



TECHNICAL COMMITTEE ON
CUSTOMS VALUATION

-
30th Session
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VT0725E1a

O. Eng.

Brussels, 11 January 2010.

CUSTOMS VALUATION OF IMPORTED ELECTRICITY :

PROPOSAL FROM BRAZIL

(Item VI (b) on the Agenda)

MEMBERS' COMMENTS

Reference documents :

VT0437E1a (TCCV/20)	VT0596E1a (TCCV/25)
VT0440E1c (TCCV/20 – Report)	VT0598E1c (TCCV/25 – Report)
VT0466E1a (TCCV/21)	VT0612E1a (TCCV/26)
VT0470E1c (TCCV/21 – Report)	VT0621E1a (TCCV/26)
VT0484E1a (TCCV/22)	VT0626E1c (TCCV/26 – Report)
VT0493E1a (TCCV/22)	VT0643E1a (TCCV/27)
VT0499E1c (TCCV/22 – Report)	VT0659E1a (TCCV/27)
VT0516E1a (TCCV/23)	VT0663E1c (TCCV/27 – Report)
VT0534E1c (TCCV/23 – Report)	VT0673E1a (TCCV/28)
VT0547E1a (TCCV/24)	VT0680E1a (TCCV/28)
VT0559E1a (TCCV/24)	VT0686E1c (TCCV/28 - Report)
VT0564E1c (TCCV/24 – Report)	VT0680E1a (TCCV/29)
VT0579E1a (TCCV/25)	VT0715E1b (TCCV/29 - Draft Report)

1. At the 27th Session, the Technical Committee agreed to continue the examination of this case and also asked the Secretariat to prepare a new document, reflecting all the relevant facts and points raised. The Secretariat summarized all the related facts and set out its comments in Doc. VT0673E1a, taking into account all the information submitted by Brazil and comments made by Members at the 27th Session. During the intersession, comments were received from Japan and reproduced in the Annex to Doc. VT0680E1a.
2. At the 28th and 29th Sessions, the Technical Committee decided to defer the examination of this case to the next consecutive meeting due to constraints of the time.

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VT0725E1a

3. The Technical Committee is invited to examine the Brazilian Case and express its views on the valuation of electricity taking into account the comments of the Members and the Secretariat, which were set out in Docs. VT0673E1a and VT0680E1a. Written comments should reach the Secretariat no later than **26 February 2010**. Comments submitted in response to these documents will be published and circulated to Members of the Technical Committee for consideration at its 30th Session.
 4. Members are reminded that comments received later than six weeks before the start of the 30th Session, will not be published as a document of the Technical Committee.
 5. For the efficient work of the Secretariat, Members are invited to send their comments in electronic format to the extent possible (E-mail address : valuation@wcoomd.org).
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COMMENTS BY BRAZIL

PRACTICAL APPLICATION OF THE AGREEMENT: CUSTOMS VALUATION OF ELECTRICITY: PROPOSAL FROM BRAZIL

3. Brazil believes that the adequate application of the Customs Valuation Agreement reflecting on the countries' valuation and taxation of energy goods is relevant to the creation of positive influences for the market trade development.
4. Electricity, natural gas and other energy goods are internationally negotiated via contract clauses concerning the commitment of payment for contracted minimum quantities, known as take-or-pay provisions. The international negotiation of these goods normally demands the deployment of heavy infrastructure, which depends upon the long-term value perception of the market uncertainty by the contracting stakeholders along the supply chain.

TAKE-OR-PAY CLAUSE

5. Take-or-pay contracts have been explained, in the last years, with the help of Real Option Theory (ROT) as opposed to the traditional Transaction Cost Theory (TCT). The ROT takes into account the value of contractual flexibility while the TCT does not.
6. New institutional economics¹ (NIE) uses ROT to understand/explain economic scenarios contemplating uncertainty and irreversibility, which is normally the case in energy markets.
7. Moreover, the option pricing theory's ability to quantify the investment's flexibility makes it an attractive tool for analyzing the present case and making recommendations for the application of the Customs Valuation Agreement so as to consider the necessary contractual value flexibility.
8. Take-or-pay clauses are an obligation of the buyer to pay for a specified amount of product (contracted minimum quantities) whether this amount is taken or not, as well as an obligation on the seller to make available defined volumes of it. The clause is regarded as the major guarantee that the seller will recover his share of expenses. The clause therefore assures the seller a minimum cash flow over the years (IEA, 2002).
9. Based on ROT, there seems to be a direct correlation between the theory of financial option pricing and the take-or-pay clause. The take-or-pay clause is considered a financial call option contract between two parties.
10. A call option is a financial contract to buy shares of stock at a specified time in the future. Often it is simply labelled a "call". The buyer of the call option contract has the right, but not the obligation to buy an agreed quantity of a particular commodity or financial instrument (the underlying instrument) from the seller of the option at a certain time (the expiration date) for a certain price (the strike price). The seller (or "writer") is obligated to sell the commodity or financial instrument should the buyer so decide. The buyer pays a fee (called a premium) for this right.

¹ New institutional economics (NIE) is an economic perspective that attempts to extend economics by focusing on the social and legal norms and rules that underlie economic activity. Major scholars associated with this school include Ronald Coase, Douglass North, Oliver Williamson, Harold Demsetz, Avner Greif, and Claude Menard.

11. As it is the case, the call option contract is flexible for only one party (buyer). The buyer chooses whether to buy 100%, less than 100% or even none of the quantity made available by the seller. For the privilege of choosing every expiration date, the buyer accepts to pay a premium to the seller, which in this case is set as the take-or-pay clause also referred to as the "take-or-pay" or "pay" clause (CARVALHINHO FILHO, 2003).
12. A distinction between the financial call option contract and the take-or-pay clause is that if the electricity made available is not totally consumed in a given month, the difference in amounts can be offset over the following months of the same year. That is legally known as "make-up clause" in energy contracts. Sometimes the opposite situation can also occur, i.e. the excess demand in certain months compensates for the less demand in other months during the calendar year, which is legally known as "swing clause".
13. Only at the end of the year, if the price of the invoiced delivered electricity (=consumed electricity) during the calendar year is lower than the minimum annual quantity, the difference between these two amounts will be paid by the buyer within 30 days after the end of the calendar year in a single installment.
14. Taking into account NIE regarding contract flexibility and ROT, our view is that the yearly take-or-pay installment is not a penalty but rather a premium the buyer has to pay to compensate the seller for having made the goods available. The buyer decision whether or not to exercise his take-or-pay right depends on several factors, such as: energy demand, prices of other suppliers, long-term strategy, etc.
15. Also, Brazil feels that the take-or-pay clause is the same as a call option contract premium. And it does not relate to the value of the goods. In this case, the payment should not be seen as price adjustment and should be treated separately from the transaction value.
16. In this regard, although based on different reasons, Brazil concurs with Japan (Docs. VT0680E1a, VT0659E1a and VT0621E1a) and the U.S. (Doc. VT0493E1a).

CONSTRUCTION PAYMENTS

17. According to the contract, the buyer of imported electricity also bears the costs of construction of the transmission system in the exporting country.
18. In this aspect (construction payments), Brazil is aligned with those countries that defend the idea that such costs are part of the customs value. These costs are incurred in the country of exportation and before importation.
19. Paraguay explained the situation in the following way :
"With regard to the payments that the importer must make for the construction of a system of electricity transmission lines in the exporting country, we consider this payment to be directly related to the sale to be made and to the price fixed, taking account of two factors which in one case would make the sale impossible, and in the other the selling price would increase in equal proportion to the cost of constructing the transmission lines. In the first hypothetical case, if the transmission lines were not constructed, we believe that the sale would not take place due to the physical impossibility of supplying electricity to the country of importation. The other case, which might arise, is that the construction costs would be borne by the exporter. This situation would doubtless lead to an increase in the selling costs of the energy. In the light of these considerations, and reasserting that the payment to be made by the importing country for the construction of the transmission lines in the country of
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exportation is directly related to the price fixed by the sale, then the Customs valuation of imported electricity must include the cost mentioned. Likewise, one must assume that the payments or undertakings to pay (shares) for the construction of the transmission lines were made prior to the importation." (Annex II to Doc. VT0612E1a)

20. It seems Japan (Docs. VT0680E1a and VT0621E1) and Venezuela (Doc. VT0559E1) have also reached a similar conclusion.

MAINTENANCE COSTS

21. Brazil believes that maintenance costs should not be taken into account for customs valuation purposes. These costs are permanent and not necessarily related to the goods imported.
22. Apparently Colombia (Doc. VT0643E1a), Japan (Docs. VT0680E1a and VT0621E1), Venezuela (Doc. VT0559E1a) and Paraguay (Doc. VT0612E1a) share a similar view that the maintenance costs for the transmission lines should not be included in the Customs value.

FINAL REMARKS

23. Brazil highly appreciates the Secretariat and members efforts to discuss the case. Our delegation agrees with other Administrations that the electricity case could be developed into an instrument, such as a case study, regarding the application of Article 1, price actually paid or payable.
24. Thus, and if a consensus on the case is reached, Brazil would like to commit itself to working together with the Secretariat to present a draft Case Study for the next session.

BIBLIOGRAPHY :

International Energy Agency. Flexibility in natural gas supply and demand. Paris. OCDE/IEA, 2002.

CARVALHINHO FILHO. José Carlos. O Valor da Flexibilidade em Cláusulas "Take-or-Pay" de Contratos para Fornecimento de Gás Natural Industrial. Dissertação de Mestrado. São Paulo. FEA/USP, 2003.

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COMMENTS BY THE UNITED STATES

CUSTOMS VALUATION OF IMPORTED ELECTRICITY : PROPOSAL FROM BRAZIL

1. The United States thanks the Secretariat for its work concerning Brazil's proposal with respect to customs valuation of imported electricity.

YEAR-END ADJUSTMENT PAYMENTS :

2. The supply agreement states that the importer is obliged to pay a minimum amount for the imported electricity, calculated on the basis of the following formula : annual guaranteed electricity X 75% X tariff rate. Annual guaranteed electricity is defined in the supply agreement as the sum of monthly guaranteed electricity for the calendar year. Monthly guaranteed electricity is, in turn, determined on the basis of monthly requests of the importer which will be supplied to the seller each year. Further, it is stated that if the sum of the invoiced value of delivered electricity during the calendar year was lower than the annual minimum price, the difference between the annual minimum price and the sum of the invoiced value of delivered electricity during the calendar year will be paid by the importer within 30 days after the end of the calendar year. Therefore, the importer has to pay certain amounts of shortfall payments to the seller at the end of the contracted period because the importer did not purchase the annual guaranteed electricity as specified in the contract. The year-end adjustment payment in this case relates to the electricity not purchased, rather than imported electricity, thus, representing a penalty triggered by non-performance of a contract. There is nothing in the contract that specifically mentions a price review clause which specifies a formula for determining an adjusted price. Accordingly, the U.S. Administration is of the view that the year-end adjustment payment is a penalty for not having purchased the minimum amount of electricity under the supply contract and, hence, should not be added to the transaction value.

PAYMENTS RELATING TO CONSTRUCTION AND MAINTENANCE :

3. The U.S. is of the view that under Article 1 and the Note to Article 1, the payments must relate in some way to the imported goods. Based on the facts of this case, it seems that this is not the case with respect to the payments for the construction and maintenance of the transmission system. The transmission system is essentially the infrastructure needed to deliver the goods to the buyer and is quite separate from the imported electricity. In our view, even under a broad application of the price actually paid or payable concept, the payments for the construction and maintenance of the transmission system are not payments for or related to the imported goods and would fall outside the scope of Article 1 and the Note to Article 1.
4. The U.S. Administration anticipates that it may have additional comments to make in respect of this matter at the 30th Session.