new law has implications not merely for current NME countries, but for MEs as well. Indeed, given the expectation that USDOC will continue to use the NME AD methodology for calculating NV in investigations involving China until at least December of 2016, the development of the new law is likely to take shape in the context of one or more ME cases.

5 The relationship between potentially rejected CV costs and CVD investigations

The developments described above have implications for any case in which sister AD and CVD cases are petitioned, leading to an expanded debate about the reach of current law with respect to "double remedies" on subsidies.[15] Those familiar with the mechanics of the prohibition against double remedies in the NME context might ask how that reasoning would not necessarily apply so as to remove the concern that a potentially aggressive CV "distorted cost-adjustment" practice might pose.

As a matter of principle, the Appellate Body's logic with respect to double remedies in DS379 should apply equally to NME and ME cases insofar as the replacement of a "distorted" cost with a non-distorted surrogate value on the AD side could duplicate the effect of countervailing a domestic input subsidy on the CVD side regardless of the economy involved. As a practical matter, however, the Appellate Body reports in DS379 and DS449 dealing with double remedies, and the U.S. legislation implementing DS379, are all technically limited to circumstances where the NME methodology[16] is used in the AD investigation. In addition, USDOC has implemented DS379 so as to require, as a prerequisite to making any adjustment for double remedies, that the respondent must demonstrate a reliably quantifiable link between the subsidy countervailed and the effect on export price.[17] That burden is further compounded by a requirement that the subsidy be shown to affect the prices of goods in the actual period in which the subsidy was granted.[18] These requirements have resulted in USDOC lowering the AD rate in only one of about 30 section 129 determinations undertaken to implement the double remedies decision.

In any event, the new distorted cost-adjustment practice may be used to effectively countervail, through the AD instrument, governmental price distorting measures that may or may not be legally countervailed. Indeed, the EU AD case against Argentinian biodiesel saw a parallel CVD case withdrawn, presumably because the export tax regime was deemed not countervailable for want of a financial contribution.[19] This practice of short-circuiting the CVD instrument to "address" through the AD instrument otherwise non-countervailable distortions poses its own set of risks, as does the fact that even when an input subsidy is otherwise countervailable, it could be preferable to choose to address the distortion though the AD instrument so as to bypass the potentially more onerous determinations needed in order to establish the countervailability of a subsidy.

6 Concluding thoughts

The picture painted here is somewhat bleak for those who would expect the end of 2016 to usher in an era of radically reduced U.S. AD duties against Chinese goods. The reality is that until the WTO's Appellate Body rules on whether the ADA permits investigating authorities to replace "distorted costs" with surrogate values, USDOC can be expected to use such a methodology to remove most of the benefit that China expects to enjoy as a result

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13 *Ibid.*

14 *See Countervailing Duty Investigation of Certain Hot-Rolled Steel Flat Products From the Republic of Korea: Preliminary Negative Determination and Alignment of Final Determination With Final Antidumping Duty Determination* (Jan. 15, 2016). The case is pending final determination as of this writing.

15 *See* generally s. VII of the WTO AB report of DS379 *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*.

16 *See* the Appellate Body's finding on double remedies in DS379, which pertain to "the concurrent imposition of anti-dumping duties calculated on the basis of an NME methodology and countervailing duties" (para. 611(d)), as well as the U.S. legislation prohibiting double remedies (Public Law 112-99 of Mar. 13, 2012), which on its face pertains only to "proceedings relating to imports from nonmarket economy countries".

17 Though here the link would presumably be subsidy to cost, which depending on the subsidy should be easier to establish than subsidy to price.

18 *See* for example, the Decision Memorandum for Preliminary Determination respect to the s. 129 Proceeding re: *Seamless Carbon and Alloy Steel Standard, Line, and Pressure Pipe from China* (Jun. 5, 2015).

19 *See* the panel report in DS194 *United States-Measures Treating Export Restraints as Subsidies*.

of the expiry of paragraph 15. Those interested in China's fate—as well as those of MEs with heavily subsidized and/or regulated industries—should therefore pay close attention to how Argentina's WTO challenge to the EU on biodiesel in DS473 is ultimately resolved.

ANNEX 1 – Pertinent TPEA Amendments to the U.S. AD Law (changes in *underline and italic*)

19 U.S.C. §1677(15) – definition of ordinary course of trade –

The term "ordinary course of trade" means the conditions and practices which, for a reasonable time prior to the exportation of the subject merchandise, have been normal in the trade under consideration with respect to merchandise of the same class or kind. The administering authority shall consider the following sales and transactions, among others, to be outside the ordinary course of trade:

(A) Sales disregarded under section 1677b(b)(1) of this title.

(B) Transactions disregarded under section 1677b(f)(2) of this title.

(C) Situations in which the administering authority determines that the particular market situation prevents a proper comparison with the export price or constructed export price.

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19 U.S.C. §1677b(e) – definition of constructed value

…

(e) Constructed value

For purposes of this subtitle, the constructed value of imported merchandise shall be an amount equal to the sum of—

(1) the cost of materials and fabrication or other processing of any kind employed in producing the merchandise, during a period which would ordinarily permit the production of the merchandise in the ordinary course of ~~business~~ *trade;*

…

For purposes of paragraph (1), if a particular market situation exists such that the cost of materials and fabrication or other processing of any kind does not accurately reflect the cost of production in the ordinary course of trade, the administering authority may use another calculation methodology under this part or any other calculation methodology. For purposes of paragraph (1), the cost of materials shall be determined without regard to any internal tax in the exporting country imposed on such materials or their disposition *that is* remitted or refunded upon exportation of the subject merchandise produced from such materials.

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19 U.S.C. §1677b(a)(1)(B)(ii)(III) – definition of normal value

…

(A) In general

The normal value of the subject merchandise shall be the price described in subparagraph (B), at a time reasonably corresponding to the time of the sale used to determine the export price or constructed export price under section 1677a(a) or (b) of this title.

(B) Price

…

The price referred to in subparagraph (A) is—

(i) the price at which the foreign like product is first sold (or, in the absence of a sale, offered for sale) for consumption in the exporting country, in the usual commercial quantities and in the ordinary course of trade and, to the extent practicable, at the same level of trade as the export price or constructed export price, or

(ii) in a case to which [the provisions regarding third country sales] applies, the price at which the foreign like product is so sold (or offered for sale) for consumption in a country other than the exporting country or the United States, if—

(I) such price is representative,

(II) the aggregate quantity (or, if quantity is not appropriate, value) of the foreign like product sold by the exporter or producer in such other country is 5 percent or more of the aggregate quantity (or value) of the subject merchandise sold in the United States or for export to the United States, and

(III) the administering authority does not determine that the particular market situation *in such other country* prevents a proper comparison with the export price or constructed export price.

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