SUBSIDY EXTINCTION AND THE DISTINCTION BETWEEN COMPANY AND SHAREHOLDERS UNDER THE SCM AGREEMENT: PROPOSING A CONTROL-CENTERED APPROACH

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ABSTRACT

The Agreement on Subsidies and Countervailing Measures allows Members to impose countervailing duties on subsidized imports that are causing harm to the relevant domestic industry. To impose Countervailing Duties (hereinafter "CVDs"), Members must establish, among other things, that the producer in question enjoyed a subsidy "benefit" during the time of export. In two privatization cases, US — Lead and Bismuth II and US — Countervailing Measures on Certain EC Products, the Panels and Appellate Body (hereinafter "AB") established a principle that could significantly affect a Member's right to impose CVDs. The principle states that the sale of shares in a company at arm's length and for fair market value presumably extinguishes any subsidy "benefit" previously enjoyed by that company. It follows that the company is no longer deemed to enjoy any subsidy "benefit", therefore, the importing Member will not be able to countervail the company's products. One particularly questionable aspect of the principle's rationale is the complete lack of a distinction between the company and its shareholders. The lack of distinction allowed for the notion that a purchase of shares made by the shareholders could extinguish a subsidy received by the company even though there was no money being taken out of the company. The Panels (and the AB to some

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extent) in the two privatization cases considered that whether the money taken out of the company is irrelevant, as the company and its shareholders are together a single subsidy "recipient" to be assessed. This paper argues that the Panel and AB's reasoning and assessment of the shareholder-company relationship are flawed and introduces a control-centered approach as a potential alternative.

KEYWORDS: *SCM Agreement, privatization, subsidy benefit, pass-through, subsidy extinction, subsidy recipient*

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I. INTRODUCTION

The Agreement on Subsidies and Countervailing Measures (hereinafter "SCM Agreement") sets forth remedies that a WTO Member can use to counter against the trade-distorting subsidies of another Member.[1] One important remedy is the unilateral imposition of countervailing duties (hereinafter "CVDs") on subsidized imports.[2] To impose CVDs, the Member must satisfy certain conditions, the first of which, is establishing the existence of a subsidy within the meaning of the SCM Agreement.[3]

Article 1 of the SCM Agreement provides that a subsidy exists when there is a (1) "financial contribution" by the government or any public body, and (2) "a benefit is thereby conferred".[4] While the description of "financial contribution" is fairly detailed, the article provides little guidance for the element of "benefit". This means that the adjudicating body may sometimes have to fill in the blanks and establish certain principles or rules regarding the determination of "benefit".

A particularly controversial principle came in a pair of cases, *US — Lead and Bismuth II* and *US — Countervailing Measures on Certain EC Products*, where it was established that privatization (i.e., the government sells the

[1] While subsidies could serve as useful tools of the government to correct market failures, they have the potential to negatively affect international trade, and in particular, the competing industries of other countries. For example, a subsidy that reduces the marginal cost of exporting firms would likely increase their production, resulting in an increase in exports into the market of the foreign country. Pursuant to basic economics, the increase in supply in the importing country will then push the price down, and the domestic companies in that country will be forced to compete at the lower price or go out of business. Likewise, a subsidy that lowers the marginal cost of production of domestic firms could result in lower prices of their product, and this could in turn serve as a soft barrier to entry for foreign companies importing into the home country, as those that are unable to compete at the lower price would eventually exit the market. *See* Gene M. Grossman & Petros Mavroidis, *United States — Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (WTO Doc. WT/DS138/AB/R): Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies*, *in* THE WTO CASE LAW OF 2001: THE AMERICAN LAW INSTITUTE REPORTERS' STUDIES 170, 180-93 (Henrik Horn & Petros C. Mavroidis eds., 2004).

[2] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14 [hereinafter SCM Agreement]. The SCM Agreement provides two remedy tracks that Members can utilize against trade distorting subsidies. Aside from the unilateral track (provided in Part V of the SCM Agreement), there is also a multilateral track (provided in Parts II and III of the SCM Agreement), which allows WTO Members to bring a complaint to the WTO against a prohibited subsidy (export subsidy) as provided under Article 3 or actionable subsidy as provided under Articles 5 and 6. In particular, to establish that a subsidy is actionable pursuant to Articles 5 and 6, it must be shown that the subsidy caused an adverse effect to the competing industry of the complaining Member. SCM Agreement arts. 3, 5-6. The use case for the multilateral remedy track is actually wider as it is not only limited to being used against subsidized imports, but can be used against subsidized products in other countries where the complaining Member's products are competing.

[3] Other conditions include establishing: (1) material injury to the relevant domestic industry and (2) a causal link between the subsidized imports and the injury. *See id.* arts. 11 & 19.

[4] *Id.* art. 1.1.

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shares of a state-owned company to private buyers) at arm's length and for fair market price warrants a presumption that the privatized company no longer enjoys a "benefit" from any non-recurring pre-privatization subsidy that it previously received. It follows that, in the absence of the "benefit", the subsidy can no longer exist.[5] This presumption was later referred to as "subsidy extinction principle" (or simply "extinction principle").[6]

The extinction principle has significant implications on the Members' ability to assess CVDs on subsidized imports, as they will be unable to establish the existence of a subsidy under such circumstances. A government can provide hundreds of millions of dollars to state-owned enterprises (hereinafter "SOE"), and these subsidies are then deemed to evaporate as soon as the government privatizes the SOE by selling their shares on the stock market. The implication would be even greater if we consider that the same rationale underlying the extinction principle is equally applicable to share transactions in general. As acknowledged in a later case, *EC — Aircraft*, applying the extinction principle broadly would "potentially eviscerate the subsidies disciplines of the SCM Agreement."[7]

This paper critically analyzes the rationale of the extinction principle. Specifically, it focuses on one particularly questionable aspect of the rationale concerning the lack of distinction of the company and its shareholders. In the factual scenario of the extinction principle, the subsidy is granted to the company, but it is the new shareholders who pay a fair market price for shares in share transactions. This raises the question of whether a subsidy received by the company can be extinguished by payments made by other persons.

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[5] Panel Report, *United States — Countervailing Measures on Certain EC Products from the European Communities*, ¶ 7.76, WTO Doc. WT/DS212/R (adopted Sept. 27, 2005) [hereinafter *U.S.— Countervailing Measures* Panel Report]; Panel Report, *United States — Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, ¶ 6.85, WTO Doc. WT/DS138/R (adopted June 7, 2000) [hereinafter *U.S.— Lead* Panel Report]. It should be noted that the privatization cases established the theory that both the sale of a productive unit/asset and the sale of shares could result in the extinction of subsidy. However, the determination with respect to the sale of shares is a far more complicated and controversial matter, mainly because, as noted by Rubini, there are three subjects that are involved: the seller (original shareholders), the buyer (new shareholders) and the company (which, apparently, the panels and Appellate Body [hereinafter AB] presumed is what is being sold in a shares transaction). LUCA RUBINI, THE DEFINITION OF SUBSIDY AND STATE AID: WTO AND EC LAW IN COMPARATIVE PERSPECTIVE 344 (2009). This complication gave rise to the question that this paper seeks to solve—that is, should the shareholder and the company be considered as separate or as part of the same producer when evaluating the existence of "benefit". For this reason, this paper will focus solely on the extinction theory with regard to share transactions.

[6] Panel Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft*, WTO Doc. WT/DS316/R (adopted June 1, 2011) [hereinafter *EC — Aircraft* Panel Report]; Kathleen Benner, *Extinction Event: Subsidies Extinction in* EC — Aircraft, 53 COLUM. J. TRANSNAT'L L. BULLETIN 30, 31 (2014).

[7] *EC — Aircraft* Panel Report, *supra* note 6, ¶ 7.246.

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Importantly, the Panel and the Appellate Body (hereinafter "AB") in the above two cases explained that whether a payment is made by the new shareholders or the company itself is irrelevant since they constitute a single producer for the purpose of the determination of "benefit" in share transactions.[8] In other words, they determined that the company and its new shareholders are together the potential "recipient" of "benefit" (or beneficiary) to be assessed.

As shown in this paper, the reasons provided to justify grouping the company and its shareholders together as one "recipient" are flawed.[9] The paper will also propose a "control-centered approach" for assessing the relationship between the company and its shareholders in the identification of "recipient". It should be noted that this paper does not argue that the extinction principle should be abandoned altogether. Rather, the control-

[8] *U.S.— Lead* Panel Report, *supra* note 5, ¶ 6.82; *U.S.— Countervailing Measures* Panel Report, *supra* note 5, ¶ 7.51.

[9] In the past, commentators' criticisms of the subsidy extinction theory have focused on the AB's definition of "benefit". In particular, Grossman and Mavroidis argued that the "benefit" should be evaluated in terms of its effect on the competitive advantage, and in particular, the production of the firm. They pointed out that the main goal of the SCM Agreement is to prevent subsidies from causing injury to the industries in the importing country. Pursuant to economic theory, a firm will increase the volume of supply when its marginal revenue is lower than its marginal cost of production. It follows that a subsidy will increase the volume of exports when it lowers the recipient's marginal cost. When the buyer purchases the shares of a company at fair market price, the company's ability to produce at a lower cost remains unchanged, which should mean that the subsidy still exists. Grossman & Mavroidis, *supra* note 1, at 180-93. Rubini also noted that the broader goal of subsidy discipline is to offset the competitive advantages enjoyed by the beneficiary. Thus, whether a market price is paid cannot be the only consideration in the determination of "benefit". RUBINI, *supra* note 5, at 352-53. The AB rejected this view in *US — Countervailing Measures*, noting that the SCM Agreement does not seek to address all competitive distortions. Rather, the SCM Agreement is only concerned with the market value (as opposed to the utility value) of an equipment acquired as a result of a financial contribution. Thus, as long as the "recipient" pays the market price for the equipment, it cannot be said to have benefited from the financial contribution regardless of the utility value it derives from the equipment. The AB also considered that the production cost and volume would be affected by the sale of shares. The AB claimed that this is because the production costs of a company include the cost of capital, which will be lowered if the shares are sold under the market value. When shares are sold less than the fair market price, it would normally result in a better return of the shareholders. As a result of the underpriced shares, the company can attract more investment that it could have otherwise. This additional investment would thus reduce the company's cost of capital and, ultimately, reduce the its overall production costs. Appellate Body Report, *United States — Countervailing Measures on Certain EC Products from the European Communities*, ¶¶ 100-03, WTO Doc. WT/DS212/AB/R (adopted Jan. 8, 2003) [hereinafter *US — Countervailing Measures* Appellate Body Report]. However, this claim by the AB is not entirely accurate. When shares are underpriced, the cost of capital is actually higher for the company, since the company would need to issue more shares in order to raise the same amount of capital. The paper is of the view that the AB's interpretation of the "benefit" is contextually correct, as it is supported by the guidelines for the calculation of "benefit" in Article 14 of the SCM Agreement. As pointed out by Diamond, the subsidy's effect on production should be a question in the causation determination rather than in the benefit determination. Richard Diamond, *Privatization and the Definition of Subsidy: A Critical Study of Appellate Body Texturalism*, 11(3) J. INT'L ECON. L. 649, 672-75 (2008). The main problem with the extinction theory is rather its flawed approach to the determination of "recipient".

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centered approach proposed here is meant to improve a particular aspect of the extinction principle.

The next part of this paper provides a detailed background on the origin, rationale and scope of application of the subsidy extinction principle. The third part of this paper will delve into an in-depth analysis of the problems regarding the panels' and AB's determination of "recipient" in the privatization cases. The fourth part of this paper proposes the control-centered approach to the determination of "recipient".

II. OVERVIEW OF THE SUBSIDY EXTINCTION PRINCIPLE: ORIGIN, RATIONALE AND SCOPE OF APPLICATION

A. The Origin and Rationale of the Subsidy Extinction Principle

As noted, the subsidy extinction principle originated from the privatization cases of *U.S. — Lead and Bismuth II* and *US — Countervailing Measures on Certain EC Products*. The core dispute in these two cases concerned the question of whether a subsidy "benefit" previously bestowed on a SOE would continue existing under the rules of the SCM Agreement after the SOE is fully privatized.

In the first case, *US — Lead and Bismuth II*, equity infusions were granted by the British government to the state-owned British Steel Company (hereinafter "BSC"). BSC subsequently spun-off its production assets to United Engineering Steels Limited (hereinafter "UES"), a joint venture between BSC and a private company. In the 1980s, the British government privatized BSC by using the state-owned British Steel plc. (hereinafter "BSplc") to assume all properties, rights and liabilities of BSC, and then selling BSplc's shares on the stock market.[10] BSplc eventually bought out the other shareholder and became the sole owner of UES, which was renamed British Steel Engineering Steels (hereinafter "BSES").[11] The United States (hereinafter "US") determined that portions of the subsidy had travelled from BSC to UES/BSES and therefore imposed CVDs on steel imports from UES/BSES. The European Communities (hereinafter "EC") asserted that the US violated the SCM Agreement by imposing CVDs, because the subsidies originally provided to BSC cannot confer a "benefit" to UES and BSplc/BSES.[12]

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[10] *U.S.— Lead* Panel Report, *supra* note 5, ¶¶ 6.22-24.
[11] *Id.* ¶¶ 2.3-4.
[12] *Id.* ¶ 6.36. The EC provided a number of examples demonstrating why this is so. In one example, it stated:

> Consider a person ("A") who is given £100 through a government financial contribution. This £100 confers a "benefit" on A, as the recipient of the money. A then purchases a chair with the £100. He sells the chair to a[n] unrelated purchaser,

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The Panel and the AB agreed with the EC. Their explanations were mostly similar and can be summarized together as follows. First, they found that, to impose CVDs, the SCM Agreement requires the existence of a present or continuing subsidy.[13] In particular, Article 21.1 states that "[a] countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization".[14] When a past subsidy no longer exists, there would also no longer be a need to "counteract subsidization".

Second, they noted that a subsidy exists only when a financial contribution confers a "benefit".[15] Regarding the definition of "benefit", they cited the AB in *Canada — Aircraft*, which held that:

> A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term "benefit", therefore, implies that there must be a recipient
>
> We also believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[16]

> B, for its fair market value, £100 . . . . The government is £100 poorer and A is £100 richer, both before and after the sale of the chair. B has not benefited at all. He has exchanged £100 for a chair which is worth that amount.

First Submission of the European Communities, *United States — Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products*, ¶ 51, WTO Doc. WT/DS138, (Apr. 27, 1999), http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114779.pdf.

[13] *US — Lead* Panel Report, *supra* note 5, ¶¶ 6.48-57; Appellate Body Report, *United States — Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, ¶¶ 52-54, WTO Doc. WT/DS138/AB/R (adopted June 7, 2000) [hereinafter *US — Lead* Appellate Body Report].

[14] SCM Agreement, *supra* note 2, art. 21.1.

[15] *US — Lead* Panel Report, *supra* note 5, ¶ 6.58; *US — Lead* Appellate Body Report, *supra* note 13, ¶ 55.

[16] The AB found contextual support for this interpretation in Article 14, which sets out guidelines "to calculate the benefit to the *recipient* conferred pursuant to paragraph 1 of Article 1" (emphasis added). The AB also found that the structure of Article 1.1 confirmed its view: "Article 1.1 has two discrete elements . . . . The focus of the first element is focused on the action of the government in

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Put simply, in any "benefit" analysis, the investigative authority must determine what the potential "recipient" (or beneficiary) got for free by reference to the benchmark in the relevant market. For example, suppose the government sells a printer to a company. The sale of goods constitutes a financial contribution under Article 1. If, in return, the company pays a market price for the printer, then the company does not "benefit" since the terms of the sale were not more favorable than those in the market for a similar printer. Conversely, if the company paid a below-market price, then it would have enjoyed a "benefit".

Finally, the Panel and AB held that, since BSplc was privatized (its shares were sold to private buyers) at arm's length and for fair market value, the privatized companies (BSplc and UES/BSES) do not enjoy any "benefit" from previous subsidies that were granted BSC.[17]

One notable issue regarding the above explanation that was raised by the US before the Panel was the fact that the purchases of shares and payments thereof are made by the new shareholders and not by the company which the subsidies were granted to.[18] Such payments by the new shareholders, even if consistent with market terms, do not in itself extract money out of the company. It is thus questionable whether the "benefit" enjoyed by the company would seize to exist after the shares transaction.

The Panel, however, held that the fact that the payment in shares transactions are made by the new shareholders rather than by the company itself is irrelevant, because "[i]n the context of privatization . . . the distinction between a company and its owners is redundant for the purpose of establishing 'benefit'."[19] This particular issue was not addressed on appeal.

Within six months of the EC's victory in *US — Lead and Bismuth II*, the EC requested consultations with the US regarding a dozen other countervailing determinations, resulting in the second case, *US — Countervailing Measures on Certain EC Products*. While the specific details of this case differed from the first case, the general factual backgrounds were

making the "financial contribution". That being so, it seems to us logical that the second element in Article 1.1 is concerned with the "benefit . . . conferred" on the *recipient* by that governmental action." *See* Appellate Body Report, *Canada — Measures Affecting the Export of Civilian Aircraft*, ¶¶ 154-55, 157, WTO Doc. WT/DS70/AB/R (adopted Aug. 20, 1999).

[17] *U.S. — Lead* Panel Report, *supra* note 5, ¶¶ 6.70-71; *US — Lead* Appellate Body Report, *supra* note 13, ¶¶ 63 & 74. It should be noted that the AB disagreed with the panel's view that the administrative review under Article 21 must be conducted in the same way as the original investigation under Article 19. According to the AB, in the original investigation, the investigative authority must establish all conditions set out under the SCM Agreement. In contrast, in an administrative review, the authority only has to address issues that are raised by the interested parties or, in the case that the review was self-initiated, issues that the authority considered warranted an examination.

[18] *U.S. — Lead* Panel Report, *supra* note 5, ¶¶ 6.82-84.

[19] *Id.* (The rationale will be explained in more detail later).

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similar insofar as they both concerned the US's continued imposition of CVDs on privatized steel companies from the EC for non-recurring subsidies those companies received prior to being fully privatized at arm's length and for fair market value (through the sale of shares or the sale of assets).[20] The argument by the EC in this case was also similar, as it again claimed that the arm's length transactions had led to the extinction of subsidy, and therefore, the US violated the SCM Agreement by imposing the CVDs.[21]

The Panel and AB in this case expanded on the holding in *US — Lead and Bismuth II* and also explained more clearly why they considered that a payment of fair market price for shares would extinguish the subsidy in the privatized company. The Panel first determined that there should be no distinction between the company and its shareholders for any "benefit" analysis, because when a company receives a subsidy, the "benefit" does not simply reside within the company, but will also be enjoyed by the shareholders.[22] Hence, the company and its shareholders should always be considered together as a single "recipient" to be assessed. It follows that, in a sale of shares, the "benefit" analysis should treat the new shareholders and the company as a single entity. As such, money taken out of the pockets of the new shareholders in the purchase of shares can be viewed as money being taken out of the company.

The Panel then explained why a fair market consideration paid in the purchase of shares would necessarily extinguish the subsidy "benefit":

> [T]he subsidy bestowed to the state-owned producer will necessarily be reflected in the balance sheet of the state-owned producer. Following privatization . . . , the sale price paid for the . . . shares of the state-owned producer will include a valuation of the advantage brought by the financial contribution . . . . [W]hen this valuation reflects market conditions, the benefit would be extinguished, since it has been fully paid for.[23]

The AB mostly upheld this finding by the Panel, stating that "[because] the value of the 'benefit' under the *SCM Agreement* is to be assessed using the *marketplace* as the basis for comparison . . . . [O]nce a fair market price

[20] Diamond, *supra* note 9, at 652; see *US — Countervailing Measures* Panel Report, *supra* note 5, ¶¶ 2.1-61 for details on the factual aspects of the case.
[21] *U.S. — Countervailing Measures* Panel Report, *supra* note 5, ¶¶ 4.9 & 4.11.
[22] *Id.* ¶¶ 7.50-51.
[23] *Id.* at 73 n.333. The AB in *US — Countervailing Measures* further made clear that since "the value of the 'benefit' under the *SCM Agreement* is to be assessed using the *marketplace* as the basis for comparison . . . once a fair market price is paid for the equipment, its *market value* is redeemed, regardless of the utility the firm may derive from the equipment." *US — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 102.

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is paid for the equipment, its market value is redeemed."[24] Hence, privatization through the sale of shares at arm's length and for fair market value compel a presumption that the subsidy previously granted to the privatized company ceases to exist. However, the AB noted that the Panel should have restricted its findings in two ways. First, the AB found that there could be situations where a distinction between the company and its shareholders are warranted for the purpose of a "benefit" analysis, and that the Panel, without considering all possible circumstances, should have limited its "recipient" determination to the particular facts of this case.[25] Second, the AB recognized that the government may impose certain policies that may affect the market's valuation of a property. Hence, the Panel's subsidy extinction principle can be rebutted when it is proven that the market price is distorted.[26]

B. Broader Application and Legal Implication

So far, this chapter has described how the subsidy extinction principle affects a WTO Member's ability to unilaterally impose CVDs on imported products from privatized companies that received subsidies prior to privatization. However, the application of the extinction principle is potentially broader. In particular, the *EC — Aircraft* case raised the possibility that the extinction principle could also be applied to share transactions between private entities.

The *EC — Aircraft* dispute concerned subsidies that were bestowed on certain national aircraft companies under the consortium Airbus Industry GIE, which was formed in 1970 by a number of EC governments to better compete in the global large civil aircraft market. In 2001, GIE was restructured into a single integrated company Airbus SAS through a series of transactions, including the sale of shares.[27] The US brought a dispute claiming, among other things, that the subsidies caused adverse effects to its

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[24] *U.S. — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 102.
[25] *Id.* ¶¶ 118-19.
[26] *Id.* ¶¶ 124-27. It should be noted that the AB left open the possibility that there may be other reasons that could be used to rebut the presumption of extinction:

> Indeed, we find that there is a rebuttable presumption that a benefit ceases to exist after such a privatization. Nevertheless, it does not necessarily do so. There is no inflexible rule requiring that investigating authorities, in future cases, automatically determine that a 'benefit' derived from pre-privatization financial contributions expires following privatization at arm's length and for fair market value. It depends on the facts of each case.

[27] *EC — Aircraft* Panel Report, *supra* note 6, ¶ 2.5; First Written Submission of the European Communities, *European Communities — Measures Affecting Trade in Large Civil Aircraft*, ¶ 45, DS316 (Apr. 5, 2007), http://trade.ec.europa.eu/doclib/docs/2007/april/tradoc_134551.pdf [hereinafter EC Written Submission in *EC — Aircraft*].

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aircraft industry.[28] The EC, citing the extinction theory established in *US — Lead and Bismuth II* and *US — Countervailing Measures on Certain EC Products*, argued that subsidies bestowed prior to 2001 were at least partially extinguished by the share transactions.[29]

One of the main differences in *EC — Aircraft* compared to the previous two cases was that some of the shares transactions at issue were conducted between private entities (private-to-private), whereas the previous cases involved only full privatizations (government-to-private). This raised the question of whether the application of the extinction principle can be expanded to private-to-private sales.

The case did not produce a clear answer with regards to this question, as each of the three AB members in this case had a different opinion on appeal and could not come to a final view. One member considered that, since the extinction principle was established in the context of full privatizations, it cannot be applied to private-to-private sales.[30] Another member considered that the rationale underlying the extinction principle also applies to situations of private-to-private transactions.[31] The third member appears to have suggested that the extinction principle is wrong entirely (more on this later as well).[32]

From a logical standpoint, the core rationale of the extinction principle (that is, new shareholders of the company do not enjoy a "benefit" as long as they pay a fair market price for shares) can be applied to any arm's length shares transaction, including those between private entities.[33] No reasonable explanation was provided in the *EC — Aircraft* to suggest otherwise. The AB member which considered the extinction principle to be inapplicable did not even provide a reason.

The Panel did suggest a couple of reasons for differentiating between privatization and private-to-private sales, but none of them were convincing. First, the Panel mentioned that privatization is different because it is "a very particular and complex change in ownership, which involves a fundamental transformation of a government-owned and controlled entity into a privately-owned, market-oriented company."[34] Even so, such a "transformation" only

[28] *EC — Aircraft* Panel Report, *supra* note 6, ¶ 3.1.
[29] *Id.* ¶ 7.203; EC Written Submission in *EC — Aircraft*, *supra* note 27, ¶ 198.
[30] Appellate Body Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft*, ¶ 726, WTO Doc. WT/DS316/AB/R (adopted June 1, 2011) [hereinafter *EC — Aircraft* Appellate Body Report].
[31] *Id.*
[32] *Id.*
[33] Coppens held the same view, stating that the application of the extinction theory in private-to-private sales "could only be rejected in a coherent way if the Appellate Body equally reverses its case law on full privatization, given that the same mechanism and rationale for accepting extinction are at stake." DOMINIC COPPENS, WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS 472 (2014).
[34] *EC — Aircraft* Panel Report, *supra* note 6, ¶ 7.253.

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entails that the company's decisions going forward may be guided by different motivations than before and that the company would not receive some of the advantages it used to enjoy, in the future. The Panel failed to explain how these changes have any effect on the existence of "benefit" that was bestowed prior to the privatization.

Second, the Panel noted that privatization would result in the government being paid a fair market consideration, which can be viewed as the government's realization of its investment.[35] In contrast, in private-to-private sales the government does not get paid, and therefore such a sale cannot extinguish the subsidy. However, this reason does not comport with the definition of "benefit" provided by the AB, which held that the "benefit" analysis is not concerned with the cost of the government. Rather, the analysis focuses on the "recipient". Therefore, whether the government realizes its investment is not necessarily relevant.

The possible applicability of the extinction principle to all arm's length shares transactions could have significant legal implications for the SCM Agreement. Specifically, if any arm's length sale of shares at fair market price could extinguish subsidies previously received by a company, then publicly traded companies would essentially be excluded from the scope of the SCM Agreement. This is because shares of publicly traded companies are constantly sold on the stock market at arm's length and fair market value. This concern was mentioned by the Panel in *EC — Aircraft*.[36]

The third AB member in *EC — Aircraft* (the one which disagreed with the extinction principle) also implied that the extinction principle would undermine the disciplines of the SCM Agreement, as companies would continue to enjoy the "benefit" from previous subsidies even after their shares are sold at fair market value:

> Shares in listed companies are traded on stock exchanges with great frequency and without any fear that sales on the market diminish the underlying value of the assets owned by these companies. . . . [N]othing about these trades extracts the value of

[35] *Id.* ¶ 7.254.

[36] *Id.* ¶¶ 7.245-46; The panel in *US — Large Civil Aircraft (2nd complaint)* when addressing a similar question also stated that:

> [D]aily trading in the shares of publicly traded corporations could not logically be excluded from the changes of ownership to which the "extinction" principles would apply. Therefore, a subsidized public trading corporation would be placed outside the disciplines of the SCM Agreement, because [the frequent sales of shares] in the company on arm's length terms and for fair market value would [quickly] "extinguish" the subsidies.

Panel Report, *United States — Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 7.870, WTO Doc. WT/DS353/R (adopted Mar. 23, 2012).

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> any asset, including the benefit of any subsidy granted. That subsidy continues to benefit the recipient, even if the ownership of the recipient's shares changes from one day to another.[37]

It is worth noting that the concern of this AB member also applies to the application of the extinction principle in privatization. Just as the transfer of shares in publicly-traded companies do not extract the value of assets from those companies, the sale of shares in a state-owned company (as was the case in *US — Lead and Bismuth II*) also would not extract the company's value of assets.

III. THE PROBLEM WITH THE EXTINCTION PRINCIPLE: A LACK OF DISTINCTION BETWEEN COMPANY AND SHAREHOLDERS IN THE DETERMINATION OF "RECIPIENT"

The problem with the rationale of the extinction principle stems primarily from the rationale for disregarding the distinction between the company and its shareholders and finding that they together constitute the "recipient". As noted, this lack of distinction made possible the idea that a payment made by shareholders for the company's shares could constitute a repayment of prior subsidies bestowed on the company even though there is no money actually being taken out of the company. This section will first summarize the rationales presented in the two cases for rejecting the distinction between the company and its shareholders before delving into an in-depth analysis of those rationales.

A. Rationales for Finding That the Company and Its Shareholders Are Together the "Recipient"

1. Price Paid by Shareholders Will Ultimately Be Paid by the Company — In *US — Lead and Bismuth II*, the Panel considered the fact that the payment came from the new shareholders rather than from the company itself did not matter, as the price paid by the new shareholders will ultimately be paid by the company.[38] This is because:

> Following privatization at arm's length, for fair market value, and consistent with commercial principles, the owners of the privatized company will be profit-maximizers, set on obtaining a market return on the entirety of their investment in the privatized company. Ultimately, therefore, the owners' investment in the

[37] *EC — Aircraft* Appellate Body Report, *supra* note 30, ¶ 726.
[38] *US — Lead* Panel Report, *supra* note 5, ¶ 6.82.

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> privatized company will be recouped through the privatized company providing its owners a market return on the full amount of their investment.[39]

Hence, the Panel held that "in the context of privatizations . . . the distinction between the company and its shareholders is redundant for the purpose of establishing 'benefit'."[40] The AB in this case did not address this particular issue.

2. The Company and Its Shareholders Are Both the Beneficiaries — In *US — Countervailing Measures on Certain EC Products*, the Panel took an even stronger position, holding that, for any "benefit" determination under the SCM Agreement (not just in the context of privatization), "no distinction should be made between a company and its shareholders, as together they constitute a producer . . . that may be the 'recipient' of the benefit to be assessed."[41] The Panel came to this conclusion based on the following reasons.

First, the Panel noted that "[t]he concept of benefit is independent of the legal business structure established pursuant to national corporate law", because the SCM Agreement does not explicitly make any distinction between the corporation and its shareholders for the purpose of the "benefit" determination.[42]

Second, the Panel considered that when a subsidy is granted to the company, its shareholders will also receive and enjoy the same "benefit", because:

> When the existence of a subsidy improves the ability of a producer to producer and export a good, it necessarily impacts on

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[39] *Id.* ¶¶ 6.82-83. The Panel noted that that the USDOC also previously found that the recipient is constituted by both the company and its shareholders:

> [I]n the real-world marketplace, the owner-shareholders' expectations of a return on their investment cannot be separated from the profitability of the newly privatized company. . . . The owners will seek to extract a rate of return from their company at least equal to that of alternative investments of similar risk. There is, then, no appreciable difference, as reflected in the marketplace, between the profit-making ability of the company and the owners' realization of a profitable return on their investment in that firm.

[40] *Id.* ¶ 6.82.

[41] *US — Countervailing Measures* Panel Report, *supra* note 5, ¶ 7.54. The panel in *US — Lead* reached the same conclusion. However, it should be noted that the panel in that case also suggested, in apparent contradiction to its conclusion, that the spinoff of BSC's assets to UES (the latter was partially owned by the former at the time) at fair market price could have extinguished the subsidy. *Id.* ¶ 6.81. If a company and its shareholder is to be considered as a single recipient entity, then the spinoff should have been considered as merely an internal transfer of assets.

[42] *US — Countervailing Measures* Panel Report, *supra* note 5, ¶ 7.50.

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> its profitability, and, therefore, on the rate of return to shareholders . . . .
>
> [When this happens], the value of the benefit conferred by a financial contribution should be reflected in the overall market value of the company which received it. When someone purchases a company for fair market value, the purchase price includes the value of the benefit conferred to that company. For the purpose of benefit determination based on market criteria . . . , there should be no distinction between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company.[43]

In other words, the Panel equated the increased financial wealth (conferred by the financial contribution) of the company to the increased rate of the return of shareholders.

3. A Clear Distinction Would Allow Governments to Indirectly Subsidize the Company — On appeal, the AB considered that a strict distinction between shareholders and the company would open "wide a door enabling subsidizing governments to circumvent [the SCM Agreement's] provisions",[44] as it is possible for the company to "benefit" indirectly from a subsidy that is bestowed on its shareholders. The AB provided the following hypothesis:

> [A] transfer of funds could be . . . provided indirectly, say, through an income tax concession to the natural persons that own the firm (inasmuch as they invest in the legal person's productive activities) . . . . [As a result], the cost of raising capital for the legal person that is the producer would be reduced. Hence . . . it is possible to confer a 'benefit' on a firm by providing a financial contribution to its owners, whether natural or legal persons, possibly holding property by means of shares.[45]

According to the AB, the mention of "subsidy bestowed . . . indirectly upon the manufacture, production or export" in footnote 36 indicates that the SCM Agreement intends to cover such situations.[46]

Nevertheless, the AB cautioned that rejecting the distinction may not be appropriate in all cases, as it is possible that a subsidy to the shareholders

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[43] *Id.* ¶¶ 7.50-51.
[44] *US — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 115.
[45] It should be noted that while the example provided by the AB is relevant to the broader discussion of whether to distinguish the company from its shareholders in all "benefit" determinations, it does not appear to be pertinent to the specific facts and issue of the case. It is thus somewhat confounding how the AB reached the decision to uphold the Panel's holding here. *Id.* ¶ 113.
[46] SCM Agreement, *supra* note 2, art. 10 n.36.

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may not flow to the company.[47] Unfortunately, the AB did not specify when it may be possible to distinguish the company from its shareholders, nor did the AB address all of the reasons provided by the Panel or how the possibility of circumvention would arise under the specific facts of the case. In the end, the AB upheld the Panel's determination of "recipient", but limited the determination to the particular facts of the case.[48]

B. Why the Rationales Were Flawed

As presented above, there are three main arguments to disregard the distinction between the company and its shareholders. This section will analyze and point out the flaws in each argument.

1. The Presumption That the "Benefit" Will Be Extracted from the Company by Its Shareholders Is Inappropriate — The first argument states that the fair market price paid by the new shareholders in the purchase of shares can be seen as coming directly from the company itself, because the new shareholders will extract the payment (and therefore the "benefit") from the company eventually by seeking a full return on their investment. Presumably, the Panel pondered the dividend payments or share buybacks which involved the company actually paying money to the shareholders. This rationale suffers from at least three problems. First, while shareholders want to seek a full return on their investment, they may not be able to do it, as the profitability of a company is not guaranteed and may depend on a number of variables.

Secondly, a company can provide returns on investment for shareholders through ways that do not involve paying money to the shareholders. A shareholder's return on investment includes dividend payments and capital gains. For example, a company can reinvest its excess earnings to increase its share value and the capital gains of its shareholders.

Thirdly, some money that leaves the company is not counted as an extraction of "benefit". In particular, dividend payments by the company comes from excess earnings, which can be a result of different factors. For example, it could be the result of a change in market demand for a product that the company sells. Unless it can be proven that dividend payments come directly from the subsidy received by the company, the "benefit" should not be deemed to be extracted from the company.

2. Misinterpretation of the Scope of "Benefit": Shareholders' Rate of Return Does Not Constitute a "Benefit" — The second argument states that the shareholders would also "benefit" when a subsidy is provided to the company, because the subsidy would also increase the shareholders' rate of

[47] *US — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 118.
[48] *Id.* ¶ 117.

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return. However, a shareholder's rate of return can and should be distinguished from the "benefit" received by the company. A subsidy does not necessarily increase the shareholder's rate of return by the same amount. As explained earlier, shareholders' returns include capital gains and dividend payments. It has been explained earlier that subsidies do not guaranteed increased dividend payments.

With regards to capital gains, the value of subsidies provided to the company may not always be fully reflected in the price of shares. The value of shares is based on either the net present value of projected future cash flow (for privately-held companies) or the combined perceptions and expectations of investors (for publicly-traded companies). The value of shares may only rise a smaller amount compared to the actual "benefit" received by the company if it is not expected to meaningfully improve future performance. For example, if the managers in a publicly-trade company are incompetent, investors may expect any subsidies granted to that company to be wasted and not have much of an impact on the future profits of the company'. As a result, a subsidy may not have a significant impact on share prices of the company.[49]

It is more accurate to characterize the increase in shareholder's rate of return as a financial advantage that is gained indirectly by the shareholders *as a result of* the company receiving the subsidy. That is, when a subsidy is granted to the company, it may often cause other entities to enjoy financial gains indirectly. For example, bondholders may experience financial gains when the issuing company receives a subsidy, because there will be increased confidence in the company's ability to pay back its debt, and therefore the bond value will increase. The increased rate of return of shareholders should only be viewed as an indirect financial gain and not be equated with the actual "benefit" received by the company.

Certainly, one question that can be raised is whether such an indirect financial gain could constitute a "benefit" within the meaning of the SCM Agreement. From a treaty interpretation angle, advantages that are gained as a result of or caused by a subsidy do not constitute a "benefit" under the SCM Agreement. Recall that Article 1 of the SCM Agreement provides that "a subsidy shall be deemed to exist" when there is a "financial contribution"

[49] As another example, suppose the government has made plans to subsidize an industry by providing a production facility to each of the publicly-traded companies in that industry. Further suppose that the plan was made public one year before the facility was transferred to those companies. During this one year, the information about this facility may affect the public's expectation of the company's future profits, prompting an increase in the value of the shares. In fact, the information that the industry will be supported by the government is likely enough to affect the price of shares, as the public will expect the company to gain other advantages, such as being able to obtain more favorable loans from banks, because the banks are more confident that the company will be able to pay back the money. All of this could happen before the facility (financial contribution) is granted to the company. In that case, how can the increase in market value of shares be a "benefit" conferred by a financial contribution that does not yet exist?

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and "a benefit is thereby conferred".[50] The present tense of the article and the term "thereby" indicates a closer link than "causation". As noted by the *EC — Aircraft* Panel, "[t]he grammatical construction of Article 1.1 suggests that the 'financial contribution' and the 'benefit' come into existence at the same time. This construction is supported by the adverb 'thereby', the ordinary meaning of which is 'by that means'."[51] In contrast, "causation" entails a sequence of events. That is, a financial contribution exists first and then its effects after.

One commentator also showed that the term "thereby" is used in a sentence to alternatively describe a particular action: "'Jim injured John and thereby broke the law'. The 'injury' did not cause Jim to break the law. Rather, 'broke the law' is an alternative legal description of Jim's action in injuring John."[52] Similarly, the phrase "a benefit is thereby conferred" means that a financial contribution (on favorable terms) *is* the "benefit".[53]

From a policy angle, including the advantages or effects that occur as a result of a subsidy would lead to unreasonable results. If the advantages caused by the financial contribution were included into the amount of "benefit", then the total amount of "benefit" may easily exceed the amount of financial contribution. For example, suppose the government bestows a $100 million grant, and the total value of shares increases by $30 million as a result. If we include the $30 million increase in share value, then the total amount of "benefit" would be $130 million, which greatly exceeds the total amount of money received and actually being used by the company producing the goods. Furthermore, the effects of the financial contribution would not stop there. It is possible for other parties whose financial interests are aligned with the company to gain an advantage as a result of the financial contribution. Allowing such unlimited extension of the scope of "benefit" may give governments the ability to abuse of CVDs.[54]

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[50] SCM Agreement, *supra* note 2, art. 1.

[51] *EC — Aircraft* Panel Report, *supra* note 6, ¶ 7.218.

[52] Diamond, *supra* note 9, at 671. Diamond used this explanation to argue that the increase in the recipient's production is an effect that is caused by the financial contribution, and therefore cannot be interpreted as a "benefit".

[53] *Id.* It should be noted though that the amount of "benefit" would only be the difference between the terms of the financial contribution and the terms obtainable on the market.

[54] The Panel in *EC — Aircraft* also considered that the fact that a subsidy may improve the rate of return to its shareholders only shows that the general economic interests of the company and its shareholders are aligned. This does not mean that the company and its shareholders must necessarily be considered together the "recipient", since the company's economic interests can be aligned with many other actors, such as bondholders, which are not considered the "recipient". In the Panel's view, the focus of a "benefit" analysis following privatization should be on the company. A fair market price paid in the shares transaction would only mean that the new shareholder did not benefit from a new financial contribution. It does nothing to eliminate the benefit conferred by the financial contribution originally bestowed to the company. *EC — Aircraft* Panel Report, *supra* note 6, ¶¶ 7.240-44.

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3. Misinterpretation of "Indirect" Subsidization — The AB was not incorrect to hold that a clear distinction between company and shareholders in all circumstances could potentially create loopholes in the SCM Agreement. However, the AB's example regarding dividend tax exemption and the referral to "indirect" subsidization were problematic.[55]

As an initial matter, while a dividend tax exemption for shareholders could potentially lower the company's cost of raising capital, for example by making the shares of the company more desirable and therefore more valuable,[56] such advantage does not fall within the scope of "benefit" for the same reasons stated above. The actual "benefit" should only include the "benefit" thereby conferred to the shareholders (the amount of dividend tax exempted). The lowered cost of raising capital is merely an aftereffect of the subsidy. Also, the money raised comes from the investors, not from the government. In addition, it is not certain that such a dividend tax exemption would necessarily improve the company's production.

The AB also appeared to have implied that the advantages caused by the subsidy could fall under "indirect" subsidization in footnote 36.[57] The negotiation history of the SCM Agreement shows that this was not the intention of the drafters. During such negotiations, the concept of indirect subsidy was mainly discussed in the context of input subsidy cases.[58] Basically, the cases of input subsidy refer to the situation where the government subsidizes the production of an upstream producer, who then sells the input product at below-market price to downstream producers. In doing so, the upstream producer passes the "benefit" to the downstream producer.[59] Once a "benefit" fully passes through from the upstream producer to the downstream producer, the upstream producer would no longer have the "benefit". Although the drafters did not preclude the possibility that there are other examples of indirect subsidies, it seems that at least they meant for indirect subsidies to refer to the transmission of subsidies from one entity to another unrelated entity, which is entirely

[55] The AB's explanation also did not seem entirely relevant since the question of whether a subsidy to the shareholders could indirectly benefit the company has nothing to do with the particular facts at issue. The pertinent issue concerns whether a subsidy to the company could benefit the shareholders, not the other way around.

[56] This means the company could raise more money than it would have absent the tax exemption by issuing additional shares.

[57] *US — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 113.

[58] Negotiating Group on Subsidies and Countervailing Measures, *Subsidies and Countervailing Measures: Note by the Secretariat*, at 14-18, GATT Doc. MTN.GNG/NG10/W/4 (Apr. 28, 1987); Negotiating Group on Subsidies and Countervailing Measures, *Checklist of Issues for Negotiations: Note by the Secretariat*, at 10 & 14, GATT Doc. MTN.GNG/NG10/W/9 (Sept. 7, 1987).

[59] *See* Panel Report, *Mexico — Definitive Countervailing Measures on Olive Oil from the European Communities*, WTO Doc. WT/DS341/R (adopted Oct. 21, 2008); Panel Report, *United States — Final Dumping Determination on Softwood Lumber from Canada*, WTO Doc. WT/DS264/R (adopted Aug. 31, 2004).

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different from the situations (two entities both gain advantages without any transaction between them) referred to by the Panel and AB in this case.

Moreover, it should be noted that the same policy concerns mentioned above (i.e., amount of "benefit" will exceed the amount of financial contribution) would also apply if we were to include any advantage gained by third parties as a result of the subsidy under the scope of indirect subsidy.

IV. A POTENTIAL CONTROL-CENTERED APPROACH FOR ASSESSING THE COMPANY-SHAREHOLDER RELATIONSHIP IN THE "RECIPIENT" DETERMINATION

The preceding part showed why the rationales for rejecting the distinction between the company and shareholders and determining that the company and shareholders constitute a single recipient were flawed. This section presents a better approach centered around the element of "control" for deciding when to give effect to the separate corporate personality and when to ignore it for the purpose of identifying the "recipient".[60]

A. The Relevance of "Control" in the Determination of "Recipient"

1. Distinction Between Passive Investors and Controlling Shareholders — As noted by the Panel and AB, the SCM Agreement does contain any language that would require the identity of the "recipient" to strictly adhere to the separate corporate personality doctrine created under domestic law.[61] As such, corporate entities can be treated in a manner that is sensitive to their economic realities rather than to their legal structure, particularly when such is required to prevent loopholes in the SCM Agreement. Historically, this has also been the approach taken by AB when interpreting WTO Agreements.[62]

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[60] In *EC — Aircraft*, the AB ambiguously introduced the element of "control" between the shareholders and the company to the extinction analysis. However, while the AB found that the extent of a change in control resulting from the sale of shares may be relevant to the extinction analysis, it did not establish how or why it is relevant. The parties held different views with regards to the relevance of control. On the one hand, the US argued that the purchaser's size of ownership and the degree of control over the company should be taken into consideration when determining whether the purchaser and the company should be treated as separate. The EC, on the other hand, argued that control should be used to determine whether "the benefit of a subsidy could still be used for its original purpose." *EC — Aircraft* Appellate Body Report, *supra* note 30, ¶¶ 731-32. This paper agrees with the US that the element of control should be a key consideration in determining whether the shareholder and the company should be treated as a single recipient.

[61] *US — Countervailing Measures* Panel Report, *supra* note 5, ¶ 7.50; *US — Countervailing Measures* Appellate Body Report, *supra* note 9, ¶ 112.

[62] Michelle Healy, *Corporate Entities and WTO Law* 2 (Soc'y of Int'l Econ. L., Working Paper No. 17/08, 2008), https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1151810_code1035635.pdf?abstractid=1151810&mirid=1.

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Based on the economic realities of their relationship, shareholders can generally be grouped into two categories. The first category of shareholders are "passive investors" whose relationship with the company resembles (although not exactly) that of a lender and borrower.[63] Passive investors do not have access the company's assets, nor do they have any real control over how those assets are used.[64] For them, the separate corporate personality is not merely a fiction created by law, but also a fair representation of the economic reality of their relationship with the company.[65] As one commentator put it, passive shareholders are essentially "money capitalists, external to companies and to the production process itself. Disinterested and uninvolved in management, and, in any case, largely stripped . . . of genuine corporate ownership rights".[66] When determining the "recipient", there is are few reasons to consider these shareholders as part of the company.

The second type of shareholders are "controlling shareholders"[67] whose relationship with the company transcends their legal boundaries. This type of relationship is often seen between a parent and its subsidiary.[68] Commonly, the parent and its subsidiaries do not operate as separate entities, but instead integrate and dedicate their resources to pursue a common purpose.[69] Creating a separate company through incorporation and then transferring business assets to that company for tax purposes or to take advantage of limited liability can be done by simply filing some paperwork.[70] Regardless of their separate legal status, the subsidiary is, in reality, merely an alter-ego or extension of the parent, and the assets of the subsidiary are effectively the assets of the parent.[71] As discussed in the next section, because it is possible for the company and its controlling shareholder to operate as a single enterprise both operationally and economically, there is a

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[63] Richard A. Booth, *Who Owns a Corporation and Who Cares*, 77 CHICAGO-KENT L. REV. 147, 152 (2001); *see* Paddy Ireland, *Company Law and the Myth of Shareholder Ownership*, 62(1) MOD. L. REV. 32, 42-47 (1999).

[64] Booth, *supra* note 63, at 152; Lynn A. Stout, *Bad and No-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1191 (2002).

[65] Ireland, *supra* note 63.

[66] *Id.* at 47.

[67] Booth refers to these shareholders as "active manager stockholders". Booth, *supra* note 63, at 152.

[68] *See* Meredith Dearborn, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, 97(1) CAL. L. REV. 195, 208-09 (2009); Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 886 (2012). It should be noted that the controlling shareholder is not limited to a parent company, but could also be a natural person.

[69] *See* ANDREW MUSCAT, THE LIABILITY OF THE HOLDING COMPANY FOR THE DEBTS OF ITS INSOLVENT SUBSIDIARIES 391-94 (1996). Assets of the parent and its subsidiaries "may be held in trusts, special purpose vehicles, and other separate legal entities". Ho, *supra* note 68, at 886. In some jurisdictions, assets of a company include those of any entity wholly-owned or controlled by that company. DEL. CODE ANN. tit. 8 § 271(c) (2012).

[70] Dearborn, *supra* note 68, at 208.

[71] *Id.* at 248.

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case to be made for disregarding the separate corporate personality and considering them as a single "recipient" to be assessed.[72]

2. Advantages of the Control-Centered Approach — From a policy point of view, the control-centered approach to the determination of recipient could prevent circumvention on two fronts. First, it would prevent companies from using their corporate structure to avoid CVDs. For example, suppose the government subsidizes the production of an upstream company, which then sells the product to its subsidiary, which is a downstream company. Technically, since the subsidiary paid a market price for the product, it did not get anything for free and therefore does not "benefit". However, in reality, the money that the subsidiary paid is not removed from its reach. In the future, if the subsidiary needs capital, the parent could always inject the cash back into the subsidiary. This concern could be avoided if the parent and subsidiary are viewed as a single recipient, and the transaction between them is treated as an internal transfer of resources.

Secondly, the control-based determination would effectively prevent normal share transactions that take place on a daily basis on the stock market from triggering an extinction analysis, because most buyers fall under the first type of shareholders. Only acquisition deals where the buyer gains control over the company would possibly lead to the extinction of subsidy. This would close the loophole described by the panel in *EC — Aircraft*; namely, by allowing subsidies to be extinguished in every fair market exchange of shares, publicly-traded companies could never be countervailed.

B. Applying the Control-Centered Approach

1. Inserting the Control Determination in the Extinction Analysis — The extinction analysis would still follow the same steps as any "benefit" analysis: identify the recipient" and determine whether the "recipient" enjoys a "benefit". However, in the first step, a determination is made with regards to whether the buyer (new shareholder) constitute a controlling shareholder following the purchase. Obviously, the key defining feature of a controlling shareholder is the ability to exercise substantial control over the company. Having control usually implies that the shareholder has majority voting interest in the company. A majority shareholder controls a company by virtue of its power to appoint directors and decide major decisions through shareholder voting.[73] Hence, if the buyer acquires more than 50% of shares in the company, the buyer and the company can generally be presumed to constitute a single "recipient".

[72] This is similar to the enterprise theory in corporate law. The enterprise theory seeks to bridge the gap where the separate corporate personality fails to reflect the economic reality of the corporate group by recognizing the group as a single enterprise entity. *Id.* at 210.
[73] Ho, *supra* note 68, at 888.

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However, the majority ownership is not always a prerequisite for effective control. A parent company can still control a subsidiary with a minority interest by having different classes of shares with differing voting rights or having overlapping directorates.[74] In some instances, a company can control an affiliated company solely through contractual agreements. Because control can be achieved through various ways, if the buyer does not acquire majority ownership, then a determination of actual control must be made based on all relevant facts and circumstances. This would include evidence regarding the financial, operational and decisional integration of the company and shareholder, the intermingling of funds, profits and losses (such as undocumented transfer of funds), the use of common employees and assets, etc.[75]

Once it is determined that the buyer and the company is a single enterprise, the analysis moves on to the second step, which is to determine whether the shares were sold at arm's length and for fair market value. To the extent that the payment by the buyer for the shares reflects the value of the subsidy, the subsidy is considered paid for and extinguished from the perspective of the enterprise.

2. Scope of Application — It should be noted that the control-centered determination should be limited in the following ways. First, it should only be applicable in the context of a "benefit" analysis in order to avoid conflict with other determinations. In particular, the determination of whether an entity constitutes a "public body" under Article 1 and the determination of whether a domestic producer is related to exporters or importers both have their own set of standards for evaluating the relationship between two entities.[76]

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[74] *Id.* at 889; Alma Pekmezovic, *Determinants of Corporate Ownership: The Question of Legal Origin: Part 1*, 18(3) INT'L COMPANY & COM. L. REV. 97, 100-01 (2007).

[75] These types of evidence have been used to justify treating a group of corporations as a single enterprise in the corporate law context. *See id.* at 889. Other evidence includes, for example, the corporate law of the country of the company at issue. Strong protection of minority shareholders could prevent controlling shareholder from moving funds out of the company, thereby affecting the degree of control the controlling shareholder has. *See* Pekmezovic, *supra* note 74, at 100. Whether the company is a publicly-traded company or a privately-held company could also be relevant, as the majority shareholder of privately-held company often has more control than their counterparts in publicly-traded company due to being less regulated.

[76] Regarding the public body determination, the AB has stated that a public body is "an entity that possesses, exercises or is vested with governmental authority". Further, when it is shown that the government exercises "meaningful control" over the conduct of an entity, it can be inferred that such an entity is a public body. Appellate Body Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶¶ 317-18, WTO Doc. WT/DS379/AB/R (adopted Mar. 25, 2011). Regarding the question of whether a domestic producer is related to the exporter or importer, footnote 48 of SCM Agreement states that:

> [P]roducers shall be deemed to be related to exporters or importers only if *(a)* one of them directly or indirectly controls the other; or *(b)* both of them are directly or indirectly controlled by a third person; or *(c)* together they directly or indirectly

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Secondly, the control-centered approach does not apply when the controlling shareholder is the government, as that would lead to conceptual problems. Specifically, in such cases, holding that the company is part of the shareholder would mean that the company is part of the government. This would turn any subsidy to the state-owned company into internal transfer of resources within the government. Thus, for the purpose of the "benefit" analysis, the government shareholder should be considered as separate from the company.

Thirdly, when the company and its shareholders are determined to be part of the same entity, it does not automatically mean that whenever the subsidy is provided to the shareholder, the importing country can countervail the products of the parent. The investigative authority must determine the amount of benefit that actually flowed to the parent's production of the imports concerned, since CVDs can only be used against "subsidized product".

V. CONCLUSION

One of the main problems of the extinction principle relates to the flawed rationales for rejecting the distinction between the company and its shareholders for the purposes of identifying the "recipient". The Panels in the privatization cases did not conduct a sufficiently in-depth analysis of the actual relationship between the company and its shareholders, but rather based their determinations on questionable economic presumptions and on a misinterpreted scope of "benefit" (*i.e.*, interpreting the rate of return of shareholders to be the "benefit"). The AB also did not provide a clear answer on how to approach the analysis of the relationship between the company and its shareholders.

This paper proposes a control-centered approach for determining whether to distinguish the company from its shareholders. Specifically, the panel or investigative authority should differentiate between a passive investor and a controlling shareholder when determining whether to ignore or give effect to the separate corporate personality. On the one hand, the separate legal personality reflects the actual relationship between passive investors and the company. Thus, passive investors should be considered as separate from the company, and any payment made by such an investor for the purchase of shares should be irrelevant to the existence of "benefit" enjoyed by the company. On the other hand, the legal boundary between the

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> control a third person, provided that there are grounds for believing or suspecting that the effect of the relationship is such as to cause the producer concerned to behave differently from non-related producers.

SCM Agreement, *supra* note 2, art. 16.1 n.48.

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controlling shareholder and the company often do not reflect their economic boundary. It is therefore reasonable to treat the controlling shareholder and the company as a single enterprise. To the extent that the payment made by the enterprise in acquiring the company reflects the value of the subsidy, the subsidy is extinguished. This proposal would be able to close the loophole that was created by the original extinction principle and can also be applied to other contexts related to the determination of the existence of "benefit", particularly where the main issue concerns the relationship between the company and its shareholders or affiliated companies.

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