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KOREA – MEASURES AFFECTING TRADE IN COMMERCIAL VESSELS (WT/DS273)

Report of the Panel

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Brazil – Aircraft (Article 21.5 – Canada)	Panel Report, *Brazil – Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU* ("*Brazil – Aircraft (Article 21.5 – Canada)*"), WT/DS46/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS46/AB/RW, DSR 2000:IX, 4093.
Brazil – Aircraft (Article 21.5 – Canada II	Panel Report, *Brazil – Export Financing Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU* ("*Brazil – Aircraft (Article 21.5– Canada II)*"), WT/DS46/RW/2, adopted 23 August 2001, DSR 2001:XI, 5481.
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft* ("*Canada – Aircraft Credits and Guarantees*"), WT/DS222/R and Corr.1, adopted 19 February 2002.
Canada – Aircraft (Article 21.5 – Brazil)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU* ("*Canada – Aircraft (Article 21.5 – Brazil)*"), WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299.
EC – Sugar Exports (Australia)	GATT Panel Report, *European Communities – Refunds on Exports of Sugar – Complaint by Australia*, adopted 6 November 1979, BISD 26S/290.
EC – Sugar Exports (Brazil)	GATT Panel Report, *European Communities – Refunds on Exports of Sugar – Complaint by Brazil*, adopted 10 November 1980, BISD 27S/69.
EEC – Wheat Flour Subsidies	GATT Panel Report, *European Economic Community – Subsidies on Export of Wheat Flour* ("*EEC – Wheat Flour Subsidies*"), 21 March 1983, unadopted, SCM/42.
Indonesia – Autos	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry* ("*Indonesia – Autos*"), WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3, 4, adopted 23 July 1998, DSR 1998:VI, 2201.
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* ("*Japan – Alcoholic Beverages II*"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97.
US – Corrosion-Resistant Steel Sunset Review	Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan* ("*US – Corrosion-Resistant Steel Sunset Review*"), WT/DS244/AB/R, adopted 9 January 2004.
US – Countervailing Measures on Certain EC Products	Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities* ("*US – Countervailing Measures on Certain EC Products*"), WT/DS212/AB/R, adopted 8 January 2003.
US - Export Restraints	Panel Report, *United States – Measures Treating Exports Restraints as Subsidies* ("*US – Export Restraints*"), WT/DS194/R and Corr.2, adopted 23 August 2001, DSR 2001:XI, 5767.
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* ("*US – FSC*"), WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619.
US – Norwegian Salmon CVD	GATT Panel Report, *Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway* ("*US – Norwegian Salmon CVD*"), adopted 28 April 1994, BISD 41S/II/576.
US – Section 211 Appropriations Act	Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998* ("*US – Section 211 Appropriations Act*"), WT/DS176/AB/R, adopted 1 February 2002.
US – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton* ("*US – Upland Cotton*"), WT/DS267/R, and Corr.1, 8 September 2004.
US – Lead and Bismuth II	Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/R and Corr.2, adopted 7 June 2000, as upheld by the Appellate Body Report, WT/DS138/AB/R, DSR 2000:VI, 2623.

Short Title	Full Case Title and Citation
US – Lead and Bismuth II	Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/AB/R, adopted 7 June 2000, DSR 2000:V, 2595.

I. INTRODUCTION

A. COMPLAINT OF THE EUROPEAN COMMUNITIES

1.1 On 21 October 2002, the European Communities requested consultations with Korea pursuant to Article 4 of the Dispute Settlement Understanding ("the *DSU*"), Article XXIII:1 of the General Agreement on Tariffs and Trade 1994 ("*GATT 1994*"), and Articles 4, 7 and 30 of the Agreement on Subsidies and Countervailing Measures ("the *SCM Agreement*"), with regard to measures affecting trade in commercial vessels.[1]

1.2 The European Communities and Korea held the requested consultations on 22 November and 13 December 2002, and 7 May 2003, but failed to reach a mutually satisfactory resolution of the matter.

1.3 On 11 June 2003, the European Communities requested the establishment of a panel to examine the matter.[2]

1.4 On 10 July 2003, the European Communities requested that the above request be placed on the agenda of the meeting of the Dispute Settlement Body ("the DSB") scheduled for 21 July 2003. The European Communities further requested that, at the same meeting, the DSB initiate the procedures provided for in Annex V of the *SCM Agreement* pursuant to paragraph 2 of that Annex.

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.5 At its meeting of 21 July 2003, the DSB established a panel in accordance with Article 6 of the DSU and pursuant to the request made by the European Communities in document WT/DS273/2.

1.6 At that meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The terms of reference are, therefore, the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS273/2, the matter referred to the DSB by the European Communities in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.7 On 11 August 2003, the European Communities requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the *DSU*. This paragraph provides:

> "If there is no agreement on the panelists within 20 days after the date of the establishment of a Panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairmen receives such a request."

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[1] WT/DS273/1.
[2] WT/DS273/2.

1.8 On 20 August 2003, the Director-General accordingly composed the Panel as follows:

Chairman: Mr. Said El-Naggar

Members: Mr. Gilles Gauthier
Ms. Ana Novik Assael

1.9 China, Japan, Mexico, Norway, Chinese Taipei and the United States reserved their third-party rights.[3]

1.10 On 11 April 2004, Mr. El-Naggar, Chairman of the Panel, passed away. On 6 May 2004, the parties jointly requested that the Director-General appoint a new Chairman to the Panel. On 11 May 2004, the Director-General appointed Mr. Julio Lacarte-Muró as the new Chairman of the Panel.[4]

C. INFORMATION GATHERING PROCEDURE UNDER ANNEX V OF THE *SCM AGREEMENT*

1.11 In its 10 July 2003 communication to the DSB requesting initiation of the information-gathering procedure under Annex V of the *SCM Agreement*, the European Communities stated that in order to facilitate the DSB's task of designating a representative pursuant to paragraph 4 of Annex V, it had proposed names and consulted with Korea. The European Communities indicated that it and Korea had not reached agreement in this respect, and thus requested that the DSB designate a representative to facilitate the information-gathering procedure.[5] At its meeting of 21 July 2003, the DSB designated Mr. András Szepesi as its representative for this purpose.

1.12 The date of 21 July 2003 was considered by the parties to be the date on which the matter was "referred to the DSB" in the sense of paragraph 5 of Annex V, such that the 60-day period established in that paragraph for completion of the information-gathering process would have ended on 19 September 2003. The parties agreed that the complaining party's first submission should be due six weeks after the end of the Annex V procedure, and the responding party's first submission six weeks after that, so that all information developed through the Annex V procedure could be used in the preparation of these submissions. The Panel established its timetable accordingly.

1.13 At a late stage in the 60-day period the 19 September 2003 date was modified, with the agreement of the parties, to allow the parties additional time to translate certain voluminous documentation into one of the three WTO working languages. The amended deadline for completion of the Annex V procedure was 10 November 2003. The Panel was immediately informed of these modifications and the causes thereof. The Panel revised its timetable accordingly.

1.14 On 10 November 2003, the Designated Representative submitted his report to the Panel. This report is set forth in Attachment 1.

D. ADDITIONAL PROCEDURES FOR THE PROTECTION OF BUSINESS CONFIDENTIAL INFORMATION

1.15 As indicated in the report of the Designated Representative the Panel, at the request of the parties, adopted additional procedures for the protection of business confidential information. These procedures ("the BCI procedures"), are set forth in Attachment 2.

[3] WT/DS274/6.
[4] WT/DS273/7.
[5] WT/DS273/3.

E. PANEL PROCEEDINGS

1.16 The Panel met with the parties on 9-10 March 2004, and 17-18 June 2004. The Panel met with third parties on 9 March 2004.

1.17 The Panel submitted its Interim Report to the parties on 24 November 2004. The Panel submitted its final report to the parties on 22 December 2004.

II. FACTUAL ASPECTS

2.1 This dispute concerns the following measures, alleged by the European Communities to constitute prohibited subsidies and/or actionable subsidies in the sense of Parts II and III of the *SCM Agreement*:

- The Act Establishing the Export-Import Bank of Korea ("KEXIM"), any implementing decrees and other regulations, alleged to specifically allow and enable KEXIM to provide Korean exporters of capital goods with financing at preferential rates.

- The pre-shipment loan ("PSL") and advance payment refund guarantee ("APRG") schemes established by KEXIM.

- The individual granting of pre-shipment loans and advance payment refund guarantees by KEXIM to Korean shipyards, including Samho Heavy Industries ("Samho-HI" or "SHI"), Daedong Shipbuilding Co. ("Daedong"), Daewoo Heavy Industry ("DHI"), Daewoo Shipbuilding and Marine Engineering ("Daewoo-SME", or "DSME"), Hyundai Heavy Industries ("Hyundai-HI", or "HHI"), Hyundai Mipo ("MIPO"), Samsung Heavy Industries ("Samsung") and Hanjin Heavy Industries & Construction Co ("Hanjin").

- Corporate restructuring measures including debt forgiveness, debt and interest relief and debt-to-equity swaps, affecting Daewoo-SME, Samho-HI, and Daedong).

- The Special Tax Treatment Control Law ("STTCL"), in particular the special taxation on in-kind contribution (Article 38) and the special taxation on spin-off (Article 45-2) scheme.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

A. THE EUROPEAN COMMUNITIES

3.1 The European Communities asks the Panel to find that Korea has granted subsidies inconsistent with its obligations under the *SCM Agreement*, because:

- "Korea, through the KEXIM Act, KEXIM Decree and Interest Rate Guidelines provides prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the SCM Agreement";

- "Korea, through the establishment and maintenance of the APRG and preshipment loan programmes provides prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the SCM Agreement";

- "Korea, through individual grants of APRGs and preshipment loans provided prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the SCM Agreement";

- "Korea, by providing subsidies to Daewoo-SME/Daewoo-HI, Samho-HI/Halla-HI, and STX/Daedong through (i) workout plans and restructuring plans; (ii) tax concessions provided to Daewoo-HI/Daewoo-SME; and (iii) the grant of KEXIM APRGs and pre-shipment loans, has caused serious prejudice to the interests of the European Communities in violation of Articles 5(c) and 6.3(c) of the SCM Agreement."

3.2 The European Communities considers that the above violations of the *SCM Agreement* have nullified and impaired benefits accruing to it under the *Marrakesh Agreement Establishing the World Trade Organization* ("*WTO Agreement*") and accordingly asks the Panel to recommend that Korea withdraw these subsidies or remove the adverse effects of the actionable subsidies in accordance with Articles 4.7 and 7.8 of the *SCM Agreement*.

B. KOREA

3.3 Korea requested the Panel to issue a number of preliminary rulings. The Panel's reasoning and conclusions in respect of Korea's requests for preliminary rulings are set forth in section VII.A, infra.

3.4 Korea also requests the Panel to dismiss all of the claims of the European Communities.

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties are set out in their submissions to the Panel. The parties' executive summaries of their submissions are attached as Annexes to this report (see List of Annexes, page viii), and constitute an integral part of this Report.

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of third parties China, Japan, Norway, Chinese Taipei and the United States, are set out in their submissions to the Panel and are attached to this Report as Annexes (see List of Annexes, page viii), and constitute an integral part of this Report. Mexico made no submissions to the Panel.

VI. INTERIM REVIEW

6.1 On 24 November 2004, we submitted the interim report to the parties. Korea submitted a written request for interim review of certain aspects of the interim report. The EC did not request interim review. The EC also submitted written comments on Korea's request. Neither party requested an interim review meeting.

6.2 Korea's communication concerning interim review contained two parts, a cover letter containing general comments, and an annex containing specific comments on certain identified paragraphs of the interim report. We address these two parts of Korea's comments separately, in sections VI.A and VI.B, respectively.

6.3 We also have made certain technical revisions and corrections to the report.

A. KOREA'S GENERAL COMMENTS IN ITS COVER LETTER

6.4 The cover letter to Korea's submission requesting review of aspects of the Panel's interim report sets forth "some reservations regarding some procedural issues and certain aspects of the prohibited subsidies analysis of the Panel". We note at the outset, however, that these comments are quite general, lacking specific references to particular paragraphs or sections of the interim report, and

failing to indicate any changes that Korea requests the Panel make to the report. We therefore doubt whether these comments meet the requirement of Article 15.2 that a party's request for interim review identify "precise aspects" of the report. In any event, as discussed below, we see no need to make any changes to the report on the basis of the comments in Korea's cover letter.

6.5 Korea states that the Panel misallocated the burden of proof "in places", shifting the burden from the EC to Korea, but identifies no specific place in which this alleged misallocation of burden occurred. We believe that the appropriate burden of proof was maintained in respect of both parties throughout the dispute. Korea also argues that the EC was permitted to introduce new factual information at a late stage of the proceedings, not as rebuttals but to establish wholly new points. We disagree with Korea's implication that it lost due process rights, as we recall that at various stages of the proceedings, the Panel requested certain information from both parties, and the parties requested certain information from each other, and that after each of these submissions, each party was given full opportunity to comment on the new factual information submitted by the other party. Concerning Korea's general objection to the benchmarks offered by the EC for APRG transactions, and the Panel's analysis of country risk spread, we believe that our findings adequately explain our overall approach and reasoning.[6] As for Korea's general disagreement with our approach to defining a public body in the sense of Article 1.1(a)(1), as discussed in our findings, in our view Korea's approach confuses the concepts of financial contribution and benefit. Concerning actionable subsidies, Korea states that it disagrees with certain of our conclusions, but provides no specifics whatsoever. Finally, concerning Korea's statement that the EC "was permitted without remark to manifestly abuse the Annex V process", we recall that Korea originally raised this issue in its first written submission, and that we ruled on it on 12 March 2004.[7]

B. KOREA'S SPECIFIC COMMENTS ON CERTAIN IDENTIFIED PARAGRAPHS OF THE INTERIM REPORT

Footnote 75 (footnote 77 of the Final Report)

6.6 Korea requested that we change the reference to "Exhibit EC – 21" to refer to "Exhibit EC – 26". We have made the change requested by Korea.

Paragraphs 7.136 and 7.137

6.7 Korea argues that Exhibits KOREA – 58 and 59 were provided in response to Question 69 from the Panel, which sought "an example (with supporting documentation) of two instances in which different Korean shipyards were not able to select the APRG provider itself". Korea asserts that the Panel did not ask Korea to rebut the specific APRG benchmarks offered by the EC. Korea supposes that the Panel adopted this approach because it was looking at the issue from a systemic general point of view. Korea asserts that if it showed that there were questions about the choice of source of APRGs, it would be up to the EC to show who made that choice, and establish that the benchmarks proposed by the EC were appropriate. Korea asserts that had the Panel demanded that Korea rebut the specific instances offered by the EC, the Panel should not have asked for examples in a manner that indicated to Korea that the Panel was taking a general perspective. Korea submits that, by doing so, the Panel prohibited Korea from offering evidence that it might have been able to generate to rebut specific instances rather than just providing examples as the Panel requested.

6.8 Korea also disagrees with the Panel's statement that the examples in Exhibit KOREA – 83 "are APRGs provided to shipyards that fall outside the scope of the EC's prohibited export subsidies claims". Korea asserts that there were no limitations on the scope of the EC's claims. Korea submits

[6] In section VI.B, *infra*. we take up Korea's detailed, specific comments (in the Annex to part of its interim review submission) in relation to precise aspects of particular paragraphs of our report pertaining to certain benchmarks.

[7] The text of our ruling is reproduced in full at paragraph 7.5.

that the information in Exhibit KOREA – 83 is therefore relevant, probative and directly responsive to Question 69 from the Panel.

6.9 The EC submits that Korea's comment is based on the erroneous view that Korea needed only to rebut specific evidence advanced by the European Communities where specifically "demanded" to do so by the Panel and that, as a result, the Panel "prohibits Korea from offering evidence that it might have been able to generate to rebut specific instances rather than just providing examples as the Panel requested."

6.10 Regarding Exhibit KOREA – 83, the EC asserts that Korea misrepresents or misunderstands the Panel's reasoning. The EC argues that the Panel is dealing in this part of the Report with the EC's complaint that individual APRG transactions constituted export subsidies. The EC asserts that it is therefore irrelevant that the Panel accepted the admissibility of the EC's *per se* claim against KEXIM's export subsidy regimes. The EC suggests that the Panel could take account of Korea's point and avoid others misunderstanding the issue in the same way by amending the penultimate sentence to paragraph 7.137 to read:

> The evidence contained in Exhibit Korea-83 relates to APRGs provided to shipyards that fall outside the scope of ~~the EC's~~ **these** prohibited export subsidy claims.

6.11 First, we note that para. 213 of Korea's First Written Submission states that:

> Shipyards *do not always* select the APRG provider by itself. *Sometimes*, they are compelled to make use of the financial institutions, domestic or foreign, designated by the ship owners for issuing the APRGs regardless of whether the premium rates by such institutions are higher than those offered by other financial institutions. (emphasis supplied)

6.12 Korea's own submission therefore makes it clear that Korea was not approaching this issue from a "general perspective". Instead, Korea argued that APRG providers were "sometimes" designated by buyers. Korea's argument could not, therefore, have operated as a general defence, or response, to the benchmarks proposed by the EC. Rather, the onus was on Korea, as the party alleging a fact, to prove that the providers of the specific APRGs identified by the EC were designated by the relevant buyers of the ships in question.

6.13 Second, it was up to Korea to decide how it wished to respond to the claims, arguments and evidence of the EC. It was not up to the Panel to instruct Korea in this regard. Nor did the Panel "prohibit" Korea from offering any evidence that it chose. Korea had numerous opportunities to present whatever evidence it wished in response to the claims, arguments and evidence presented by the EC. The Panel addressed Question 69 to Korea in order to clarify Korea's argument regarding buyer designation. It did not do so in order to dictate how Korea should respond to the claims, arguments and evidence presented by the EC. The fact that the Panel phrased Question 69 in a particular manner did not prevent Korea from deciding for itself how it wished to respond to the claims, arguments and evidence presented by the EC.

6.14 Regarding Exhibit KOREA – 83, we note that our findings regarding individual APRG transactions were necessarily limited to those transactions specifically identified by the EC. We had no basis to make findings in respect of other individual APRG transactions for which no evidence had been submitted by the EC. We have made the change suggested by the EC in order to clarify this matter.

Paragraph 7.167

6.15 Korea asserts that the value of Yangdo Dambo is (at least) 50 per cent of the value of Physical Collateral such as government bonds. Korea submits that it clearly showed that differences existed as regards different types of collaterals and that the value of the Yangdo Dambo exceeds that of cash deposits for foreign APRGs which was 10 to 30 per cent of the amount covered by the APRGs in terms of collateral value.

6.16 The EC asserts that Korea's comment is addressed in para. 7.169 and footnote 95 of the Interim Report.

6.17 We maintain the view we expressed in footnote 95 that "at a certain point the value of a smaller portion of credit coverage by a stronger form of collateral will equal, or exceed, the value of a larger portion of credit coverage by a weaker form of collateral". We also recall our statement in para. 7.167 that, in order for Korea's argument to prevail, "Korea would need to demonstrate that the collateral value of the Yangdo Dambo exceeds that of the cash deposits". Korea has failed to show this, since Korea has failed to establish the collateral value of the cash deposits, i.e., it has failed to establish how much the credit spread was adjusted in order to reflect the value of the 10 – 30 per cent cash deposits.

Paragraph 7.234

6.18 Korea asserts that, contrary to the Panel's finding in para. 7.234, it did provide sufficient information to rebut the EC's argument regarding the **[BCI: Omitted from public version]** guarantee. Korea refers in this regard to its response to Question 17 from the EC, read in light of the information provided by the EC in Exhibit EC – 118.

6.19 The EC asserts that the evidence referred to by Korea is not sufficient to rebut the EC's argument.

6.20 Korea's reply to Question 17 from the EC refers to a "payment guarantee". It does not provide the value of that guarantee. Nor does it indicate the terms of that guarantee. Nor is this information to be found in Exhibit EC – 118. Accordingly, there is no basis for us to change our finding in para. 7.234.

Paragraph 7.237

6.21 Korea asserts that there is a difference in the value of the types of collateral referred to in para. 7.237 (i.e., factory and Yangdo Dambo). Korea asserts that the value of the factory is greater than the value of the Yangdo Dambo.

6.22 Korea's comment does not address the issue raised in para. 7.237 of the Interim Report. The fact that the different types of collateral may have different values is not denied in para. 7.237. Instead, we indicate that we have no information regarding what those values might be. Korea's comment does not address this issue, since it does not identify any evidence submitted during the Panel proceedings regarding the values of the types of collateral at issue. In any event, we note that para. 7.237 also provides additional reasons (unrelated to the value of the relevant collaterals) for rejecting the STX/Daedong corporate bond data submitted by Korea.

Paragraph 7.240

6.23 Korea asserts that it provided information regarding the interest rates for the Hyundai/Mipo corporate bonds at para. 238 of its First Written Submission.

6.24 We do not disagree with Korea. However, Korea's comment does not address the issues raised in para. 7.240 of the Interim Report. In particular, Korea's comment does not point to record evidence indicating whether or not the relevant bonds were guaranteed or collateralized.

Paragraph 7.243

6.25 Korea asserts that the reference to "collateral" in Exhibit KOREA – 22 was an error. Korea identifies record evidence indicating that the HHI corporate bonds were not collateralized.

6.26 The EC does not respond to Korea's comment. In the absence of any objection by the EC, and on the basis of the explanation provided by Korea, we shall amend para. 7.243 of the Report to remove references to the issue of collateralization. However, we note that para. 7.243 will still reflect the fact that the bond rates cannot be used as market benchmarks because of differences in maturity.

Footnote 154 (footnote 156 of the Final Report)

6.27 Korea asserts that the Panel failed to acknowledge that joint and several guarantees do have certain values. Korea asserts that the fact that joint and several guarantees have certain values is clear from paragraphs 15 and 16 of Exhibit KOREA – 90.

6.28 The Panel did not state that joint and several guarantees do not have any value. Rather, in footnote 154 the Panel quoted Korea's explicit statement that KEXIM treated such guarantees as if they had no value. Korea has not denied this. The Panel also stated that "[i]n any event, since Korea has failed to quantify the alleged value of such collateral, there is no basis for us to make any adjustment". This statement remains valid, since Korea has failed to identify any evidence regarding the value of the joint and several guarantees at issue. Paragraphs 15 and 16 of Exhibit KOREA – 90 do not indicate the value of such guarantees.

Footnote 174 (footnote 176 of the Final Report)

6.29 We have corrected a clerical error identified by Korea.

Paragraphs 7.290 and 7.291

6.30 Korea asserts that it did establish that the value of collateral was reflected in KEXIM's interest rate calculations. Korea also asserts that it identified Attachment 1 to the KEXIM Interest Rate Guidelines as the statutory basis for the application of different credit risk spreads depending on the types of security interests provided.

6.31 We note that Attachment 1 to the KEXIM Interest Rate Guidelines does not contain any reference to **[BCI: Omitted from public version]**. Nor was any other evidence presented by Korea regarding the amount of any interest rate adjustment made in respect of such collateral. Accordingly, there is no need for us to amend our statement (para. 7.292) that "[e]ven if an additional adjustment were necessary, therefore, there is no basis for the Panel to determine what exactly that adjustment should be".

Footnote 182 (footnote 184 of the Final Report)

6.32 Korea asserts that the references to "Samho" should be replaced by "STX/Daedong".

6.33 We disagree with Korea's comment, as the footnote is dealing with the EC's treatment of Samho PSLs in Figure 17 of the EC's first Written Submission. This is what Korea is referring to in para. 235 of its First Written Submission. We have slightly amended footnote 184 of the Final Report to clarify this point.

VII. FINDINGS

A. KOREAN REQUESTS FOR PRELIMINARY RULINGS

1. 29 August 2003 request for suspension of the Annex V information-gathering procedure

7.1 On 29 August 2003, Korea requested the suspension of the Annex V information-gathering procedure. On 3 September 2003, the Panel sent the following communication to the parties regarding this matter:

> I am writing to you in respect of Korea's request for preliminary rulings dated 29 August 2003. This letter concerns only Korea's request regarding the suspension or adaptation of the Annex V procedure pending issuance of the preliminary rulings sought by Korea. It does not address the substance of any of the requested preliminary rulings.
>
> In Section II.D of its request, Korea submits that the Annex V procedure should be immediately suspended until such time as the Panel has issued preliminary rulings on the issues raised by Korea in its request. In the alternative, Korea asks (Section I, para. 6) that replies to the Facilitator's questionnaires should only be submitted to the Panel (through the Facilitator), but not to the parties, until such time as the Panel has had the opportunity to make the preliminary rulings requested by Korea. In its comments dated 2 September 2003, the European Communities submits that there is no basis to suspend or otherwise interrupt the Annex V procedure.
>
> First, the Panel notes that, in accordance with paragraph 2 of Annex V, the Annex V procedure in the present case was initiated by the Dispute Settlement Body ("DSB"). There is no provision in Annex V which envisages the suspension of that procedure, either by the DSB itself or by any other body. In the absence of any provision explicitly authorising the Panel to suspend a procedure initiated by the DSB, the Panel has no authority to grant Korea's request for suspension of the Annex V procedure.
>
> Second, we understand paragraph 4 of Annex V to mean that the Annex V procedure is under the control of the Facilitator. In light of paragraph 4, we do not see any scope for intervention by the Panel in procedural issues relating to Annex V. We further note that Korea already asked the Facilitator to suspend or adapt the Annex V procedure in the third paragraph of a letter dated 8 August 2003, and that Korea's request was rejected by the Facilitator in a letter to the parties dated 11 August 2003.
>
> For the above reasons, we reject Korea's request that the Panel should suspend or adapt the Annex V procedure.

2. Other preliminary rulings requested by Korea on 29 August 2003

7.2 On 19 September 2003, the Panel addressed the following communication to the parties regarding other preliminary issues raised by Korea:

> 1. On 29 August 2003, Korea submitted a request for a number of preliminary rulings by the Panel. At the request of the Panel, the European Communities submitted comments on Korea's request, on 2 and 5 September 2003.
>
> 2. One of the preliminary rulings requested by Korea concerned the suspension of the Annex V information-gathering procedure. The Panel sent a communication to

the parties regarding that matter on 3 September 2003. The present communication addresses the remainder of the preliminary rulings requested by Korea, concerning the scope of the claims contained in the request for establishment, the conformity of that request with Article 6.2 of the DSU, and a number of issues characterized by Korea as substantive in nature.

A. THE SCOPE OF THE KEXIM CLAIMS INCLUDED IN THE REQUEST FOR ESTABLISHMENT

1. Arguments of Korea

3. Korea submits that the European Communities has sought to extend the scope of these dispute settlement proceedings beyond the measures specified in the request for consultations, and beyond the scope of the consultations held between the parties, contrary to Articles 4.2, 4.4, 7.2 and 7.4 of the SCM Agreement, and Articles 4 and 6.2 of the DSU.

4. First, Korea asserts that the scope of the European Communities' request for establishment of a panel is unduly broad since it includes the KEXIM Act itself, as applicable to all capital goods, and preferential financing at large outside the scope of the APRGs and pre-shipment financing for commercial vessels, which according to Korea had never been included in the "matter" referred to in the European Communities' request for consultations.

5. Second, Korea claims that the European Communities' request for establishment is unduly broad since it includes serious prejudice claims in respect of assistance provided by KEXIM under the APRG and PSL programmes. Korea asserts that no KEXIM assistance was included in the serious prejudice claim set forth in the request for consultations, and that APRG and PSL assistance was only cited in respect of the prohibited subsidy claim. Korea further submits that the European Communities' request for establishment is unduly broad since it cites as the legal basis both Articles 3 and 5 of the SCM Agreement for the same measures, i.e., the corporate restructuring packages, tax concessions and KEXIM programmes. Korea asserts that the request for establishment should only have challenged the KEXIM measures as prohibited subsidies under Article 3, and the corporate restructuring subsidies and tax programmes as actionable subsidies under Article 5. According to Korea, a challenge of the same measures as both prohibited and actionable subsidies is legally and factually impossible.

6. Third, Korea asserts that the KEXIM Act and implementing decrees and regulations referred to in the request for establishment do not constitute the basis for any claim in and of themselves, since they do not mandate the providing of export subsidies.

7. In respect of the above, Korea asks the Panel to issue preliminary rulings that:

- "un-specified KEXIM programs for capital goods at large are not legitimately in front of the Panel in accordance with Articles 4.2, 4.4, 7.2 and 7.4 of the SCM Agreement as well as Articles 4 and 6.2 of the DSU";

- "only the KEXIM APRGs and the pre-shipment loans for commercial vessels as prohibited subsidies and the corporate restructuring and tax subsidies as actionable subsidies are legitimately in front of the Panel"; and

- "the KEXIM Act and its implementing decrees and regulations do not mandate the adoption of prohibited and actionable subsidies and cannot be challenged as such; only the implementing measures specified for commercial vessels are the measures at issue."

2. Arguments of the European Communities

8. The European Communities submits that all of the KEXIM measures covered by its request for establishment were subject to consultations. The European Communities asserts that because the KEXIM Act "as such" is applicable to all capital goods, it consequently covers more than just commercial vessels. The European Communities asserts that the reference to capital goods other than commercial vessels only arises in respect of the *per se* challenge to the KEXIM Act as a prohibited subsidy. With regard to the scope of its serious prejudice claims, the European Communities submits that KEXIM subsidies were included in that claim during the course of consultations. The European Communities submits that Korea's objections regarding the mandatory nature of the KEXIM legal instruments, and the European Communities' reliance in the request for establishment on both Articles 3 and 5 of the SCM Agreement as concurrent or alternative legal bases, are substantive in nature, and should be addressed in the light of the submissions to the substantive meetings of the Panel.

3. Assessment by the Panel

9. We begin our consideration of these issues by noting that Articles 4.2, 4.4, 7.2 and 7.4 of the SCM Agreement are identified as "special or additional rules and procedures" in Appendix 2 of the DSU. If possible, these provisions should therefore be read so as to complement the relevant provisions of the DSU, including Article 4.2 – 4.7.[8] As regards the relationship between these SCM and DSU provisions, we agree with the finding by the panel in *Canada – Aircraft* that:

> "In our view, a panel's terms of reference would only fail to be determinative of a panel's jurisdiction if, in light of Article 4.1 - 4.4 of the SCM Agreement applied together with* Article 4.2 - 4.7 of the DSU, the complaining party's request for establishment were found to cover a "dispute" that had not been the subject of a request for consultations. Article 4.4 of the SCM Agreement permits a Member to refer a "matter" to the DSB if "no mutually agreed solution" is reached during consultations. In our view, this provision complements Article 4.7 of the DSU, which allows a Member to refer a "matter" to the DSB if "consultations fail to settle a dispute". Read together, these provisions prevent a Member from requesting the establishment of a panel with regard to a "dispute" on which no consultations were requested. In our view, this approach seeks to preserve due process while also recognising that the "matter" on which consultations are requested will not necessarily be identical to the "matter" identified in the request for establishment of a panel. The two "matters" may not be identical because, as noted by the Appellate Body in *India - Patents*, "the claims that are made and the facts that are established during consultations do much to shape the

[8] See Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala – Cement I*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767, paras 64-66.

> substance and the scope of subsequent panel proceedings."* [9]
> (* footnotes omitted)

This principle was reaffirmed by the Appellate Body in *Brazil – Aircraft*.[10]

10. We do not consider that the scope of the request for establishment need be identical to the scope of the request for consultations. Rather, the scope of the request for establishment is governed by, and may not exceed, the scope of the consultations that actually took place between the parties. Provided the request for establishment concerns a dispute on which consultations had been requested, there is no need for the matter[11] identified in the request for establishment to be identical to the matter on which consultations were requested. Subject to our comments below regarding the European Communities' claims against the KEXIM legal instruments "as such", the request for establishment and the request for consultations clearly relate to the same dispute, namely whether or not Korean measures affecting trade in commercial vessels are prohibited by provisions of the SCM Agreement, and/or give rise to adverse effects thereunder. Thus, in order to address Korea's objections regarding the scope of the KEXIM claims included in the request for establishment, we must consider whether or not the scope of the request for establishment exceeded the scope of the consultations that actually took place between the parties.

11. In respect of the issue of whether or not the European Communities was entitled to include the entirety of the "Act Establishing the Export-Import Bank of Korea ("KEXIM"), any implementing decrees and other regulations" in its request for establishment, we note that the Statement of Available Evidence attached to the European Communities' request for consultations referred expressly to "the KEXIM Act and its Enforcement Decree". We further note that on 15 November 2002 the European Communities submitted a number of questions to Korea concerning the KEXIM Act and the implementation thereof.[12] This evidence alone is sufficient for us to conclude that the parties consulted on the entirety of the KEXIM Act, including any implementing decrees and other regulations, and that the European Communities was therefore entitled to include those measures in its request for establishment.

12. Turning to the question of whether the European Communities' request for establishment properly included the abovementioned measures insofar as they apply to Korean exporters of "capital goods" generally, rather than commercial vessels in particular, we note that the questions referred to in the preceding paragraph were not restricted to the KEXIM measures insofar as they applied to commercial vessels only. The questions referred to the KEXIM measures generally. Furthermore, we note the European Communities' argument that because the KEXIM Act "as such" is applicable to all capital goods, it consequently covers more than just commercial vessels. To the extent that a claim is brought against the KEXIM Act "as such", and to the extent that the KEXIM Act does not differentiate between assistance in respect of commercial vessels and assistance to capital goods more generally, the KEXIM

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[9] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, WT/DS70/AB/R, DSR 1999:IV, 1443, at para. 9.12.

[10] Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* ("*Brazil – Aircraft*"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, at para. 132.

[11] We recall that the term "matter" was defined by the Appellate Body in *Guatemala – Cement I* to mean the specific measures at issue and the legal basis of the complaint (WT/DS60/AB/R, para. 72). Accordingly, there is no need for the measures and legal claims identified in the request for establishment to be identical to the measures and legal claims identified in the request for consultations.

[12] See, for example, Questions 2, 3, 8, 9, 10, 11 and 12.

Act as a whole is under review. Thus, we see no basis at present to restrict our findings to the KEXIM Act "as such" only as applicable to commercial vessels.[13]

13. Regarding the inclusion in the European Communities' request for establishment of Article 5 / serious prejudice claims in respect of assistance provided under the KEXIM APRG and PSL programmes, and the inclusion of Article 3 / prohibited export subsidy claims in respect of restructuring assistance and tax programmes, we recall that provided the request for establishment concerns a dispute on which consultations had been requested, there is no need for the matter identified in the request for establishment to be identical to the matter on which consultations were requested. Since consultations took place in respect of all of the abovementioned measures, in the context of a dispute concerning the application to those measures of certain disciplines under the SCM Agreement, we consider that the European Communities was entitled to formulate its request for establishment on the basis of any combination of those measures and legal provisions. Furthermore, we note that in a letter to Korea dated 3 April 2003, the European Communities referred to the need to "clarify ... the effects of KEXIM financing and restructuring measures on the shipbuilding market". Attached to that letter were six questions under the title "Impact of KEXIM programmes on the market". In our view, this letter provides sufficient factual evidence to conclude that issues regarding serious prejudice allegedly caused by KEXIM programmes were consulted on, and were therefore properly included in the request for establishment.

14. The issue raised by Korea of whether or not the challenge of the KEXIM programmes and the corporate restructuring and tax subsidies under both Articles 3 and 5 of the SCM Agreement as prohibited and actionable subsidies is legally and factually impossible is substantive in nature. We will therefore only consider this issue in light of the submissions of the parties and third parties to the substantive meetings of the Panel.

15. We also consider that Korea's argument that the KEXIM legal instruments do not mandate the provision of export subsidies is similarly substantive in nature, since it brings into question the very substance of those legal instruments. Again, therefore, it is only appropriate for us to consider this issue in light of the submissions of the parties and third parties to the substantive meetings of the Panel.

16. For the above reasons, we are unable to grant Korea's request for preliminary rulings that (i) "un-specified KEXIM programs for capital goods at large are not legitimately in front of the Panel in accordance with Articles 4.2, 4.4, 7.2 and 7.4 of the SCM Agreement as well as Articles 4 and 6.2 of the DSU", and (ii) "only the KEXIM APRGs and the pre-shipment loans for commercial vessels as prohibited subsidies and the corporate restructuring and tax subsidies as actionable subsidies are legitimately in front of the Panel".

[13] By contrast, with respect to the European Communities' claims regarding the actual application of the KEXIM legislation and schemes thereunder, it is clear that the request for establishment relates only to financing under the APRG and PSL programmes, and only in respect of commercial vessels.

B. CONFORMITY OF THE REQUEST FOR ESTABLISHMENT WITH ARTICLE 6.2 OF THE DSU

1. Arguments of Korea

17. Korea submits that the European Communities' request for establishment fails to meet the requirements of Article 6.2 of the DSU by not defining sufficiently the specific measures at issue and by not providing a sufficient brief summary of the legal basis of the complaint so as to present the problem clearly.

18. First, Korea asserts that the request for establishment failed to meet the standard of clarity required by Article 6.2 of the DSU because it failed to choose between prohibited and actionable subsidy claims in respect of the same measures. According to Korea, the European Communities should not have claimed that one and the same measures are either prohibited or actionable subsidies.

19. Second, Korea asserts that the European Communities' claims are impermissibly vague and contradictory because the European Communities failed to specify (i) the product scope and geographical market of its serious prejudice and injury claims, and (ii) which of the circumstances indicating serious prejudice under Article 6.3 of the SCM Agreement it is alleging to exist as a result of Korean subsidies.

20. Korea submits that the European Communities' failure to specify the legal basis of its claims violates Korea's rights of defence.

21. Korea requests that the Panel issue preliminary rulings that:

- "the request for establishment of the Panel violates Articles 6.2 of the DSU and the corresponding provisions of the SCM Agreement in several (…) respects by not defining sufficiently the specific measures at issue and not providing a sufficient brief summary of the legal basis of the complaint so as to present the problem clearly, in particular, as regards the absence of the specific legal basis relied upon and the absence of clear indication of the geographical and product scope of the measures challenged"; and

- "by failing to specify the subparagraphs relied upon with respect to Article 6.3, the European Communities' panel request in this regard is inconsistent with the requirements of Article 6.2 of the DSU and hence these claims are inadmissible, or at least that Article 6.3(a), (b) and (d) are outside the terms of reference of the Panel."

2. Arguments of the European Communities

22. The European Communities submits that its request for establishment meets the requirements of Article 6.2 of the DSU because it clearly delineates the specific provisions and paragraphs that make up the legal basis of the complaint. The European Communities also asserts that Korea's argument that a subsidy cannot qualify simultaneously as both an actionable and prohibited subsidy, and its contention regarding the relationship between actionable and prohibited subsidies, is a question of substance and not subject to preliminary ruling.

23. Regarding the product scope of its claims, the European Communities submits that it has never demonstrated any interest in developing a serious prejudice

claim outside of the shipbuilding industry. As for Korea's argument that the panel request is vague with respect to the "market" at issue in this case, the European Communities asserts that it has made clear that its focus is on a world, or global market. By referring to SCM Article 6.5, and in listing the adverse effects referred to in Article 6.3(c), the European Communities asserts that its request for establishment has clearly identified which particular provision of Article 6.3 forms the basis of this claim. Moreover, through this reference to Article 6.3(c) of the SCM Agreement, and its reference, in turn, to the negative effects of a subsidy "in the same market", the European Communities asserts that its request for establishment clearly indicated that it was not concerned with any one geographic or national market in particular, but with the global market in which shipbuilders of the European Communities and Korea compete.

24. The European Communities denies that Korea's right to defend itself has been prejudiced.

3. Assessment by the Panel

25. Article 6.2 of the DSU provides in relevant part:

> The request for the establishment of a panel (…) shall (…) identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

26. In its request for establishment, the European Communities stated that the relevant measures:

> are in breach of Korea's obligations under the provisions of the *SCM Agreement*, in particular, but not necessarily exclusively of:
>
> – Articles 3.1(a) and 3.2 of the *SCM Agreement*, because, *inter alia*, the KEXIM Act, the advance payment refund guarantees and the pre-shipment loans provided by KEXIM and the corporate restructuring packages and tax concessions are specific subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement* and are *de jure* or *de facto* export contingent.
>
> - Article 5(a) of the *SCM Agreement*, because, *inter alia*, the above-mentioned KEXIM subsidies, the corporate restructuring packages and tax concessions are specific subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement* and are causing injury to the Community industry.
>
> – Article 5(c) of the *SCM Agreement*, because, *inter alia*, the above-mentioned KEXIM subsidies, the corporate restructuring packages and tax concessions are specific subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement* and cause serious prejudice to the interests of the European Communities, in particular through significant price undercutting, price suppression, price depression or lost sales within the meaning of Articles 6.3 and 6.5 of the *SCM Agreement.*

27. We note the finding of the Appellate Body in *Korea – Dairy Products* that:

> "There may be situations where the simple listing of the articles of the agreement or agreements involved may, in the light of attendant circumstances, suffice to meet the standard of clarity in the statement of the legal basis of the complaint. However, there may also be situations in which the circumstances are such that the mere listing of treaty articles would not satisfy the standard of Article 6.2. This may be the case, for instance, where the articles listed establish not one single, distinct obligation, but rather multiple obligations. In such a situation, the listing of articles of an agreement, in and of itself, may fall short of the standard of Article 6.2." [14]

28. We first consider Korea's assertion that the European Communities failed to satisfy the requirements of Article 6.2 of the DSU because it failed to choose between prohibited and actionable subsidy claims in respect of the measures at issue. Given its view that it is "legally and factually impossible" for a given measure to be at the same time both a prohibited and an actionable subsidy, Korea apparently believes that the European Communities is identifying the provisions at issue as alternative claims. Korea then seems to suggest that it is impermissible to raise alternative claims in a WTO dispute. In our view, the question of whether it is permissible to raise alternative claims is substantive, and it is neither necessary nor appropriate to address it at this time. We would note as a factual matter, however, that citing multiple provisions in respect of a given measure, both as complementary and as alternative claims, is very common in WTO dispute settlement.[15]

29. Leaving aside the substantive question, and returning to the requirements of Article 6.2 of the DSU, we can only conclude that if a complaining party wishes to pursue claims in respect of a given measure under multiple provisions, whether complementarily or alternatively, not only is it *permitted* by Article 6.2 of the DSU to refer to all of those provisions in its request for establishment, but it is *required* to do so. In this respect, we find that the European Communities' request for establishment meets this requirement, as it identifies quite clearly which provisions are at issue, namely Articles 3.1(a), 3.2, 5(a) and 5(c) of the SCM Agreement, and it explicitly states the European Communities' view that, pursuant to these provisions, the relevant measures are specific subsidies that are export contingent, and that cause serious prejudice to the interests of the European Communities. There is thus no doubt as to which provisions are cited by the European Communities in respect of which measures, and on what basis. As for the substantive issues, including whether it is possible to demonstrate that the relevant measures could constitute at one and the same time both prohibited and actionable subsidies, these should only be addressed in light of the submissions of the parties and third parties to the substantive meetings of the Panel.

30. Concerning the question of which subparagraph of Article 6.3 forms the basis of the European Communities' claim of serious prejudice, Korea asks the Panel to rule "at least that Article 6.3(a), (b) and (d) are outside the terms of reference of the Panel". In this regard, the European Communities has asserted that "the focus of the

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[14] Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products* ("*Korea – Dairy*"), WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3, at para. 124.

[15] See, e.g., the *Canada – Dairy* dispute (WT/DS103/R-WT/DS113/R), in which alternative claims were raised in respect of the measures at issue, and the *Indonesia – Autos* dispute (WT/DS54/R-WT/DS55/R-WT/DS59/R-WT/DS64/R), in which complementary claims were raised in respect of the measures at issue.

claim is, in fact, on Article 6.3(c) of the *SCM Agreement*, as demonstrated by the inclusion of Article 6.5 (which specifically refers to Article 6.3(c)) in the panel request, [and] in the reference to 'significant price undercutting, price suppression, price depression, or lost sales within the meaning of Articles 6.3 and 6.5 of the *SCM Agreement*'."[16] On the basis of this statement, and the language in the request for establishment that it cites, we see no need to issue, at this stage, the ruling sought by Korea on this point.

31. In respect of product scope, we understand Korea to argue that the European Communities' request for establishment is not sufficiently clear for the purpose of Article 6.2 of the DSU because it fails to specify that the actionable subsidy (serious prejudice and injury) claims relate only to commercial vessels, and further, that in any event such a reference is overly broad. In this regard, we first note the European Communities' assertion that "its actionable subsidy claim relates to commercial vessels".[17] Since the European Communities used the heading "Korea – Measures Affecting Trade in Commercial Vessels" in its request for establishment, we are in no doubt that the request for establishment was sufficiently specific for the purpose of Article 6.2 of the DSU insofar as it applies to measures affecting trade in "commercial vessels". Since the European Communities has indicated that there will be no actionable subsidy claims in respect of products other than commercial vessels, there is simply no need for us to consider whether or not the request for establishment was sufficiently specific in respect of other products. Furthermore, we find the reference to "commercial vessels" as used in the request for establishment to be a sufficiently precise specification of the product scope of these claims to satisfy the standard of Article 6.2 of the DSU.[18]

32. Korea also asserts that the European Communities' failure to specify a geographic market in its serious prejudice and injury claims is inconsistent with Article 6.2 of the DSU. With respect to the serious prejudice claims, we note that the request for the establishment of a panel explicitly refers to "price undercutting, price suppression or lost sales within the meaning of Article 6.3 and Article 6.5 of the SCM Agreement". As discussed above, it is readily apparent to the Panel, as it should be to the parties, that the specific provision at issue is Article 6.3(c), which refers to "the same market", that is, a market where Korean and European Communities producers of commercial vessels compete and where the alleged adverse effects of the subsidies on prices or sales will need to be substantiated. Given this, we do not consider that a further elaboration as to geographic market is necessary in the request for establishment, in respect of the serious prejudice claims. As for the injury claims, it is clear from the text of Article 5(a), the cited provision, that the alleged injury is to the "domestic industry" of the complaining party, coupled with which the request for establishment explicitly refers to injury to the "Community industry". Given this, we find a simple citation to the provision to be sufficient. In sum, we recall that the requirement under Article 6.2 of the DSU is to "provide a brief summary of the legal basis of the complaint", and we believe that this requirement does not extend to a further elaboration, beyond that implicit or explicit in the provisions cited in this case, of the geographical locus of the alleged adverse effects.

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[16] European Communities' submission of 5 September 2003, para. 41.

[17] *Id*., para. 42. See also para. 33.

[18] Here, in any case, we note that the European Communities has clarified, in its 5 September 2003 submission, at para. 43, that its actionable subsidy claims relate to only certain kinds of commercial vessels. Thus we would not expect to receive arguments from the European Communities regarding other kinds of vessels in the context of these claims.

> 33. For the above reasons, we decline to rule that "the request for establishment of the Panel violates Articles 6.2 of the DSU and the corresponding provisions of the SCM Agreement in several [] respects by not defining sufficiently the specific measures at issue and not providing a sufficient brief summary of the legal basis of the complaint so as to present the problem clearly, in particular, as regards the absence of the specific legal basis relied upon and the absence of clear indication of the geographical and product scope of the measures challenged."
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> 34. Korea has asserted that the European Communities' failure to specify the legal basis of its claims violates Korea's right of defence. Since we do not find that the European Communities' request for establishment fails to meet the requirements of Article 6.2 of the DSU, there is no need for us to consider whether or not the alleged violation of that provision prejudiced Korea's right of defence.
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> C. OBJECTIONS CHARACTERIZED BY KOREA AS SUBSTANTIVE IN NATURE
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> 35. In its request for preliminary rulings, Korea has also raised a number of issues which it expressly characterizes as "substantive" objections. In particular, Korea submits that in the context of ships and trade in commercial vessels a claim of serious prejudice cannot be entertained in the context of a "world market" under the SCM Agreement, and that the European Communities cannot be permitted in the context of this case and the EC's request for the establishment of a Panel, to rely on both Article 3 and Article 5 of the SCM Agreement as concurrent or alternative legal bases for its claims against the same Korean measures. As already noted, the Panel does not deem it appropriate to consider substantive issues before receiving the submissions of the parties and third parties to the substantive meetings of the Panel. We therefore decline to make any preliminary rulings in respect of those issues characterized by Korea as substantive in nature.

3. Exclusion of certain Annex V information

7.3 At para. 68 of its first written submission, Korea asserts that the EC abused the Annex V procedure, by using that procedure to obtain information for (Part II) claims in respect of which the Annex V procedure does not apply. In particular, Korea asserts that the EC used the Annex V procedure (reserved for Part III claims) to obtain information regarding non-shipbuilding sectors, even though its Part III claims were limited to the shipbuilding sector. Korea asserts that the EC did so in order to obtain information to support its Part II claims, which do extend beyond the shipbuilding sector, but which fall outside the scope of the Annex V process.

7.4 Korea submits that the Panel should exclude from its consideration under Part II of the *SCM Agreement* any evidence or information obtained under the Annex V procedure. Korea also submits that the Panel could decide to exclude any and all evidence obtained in the context of the Annex V process from the evidence considered by the Panel in reaching its decision as to the EC's claims under both Part II and Part III of the *SCM Agreement*.[19]

7.5 On 12 March 2004, the Panel issued the following ruling regarding this matter:

> 1. Korea asserts that the EC abused the Annex V procedure by using it to obtain information for (Part II) claims in respect of which the Annex V procedure does not

[19] Korea also asserts (at para. 74 of its first written submission) that the EC's alleged lack of prima facie evidence before bringing its case may be inconsistent with Article 3.7 of the *DSU*. Since Korea does not request a ruling from the Panel regarding this matter, we need not consider it further.

apply. In particular, Korea asserts that the EC used the Annex V procedure (which it claims is reserved for Part III claims) to obtain information regarding non-shipbuilding sectors, even though its Part III claims were limited to the shipbuilding sector. Korea asserts that the EC did so in order to obtain information to support its Part II claims, which do extend beyond the shipbuilding sector, but which in Korea's opinion fall outside the scope of the Annex V process.

2. Korea submits that the Panel should exclude from its consideration under Part II of the *SCM Agreement* any evidence or information obtained under the Annex V procedure. Korea also submits that the Panel could decide to exclude any and all evidence obtained in the context of the Annex V process from the evidence considered by the Panel in reaching its decision as to the EC's claims under both Part II and Part III of the *SCM Agreement*.

3. We note that the information at the heart of Korea's preliminary objection relates to the individual APRG and PSL transactions identified in paragraphs 170 and 172 of the EC's first written submission. In requesting transaction-specific APRG and PSL information from Korea, the Facilitator carefully limited the scope of the request to APRG and PSL transactions relating to "companies (involved (directly or indirectly) in trade in commercial vessels)". In conformity with that request, the transaction-specific information provided by Korea did not extend beyond the commercial vessels sector. As a result, the transaction-specific information at issue does not extend beyond the commercial vessel sector. Furthermore, the relevant information concerns the existence of subsidization, and was relied on by the EC in respect of its Part III claims. We note that paragraph 2 of Annex V envisages the gathering of such information as necessary "to establish the existence and amount of subsidization". In addition, paragraph 5 of Annex V states that the designated representative's report to the Panel should include "data concerning the amount of the subsidy in question". In our view, therefore, the information relied on by the EC in support of its Part III claims regarding the existence of subsidization was properly gathered under the Annex V procedure. The EC therefore did not abuse the Annex V procedure in seeking that information.

4. We must now consider whether or not the EC was entitled to use that information for the additional purpose of supporting its Part II claims. In particular, the question is whether information properly gathered under the Annex V mechanism regarding the existence of alleged subsidization, which was properly relied on by the EC in support of its Part III serious prejudice claims against certain alleged subsidies, could also be used in the context of Part II claims concerning the same alleged subsidies.

5. In the context of the EC's Part III claims, we must determine whether or not the relevant APRG and PSL transactions constitute subsidies. In doing so, we are bound by the provisions of Article 1 of the *SCM Agreement*. At paragraphs 170 and 172 of the EC's first written submission, the EC is requesting us to perform the same analysis of subsidization[20] in respect of the same measures in the context of its Part II claims. We see nothing in Annex V that would require us to ignore our Part III analysis of subsidization when reviewing the EC's Part II claims which concern allegations of the same subsidization in respect of the same measures. Nor indeed do

[20]Article 3.1(a) claims necessarily involve an additional analysis of export contingency. We note that the EC's allegation of export contingency is not based on the Annex V information set forth in paragraphs 170 and 172 of the EC's first written submission.

we see any requirement in the *SCM Agreement* to perform this analysis more than once for any given measure alleged to be a subsidy.

6. In any event, even if we were precluded from relying on the relevant Annex V information when determining the existence of subsidization in the context of the EC's Part II claims, at the very least any finding of the existence of subsidization in respect of the EC's Part III claims would compel us to "seek" that very same information (i.e., regarding the same alleged subsidies) from Korea under Article 13.1 of the *DSU*. In other words, the very same information would in any event be brought before the Panel, but only much later in the proceedings, after the Panel had made findings regarding the existence of subsidization in respect of the EC's Part III claims. We recall that there is no textual basis for requiring us to rule that the relevant Annex V information is not directly admissible in respect of the EC's Part II claims. We therefore see no basis for ruling that the relevant information should only enter the record indirectly, and much later in the proceedings, via Article 13.1 of the *DSU*.

7. For the above reasons, we decline to rule that the EC was precluded from using information that was properly gathered under the Annex V mechanism regarding the existence of alleged subsidization, and properly relied on by the EC in respect of its Part III serious prejudice claims against certain alleged subsidies, in support of additional Part II claims concerning the same alleged subsidies.

4. Prejudice to Korea's earlier preliminary ruling request

7.6 At para. 76 of its first written submission, Korea submits that "it would appear reasonable for the Panel to reconsider" its 19 September 2003 preliminary ruling concerning the alleged impermissible ambiguity of the EC's serious prejudice claims. Korea suggests that reconsideration of the ruling would be necessary subject to two conditions: (1) that the EC's statement (in its 5 September 2003 submission) that it had "never" intended its serious prejudice claims to cover a wider product scope than commercial vessels is inaccurate; and (2) that this may have had a bearing on the Panel's decision to decline Korea's preliminary ruling request on this point.

7.7 Although Korea does not explicitly say so, we understand that Korea is referring to the Panel's preliminary ruling regarding the conformity of the EC's request for establishment with Article 6.2 of the *DSU*. The relevant ruling is found at para. 31 of the abovementioned communication dated 19 September 2003. It is apparent from the text of that communication that the Panel's ruling was not based on the EC's statement that it had "never" intended its serious prejudice claims to cover a wider product scope than commercial vessels. The Panel only took into account the EC's assertion that "its actionable subsidy claim relates to commercial vessels". In other words, the Panel focused on what was included in the EC's serious prejudice claim, and not whether or not the EC had ever demonstrated an interest in developing a serious prejudice claim outside of the shipbuilding industry. Since the second condition identified by Korea is not fulfilled, there is no need for the Panel to reconsider its earlier ruling.

5. Withdrawal of Article 5(a) claim

7.8 Korea asserts that the EC has failed to pursue its claim under Article 5(a) of the *SCM Agreement*, and that it has not presented a *prima facie* case of any alleged injury in its first submission. Korea therefore requests that the Panel formally find that this claim has been effectively withdrawn.

7.9 This issue is addressed by the Panel at para. 7.521 *infra*.

6. Price suppression and price depression / Article 6.3(c)

(a) Exclusion of price undercutting claim

7.10 Korea notes that the EC's Article 6.3(c) claim rests solely on price suppression and price depression, and not price undercutting. Korea submits that the EC has failed to pursue its claim on price undercutting, and that it has not presented a *prima facie* case of any such price undercutting in its first submission. Korea therefore requests that the Panel formally find that this claim has been effectively withdrawn.

7.11 This issue is addressed by the Panel at para. 7.521 *infra*.

(b) Scope of serious prejudice claim

7.12 Korea asserts that the product scope of the EC's serious prejudice claims must be restricted to commercial vessels pursuant to the EC's latest assertion of 5 September.

7.13 We understand that Korea's assertion regarding the scope of the EC's serious prejudice claim relates to Korea's original request for a preliminary ruling in respect of Article 6.2 of the *DSU*. Korea appears to be asking the Panel (although there is no explicit request) to rule that the scope of the EC's serious prejudice claims be restricted to commercial vessels.

7.14 At para. 31 of the abovementioned 19 September 2003 communication, the Panel stated *inter alia*:

> Since the European Communities has indicated that there will be no actionable subsidy claims in respect of products other than commercial vessels, there is simply no need for us to consider whether or not the request for establishment was sufficiently specific in respect of other products.

7.15 It is clear, therefore, that the Panel already indicated its understanding that the scope of the EC's serious prejudice claim is limited to commercial vessels.

7. The extent of the record

7.16 At para. 82 of its first written submission, Korea disputes the EC's argument that the responses provided in the context of the Annex V process should be considered the "record" on the basis of which the panel should reach its conclusions in this case.

7.17 Since Korea has not requested a preliminary ruling on this issue, there is no need for the Panel to consider this matter further.

8. Continued relevance of Korea's 29 August 2003 request for preliminary rulings

7.18 At para. 84 of its first written submission, Korea submits that a number of issues raised in its 29 August 2003 request for preliminary rulings remain applicable. In our view, these issues have already been addressed in our communications dated 19 September 2003 and 12 March 2004. We therefore do not consider it necessary to revisit the issues raised in Korea's submission of 29 August 2003.

B. ALLEGED PROHIBITED EXPORT SUBSIDIES

7.19 The EC claims that Korea has provided and continues to provide its shipbuilding industry prohibited export subsidies, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.*

7.20 First, the EC claims that such subsidies were and are provided pursuant to the Export-Import Bank of Korea ("KEXIM") Act, the KEXIM Decree, and the KEXIM Interest Rate Guidelines (the "KEXIM legal regime", or "KLR"). The EC asserts that these measures "as such" (i.e., by their very existence, irrespective of their application in a given case) violate Articles 3.1(a) and 3.2 of the *SCM Agreement*.

7.21 Second, the EC claims that Korea provides and has provided prohibited export subsidies pursuant to the KEXIM Advance Payment Refund Guarantee ("APRG") and Pre-shipment Loan ("PSL") programmes. Again, the EC claims that these measures "as such" violate Articles 3.1(a) and 3.2 of the *SCM Agreement*.

7.22 Third, the EC claims that individual APRGs and PSLs (i.e., the application of the APRG and PSL programmes in individual cases) violate Articles 3.1(a) and 3.2 of the *SCM Agreement*.

1. Kexim Legal Regime

7.23 Before turning to the substance of the EC's claims, we observe that a measure is generally to be treated as a prohibited export subsidy if it is a subsidy (as defined by Article 1 of the *SCM* Agreement) that is "contingent … upon export performance" (in the meaning of Article 3.1(a) of the *SCM Agreement*). While the EC's claims do not raise many issues regarding the notion of export contingency, the parties have made extensive arguments on the question of whether or not the measures at issue constitute subsidies. A subsidy exists if there is a "financial contribution" by a government or public body (or a private body entrusted or directed by the government) that confers a "benefit".

7.24 We shall begin our analysis of the EC's claim against the KLR by determining whether measures taken under the KLR constitute financial contributions, and whether KEXIM is a public body. If so, we shall then determine whether or not the KLR confers a benefit. We shall then consider whether or not measures taken under the KLR are contingent on export performance.

(a) Does the KLR Provide for Financial Contributions?

(i) Arguments of the parties

7.25 The EC submits that the KEXIM Act provides for direct transfers of funds within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. The EC asserts that Article 18 of the KEXIM Act provides for loans and loan guarantees, among other types of financing. The EC states that loans and loan guarantees are identified as types of direct transfer of funds in Article 1.1(a)(1)(i) of the *SCM* Agreement.

7.26 Korea submits that the KLR does not provide for "financial contributions" in the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement* because KEXIM does not engage in "government practice". Korea asserts that even if a body is a public body, it does not make a financial contribution if it is not involved in a "government practice". Korea states that the term "government practice" means the exercise of government authority, e.g., regulatory powers and taxation authority. According to Korea, this is confirmed by the context of Article 1.1(a)(1)(iv) of the *SCM Agreement*, which provides that there is a "government practice" only when a body carries out a function "which would normally be vested in the government" and "the practice, in no real sense, differs from practices normally followed by governments". Korea argues that the panel in *US – Export Restraints* looked at the negotiating history of the term "normally vested in the government" in Article 1.1(a)(1)(iv) of the *SCM Agreement* and concluded that the term "was a general reference to the delegation to private

parties of the particular government functions of taxation and expenditure of revenue and not a reference to government market intervention in the general sense, or the effects thereof."[21]

7.27 Korea asserts that KEXIM is set up for the specific purpose of meeting needs of an industrial or commercial nature, i.e., activities involving the extension of financing facilities on markets where it competes with other public or private operators based on market-oriented principles. Korea argues that in extending financing facilities such as APRGs or PSLs, KEXIM operates in a traditional banking capacity, performing functions normally performed by banks – not by governments.

(ii) Evaluation by the Panel

7.28 We do not accept Korea's argument that there is only a "financial contribution" in the meaning of Article 1.1(a)(1(i) if the relevant government or public body is engaged in "government practice" such as regulation or taxation. Article 1.1(a)(1) states in relevant part that the term "government" refers to both "government" and "public body". Since the phrase "government practice" in Article 1.1(a)(1)(i) therefore refers to the practice of both governments and public bodies, the practice at issue need not necessarily be purely "governmental" in the narrow sense advocated by Korea. In this regard, we consider that the concept of "financial contribution" is writ broadly to cover government and public body actions that might involve subsidization. Whether the government or public body action in fact gives rise to subsidization will depend on whether it gives rise to a "benefit". Since the concept of "benefit" acts as a screen to filter out commercial conduct, it is not necessary to introduce such a screen into the concept of "financial contribution".

7.29 In our view, the phrase "government practice" in Article 1.1(a)(1)(i) is simply a grammatical construction, or series of words, chosen because sub-paragraph (i) of Article 1.1(a)(1) could not have been drafted in the direct form.[22] As such, it refers to cases ("practice") where governments or public bodies provide direct or potential direct transfers of funds. The phrase "government practice" is therefore used to denote the author of the action, rather than the nature of the action. "Government practice" therefore covers all acts of governments or public bodies, irrespective of whether or not they involve the exercise of regulatory powers or taxation authority. If the phrase "government practice" fulfils the filtering role advocated by Korea, this phrase would presumably also have been included in sub-paragraphs (ii) and (iii) of Article 1.1(a)(1). In particular, we would have expected it to be included in sub-paragraph (iii), such that only the provision of goods and services pursuant to the exercise of regulatory powers or taxation authority would be covered by that provision.[23] However, sub-paragraph (iii) is not drafted in this way.

7.30 We note Korea's argument that Article 1.1(a)(1)(iv) of the *SCM Agreement* refers to functions "normally (...) vested in the government" and "practice [that] in no real sense, differs from practices normally followed by governments". We note that this language was addressed by the panel in *US – Export Restraints*. That panel referred to the report of the Group of Experts on the Calculation of the Amount of a Subsidy, which in turn referred to a 1960 panel report.[24] Like that panel, we too "find very significant the Group of Experts' interpretation that the 1960 Panel's reference to 'practice . . . in no real sense different from those normally followed by governments' was a general reference to the *delegation* to private parties of the particular government functions of taxation and expenditure of

[21] Panel Report, *US – Export Restraints*, para. 8.72.

[22] It is grammatically inconceivable that sub-paragraph (i) could have been drafted as "a government provides a direct transfer of funds or a potential direct transfer of funds", since it makes no sense to refer to a government concretely providing a potential, or hypothetical, direct transfer of funds.

[23] We also note that there has never been any suggestion in any previous panel or Appellate Body reports addressing Article 1.1(a)(1) of the *SCM Agreement* that the scope of that provision (or parts thereof) is confined to government or public body measures taken pursuant to the exercise of regulatory powers or taxation authority.

[24] See MTN.GNG/NG10/W/4, "Subsidies and Countervailing Measures – Note by the Secretariat", 28 April 1987, Section 4.1.A.

revenue, ...".[25] The Panel notes that the reference to functions "normally vested in the government" textually mirrors the reference to "practices normally followed by governments". Accordingly, the Panel considers that the reference to functions "normally vested in the government" should also be understood to mean functions of taxation and revenue expenditure. Thus, a function may be said to be "normally vested in the government" if that function involves the levy of taxation or the expenditure of revenue. Accordingly, since loans and loan guarantees involve revenue expenditure, they may be treated as functions "normally vested in the government", whether or not they are provided pursuant to the exercise of regulatory powers or taxation authority.[26]

7.31 In light of the above, and since Korea does not dispute the EC's assertion that loans and loan guarantees fall within the scope of Article 1.1(a)(1)(i), we find that the KLR provides for "financial contributions" in the meaning of Article 1.1(a)(1) of the *SCM Agreement.*

(b) Is KEXIM a Public Body?

(i) Arguments of the parties

7.32 The EC submits that KEXIM is a public body because (i) it is created and operates on the basis of a public statute giving the Government of Korea ("GOK") control over its decision-making, (ii) it pursues a public policy objective, and (iii) it benefits from access to state resources.

7.33 Concerning governmental control over decision-making, the EC submits that as of December 2002 KEXIM was owned 51.6 per cent by the GOK, 42.8 per cent by the Bank of Korea, and 5.6 per cent by the Korea Development Bank ("KDB"), both of which latter are wholly subscribed by the Government of Korea. The EC further asserts that KEXIM's key management is appointed and dismissed by the GOK, and its operations and budget are subject to the approval and control of the GOK. The EC also submits that KEXIM's annual Operation Plans are formulated under the control of the GOK.

7.34 Concerning public policy objective, the EC asserts that pursuant to Article 1 of the KEXIM Act, KEXIM was created to fulfil the public purpose of promoting "the sound development of the national economy and economic cooperation with foreign countries."[27] According to the EC, KEXIM itself acknowledges that it is a public body that acts in the interests of the country by serving as "an official export credit agency providing comprehensive export credit and project finance to support Korean exporters and investors" and facilitating "the development of the national economy and enhanc[ing] economic cooperation with foreign companies as a financial catalyst."[28] The EC further notes that KEXIM's annual reports specifically refer to KEXIM as "a special governmental financial institution",[29] and as "an agent of the Government".[30] Similarly, the EC asserts that KEXIM's website describes KEXIM as a "special government financial institution under the guardian authority

[25] *US – Export Restraints*, para. 8.72.

[26] We also note that Korea agrees (see Korea's First Written Submission, para. 163) with the statement by the US – Export Restraints panel that "the difference between subparagraphs (i) – (iii) on the one hand and subparagraph (iv) on the other has to do with the identity of the actor and not the nature of the action". Since we have already concluded that the text of subparagraph (i) is not limited to the exercise of regulatory powers or taxation authority, the above statement suggests that the same must also be true of subparagraph (iv) (because the only difference between sub-paragraphs (i) – (iii) and (iv) is the author, not the nature, of the action). Subparagraph (iv) cannot therefore be relied on by Korea to limit the scope of actions covered by subparagraph (i).

[27] See Exhibit EC – 10.

[28] *See* KEXIM 2002 Annual Report, at "Profile" (Exhibit EC-14).

[29] KEXIM Annual Report 2000, at "Profile" (Exhibit EC-15).

[30] KEXIM 2002 Annual Report, p. 35 (Exhibit EC-14); KEXIM 2000 Annual Report, p. 31 (Exhibit EC-15); KEXIM 2001 Annual Report, p. 32 (Exhibit EC-16).

of MOFE [*i.e.*, the Ministry of Finance and Economy]"[31], and as "a government institution [that] supports the Government's policies on international trade and overseas investment."[32] According to the EC, other KEXIM materials confirm that KEXIM "is a special government financial institution whose purpose is to promote the development of the Korean economy and economic cooperation with foreign countries ... [and] expand appropriate financing activities to conform with government policies."[33]

7.35 Concerning access to state resources, the EC submits that the GOK is required to guarantee any net loss incurred by KEXIM. In this regard, the EC asserts that GOK, and government-owned banks, injected over 1.6 trillion Korean Won ("KRW") between 1998 and 1999 into KEXIM, and at least an additional KRW 270 billion since January 2000. The EC asserts that an unlimited guarantee for losses and massive capital injection provide evidence of government influence and control over KEXIM.

7.36 In the alternative, the EC submits that KEXIM is a private body "entrusted" or "directed" by the Korean Government within the meaning of Article 1.1(a)(1)(iv) of the *SCM Agreement*.

7.37 Korea asserts that KEXIM is not a public body, as it is a body that carries on a business equivalent to that of a private operator. Korea submits that an organization is a public body only when it acts in an official capacity, or is engaged in governmental functions. Korea submits that the term "public" in Article 1.1(a)(1) of the *SCM Agreement* should be defined as "[a]cting in an official capacity on behalf of the people as a whole; as a public prosecutor".[34]

7.38 According to Korea, the pursuit of a public policy objective does not confer on a body the status of a public body when such body is set up for the specific purpose of meeting needs of an industrial or commercial nature through the supply of goods or services on markets which are open to other public or private operators under fully competitive conditions. Korea submits that a general public policy purpose reflected in sectoral focuses is characteristic of many privately owned companies, particularly in the financial sector. By way of example, Korea asserts that investment trusts are limited in their activities in many countries, home mortgage lending is often a separate specialty, and often it is required that merchant banking be legally separate from retail banking. Korea asserts that it is a matter of focusing expertise, protecting consumers (corporate as well as natural), and protecting the integrity of the overall financial markets from errors caused by financial institutions venturing into substantive areas where they have insufficient expertise.

7.39 Korea refers to the International Law Commission's Articles on State Responsibility in support of its position. According to Korea, Article 5 of the Articles on State Responsibility[35] provides for a two-step analysis that helps clarify whether an entity is a public body. First, Korea submits that, pursuant to Article 5, the entity will be a public body if it "is empowered by the law of the State to exercise elements of the governmental authority." Korea asserts that this is a simple and logical test, based on the substance of what an entity is required to do rather than on questions of form

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[31] KEXIM "On-line Road Show" <http://www.koreaexim.go.kr/web/eng/index.jsp>, p. 2 (Exhibit EC-17).

[32] *See* "The Bank in Outline" <http://www.koreaexim.go.kr/web/eng/about/M01/m1_01.html> (visited 21 November 2002) (Exhibit EC-18).

[33] *See* Brief Guide to Korea Eximbank (March 2000), p. 1 (Exhibit EC-19).

[34] Webster's New Twentieth Century Dictionary, unabridged second edition at page 1456.

[35] Article 5 of the Articles on State Responsibility provides:

> "The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance."

such as whether a statute is a "public statute" or not. Regarding the second step, Korea submits that the acts in question will be considered acts of State only if such entities are acting pursuant to such authority in the particular instance. Thus, Korea asserts that it is not the case that an entity is a public body for all purposes simply because it might have been given authority to act for the State in some matters. Korea asserts that one must still determine that the acts in question were undertaken pursuant to the specific grant of governmental authority. According to Korea, if financing is offered as part of a commercial program by a para-statal entity, it is presumptively non-governmental and therefore should not be considered a financial contribution.

7.40 Korea submits that in extending financing facilities, KEXIM is not acting in an official or governmental capacity. Korea asserts that KEXIM has no authority to regulate, and manufacturers and borrowers are free to seek financing from other financial institutions. According to Korea, the role played by KEXIM in its financing activities is the same as that of other financial institutions offering private financing. Korea argues that, even though KEXIM may have been established in the general interest of the public for the promotion of the growth of the national economy,[36] it supplies financial services in markets that are open to other public or private operators under full competitive conditions in accordance with Article 18 of the KEXIM Act.

7.41 In addition, Korea asserts that Article 26 of the KEXIM Act provides that KEXIM must operate to cover its expenses and fees so as to include a profit element. As regards guarantees such as the APRGs, Korea argues that this means that the premium rates must cover the long-term operating costs and losses of the programmes.[37] According to Korea, even if a body disposes of governmental resources, it does not necessarily mean that the receiving body is a public body. Instead, Korea asserts that it could well be that the provision of governmental resources simply constitutes a subsidy to that body which still is a private body. Korea asserts that GOK injected capital into KEXIM not to cover KEXIM's losses, but to avoid negative credit ratings and maintain a sound Bank of International Settlements ("BIS") adequacy ratio. Korea rejects the EC's argument that KEXIM is not required to repay capital contributions made by the GOK, even during years in which KEXIM achieves a profit, since Article 36(2) of the KEXIM Act provides for the payment of dividends to the KEXIM shareholders, including the GOK, even if part of the profits will first be paid out to (non-GOK) preferential shareholders. Korea asserts that this preferential treatment was intended to help persuade commercial financial institutions and other entities to participate in capital contributions into KEXIM.

7.42 Regarding government control, Korea argues that the daily operations of KEXIM are under the ultimate responsibility of, and thus decided by, the Board of Directors, without any form of control by the Government. Korea asserts that although KEXIM is to submit for approval by the Ministry of Finance and Economy the annual Operation Plans, which include the schedules/plans in broad perspectives as to administering loan provisions as well funding requirements therefor, the annual Operation Plan does not pertain to any terms or conditions prescribed for APRGs, nor does the Government require such terms or conditions for APRGs to be included.

7.43 Korea also refers to paragraph 5(c)(i) of the *GATS Annex on Financial Services*, which provides that the term "public entity" does not include "an entity principally engaged in supplying financial services on commercial terms". Korea argues that this definition is context for the interpretation of "public body" under Article 1.1 of the *SCM Agreement* in the present case, since

[36] Korea asserts that, among other things, KEXIM was set up to provide extra liquidity. According to Korea, this was very common in developing countries (which Korea was when KEXIM was set up), as capital markets are undeveloped and funding for commercial enterprises may be limited in a manner not always familiar to those Members with highly developed and liquid capital markets.

[37] Korea asserts that Article 26 has never been applied in practice. According to Korea, it was set forth with the concept of "matching" in the OECD Arrangement on Guidelines for Officially Supported Export Credits in mind and, in any event, it is normal commercial behavior to occasionally sell goods or services below cost in order to meet competition so as to strengthen the firm's competitive position and, therefore, overall to strengthen profitability.

KEXIM is engaged in the provision of financial services. According to Korea, since KEXIM is demonstrated to be an entity principally engaged in supplying financial services on commercial terms, the GATS *Annex on Financial Services* indicates that KEXIM should not be treated as a "public body".

(ii) Evaluation by the Panel

7.44 By asserting that an entity will not constitute a "public body" if it engages in market (non-official) activities on commercial terms, Korea is essentially arguing that we should apply the "benefit" test (whereby a "financial contribution" only confers a "benefit" if it was made available on terms more favourable than the recipient could have obtained on the market).[38] The Appellate Body ruled in *Brazil – Aircraft* that "the issues – and the respective definitions – of a 'financial contribution' and a 'benefit' [are] ... two separate legal elements".[39] Likewise, we consider that the concepts of "public body" and "benefit" should also be treated as separate legal elements. Thus, the question whether an entity is a public body should not depend on an examination of whether that entity acts pursuant to commercial principles. Rather, it is the fact that a financial contribution is provided by a public body (or pursuant to entrustment or direction by a public body) that gives rise to the possibility that the financial contribution might be provided on below-market terms in order to advance public policy goals.

7.45 We cannot accept Korea's approach because it would mean that at different times, the same financial entity could be both a public and a private body, depending on how that entity were conducting itself in the market. Thus, on one day the entity could provide financing on market terms and constitute a "private" entity, whereas on the next day it could make cash grants and then constitute a "public" body. This would make the "private"/"public" body determination entirely dependent on the existence of benefit, despite Article 1.1 of the *SCM Agreement* clearly referring to "public body" and "benefit" as separate concepts.

7.46 Korea denies that its argument fails to properly distinguish between the concepts of public body and benefit. Korea asserts that the issue of lending on a commercial basis is, at the outset, a general one. According to Korea, therefore, if there is a general practice of lending on a commercial basis, then the entity is not a public body. We understand Korea to mean that one would assess whether or not an entity were lending on a commercial basis generally, rather than conducting the type of transaction-specific analysis that might be required for a "benefit" determination. We are not convinced by this argument, since it immediately raises the issue of how one would determine whether or not an entity were engaging in a "general practice of lending on a commercial basis".[40] Would this only be the case if 100 per cent of total lending were on a commercial basis, or would 80 per cent suffice? And how would one determine that the lending is on a "commercial basis" without looking at the sort of factors envisaged in a "benefit" analysis? In our view, it is precisely because of the uncertainty surrounding such issues that it is important to maintain a clear distinction between the concepts of benefit and financial contribution / public body.

7.47 We have the same concerns regarding Korea's reliance on paragraph 5(c)(i) of the *GATS Annex on Financial Services*.[41] That is to say, Korea again fails to distinguish between the concepts

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[38] Korea also argues that KEXIM is not a public body because it supplies financial services in markets that are open to other public or private operators under full competitive conditions. We are unable to accept this argument, however, because it is tantamount to asserting that the *SCM Agreement* only applies when the government or public bodies are monopoly suppliers.

[39] Appellate Body report, *Brazil – Aircraft*, para. 157.

[40] See Korea's oral statement at the second substantive meeting with the parties, para. 45.

[41] Paragraph 5(c) provides in relevant part:

"'Public entity' means:

of "public body" and "benefit". By defining "public body" on the basis of whether or not an entity operates on commercial terms, Korea is introducing considerations of benefit into the analysis of the private / public status of an entity. Furthermore, we question the relevance of the *GATS Annex on Financial Services* to an interpretation of Article 1.1(a)(1) of the *SCM Agreement*.[42]

7.48 Korea also relies on part of a dictionary definition that assimilates "public body" with an entity that acts in an "official capacity". However, it is not clear to us that an entity will cease to act in an official capacity simply because it intervenes in the market on commercial principles if that intervention is ultimately governed by that entity's obligation to pursue a public policy objective. For example, a police officer patrolling a football match as part of his/her police work does not cease to act in an official capacity simply because the home football club is required to pay a market rate for that service.

7.49 The *SCM Agreement* envisages a more straightforward approach, based on a clear distinction between public and private bodies. On the basis of this clear distinction, one may establish with relative certainty whether or not an entity is a public body whose financial contributions fall within the scope of the *SCM Agreement*. Only then need one address the more complex issue of whether or not a benefit is conferred (on the basis of a market benchmark). Korea's approach would blur the clear distinction between public and private bodies, and introduce complex considerations of benefit into the initial filtering process.

7.50 In our view, an entity will constitute a "public body" if it is controlled by the government (or other public bodies). If an entity is controlled by the government (or other public bodies), then any action by that entity is attributable to the government,[43] and should therefore fall within the scope of Article 1.1(a)(1) of the *SCM Agreement*. We consider that KEXIM is a "public body" because it is controlled by GOK. This is evidenced primarily by the fact that KEXIM is 100 per cent owned by GOK or other public bodies.[44] Evidence suggesting governmental control over KEXIM also lies in the fact that the operations of KEXIM are presided over by a President (Article 9(1) of the KEXIM Act) appointed and dismissed by the President of the Republic of Korea (Article 11(1) of the KEXIM Act), and that the KEXIM President shall be assisted by a Deputy President and Executive Directors (Article 9(2) and (3) of the KEXIM Act) to be appointed and dismissed by the Minister of Finance and Economy upon the recommendation of the President of KEXIM (Article 11(2) of the KEXIM Act). Government control is also exercised through the Ministerial approval of the annual KEXIM Operation Programs (Article 21 of the KEXIM Act).

7.51 Although there is some flexibility for the KEXIM President to change the Operation Program pursuant to resolutions passed by the Board of Directors, the circumstances in which the KEXIM President may do so are exhaustively set forth in the Operation Program, and therefore subject to Government control. In addition, we recall that the KEXIM President is a Government appointee.

> (i) a government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms".

[42] In any event, this provision seems to indicate that "an entity principally engaged in supplying financial services on commercial terms" might be treated as a "public entity" absent this clarification in the last phrase of that provision ("not including ..."). Were this not possible, there would be no need for such clarification. This could undermine Korea's argument that a public entity acting on commercial terms could not be treated as a "public body".

[43] This approach is consistent with the fact that Article 1.1(a)(1) provides that both governments and public bodies shall be referred to as "government".

[44] The relevant public bodies are KDB and BOK. We find below (para. 7.172 *infra*) that KDB is a public body. Korea acknowledged in response to Question 76 from the Panel that BOK is a public body.

7.52 The Operation Programs provide detailed direction on the allocation of KEXIM financing between different financing activities and, thereafter, between different sectors. Thus, the Operation Programs generally identify three types of "financing supply" to be provided by KEXIM, and state the proportion of total financing for which each type of "financing supply" should account. Furthermore, the Operation Programs go so far as to stipulate how much of one specific type of "financing supply" should be directed towards specifically identified activities and industrial sectors.

7.53 Korea asserts that the Operation Program does not pertain to any terms or conditions prescribed for APRGs and PSLs. While this may be true, GOK nevertheless enjoys extensive control over the parameters within which KEXIM must operate. Thus, if the Operation Program were to require KEXIM to cease providing financing in the shipbuilding sector, it would appear that KEXIM would be required to do so, even if that sector were the most profitable one in which KEXIM operated. The ability of the Government to issue such instructions is established by virtue of certain "basic directions" set forth in the Operation Programs.[45] For example, the "basic directions" of the 1999 Operation Program required KEXIM to "support the export of capital goods such as ships, industrial plant, machinery, etc., which creates high net export earnings and industrial backward-forward effect".[46] Such "basic directions" necessarily have an impact on the day-to-day operations of KEXIM, since they stipulate the areas in which KEXIM should focus its day-to-day operations (irrespective of purely commercial considerations).

7.54 We consider that the "public" nature of KEXIM is further confirmed by KEXIM's own perception of itself as a "special governmental financial institution". In addition, we note that Korea describes KEXIM as an "export credit agency" (see Korea's reply to Question 52 from the Panel). This phrase is generally reserved for official export credit agencies, and not for private providers of export financing or insurance. Since the term "agency" suggests a relationship of agent and principal, one could reasonably assume that the relevant principal on whose behalf KEXIM acts as agent is the Government of Korea.

7.55 The EC also refers to KEXIM's public policy objective in support of its argument that KEXIM is a public body. Although a public policy objective or creation through public statute might also be indicative of the public nature of an entity, this may not always be the case. For example, the fact that a private philanthropist may pursue public policy objectives should probably not cause that person to be treated as a "public body". In addition, the privatization of a company might be finalized through a public statute. In all cases, though, we consider that public status can be determined on the basis of government (or other public body) control.

7.56 Since we find that KEXIM is a "public body", there is no need to consider the EC's alternative argument that KEXIM is a private body entrusted or directed by the government.

(c) Subsidization

7.57 The EC's claim that the KLR confers a benefit is based on a number of provisions of the KLR. We shall examine the parties' arguments concerning these provisions below. Before doing so, however, we must first decide whether or not to apply what is known as the traditional mandatory / discretionary distinction in reviewing the KLR provisions at issue.

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[45] Earlier Operation Programs provided that KEXIM "shall make efforts to accomplish" specified "basic directions". The requirement on KEXIM to "make efforts" to accomplish the specified "basic directions" was strengthened further in the 2003 Operation Program, which provided that KEXIM "shall do the Operation Program 2003 in accordance with the following basic directions" (see Exhibit EC – 95).

[46] KEXIM 1999 Operation Program, Exhibit EC – 95.

(i) Application of the Traditional Mandatory/Discretionary Distinction

Arguments of the parties

7.58 According to the traditional mandatory / discretionary distinction, only measures mandating WTO-inconsistent conduct could be condemned as such (i.e., on their face, rather than as applied in particular cases). Under this traditional distinction, therefore, the KLR could only be challenged as such if it mandated *inter alia* subsidization. The EC considers that this traditional distinction is no longer applicable, and claims that its application was excluded by the Appellate Body in *US – Corrosion Resistant Steel Sunset Review*. According to the EC, therefore, it is no longer necessary that legislation must mandate export subsidization in order for it to be condemned under Article 3.1(a) of the *SCM Agreement*. The EC asserts that it is enough that legislation specifically envisages export subsidization in order for it to be condemned. The EC also argues that Article 3.2 of the *SCM Agreement* confirms that Members may not maintain the discretionary power to provide export subsidies. The EC relies on the panel report in *Brazil – Aircraft* to support an argument that a legal framework that provides for the provision of future export subsidies may be subject to an "as such" attack.

7.59 Korea argues that the traditional mandatory / discretionary distinction remains applicable, and has not been overruled by the Appellate Body.

Evaluation by the Panel

7.60 There is no dispute between the parties regarding the fact that the traditional mandatory / discretionary distinction has been applied by both GATT and WTO dispute settlement panels. The only dispute is whether or not that distinction continues to apply. Since the starting point for the EC's analysis is that "[t]he Appellate Body has recently laid to rest the notion that non-mandatory measures cannot be the subject of dispute settlement in *US – Sunset Review (Japan)*",[47] we shall focus principally on whether or not the Appellate Body in that case really did rule against the continued application of the traditional mandatory / discretionary distinction.

7.61 In order to do so, we shall first consider the Appellate Body's treatment of this issue in the earlier *US – Section 211 Appropriations Act* case. The Appellate Body analysed the panel's application of the traditional mandatory / discretionary distinction in the following terms:

> 259. ... the Panel relied on previous rulings addressing the issue of legislation that gives discretionary authority to the executive branch of a Member's government. As the Panel rightly noted, in *US – 1916 Act*, we stated that a distinction should be made between legislation that mandates WTO-inconsistent behaviour, and legislation that gives rise to executive authority that can be exercised with discretion. We quoted with approval there the following statement of the panel in *US – Tobacco*:
>
> > … panels had consistently ruled that legislation which mandated action inconsistent with the General Agreement could be challenged as such, whereas legislation which merely gave the discretion to the *executive authority* of a contracting party to act inconsistently with the General Agreement could not be challenged as such; only the actual application of such legislation inconsistent with the General Agreement could be subject to challenge.
>
> Thus, where discretionary authority is vested in the executive branch of a WTO Member, it cannot be assumed that the WTO Member will fail to implement its

[47] EC first written submission, para. 73.

> obligations under the *WTO Agreement* in good faith. Relying on these rulings, and interpreting them correctly, the Panel concluded that it could not assume that OFAC would exercise its discretionary executive authority inconsistently with the obligations of the United States under the *WTO Agreement*. Here, too, we agree.[48]

7.62 Although the Appellate Body went on to reverse the panel's application of the traditional mandatory / discretionary distinction to the facts of that case, the above extract indicates clearly to us that the Appellate Body was not rejecting the use of the traditional mandatory / discretionary distinction *per se*. To the contrary, the Appellate Body explicitly found that "where discretionary authority is vested in the executive branch of a WTO Member, it cannot be assumed that the WTO Member will fail to implement its obligations under the *WTO Agreement* in good faith." This is generally understood to be the very rationale behind the traditional mandatory/discretionary distinction.

7.63 In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body examined two issues. First, it considered whether certain types of measures could not, as such, be subject to dispute settlement proceedings. Second, the Appellate Body considered whether the measure at issue in that case could be inconsistent with the *AD Agreement*. The Appellate Body treated the first issue as a jurisdictional matter. Thus, having found that there was "no reason for concluding that, in principle, non-mandatory measures cannot be challenged 'as such'",[49] the Appellate Body stated that panels are not "obliged, as a preliminary jurisdictional matter, to examine whether the challenged measure is mandatory".[50] However, this does not mean that the Appellate Body was excluding the application of the traditional mandatory / discretionary distinction, since it went on to acknowledge that the distinction might be relevant as part of the second issue, i.e., the panel's assessment of whether the measure at issue was inconsistent with particular obligations.[51] In addressing that second issue, the Appellate Body "caution[ed] against the application of [the traditional mandatory / discretionary] distinction in a mechanistic fashion".[52] In particular, the Appellate Body condemned the panel for having taken a "narrow approach", and failing to consider other indications as to whether or not the measure at issue was "binding"[53] or of a "normative nature".[54] The use of such phrases suggests to us that the Appellate Body ultimately resolved the case on the basis of whether or not the measure at issue was mandatory (i.e., "binding", or "normative" in nature). Furthermore, we note that the Appellate Body stated that it was not "undertak[ing] a comprehensive examination of this distinction". Having explicitly applied the traditional mandatory / discretionary distinction in *US – Section 211 Appropriations Act*, we fail to see how the Appellate Body could be understood to have excluded the continued application of that distinction in a subsequent case in which it was not even conducting a "comprehensive examination" of the distinction.

7.64 The EC also argues that *SCM* Article 3.1(a) prevents a Member from maintaining the discretion to provide export subsidies. We note, however, that such an approach would be inconsistent with the principle – confirmed by the Appellate Body in *US – Section 211 Appropriations Act*, that "where discretionary authority is vested in the executive branch of a WTO Member, it cannot be assumed that the WTO Member will fail to implement its obligations under the *WTO Agreement* in good faith".[55]

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[48] See Appellate Body Report, *US – Section 211 Appropriations Act*, para. 259 (footnotes omitted).
[49] *US – Corrosion-Resistant Steel Sunset* Review, para. 88
[50] *Ibid*, para. 89
[51] *Ibid*, para. 89.
[52] *Ibid*, para. 93.
[53] *Ibid*, para. 97.
[54] *Ibid*, para. 98.
[55] See Appellate Body Report, *US – Section 211 Appropriations Act*, para. 259.

7.65 The EC has also relied on the following statement by the *Brazil – Aircraft* panel to argue that measures that provide for the provision of future export subsidies may be subject to an "as such" attack:

> the effective operation of the SCM Agreement requires that a party be able in some manner to obtain prospective discipline on the provision of subsidies in cases where it can be established in advance, *based upon the legal framework governing the provision of those subsidies*, that they would be inconsistent with Article 3 of the SCM Agreement.[56] (Emphasis added)

7.66 We consider that, contrary to the EC's argument, this statement actually supports the application of the traditional mandatory / discretionary distinction, since it relates to circumstances in which one can establish in advance that a provision or measure "would" be inconsistent with Article 3 of the *SCM Agreement.* The word "would" (as opposed to "could") suggests to us a degree of certitude that is only be found in mandatory (as opposed to discretionary) provisions.

7.67 For the above reasons, we reject the EC's argument that the Appellate Body ruled against the application of the traditional mandatory / discretionary distinction in *US – Corrosion-Resistant Steel Sunset Review.* We shall therefore resolve the EC's "as such" claims on the basis of whether or not the measure at issue mandates the provision of (export) subsidies.

(ii) Benefit

7.68 The relevant arguments of the parties in respect of whether the KEXIM legal regime mandates (export) subsidies concern the KEXIM Act non-competition clause, the alleged absence of any obligation on KEXIM to take market conditions into account, the availability of government funding, the Market Adjustment Rate, the KEXIM Act provision concerning international competitiveness, and KEXIM documentation.

Non-competition clause

7.69 Article 24 of the KEXIM Act provides:

> [KEXIM] shall not compete with other financial institutions in performing the operations provided for in Article 18.

7.70 Article 25(2) of the KEXIM Act provides in relevant part:

> [KEXIM] may lend funds, discount drafts or notes, or guarantee obligations under paragraph (1) of Article 18 only when the term of repayment, payment or discharge is six (6) months or more but twenty five (25) years or less.

- Arguments of the parties

7.71 The EC asserts that the non-competition clause means that KEXIM is specifically directed to perform functions and provide financing in situations in which no commercial bank would act, and therefore to make available loans and guarantees in financial circumstances that the market would not support.

7.72 Korea states that in fact KEXIM is permitted to compete with commercial financial institutions, as confirmed by an earlier amendment of Article 18 of the KEXIM Act, whereby an obligation on KEXIM not to engage in operations "normally conductible by other financial

[56] Panel Report, *Brazil – Aircraft*, para. 7.2 n. 187.

institutions" was removed. Korea asserts that KEXIM is currently "in competition with commercial banks in all areas of financial services, except the long-term export credits with deferred payment terms that are regulated by the OECD Arrangement".[57] Korea argues that this is consistent with Article 25(2) of the KEXIM Act, whereby the maturity of KEXIM loans should be between six months and 25 years, and therefore of a maturity offered by commercial institutions. Korea argues that Article 24 "must be read together"[58] with Article 25(2) to appreciate the limited scope of this prohibition. Korea further states that Article 24 should have been repealed, and that in fact "KEXIM has been contemplating proposing the repeal or amendment of Article 24".[59]

- Evaluation of the Panel

7.73 We are not persuaded by Korea's arguments regarding the alleged interaction between Articles 24 and 25(2) of the KEXIM Act. First, we note that there are no cross-references between these provisions. Second, the fact that the limits under Article 25(2) on the maturity of KEXIM financing coincide with the maturity of commercial financing does not necessarily mean that KEXIM competes with commercial institutions, since it is still possible for KEXIM to comply with both provisions and offer financing with a maturity of between six months and 25 years in respect of which there is no competition from commercial financial institutions.

7.74 Furthermore, even if Korea may be correct in stating that KEXIM does compete with private financial institutions in practice, we note that the EC's argument regarding Article 24 is made in the context of an "as such" claim against the KEXIM Act. Thus, because Article 24 continues to impose a legal obligation on KEXIM not to compete with other financial institutions, the fact that Article 24 may not be respected in practice is not relevant. The EC's "as such" claim concerns the KEXIM legal regime on its face, and not as applied in practice.

7.75 That being said, we are not persuaded that the language of Article 24 of the KEXIM Act is sufficiently clear to conclude that it necessarily requires KEXIM to confer a benefit, i.e., offer terms that are more favourable than those available to the recipient on the market. In particular, does the non-competition clause mean that KEXIM is only required to provide financing when market operators are unable to do so? Or does it mean that KEXIM is not permitted to take business away from market operators? We consider that the terms of Article 24 are far too imprecise to draw the specific conclusion that it requires KEXIM to act in a below-market manner.

<u>No obligation to take market conditions into account</u>

- Arguments of the parties

7.76 The EC claims that the KEXIM legal regime confers a "benefit" as such because the KEXIM Act imposes no obligation on KEXIM to take market conditions into account when disbursing funds.

7.77 Korea submits that KEXIM is required to operate on a market-oriented basis. In particular, Korea asserts that the KEXIM legal regime requires KEXIM to appropriately assess the credit risks of the borrower, to apply interest rates or guarantee premia commensurate to the credit rating of the borrower/applicant, to take into account market situations when setting up interest rates/premium, to properly manage risks associated with the KEXIM business, and to ensure soundness of management.[60]

[57] See Korea's Second Written Submission, para. 99.
[58] See Korea's First Written Submission, para. 120.
[59] See Korea's response to Question 53 from the Panel.
[60] See Korea's reply to Question 103 from the Panel.

- Evaluation by the Panel

7.78 We do not consider that a legal instrument may be found to mandate subsidization simply because it neither prohibits subsidization nor requires market conditions to be taken into account. The fact that a legal instrument is silent on subsidization should not lead to a conclusion that the resultant discretion will of necessity be exercised in a manner that results in subsidization. As stated by the Appellate Body in *US – Section 211 Appropriations Act*, "where discretionary authority is vested in the executive branch of a WTO Member, it cannot be assumed that the WTO Member will fail to implement its obligations under the WTO Agreement in good faith".[61]

Government funding

- Arguments of the parties

7.79 The EC asserts that KEXIM need not act on market terms or with proper regard to risk, as the Government of Korea provides virtually unlimited funds to KEXIM. In this regard, the EC notes that Article 19 of the KEXIM Act provides that KEXIM "may borrow funds from the Government [and] the Bank of Korea . . . ". The EC also argues that Article 36(2) of the KEXIM Act indicates that KEXIM is not required to pay . . . capital contributions made by the Government of Korea, even during years in which KEXIM achieves a profit. In this regard, the EC notes that Article 36(2) provides that KEXIM shall distribute its profits "on a preferential basis" "to capital contributors other than the Government." According to the EC, this provides further support for the understanding that KEXIM need not act in the same manner as a commercial bank, as it has access to funds of an important shareholder that does not demand to be treated in the same manner as shareholders operating pursuant to market considerations. The EC submits that KEXIM therefore receives a subsidy that it can pass on to its customers.

7.80 The EC further asserts that Article 37 of the KEXIM Act provides that any net loss incurred by KEXIM that cannot be covered by its reserves shall be covered by funds from the Government of Korea. The EC argues that KEXIM need not therefore act in the same manner as a commercial bank, as it has no risk of insolvency. According to the EC, combining (a) the guarantee by Article 37 that the Government "shall provide funds to cover such net loss" and (b) the specific exclusion of the Government in Article 36(2) from the capital contributors that shall benefit from KEXIM's net profit, underscores the fact that KEXIM need not act on market terms. The EC acknowledges that KEXIM must first attempt to cover net losses with its reserves, but argues that the ultimate guarantee of losses by the Government reduces the incentive for KEXIM to maintain a sufficient reserve and allows KEXIM to act otherwise than would a body subject to market forces.

7.81 Korea asserts that there is no logical inference from Articles 19, 36(2) and 37 of the KEXIM Act that KEXIM need not act on market terms or with proper regard to risk. Korea argues that although these provisions indicate that the Government may provide funds, this is not the same as stating that KEXIM's financing facilities need not be market-oriented. According to Korea, KEXIM is explicitly required by law to operate on a market-oriented basis.

7.82 Korea asserts that the Government's capital contributions into KEXIM were necessary to allow KEXIM to maintain a good credit rating as well as a sound Bank of International Settlements ("*BIS*") adequacy ratio. Korea also asserts that Article 36 of the KEXIM Act was intended to encourage other entities to participate in capital contributions into KEXIM. Korea asserts that it is not uncommon in private corporations that the major shareholders receive less dividends and take more risks than other minor shareholders.

[61] Appellate Body Report, *US – Section 211 Appropriations Act*, para. 259.

7.83 Korea submits that the source of KEXIM's funds is not legally relevant, as the legal standard for subsidization is "benefit" to the recipient, rather than cost to the government. Korea submits that whatever the source of KEXIM's funds, there is no indication in particular that any of these funds are used in loans or guarantees which bestow a benefit onto their recipient or were envisaged as such.

- Evaluation by the Panel

7.84 Given that it is now well established that the legal standard for "benefit" is benefit to the recipient, and not cost to the government, the source of KEXIM's funds is irrelevant to the issue of whether or not the KEXIM legal regime mandates (export) subsidization. The fact that KEXIM may receive subsidized government funding does not mean that it will inevitably provide subsidized financing to its customers. It is possible that KEXIM might charge market rates and increase its profit margin instead.

7.85 Furthermore, Articles 19, 36(2) and 37 of the KEXIM Act are relied on by the EC in support of an argument that KEXIM "need not" act on market principles. However, the EC has neither argued nor demonstrated that these provisions prevent KEXIM from acting on market principles. In other words, the EC has not argued that these provisions mandate subsidization.

Market Adjustment Rate

- Arguments of the parties

7.86 According to the EC, the KEXIM Interest Rate Guidelines clarify that market conditions are not taken into account even in situations where KEXIM has specifically determined that its rates would be better than those available in the market. According to the EC, Articles 17(2) and 25(6) of the KEXIM Interest Rate Guidelines explicitly prevent, under certain situations, full market-based adjustments of KEXIM's interest rates even when it has been determined that the rates are below those available in the market. According to the EC, the KEXIM Guidelines establish an explicit cap on the "Market Adjustment Rate" that would otherwise be applied to bring KEXIM's rates into accord with the market's rates.

7.87 The EC notes that a new translation of Articles 17(2) and 25(6) of the KEXIM Interest Rate Guidelines recently submitted by Korea reads **[BCI: Omitted from public version]**.[62] According to the EC, Korea's modified translation indicates that the Market Adjustment Rate is only a downward adjustment. The EC argues that if the Market Adjustment Rate can only be used to adjust the cost-based rate downwards, this provision will often lead to interest rates that are below the market rate. The EC asserts that in any event, these provisions do not, by their terms, ensure that KEXIM provides loans at market rates, since the Market Adjustment Rate is an adjustment to the cost based rate that takes account not only of lower offers by other banks but also of the "business relationship with the borrower and the distinctive features of the transactions, etc."[63]

7.88 Korea submits that the Market Adjustment Rate in Articles 17(2) and 25(6) of the Interest Rate Guidelines operates on a market-oriented basis to take into account the PSL interest rates and the APRG premia offered by other financial institutions, the track record and relationship of the applicant with KEXIM and other considerations including the particulars of the project concerned.

7.89 Korea asserts that a "market rate" exists in the form of "range" or "band", not a single rate. Korea explains that the Market Adjustment Rate is one of the spreads (discounts or premia) that are to be applied upward or downward to the base rate in addition to other spreads such as "credit risk

[62] Responses to Questions from the Panel by Korea, 22 March 2004, Question 57, citing Exhibit Korea-56.

[63] Article 17(2) of the KEXIM Interest Rate Guidelines, Exhibit EC – 13.

spread" and "target margin". According to Korea, this Market Adjustment Rate may be applied by the KEXIM loan managers when determining the rates for a specific applicant in a specific individual transaction. Korea asserts that the following factors are to be taken into account when determining whether and to what extent to apply this Market Adjustment Rate: the APRG premia offered by other financial institutions; the track record and relationship of the applicant with KEXIM; and other considerations including particulars of the project concerned.

7.90 Korea also submits that while the Market Adjustment Rate allows the KEXIM loan managers to react to the market, the loan manager is nevertheless prohibited, when he applies the Market Adjustment Rate for 'downward' adjustment of an ARPG fee, from applying it beyond a certain limit **[BCI: Omitted from public version]**. In contrast, there is no limitation when the loan manager applies it for upward adjustment. Korea asserts that in this sense, the Market Adjustment Rate is a "floor", not a "cap". Korea submits that the Market Adjustment Rate does not cause the final fee rate to be set below the market rates.

- Evaluation by the Panel

7.91 According to Korea, Article 17 of the KEXIM Guidelines for Interest Rates and Fees Amended provides:

[BCI: Omitted from public version.]

7.92 According to Korea, Article 25 of the KEXIM Guidelines for Interest Rates and Fees Amended provides:

[BCI: Omitted from public version.]

[...]

[BCI: Omitted from public version.]

7.93 The above translation of Articles 17 and 25 was attached to Korea's reply to Question 57 from the Panel, and amends the translation initially provided by Korea during these proceedings. The EC has not contested the accuracy of the amended translation.

7.94 We do not consider that the EC's argument that Articles 17(2) (Market Adjustment Rate in respect of loan interest rates) and 25(6) (Market Adjustment Rate in respect of guarantee premia) only allow a downward adjustment is correct. In our view, the fact that these provisions do not explicitly refer to upward adjustments does not mean that they should be interpreted to mean that upward adjustments are precluded. Indeed, we note that Korea has provided evidence of situations in which upward adjustments have been made in practice (see Korea's reply to Question 58 from the Panel). Furthermore, we note that Articles 17(2) and 25(6) do not impose limits on the amount of upward adjustment. The possibility of upward adjustment, and the absence of any limit on the amount of such upward adjustment, means that KEXIM is not automatically locked into providing below-market financing.

7.95 In addition, we note the EC's argument that the above Market Adjustment provisions do not "ensure" that KEXIM provides services at market rates. As noted above, we do not consider that the absence of an obligation on KEXIM to apply market rates permits a finding that the KEXIM legal regime mandates below-market rates, and therefore subsidization. We also recall that in *Canada – Aircraft – Article 21.5* the Appellate Body expressed reservations regarding the application of an "ensure" standard, noting that such a standard could "be very difficult, if not impossible, to satisfy".[64]

[64] See Appellate Body Report, *Canada – Aircraft – Article 21.5*, para. 38.

We further recall that the panel only applied an "ensure" standard because it was proposed by the parties in that case.[65]

7.96 For the above reasons, we reject the EC's arguments concerning Articles 17(2) and 25(6) of the KEXIM Interest Rate Guidelines.

KEXIM On-Line Road Show

- Arguments of the parties

7.97 The EC submits that KEXIM has itself acknowledged its role as providing financial contributions to Korean exporters in cases and on terms that would not be provided by commercial banks. In this regard, the EC notes that KEXIM's 2003 "On-Line Road Show" stated that one of the core missions of KEXIM's business was to serve "a complementary but pioneering role and function for the national economy, which would be hard for commercial banks to shoulder."[66] The EC asserts that KEXIM has therefore acknowledged its role as providing financial contributions to Korean exporters in cases and on terms that would not be provided by commercial banks.

7.98 Korea asserts that the "On-Line Road Show" contains a description of the specialized role and function being performed by KEXIM as an export credit agency. Korea submits that export credit agencies, such as KEXIM, generally provide specialized trade-related financing involving longer-term project-related loans (e.g., mid- and long-term export loans), special payment terms (e.g., deferred or specially structured payments) or specialized collateralization methods. Korea submits that it is important to remember the context of the establishment of KEXIM, i.e., the fact that Korea was a developing country with inadequately formed capital markets, among other things. According to Korea, it is quite typical in such situations for specialist banks to be set up to provide such pioneering expertise. Korea submits that the "On-Line Road Show" is irrelevant to the question of below-market financing by KEXIM.

- Evaluation by the Panel

7.99 We note that the EC refers to the On-Line Road Show as evidence that "KEXIM has acknowledged its role as providing financial contributions to Korean exporters in cases and on terms that would not be provided by commercial banks".[67] The On-Line Road Show describes KEXIM's alleged practice, rather than its legal obligations under the KEXIM legal regime. Since the On-Line Road Show relates to practice, rather than the KEXIM legal regime *per se*, it has no bearing on our findings regarding the EC's claim against the KEXIM legal regime "as such".

Maintenance of international competitiveness

- Arguments of the parties

7.100 The EC asserts that Article 26 of the KEXIM Act demonstrates that KEXIM values the "international competitiveness" of Korean export-oriented industries over its own financial condition, a situation that increases KEXIM's ability to provide support on terms better than those available in the market.

[65] See Panel Report, *Canada – Aircraft – Article 21.5*, para. 5.66.
[66] Exhibit EC – 17.
[67] EC first written submission, para. 128.

7.101 Article 26 provides:

> Except where inevitable for maintaining the international competitiveness to facilitate the export, or for promoting the overseas investment or overseas exploitation of natural resources, the interest rates, discount rates and fee rates applicable to loans, discounts and guarantees ... shall be so set as to cover the operating expenses, commissions for undertaking of delegated operations, interest on borrowed funds, and depreciation of assets which [KEXIM] incurs.

7.102 The EC asserts that although Article 26 of the KEXIM Act states that interest rates and fees imposed with respect to loans and guarantees are to be set so as to cover the operating costs of KEXIM, there is no requirement that KEXIM establish rates that comport with market rates. The EC notes that Article 26 permits KEXIM to avoid the requirement to cover its operating costs where "inevitable for maintaining the international competitiveness to facilitate . . . export . . . .".

7.103 Korea submits that Article 26 has no purpose other than to provide that all fees and rates must cover "at least" the costs when KEXIM provides financing. Korea asserts that Article 26 does not prohibit KEXIM from earning profits and, instead, effectively requires it to carry on profitable operations. Korea argues that other relevant provisions of the KEXIM Decree, such as Articles 17-3 through 17-13 (providing parameters for sound and profitable management of KEXIM), also effectively require KEXIM to carry on its business for profit. Korea further asserts that the Interest Rate Guidelines of KEXIM provide that KEXIM interest rates and fees are always aligned with market rates.

7.104 Korea submits that the phrase "inevitable for maintaining the international competitiveness to facilitate ... export" was included in Article 26 of the KEXIM Act in order to allow KEXIM the option to provide financing at below-cost levels in exceptional situations when KEXIM faces severe 'rates' competition from foreign financial institutions, as in the context of "matching" under the *OECD Arrangement*. Korea submits that because "matching" would be exceptional, Article 26 uses the term "inevitable", which means that under normal or ordinary circumstances this exception must not be applied. Korea notes that this "exception" under Article 26 has never been applied in practice thus far. Further, Korea asserts that KEXIM has interpreted this matching mechanism in such a restrictive manner that it can be applied only for matching of "country risk premium", not the total interest rate applied by the competing export credit agencies. Korea also submits that even if KEXIM's interest rates had in exceptional circumstances gone below its operating expenses (which Korea claims they have never done), this has nothing to do with the finding of a benefit or a subsidy. According to Korea, as long as Article 26 permits KEXIM to match the low interest rates applied by other competing export credit agencies, KEXIM will always end up applying the market benchmark (i.e., the prevailing conditions in the market), whether or not the KEXIM rate is below or above its operating expenses.

7.105 The EC notes Korea's argument that this provision allows KEXIM to finance at below-cost when "matching" under the *OECD Arrangement*. However, the EC considers that this explanation does not justify the provision. First, the EC asserts that there is absolutely no mention of either the *OECD Arrangement* or "matching" in this provision. Although Article 43 of the KEXIM Interest Rate Guidelines does refer to matching, the EC submits that there is nothing in these Guidelines that indicates that this Article should be read together with Article 26 of the KEXIM Act. Second, the EC notes that the panel in *Canada – Aircraft Credits and Guarantees* concluded that "matching" under the *OECD Arrangement* does not provide a valid affirmative defence for measures that violate the terms of the *SCM Agreement*.[68]

[68] The EC refers in this regard to Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.180.

- Evaluation by the Panel

7.106 Leaving aside the question of whether or not "matching" under the *OECD Arrangement* is in conformity with the *SCM Agreement*, we would simply note that the EC again applies the incorrect legal standard in pursuing its arguments regarding Article 26 of the KEXIM Act. First, the EC states that there is no requirement that KEXIM rates comport with market rates. As noted above, however, the fact that there is no requirement to act on market terms does not mean *ipso facto* that KEXIM is required, or mandated, to provide below-market terms. Second, the EC asserts that Article 26 permits KEXIM to avoid the requirement to cover its operating costs in certain circumstances, and increases KEXIM's ability to provide support on terms better than those available in the market. Again, however, the EC does not argue that Article 26 requires KEXIM to provide below-market financing. Providing a public body with the legal and financial ability to subsidize is not the same as requiring it to do so.

Conclusion

7.107 For the above reasons, the EC has failed to establish a *prima facie* case that the KEXIM legal regime mandates subsidization. Although certain provisions of the KLR might indicate that it was intended as a means of providing subsidies, a conclusion that the KLR *could* be applied in a manner that confers a benefit would not be a sufficient basis to conclude that the KLR as such is mandatory legislation susceptible of inconsistency with Article 3.1(a) of the *SCM Agreement*.[69]

(d) Export contingency

(i) Arguments of the parties

7.108 The EC submits that, pursuant to Article 18 of the KEXIM Act, financial contributions by KEXIM are "[f]or the purpose of facilitating exports of products" and, therefore, contingent on export within the meaning of Article 3.1(a) of the *SCM Agreement*.

7.109 Korea has not taken a position on whether or not the KLR is export contingent.

(ii) Evaluation by the Panel

7.110 In light of our finding that the EC has failed to establish a prima facie case that the KLR mandates subsidization, we do not consider it necessary to determine whether or not then KLR is "contingent ... upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.

(e) Conclusion

7.111 Given our finding that the EC failed to establish a *prima facie* case that the KEXIM legal regime mandates subsidization, we reject the EC's claim that the KEXIM legal regime "as such" is inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

2. APRG programme

7.112 An APRG provides foreign buyers with a guarantee that they will be refunded any advance payments made to an exporter, including any accrued interest on the advance payments, in case the Korean company defaults under the relevant export contract. In exchange, the Korean exporter pays a premium consisting of (1) a minimum base rate, and (2) additional spreads (*e.g.*, credit and market risk spreads).

[69] We note that a similar approach was adopted by the panel in *Brazil –Aircraft, Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, adopted 23 August 2001, para. 5.43, DSR 2001:XI, 5481.

(a) Arguments of the Parties

7.113 The EC asserts that the KEXIM APRG programme "as such" provides for the grant of subsidies that are contingent on export, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement*. The EC submits that the APRG programme provides for financial contributions because (i) KEXIM is a public body, and (ii) APRGs constitute a "potential direct transfer of funds" pursuant to Article 1.1(a)(1)(i) of the *SCM Agreement*. The EC submits that the APRG programme confers a benefit because, although KEXIM levies a premium when granting APRGs, the premium fails to reflect the degree of creditworthiness, or lack thereof, of the Korean exporters. According to the EC, KEXIM issues guarantees without proper consideration of the risk involved in the transaction – in many cases, granting guarantees to financially troubled companies that would not have been able to obtain a guarantee from a commercial bank. The EC submits that the APRG programme is *de jure* export contingent because KEXIM APRGs are provided for the specific purpose of guaranteeing the down payments for Korean goods intended for export.

7.114 Korea asserts that the EC's description of the measure is incomplete and inadequate to support its claim regarding the KEXIM APRG programme. According to Korea, whilst a definition is given of what the guarantees denominated as APRGs entail for the manufacturers of the capital goods and their purchasers, the EC fails to identify what precisely constitutes the so-called "APRG programme". Korea submits that the measure at issue is therefore un-defined and cannot as such be the subject of a detailed factual or legal analysis.

7.115 Korea also denies that the APRG programme constitutes a prohibited export subsidy. Korea asserts that the APRG programme does not constitute a financial contribution covered by the *SCM Agreement* because KEXIM is not a "public body". Korea also denies that the APRG programme confers a "benefit". Korea asserts that the EC must provide a benchmark to define whether the APRG program "as such" yields premium rates that confer a benefit. Korea considers that the EC has failed to meet this burden, since it only refers to certain individual APRGs extended to shipyards alone rather than to the basic conditions of the program as such irrespective of the sector of industry. In the alternative, Korea submits that the APRG programme benefits from a safe haven pursuant to item (j) of the *Illustrative List of Export Subsidies*.

(b) Evaluation by the Panel

7.116 We shall first address Korea's arguments regarding the identification of the measure. We shall then turn to the substance of the EC's claim against the APRG programme.

7.117 Regarding the identification of the measure at issue, the Panel sought clarification from the EC regarding the extent to which its claim against the APRG programme differed from its claim against the KEXIM legal regime. In response to Question 138 from the Panel, the EC stated that the APRG and PSL programmes are linked to the KEXIM legal regime, in the sense that they are a consequence of the KEXIM legal regime. According to the EC, the APRG and PSL programmes are also distinguishable from the KEXIM legal regime since, although the KEXIM legal regime envisages the provision by KEXIM of financial services, these financial services do not necessarily need to be the APRG and PSL programmes, as KEXIM could provide financial assistance to exporters in other forms.

7.118 Furthermore, in its first written submission, the EC stated that the APRG programme was introduced immediately after the establishment of KEXIM, and has been administered since that time pursuant to Article 18 of the KEXIM Act.[70] The EC also submits that KEXIM is authorised to issue

[70] See Responses to Annex V Questions (Non-confidential Version), Answer 1.2(26), pp. 14-15 (Exhibit EC-39).

"performance guarantees related to contracts for export" pursuant to Article 23(1) of the KEXIM Operating Manual.[71]

7.119 In our view, the EC has done enough to identify an APRG programme "as such". We consider that the legal basis for that programme is set forth in Article 18 of the KEXIM Act and Article 23(1) of the KEXIM Operating Manual. We shall conduct our analysis of subsidization and export contingency on the basis of those provisions.

7.120 We recall that a measure is only a subsidy covered by the *SCM Agreement* if it is a "financial contribution" by a government or public body that confers a "benefit". We have already found that KEXIM is a "public body" in the meaning of Article 1.1(a)(1) of the *SCM Agreement*.[72] Regarding the "financial contribution" element, we accept the EC's argument that the APRG programme, pursuant to Article 23(1) of the KEXIM Operating Manual, provides for a "potential direct transfer of funds" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. We therefore find that the APRG programme constitutes a "financial contribution" covered by the *SCM Agreement*.

7.121 As to whether the APRG programme "as such" confers a "benefit", however, we recall that we are applying the traditional mandatory / discretionary approach. The issue before us, therefore, is whether or not the APRG programme mandates the conferral of a benefit by requiring the provision of APRGs on terms more favourable than Korean shipyards could obtain on the market. We do not consider that the EC has established a *prima facie* case to this effect.[73] Neither Article 18 of the KEXIM Act nor Article 23(1) of the KEXIM Operating Manual even refer to the terms on which KEXIM shall offer APRGs, let alone require below-market guarantees. The EC has not identified any other provisions regulating the terms of APRGs.[74] Accordingly, we reject the EC's claim that the APRG programme "as such" constitutes a subsidy. For this reason, there is no need for us to examine the EC's claim that the APRG programme is *de jure* export contingent, nor Korea's reliance on item (j) of the *Illustrative List*.

3. PSL programme

7.122 PSLs are loans made to Korean companies in connection with export contracts for the purpose of assisting Korean exporters to finance production.

(a) Arguments of the Parties

7.123 The EC asserts that the KEXIM PSL programme "as such" provides for the grant of subsidies that are contingent on export, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement*. The EC submits that the PSL programme provides for financial contributions covered by the *SCM Agreement* because (i) KEXIM is a public body, and (ii) PSLs constitute a "direct transfer of funds" pursuant to Article 1.1(a)(1)(i) of the *SCM Agreement*. The EC submits that the PSL programme confers a

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[71] See KEXIM Operating Manual, Responses to Annex V Questions, Attachment 1.1(9) (Exhibit EC-58).

[72] See para. 7.50 *supra*.

[73] We note that the EC has argued that KEXIM failed to apply any credit risk spread before 12 March 1998. Since credit risk provisions were introduced after that date, the absence of any obligation to impose credit risk spreads in the pre-12 March 1998 APRG programme is not relevant to our analysis of the EC's claims against the (current version of the) APRG programme "as such".

[74] Although the EC has adduced evidence regarding KEXIM's practice of providing APRG guarantees (see paras 146-148 of the EC's first written submission), such evidence of practice is not relevant to our analysis of the EC's claim against the APRG programme "as such". Although the Panel was initially unclear whether the EC adduced this evidence of practice under the APRG programme in support of its claim against that programme "as such", the EC confirmed in response to Question 8 from the Panel that, in its view, the practices "are ... separate violations in their own right". Furthermore, in reply to Question 138 from the Panel, the EC stated that "the individual export subsidy transactions are ... separate, even if linked, violations".

benefit because PSLs are provided at preferential interest rates that place the Korean exporters in a more advantageous position than if they were to obtain such financing on market terms. The EC submits that KEXIM's website describes the PSL programme as designed "to encourage the export of capital goods such as . . . ships . . . involving larger credits and longer repayment terms than what suppliers or commercial banks would provide."[75] According to the EC, this shows that the very purpose of KEXIM's pre-shipment loans is to provide financing to shipbuilders on better terms than they could receive in the market. The EC submits that the PSL programme is *de jure* export contingent because KEXIM PSLs are provided for the specific purpose of guaranteeing the down payments for Korean goods intended for export.

7.124 Korea submits that the EC has failed to identify what precisely constitutes the so-called "KEXIM pre-shipment loan program". Korea therefore considers that the measure at issue is un-defined and cannot "as such" be the subject of a detailed factual or legal analysis. Korea further asserts that the EC fails to give any support other than by way of general statements -- without evidentiary support or, in some cases, outright inaccurately -- as regards the benchmark on the basis of which it claims that the pre-shipment loan program confers a benefit. For Korea, the EC fails to make a *prima facie* case that the PSL program "as such" constitutes a subsidy. According to Korea, as the interest rates for the pre-shipment loans under the KEXIM program are determined taking into account base rates reflecting market rates, the credit rating of the manufacturer of the capital goods covered by the pre-shipment loan and the collateral provided by the pre-shipment loan beneficiary, the pre-shipment loan program "as such" does not confer a benefit. Regarding the abovementioned extract from the KEXIM website, Korea considers that providing a longer term than is generally available does not mean that the rates are below market, since it depends on how those rates are adjusted to reflect the different terms. According to Korea, the size of a credit may or may not require different rates; it depends on factors extraneous to size alone. In the alternative, Korea submits that the PSL programme benefits from a safe haven pursuant to the first paragraph of item (k) of the *Illustrative List*.

(b) Evaluation by the Panel

7.125 We recall that the EC replied to Question 138 from the Panel regarding the identification of the PSL programme, as set forth at para. 7.117 above. We also note that the EC stated that the PSL programme was introduced immediately after the establishment of KEXIM, and has been administered since that time pursuant to Article 18 of the KEXIM Act.[76] The EC further argued that KEXIM is authorised to provide "Pre-delivery Export Loans, which are extended until the delivery date of the export goods and/or services concerned" pursuant to Article 11(4) of the KEXIM Operating Manual.[77] In light of these considerations, we find that the EC has done enough to identify a PSL programme "as such". We consider that the legal basis for that programme is set forth in Article 18 of the KEXIM Act and Article 11(4) of the KEXIM Operating Manual. We shall conduct our analysis on the basis of those provisions.

7.126 Regarding the existence of a "financial contribution" covered by the *SCM Agreement*, we have already found that KEXIM is a "public body" in the meaning of Article 1.1(a)(1) of the *SCM Agreement*. We further accept the EC's argument that the PSL programme, pursuant to Article 11 of the KEXIM Operating Manual, provides for a "direct transfer of funds" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. We therefore find that the PSL programme constitutes a "financial contribution" covered by *SCM* Article 1.1(a)(1).

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[75] See Description of Services and Products, "Project Related Guarantees" <http://www.koreaexim.go.kr/web/eng/products/M03/s3_02.html> (Exhibit EC-26).

[76] See Responses to Annex V Questions (Non-Confidential Version), Answer 1.2(26), at 14-15 (Exhibit EC-39).

[77] See KEXIM Operating Manual, Exhibit EC-58.

7.127 As to whether the PSL programme confers a "benefit" and therefore constitutes a subsidy, the issue before us is whether or not the PSL programme mandates the conferral of a benefit by requiring the provision of PSLs on terms more favourable than Korean shipyards could obtain on the market. We do not consider that the EC has established a prima facie case to this effect.[78] Neither Article 18 of the KEXIM Act nor Article 11(4) of the KEXIM Operating Manual even refer to the terms on which KEXIM shall offer PSLs, let alone require below-market loans. The EC has not identified any other provision regulating the terms of PSLs.[79]

7.128 Regarding the KEXIM website material, we note that it was submitted by the EC in support of an argument regarding the "purpose"[80] of the PSL programme. We recall, however, that the question we must answer is whether or not the PSL programme requires KEXIM to provide prohibited export subsidies. The intent behind the PSL programme is not relevant to this issue. In this respect, we agree with the following statement by the panel in *Brazil – Aircraft (Article 21.5 – Canada II)*:

> In our view, a conclusion that PROEX III *could* be applied in a manner which confers a benefit, or even that it was intended to be and *most likely would* be applied in such a manner, would not be a sufficient basis to conclude that PROEX III as such is mandatory legislation susceptible of inconsistency with Article 3.1(a) of the *SCM Agreement*.[81]

7.129 In light of the above, we reject the EC's claim that the PSL programme constitutes a subsidy. For this reason, there is no need for us to examine the EC's claim that the PSL programme "as such" is *de jure* export contingent, nor Korea's reliance on the first paragraph of item (k) of the *Illustrative List*.

4. Individual APRG transactions

7.130 The EC has identified a number of KEXIM APRGs which it claims are prohibited export subsidies. The EC argues that these APRGs were provided on terms more favourable than the recipients could have obtained on the market. This argument is based on a comparison of the terms of the KEXIM APRGs with those of APRGs provided by certain other domestic banks and foreign banks.

7.131 Korea denies that the APRGs identified by the EC constitute prohibited export subsidies. In the alternative, Korea asserts that KEXIM APRGs benefit from a safe haven provided for through an *a contrario* reading of item (j) of the *Illustrative List*. The EC submits that an item (j) defence is not available to Korea.

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[78] We note that the EC has argued in respect of both the APRG and PSL programmes that KEXIM failed to apply any credit risk spread before 12 March 1998. Since credit risk provisions were introduced after that date, the absence of any obligation to impose credit risk spreads in the pre-12 March 1998 programmes is not relevant to our analysis of the EC's claims against the APRG and PSL programmes "as such".

[79] Although the EC has adduced evidence regarding KEXIM's practice of providing PSLs (see para 161 of the EC's first written submission), such evidence of practice is not relevant to our analysis of the EC's claim against the PSL programme "as such". Although the Panel was initially unclear whether the EC adduced evidence of practice under the PSL programme in support of its claim against that programme "as such", the EC confirmed in response to Question 8 from the Panel that, in its view, the practices "are ... separate violations in their own right". Furthermore, in reply to Question 138 from the Panel, the EC stated that "the individual export subsidy transactions are ... separate, even if linked, violations".

[80] See EC First Written Submission, para. 159.

[81] *Brazil – Aircraft, Second Recourse by Canada to Article 21.5 of the DSU*, para. 5.43 (emphasis in original).

7.132 The arguments of the parties raise a number of horizontal issues, mostly concerned with the market benchmarks proposed by the EC. We shall consider these horizontal issues before turning to the parties' transaction-specific arguments. In the event that we find any of the relevant APRG transactions inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, we shall consider the availability of a defence under item (j) of the *Illustrative List*.

(a) Horizontal issues

7.133 The parties have made arguments regarding the following horizontal issues: designation by the ship purchaser of a specific foreign APRG provider, use of foreign benchmarks, country risk spreads, use of domestic benchmarks, credit risk spread, past subsidies, and adverse inferences.

(i) Buyer's designation of foreign APRG-provider

7.134 Korea asserts that certain shipyards are not always able to choose which financial institution would provide the APRG for its customers, since certain buyers require Korean shipyards to procure APRGs from designated foreign banks. Korea submitted evidence of a number of such designations. The EC has not responded to Korea's argument.

7.135 In our view, the fact that a buyer designates the source from which a shipyard is to procure an APRG establishes a prima facie case that such APRG should not be treated as a market benchmark. In such cases, the designation of the APRG-provider by the buyer means that there is a risk that the APRG is not negotiated at arm's length, since the shipyard is a captive buyer. The rate paid by the shipyard might therefore be higher than it would if the shipyard were able to shop around and compare offers from alternative suppliers.

7.136 Korea has submitted evidence pertaining to one transaction (Exhibit Korea-59) demonstrating that the buyer, **[BCI: Omitted from public version]** designated **[BCI: Omitted from public version]** as the provider of two APRGs proposed by the EC as market benchmarks against which to assess the terms of KEXIM APRGs provided in respect of Daedong. For the reasons set forth in the preceding paragraph, and given the absence of any rebuttal by the EC, we reject the use of these two APRGs, dated 7 July 1999, as market benchmarks. That being said, we note that this nevertheless leaves one **[BCI: Omitted from public version]** APRG (provided on the same terms, and about which Korea has not adduced any evidence of buyer designation) for use as a market benchmark.

7.137 Korea also submitted further evidence in Exhibits KOREA-58 and KOREA-83, concerning foreign APRG providers. This evidence is less probative, however. Exhibit KOREA-58 relates to an APRG transaction that is not proposed as a market benchmark by the EC. The evidence contained in Exhibit Korea-83 relates to APRGs provided to shipyards that fall outside the scope of these prohibited export subsidy claims. The evidence in these Exhibits is therefore of no direct relevance to our findings.

(ii) Foreign market benchmark

7.138 Early in the proceedings, the Panel was under the impression that Korea was arguing that, as a matter of law, APRGs provided by foreign banks could not form part of the "market" against which to compare APRGs provided by KEXIM. During the second substantive meeting, however, Korea stated that:

> "the Panel may wish to do as the EC requests and make a ruling that foreign lenders can be part of the market, but such a ruling would be completely beside the issue of choosing an appropriate benchmark. The EC cites the Appellate Body report in

> *US -- Lumber CVD Final* as support for its position, but that only serves as an illustration of the "straw man" argument the EC is using."[82]

7.139 In light of this statement, we do not consider that Korea disputes that foreign market benchmarks could be used as a matter of law.[83] Rather, we understand Korea to argue that, as a matter of fact, the foreign market benchmarks relied on by the EC are not representative of APRG activities in the Korean market since the foreign APRG providers only participated in the APRG business on an exceptional basis, and were less familiar with that business.[84]

7.140 In response, the EC submits that there is no reason to believe that foreign institutions are less capable of evaluating the creditworthiness of a shipyard or its technical capability to carry out the construction project until delivery. In response to Question 10 from the EC, Korea stated that its argument "is based on discussions with the shipyards and KEXIM. Korea has asked the shipyards and KEXIM for any further documentation and it will be submitted when provided to the Government of Korea".

7.141 We do not consider that a vague reference to shipyard and KEXIM perceptions is sufficient to reject the foreign market benchmarks proposed by the EC. We also note that, despite Korea's response to Question 10 from the EC, no documentation supporting the alleged perception of the shipyards and KEXIM was submitted in the subsequent stages of the Panel proceedings. In the absence of more substantial arguments by Korea regarding alleged shortcomings in foreign banks' evaluation of the creditworthiness of shipyards, we are not persuaded by Korea's argument that foreign benchmarks are not appropriate as a result of their lack of familiarity with the APRG business. In our view, provided the terms of an APRG are negotiated at arm's length for fair market value, the fact that the provider engages in only a limited number of transactions should not be conclusive, and should not preclude the use of such transactions as market benchmarks.

(iii) Country risk spreads

7.142 Korea has submitted evidence to the effect that at least one foreign bank proposed by the EC as a market benchmark included a 0.6 per cent country risk spread in its APRG rates for Korean shipyards. Korea submits that all other foreign banks would have done likewise. Korea submits that this means that foreign market APRG rates cannot be compared with KEXIM APRG rates without adjusting for country risk.

7.143 The EC does not contest that a country risk spread would have been included by foreign APRG providers. However, the EC submits that the same spread should also have been included by Korean banks, since the APRGs were provided in a foreign currency (i.e., US dollars). The EC argues that the risk of providing an APRG to a Korean company in a foreign currency, as it is the case for most of the APRGs, is the same regardless of where the bank is based. The EC notes in this regard that the *Comptroller's Handbook on Country Risk Management* prepared by the US Comptroller of the Currency provides that "[c]ountry risk is not necessarily limited to a bank's exposures to foreign-domiciled counterparties".[85]

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[82] Korea's second oral statement, para. 77.

[83] We therefore consider that any potential argument by Korea that APRGs provided by foreign banks could not form part of the "market" against which to compare KEXIM APRGs is a "straw man" that we need not consider.

[84] In light of para. 79 of Korea's second oral statement, Korea could also be understood to argue that all foreign benchmarks are unreliable because foreign banks only provided APRGs when designated by the buyer. However, since Korea argued these two issues separately in its earlier submission, we shall continue to treat them separately in these findings. The buyer designation issue is addressed at paras 7.134- 7.137 *supra*.

[85] Exhibit EC – 148, page 9.

7.144 The EC asserts that a Korean country premium has to be taken into account whenever a currency exposure is generated, regardless of whether a domestic or foreign bank issues the APRGs. The EC asserts that KEXIM quoted below-market rates because it failed to take such currency exposure into account. According to the EC, the country risk of Korea needs to be taken into account in the price as an add-on to cover the transfer risk resulting from the company needing to find foreign currency in the case where a government wants to keep the "strong" foreign currencies, and as an add-on resulting from the bank's needs to obtain refinancing in the foreign currency (in the case of default by the shipyard).

7.145 Korea submits that Korean domestic banks, by definition, cannot face the risk of their own country. Korea asserts that, for Korean banks, risks from events in their own country are no longer "country risk." Korea asserts that the *Comptroller's Handbook* does not imply that country risk can be applied to "every" domestic counterparty that is involved in "an export transaction". Rather, the handbook itself establishes that the country risk may be exceptionally applied to transactions with domestic counter parties under very limited circumstances, e.g., where the business of a domestic borrower is heavily relying on the businesses associated with that particular foreign country with respect to which the country risk is assessed. Korea asserts that this explanation is understandable because, in the situations where the business of a borrower (or guarantor) is heavily relying on transactions associated with a specific foreign country, events in such a foreign country will directly and significantly affect the general credit risks of the borrower (or guarantor) which in turn will significantly and directly affect the creditworthiness of the borrower (or guarantor). According to Korea, only in such specific circumstances would it make sense to take into account the country risk of such specific foreign country when assessing the creditworthiness of such borrower (or guarantor).

7.146 Korea submits that no Korean shipyards deal exclusively with a specific foreign country such that the events in that foreign country would significantly and directly affect the creditworthiness of the Korean shipyards. Korea also asserts that among the buyers of Korean ships, the absolute majority of buyers come from high income *OECD* countries, such as the EC, Norway, USA and Japan. Korea submits that no foreign financial institution would apply country risk with respect to counterparties from such countries as they do not bear any country risks.

7.147 Korea submits that, moreover, even if a Korean shipyard were exposed to the country risk of a particular foreign country by retaining significant "export receivables" from the buyers in that foreign country, the country risk it bears is the country risk of that particular "foreign" country, and not the country risk of "Korea". In other words, in such case, any Korean banks issuing APRGs to such Korean shipyard would apply the country risk of the said "foreign" country, not the "Korean" country risk.

7.148 Korea also asserts that Korean country risk relates to Korea's ability to honor its "external" financial commitments. Korea therefore asserts that Korean domestic banks cannot face similar "Korea risks" to those faced by foreign banks. Korea also submits that, in light of the definition of country risk, country risk factors such as the risk of expropriation of assets and the risk of currency manipulations must be understood to mean those that are of such nature that rather directly affect external financial obligations of Korea. Korea asserts that, by nature, these risks could not be the same as those risks faced by Korean domestic banks.

7.149 Korea acknowledges that, during the period of the financial crisis, the Korean banks were facing credit risks that were generally increased throughout the country, but states that such risks were different from the "country risk factors" as faced by foreign banks. Korea submits that such increased risks during the crisis were taken into account by the Korean banks (as by foreign banks) as the "general credit risk" of the Korean shipyards.

7.150 While Korea has provided evidence to the effect that foreign banks included country risk spreads when providing APRGs to Korean shipyards,[86] we consider that the EC has established that at least something equivalent to a country risk spread would also have been included by domestic APRG providers. A country risk spread is generally applied whenever a financial institution incurs international exposure. This will occur when a currency exposure is incurred. A currency exposure is incurred by both domestic and foreign providers of APRGs to Korean shipyards, because APRGs are provided to Korean shipyards in a foreign currency, i.e., US dollars.

7.151 In addition, we note that an APRG guarantees the repayment of pre-payments in the event of default by the shipyard. The risk of default by the shipyard is related to the general economic conditions in Korea, and would therefore form part of the country risk assessment. This risk applies to both domestic and foreign banks.

7.152 For these reasons, we proceed on the basis that APRG rates offered by Korean banks also reflect a country risk spread, or something equivalent thereto.

(iv) Domestic market benchmark

7.153 Korea also rejects the use of certain Korean domestic banks as a market benchmark. Korea asserts that domestic rates should only be taken into account (in fixing an appropriate market benchmark) if they represent a statistically representative number of transactions. Thus, rates charged by domestic entities that only provided APRGs rarely or exceptionally should not be taken into account.

7.154 The EC asserts that such domestic banks only provided APRGs exceptionally because they could not compete with the beneficial terms offered by KEXIM.

7.155 In our view, the exceptional nature of any market APRG (be it domestic or foreign) should not preclude its use as an appropriate market benchmark for the purpose of determining the existence of "benefit". Provided it is negotiated on a commercial basis by a market operator, and is comparable in terms of duration etc., any APRG should be admissible as a market benchmark. Korea has submitted no evidence demonstrating that this was not the case for the domestic APRGs relied upon by the EC as market benchmarks.

(v) Credit risk spread

7.156 The EC claims that APRGs issued by KEXIM before 12 March 1998 conferred a benefit because the terms did not include any credit risk spread.

7.157 In Attachment 6 to its first written submission, Korea states that "[u]ntil March 1998, KEXIM did not take credit risks into account for its APRG transactions". There is therefore no disagreement between the parties regarding the factual element of the EC's claim. Regarding the legal issue of whether or not the absence of credit risk spreads confers a "benefit", we consider that market operators of necessity would take account of credit risk, and that the failure by KEXIM to include a credit risk spread would result in APRGs being offered on terms that are more favourable than those offered on the market. In this regard, we note that at page 62 of its first written submission, Korea stated (in respect of PSLs, but the same principle would apply in respect of APRGs) that "Chapter 2 of the Interest Rate Guidelines provides detailed standards for determining the interest rates including the base rates and spreads requiring in particular to take a credit risk spread into account in the same way as a private financial institution would." (emphasis supplied, footnote omitted) This would suggest that Korea accepts that failure to apply a credit risk spread is inconsistent with market behaviour (i.e., the behaviour of a private financial institution). In light of the above, we find that the

[86] See Exhibits KOREA - 86a and b.

following pre-12 March 1998 APRGs confer a "benefit" by virtue of KEXIM's failure to include a spread for credit risk:

[BCI: Omitted from public version.]

(vi) Past subsidies

7.158 Korea submits that an alleged subsidy may only be challenged if it is conferring a benefit at the time that the dispute settlement proceeding is initiated. According to Korea, Article 1.1(a)(1) and (2), Article 3 and Article 4 do not apply to subsidies that were granted in the past, and that are not currently being maintained.

7.159 The EC submits that there is no rule in the WTO that a violation is forgiven once it is in the past. According to the EC, Korea confuses the issue of whether a subsidy has been granted with countervailing duty principles, which only allow current benefit to be offset.

7.160 Despite Korea's abovementioned argument, Korea stated in response to Question 108 from the Panel that it was "not making a general argument that the EC cannot challenge alleged past subsidies as a matter of principle". In light of Korea's reply, we see no need to rule on whether or not the EC is entitled to challenge "past" subsidies.[87]

(vii) Adverse inferences

7.161 The EC requests adverse inferences on the basis of Korea's alleged failure to provide information regarding APRGs issued by independent entities after 28 May 2001. The EC requests the Panel to find in accordance with paragraph 7 of Annex V of the *SCM Agreement* that these banks either stopped issuing APRGs because they determined that they could not compete with KEXIM's low premia, or that they continued issuing APRGs at comparatively higher premia than KEXIM.

7.162 We note that the EC has requested an adverse inference on the basis of paragraph 7 of Annex V of the *SCM Agreement*. Korea argues that adverse inferences cannot be drawn on the basis of that provision in the context of claims brought under Part II of the *SCM Agreement*. We do not consider it necessary to resolve this legal issue, since in any event it is well established that WTO dispute settlement panels retain a residual authority[88] to draw adverse inferences outside of the circumstances set forth in Annex V. Thus, even if that provision does not apply in respect of Part II claims, our residual authority to draw adverse inferences remains.

7.163 As a factual matter, however, we consider that the EC has failed to establish that an adverse inference would be warranted. The EC request is based on Korea's alleged failure to provide information regarding APRGs issued by private banks to Daewoo-SME/Daewoo-HI after 28 May 2001, to Samho-HI/Halla-HI after 1 December 2000, and to STX/Daedong after 14 September 1999. The EC asks the Panel to infer (because of Korea's failure to provide the relevant information) that such APRGs were issued at rates higher than those charged by KEXIM. However, the EC has failed to provide any evidence that such APRGs were actually provided to the shipyards concerned after the dates specified by the EC, whereas Korea submits that it has provided all information regarding APRGs in its responses to the Annex V questions. In the absence of any

[87] We note that Korea raised concerns regarding the probative value of "past" subsidies. To the extent this issue is relevant in respect of the EC's Part III claims, it is addressed in section VII.D *infra*.

[88] See Appellate Body Report, *Canada – Aircraft*, para. 198.

evidence regarding the existence of the alleged APRGs, there is no basis for us to draw any inference regarding the terms on which such alleged APRGs were issued. [89]

(b) Transaction-specific issues

(i) Daewoo

7.164 The EC has proposed a number of market benchmarks to argue that certain APRGs[90] provided by KEXIM to DHI or DSME were below market rates. In particular, the EC has compared certain APRGs provided by KEXIM in 1998, 2000 and 2001 with a number of APRGs provided by **[BCI: Omitted from public version]** during that period.

7.165 Korea rejects the market benchmarks proposed by the EC, and submits that the rates of KEXIM's APRGs should be compared with APRGs provided to those companies by KDB. Korea rejects the use of the EC's **[BCI: Omitted from public version]** benchmarks APRGs because, in Korea's view, those APRGs did not involve collateral of the same value as that provided in respect of the relevant KEXIM APRGs, i.e., Yangdo Dambo.[91]

7.166 In response, the EC submits (on the basis of information provided by Korea in its reply to Question 14 from the EC) that the APRGs issued by **[BCI: Omitted from public version]** were guaranteed by cash deposits, which the EC claims is a stronger form of collateral than Yangdo Dambo.

7.167 Information provided by Korea confirms the EC argument that the **[BCI: Omitted from public version]** APRGs were collateralized by cash deposits.[92] The EC has provided a convincing explanation in support of its argument that cash deposits are a stronger form of collateral than Yangdo Dambo. The EC asserts that Yangdo Dambo "presents [] a wide spread depending on the financial situation of the shipyard, the quality of the shipyard work, its on-time delivery record, the evolution of the construction of the vessel, the sales price versus production cost of the ship, the technological requirements of the buyer and the ease with which these will be met".[93] The EC also states that "[i]t is not unusual for instance that the final price paid by the purchaser of the ship be dependent upon a certain number of technical characteristics of the ship such as its speed for instance. In such a case, the final value of the ship will only be known at the end of the production process. The value of such a collateral is therefore highly dependent upon the quality of the shipyard."[94] The value of Yangdo Dambo is therefore dependent on a number of variables, whereas the value of a cash deposit is self-evident. Korea has failed to rebut the EC's arguments. Instead, Korea asserts that the cash deposits provided in respect of the **[BCI: Omitted from public version]** APRGs covered only a small portion of the guarantee, compared with the 100 per cent coverage of the Yangdo Dambo provided in respect of the KEXIM APRGs. In order for this argument to prevail, Korea would need to demonstrate that

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[89] We note that the EC also acknowledged the possibility that subsequent APRGs did not exist, but nevertheless asked the Panel to infer that the APRGs ceased because market providers were not able to compete with the terms offered by KEXIM. If the APRGs did not exist, however, there is no basis for any adverse inference. In particular, there is no basis for us to find that Korea failed to provide information concerning APRGs that did not exist.

[90] See Figure 11 of the EC's first written submission.

[91] Korea describes Yangdo Dambo as "a security interest (including on the hull and the materials used by the shipyards) created by way of transfer of the title /ownership of a property to the creditor. Such transfer takes place based on an agreement providing that the creditor can either cover his claims through the sale or the assumption of the definitive ownership to the property upon the default of the debtor or return of the title / ownership to the property to the debtor when the latter fully settles the claim of the creditor" (see para. 215 of Korea's first written submission).

[92] See, for example, Korea's reply to Question 14 from the EC.

[93] See Exhibit EC – 118, page 16.

[94] See Exhibit EC – 118, page 4.

the collateral value of the Yangdo Dambo exceeds that of the cash deposits. We consider that Korea has failed to do so, since Korea has made no attempt to do so.[95] We consider such a demonstration to be particularly necessary since Korea has not challenged the EC's assertion that "cash deposits [] are one of the strongest forms of collateral compared to Yangdo Dambo".[96]

7.168 We do not consider that the EC could have done more to prove its argument that the **[BCI: Omitted from public version]** collateral matched that of the KEXIM Yangdo Dambo. The EC was dependent on Korea for information regarding the value of the **[BCI: Omitted from public version]** cash deposits. The EC was also dependent on Korea for information regarding the value of the Yangdo Dambo required by KEXIM. However, in its reply to Question 67 from the Panel (concerning one of the **[BCI: Omitted from public version]** transactions), Korea indicated that it could not provide worksheets or other documentation regarding KEXIM's consideration of collateral. Korea was only able to provide very basic information regarding the Yangdo Dambo at issue.[97] Given the number of variables that determine the collateral value of Yangdo Dambo, this limited information is not sufficient to conclude that the value of the Yangdo Dambo exceeds that of the relevant cash deposits.

7.169 Furthermore, even though Korea seeks to rely on the limited value of the cash deposits provided in respect of the **[BCI: Omitted from public version]** APRGs, Korea has failed to establish the precise scope of those cash deposits. Thus, at note 155 to its first written submission, Korea reported the collateral for the **[BCI: Omitted from public version]** APRGs as "a pledge against bank deposits amount[ing] to 20 to 30% of the advance payments". Then, in reply to Question 14 from the EC, Korea stated that the cash deposits for the four **[BCI: Omitted from public version]** APRGs amounted to 10, 12, 20 and 20 per cent respectively, whereas the cash deposit for the **[BCI: Omitted from public version]** APRG was 30 per cent. As the party seeking to rely on the allegedly limited coverage of the relevant cash deposits, Korea should at least have stated clearly what that allegedly limited coverage was. Furthermore, Korea has failed to provide any evidence in support of its reporting of the coverage of the **[BCI: Omitted from public version]** cash deposits. Such evidentiary support is particularly necessary in this case, given the differences in Korea's reporting of the cash deposits at issue.

7.170 In light of the above, there is no basis for us to accept Korea's argument that the **[BCI: Omitted from public version]** market benchmarks proposed by the EC should be rejected because the relevant collaterals were not comparable. In the absence of additional argumentation by Korea, we consider that the 1998, 2000 and 2001 KEXIM APRGs identified at Figure 11 of the EC's first written submission should be compared with those benchmarks in order to determine whether or not they were provided on terms more favourable than those available on the market. Since the KEXIM premia rates were less than the market benchmarks proposed by the EC, we find that the 1998, 2000 and 2001 KEXIM APRGs identified at Figure 11 of the EC's first written submission conferred a benefit and therefore constitute subsidies.

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[95] At para. 81 of its second oral statement, Korea stated that "[t]he strength of a type of collateral is relevant, but is not particularly useful as a basis for comparison if it only covers a small portion of the credit". We do not consider that this statement rebuts the EC's claim, since at a certain point the value of a smaller portion of credit coverage by a stronger form of collateral will equal, or exceed, the value of a larger portion of credit coverage by a weaker form of collateral.

[96] EC second written submission, para. 100.

[97] In Exhibit KOREA-57, "Security interests" are reported as:

"[on-Credit: 100%]

- Yangdo Dambo as for shipbuilding materials & ships being built
- Yangdo Dambo as for ship price payment claim
- Procuring insurance against loss as to ships being built on behalf of KEXIM as beneficiary."

This was the only information submitted by Korea regarding the value of the collateral at issue.

7.171 The EC has also proposed APRGs offered by **[BCI: Omitted from public version]** and **[BCI: Omitted from public version]** as market benchmarks against which to compare KEXIM APRGs provided to Daewoo in 1997. It is not necessary for us to review the EC's argument, since we have already found that KEXIM's pre-March 1998 APRGs constituted subsidies because the terms did not include any credit risk spread.[98]

7.172 We recall that Korea proposed the use of certain APRGs provided by KDB to Daewoo as market benchmarks. Korea's proposal was based on its argument that KDB is not a public body. We disagree with this argument, however. In our view, KDB is a public body because it is subject to government control. Government control derives from the fact that it is 100 per cent owned by the GOK.[99] Further evidence of government control is found in the fact that GOK "appoints the Governor, Vice Governor, Directors and Auditors of the KDB…, approves its annual operation plan…, and has an oversight role with respect to its operations….".[100] Since the KDB is a public body, there is a risk that its APRG rates are based on public policy, rather than commercial, principles.[101] The KDB APRG rates therefore do not constitute an appropriate market benchmark.

(ii) Samho/Halla

7.173 The EC has proposed a number of market benchmarks to argue that certain APRGs provided by KEXIM to Samho / Halla in 2000 were below market rates. The relevant KEXIM APRGs are set forth at Figure 12 of the EC's first written submission. Korea asserts that the KEXIM APRGs are not comparable with the EC's proposed market benchmarks, since the latter were not collateralized whereas the former were provided on the basis of Yangdo Dambo. Korea submits that the KEXIM APRGs should instead be compared with a number of APRGs provided by KDB.[102] Korea also asserts that the KEXIM APRGs identified by the EC were not provided to Samho / Halla.

7.174 Regarding Korea's reliance on KDB APRGs, we recall our finding that KDB is a public body. KDB rates therefore cannot be used as a market benchmark.

7.175 Regarding Korea's argument on collateralization, the EC refers to its translation of a document submitted by Korea in the Annex V procedure, and asserts that the KEXIM APRGs were issued "on credit", and therefore without collateral.[103] In its first written submission, however, Korea stated that KEXIM APRGs were always provided against "real property (land, buildings, factories as a whole), personal property, securities (i.e., 'Yangdo Dambo' [...] on significant items such as the hull of a vessel) and guarantees."[104] In response to Question 67 from the Panel, Korea has demonstrated that KEXIM APRG transactions reported by Korea as being "on credit" actually involved the

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[98] For the sake of completeness, however, we note that Korea's reply to Question 14 indicated that no collateral had been required in respect of the **[BCI: Omitted from public version]** and **[BCI: Omitted from public version]** APRGs relied on by the EC. Korea asserts that those APRGs therefore cannot be properly compared with KEXIM APRGs, which were collateralized. In the absence of any argument by the EC that the **[BCI: Omitted from public version]** and [**BCI: Omitted from public version**] APRGs were collateralized, or that the KEXIM APRGs were not, there is no basis for us to find that the **[BCI: Omitted from public version]** and **[BCI: Omitted from public version]** APRGs may be properly compared with the relevant KEXIM APRGs.

[99] See Attachment 3 to the EC's replies to the Panel's questions after the first substantive meeting.

[100] See Responses to Annex V Questions (Non-Confidential Version), Answer 2.4(29), at 45 (citing Articles 12, 21, and 47 of Korea Development Act) (citations omitted) (Exhibit EC-50).

[101] Otherwise, the rates of one public body could be used to show that the rates of another public body do not confer a "benefit", even though there is a risk that the rates of both entities are below market. This, of course, is the reason that Article 1 of the *SCM Agreement* brings financial contributions by public bodies into the scope of the disciplines of the *SCM Agreement*.

[102] See Korea's reply to Question 71 from the Panel.

[103] See para. 100 of the EC's second written submission, note 117.

[104] See Korea's first written submission, para. 188. See also para. 215 of that submission.

provision of collateral such as Yangdo Dambo.[105] There is therefore no basis to doubt that the KEXIM APRGs provided to Samho / Halla and reported as being "on credit" were actually collateralized. Since the EC has failed to demonstrate that its proposed market benchmarks were also collateralized, we are unable to accept the use of those proposed market benchmarks for comparing with collateralized KEXIM APRGs. We therefore reject the EC's claim against the KEXIM APRGs identified in Figure 12 of its first written submission.

7.176 In response to a Korean argument that some of the KEXIM APRGs included in Figure 12 of the EC's first written submission did not relate to Samho, the EC performed an additional benefit analysis in respect of other KEXIM APRGs provided to Samho / Halla.[106] However, the EC's modified analysis is based on the same proposed market benchmarks, which (as described above) we are unable to compare with collateralized KEXIM APRGs. Since the EC has given us no reason to doubt Korea's assertion that all KEXIM APRGs were collateralized, we reject the EC's modified analysis in respect of the additional[107] KEXIM APRGs identified by the EC. We therefore reject the EC's claim against those additional KEXIM APRGs provided to Samho / Halla.

(iii) STX/Daedong

7.177 The EC submits that two KEXIM APRGs issued to STX/Daedong in 1999 (see Figure 13 of the EC's first written submission) constitute prohibited export subsidies. The EC claims that the terms of the KEXIM APRGs were more favourable than those of three APRGs provided to STX / Daedong by **[BCI: Omitted from public version]** in 1999. Korea opposes any comparison with APRGs provided by **[BCI: Omitted from public version]**. Korea asserts that those APRGs were not collateralized, whereas KEXIM's APRGs were. Korea submits that the KEXIM APRGs should instead be compared with APRGs provided by the Korea Exchange Bank ("KEB") in 2001 and KDB in 2002.

7.178 We recall that we have already rejected the use of two of the three **[BCI: Omitted from public version]** APRGs.[108] We shall therefore examine the EC's claim in light of the terms and conditions of the one remaining **[BCI: Omitted from public version]** APRG. Regarding comparability on the basis of collateralization, we recall Korea's argument that all KEXIM APRGs were collateralized. KEXIM APRGs should therefore be compared with collateralized market benchmarks. In this regard, we note that the remaining **[BCI: Omitted from public version]** APRG was collateralized "with cash deposits amounting to 5% of the advance payment amount and an export guarantee insurance".[109] Since Korea has failed to argue that such collateral is not comparable with any collateral required in respect of the relevant KEXIM APRGs, we consider that it is appropriate to compare the two 1999 KEXIM APRGs with the single **[BCI: Omitted from public version]** APRG provided to STX / Daedong in 1999. On the basis of such comparison, we find that the KEXIM APRGs were below market, and therefore conferred a benefit.

7.179 We recall that Korea has argued that the terms of the KEXIM APRGs should be compared with the terms of certain APRGs provided by KDB and KEB. In this regard, we recall our finding that KDB is a public body. Accordingly, KDB APRGs do not constitute a reliable market benchmark with which to asses the existence of benefit. As for KEB, we note that Korea has sought to rely on APRG rates offered by KEB in 2001, whereas the KEXIM APRGs at issue date from 1999. Given the absence of any temporal correlation between the KEXIM APRGs challenged by the EC and the KEB APRGs identified by Korea, and our preference for rates charged by entities without government

[105] See Exhibit KOREA – 57, under the heading "II. Items relating to the resolution", where various security interests are reported in respect of a transaction described as being "On-Credit: 100%".
[106] See para. 36 of the EC's second oral statement.
[107] As set forth at para. 36 of the EC's second oral statement.
[108] See para. 7.136 *supra*.
[109] See Korea's reply to Question 14 from the EC.

ownership, we do not consider it appropriate to use KEB APRGs as a market benchmark for determining whether or not the KEXIM APRGs conferred a benefit. We also note the EC argument that KEB is not a reliable market benchmark as a result of government entrustment or direction[110] and government ownership.[111] We are not persuaded by the EC's argument concerning government entrustment or direction, since the only evidence provided by the EC of the government's alleged role is in relation to KEB's participation in the Daewoo workout, and has nothing to do with KEB's provision of APRGs to Samho / Halla. Regarding government ownership, the EC asserts that GOK has a minority shareholding in KEB. In choosing an appropriate market benchmark, we consider it preferable to choose when possible entities without any government ownership. The absence of government ownership generally removes the possibility that rates have been fixed on the basis of public policy, rather than commercial principles.

7.180 In light of the above, we uphold the EC's claim against the KEXIM APRGs identified in Figure 13 of the EC's first written submission.

(iv) Hanjin

7.181 The EC claims that two APRGs provided by KEXIM to Hanjin in 2002 constitute subsidies because they were provided on terms more favourable than those of two APRGs provided by **[BCI: Omitted from public version]** to Hanjin in the same year. The relevant APRGs are set forth at Figure 14 of the EC's first written submission.

7.182 Korea opposes the comparison proposed by the EC because of differences in collateralization. Korea submits that the relevant KEXIM APRGs should instead be compared with certain APRGs provided by **[BCI: Omitted from public version]**, KEB, KDB and **[BCI: Omitted from public version]** in 1997.[112]

7.183 In its reply to Question 71, Korea submits that no security was deposited for the **[BCI: Omitted from public version]** APRGs, whereas Yangdo Dambo was provided for the relevant KEXIM APRGs. Korea submits that such differences in collateralization preclude any comparison between the **[BCI: Omitted from public version]** and KEXIM APRGs at issue. The EC submits that Korea's argument that the two APRGs issued by **[BCI: Omitted from public version]** were not collateralized is inconsistent with Korea's statement in the Annex V process[113] that "[a]ll APRGs" reported by Korea, including therefore those from **[BCI: Omitted from public version]**, "were issued with the collaterals of *Yangdo Dambo*".

7.184 Despite Korea's contradictory statement in the Annex V process, Korea provided documentary evidence[114] during these proceedings demonstrating that the two **[BCI: Omitted from public version]** APRGs at issue were not collateralized. The EC has not disputed that the KEXIM APRGs at issue were, by contrast, collateralized. Given these differences in collateralization, and the fact that the EC has not provided us with any basis for making adjustments to reflect such differences, we are unable to determine benefit on the basis of a comparison of the **[BCI: Omitted from public version]** APRGs with the KEXIM APRGs. We are therefore unable to accept the use of the **[BCI: Omitted from public version]** APRGs as a market benchmark, and reject the EC's claim against the Hanjin APRGs accordingly.

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[110] See EC reply to Question 171 from the Panel.

[111] See para. 103 of the EC's second written submission.

[112] See para. 223 of Korea's first written submission, which refers to other domestic, non-KEXIM APRGs set forth in Exhibit Korea – 16.

[113] See Annex V information submitted as Exhibit EC-24.

[114] See Exhibit Korea – 88, which clearly states that no securities were provided in respect of APRG projects N-120 and N-121.

7.185 In light of the above finding, it is not strictly necessary for us to consider the **[BCI: Omitted from public version]**, KEB, KDB and **[BCI: Omitted from public version]** benchmarks proposed by Korea. We shall do so, however, for the sake of completeness. We have already indicated that KDB APRGs would not constitute an appropriate market benchmark, since KDB is a "public body". Although the EC does not argue that **[BCI: Omitted from public version]**, KEB and **[BCI: Omitted from public version]** are public bodies, it asserts that they are entrusted or directed by the government.[115] We must reject this argument, since the EC has not provided any evidence that these entities were entrusted or directed to provide APRGs to Hanjin. The only evidence of alleged government entrustment or direction of these entities relates to their participation in some of the restructurings at issue in these proceedings. Nevertheless, we note that the alternative APRGs proposed by Korea as market benchmarks all relate to 1997, whereas the KEXIM APRGs challenged by the EC relate to 2002. Given the lack of temporal correlation between these APRGs, the **[BCI: Omitted from public version]**, KDB, KEB and **[BCI: Omitted from public version]** APRGs do not constitute appropriate market benchmarks for the purpose of assessing the KEXIM APRGs at issue.

(v) Samsung

7.186 In respect of Samsung, the EC challenges four KEXIM APRGs, all of which were issued in 1997. The EC claims that these APRGs conferred a benefit because they were issued on terms more favourable than 1997 APRGs provided by **[BCI: Omitted from public version]** and **[BCI: Omitted from public version]**. The relevant APRGs are set forth at Figure 15 of the EC's first written submission.

7.187 We recall that we have already found that KEXIM's pre-March 1998 APRGs to Samsung constitute subsidies because their terms did not include any credit risk spread. For this reason, there is no need for us to consider additional arguments by the parties regarding the comparability of these APRGs with the market benchmark APRGs proposed by the EC.

7.188 For the sake of completeness, we note Korea's argument regarding the use of KDB APRGs as a market benchmark. We recall that KDB is a public body.[116] As a public body, KDB does not constitute a market benchmark for the purpose of assessing whether or no the relevant KEXIM APRGs conferred a benefit.

(c) Export contingency

(i) Arguments of the Parties

7.189 The EC submits that APRGs are provided for the specific purpose of guaranteeing the down payments for Korean goods intended for export. The EC asserts that any transaction financed through KEXIM's APRG programme must, by definition, be an export transaction, and that APRGs provided pursuant to the programme are expressly contingent on export within the meaning of Article 3.1(a) of the *SCM Agreement.*

7.190 When asked by the Panel (Question 48) whether Korea contests the EC's claim that PSLs and APRGs under the KEXIM legal regime are contingent on export performance, Korea responded that it "has not taken any position as to whether [PSLs and APRGs] are contingent on export performance". In response to an oral question from the Panel at the second substantive meeting, Korea stated that it was not contesting the EC's claim of export contingency.

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[115] See EC reply to Question 171 from the Panel.
[116] See para. 7.172 *supra*.

(ii) Evaluation by the Panel

7.191 We find that the EC has established a *prima facie* case that KEXIM APRGs are contingent on export performance. In light of Korea's decision no to contest the EC's arguments regarding this matter, we find that KEXIM APRGs are "contingent ... upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.

(d) Specificity

7.192 Pursuant to Article 1.2, the disciplines of the *SCM Agreement* only apply to subsidies that are "specific" within the meaning of Article 2 thereof. Article 2.3 of the *SCM Agreement* provides that "[a]ny subsidy falling under the provisions of Article 3 shall be deemed to be specific". Since export contingent subsidies fall under the provisions of Article 3 (paragraph 1(a)), they are "specific". Pursuant to Article 2.3, therefore, we conclude that those APRGs that we have found to be export subsidies are "specific".

(e) Item (j) defence

7.193 In light of our findings that certain APRGs constitute subsidies, and that such subsidies are contingent on export performance, we will be required to find that such APRGs are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* unless we uphold Korea's claim that they benefit from a safe haven pursuant to item (j) of the *Illustrative List*.

7.194 Korea submits that item (j) should be interpreted such that export credit guarantee programmes, or guarantee programmes against increases in the cost of exported products, that are provided at premium rates that cover the long-term operating costs and losses of the programmes should be found not to constitute export subsidies. In other words, Korea relies on an *a contrario* interpretation of item (j). Korea's reliance on item (j) raises a number of issues. First, is an *a contrario* interpretation of item (j) permissible? Second, if so, what are the relevant conditions to be fulfilled? Third, have those conditions been fulfilled in this case?

(i) Is an a contrario interpretation permissible?

7.195 We note that the panel in *Brazil – Aircraft – Article 21.5* was required to consider whether or not one of the items of the *Illustrative List* could be interpreted in an *a contrario* manner. In doing so, that panel observed that footnote 5[117] to the *SCM Agreement* provides an explicit textual basis for determining whether and under what conditions the *Illustrative List* may be used to demonstrate that a measure is not a prohibited export subsidy.[118] The panel noted that footnote 5 provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." The panel observed that, in its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy. The panel therefore considered whether or not the *Illustrative List* provision at issue contained any affirmative statement that a measure is *not* an export subsidy, or that a measure not satisfying the

[117] The *SCM Agreement* also includes a provision governing the relationship between certain elements of the *Illustrative List* and Article 1 of the Agreement. Footnote 1 to the *Agreement* provides that, "[i]n accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties and taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy." Footnote 1 therefore indicates when certain measures will not constitute a subsidy, whereas footnote 5 addresses situations where certain measures will not constitute prohibited export subsidies. Footnote 1 is not applicable to the situation at hand, as Korea has not alleged that APRGs (or PSLs) are related to the exemption of an exported product from duties or taxes.

[118] See Panel Report, *Brazil – Aircraft – Article 21.5*, paras. 6.33-6.34.

conditions of that provision is *not* prohibited, and thus falls within the scope of footnote 5.[119] Finally, the panel noted that a broad reading of footnote 5 could place developing country Members at a permanent, structural disadvantage in the field of export credit terms, a result that it considered to be inconsistent with one of the objects and purposes of the *WTO Agreement*.[120]

7.196 We find the reasoning[121] expressed by the *Brazil – Aircraft-Article 21.5* panel to be convincing, and consider it appropriate for us to be guided by it in these proceedings. We are of course aware that the *Brazil – Aircraft-Article 21.5* panel was considering whether or not the first paragraph of item (k) of the *Illustrative List* could be interpreted *a contrario*. However, the panel's reasoning was based in the first instance on an interpretation of footnote 5 of the *SCM Agreement*, and was not confined to the text of item (k) in isolation. Furthermore, the panel's concerns regarding structural discrimination against developing country Members were based explicitly on considerations regarding item (j). Accordingly, there is no reason why the panel's reasoning should not also be applied in respect of the remaining provisions of the *Illustrative List*, including item (j).

7.197 Korea argues that we should not follow the reasoning of the *Brazil – Aircraft – Article 21.*5 panel because it was invalidated by the Appellate Body. In particular, Korea relies on the statement by the Appellate Body in those proceedings that "[i]f Brazil had demonstrated that the payments made under the revised PROEX were not 'used to secure a material advantage in the field of export credit terms', and that such payments were 'payments' by Brazil of 'all or part of the costs incurred by exporters or financial institutions in obtaining credits', then we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the *Illustrative List*."[122] However, we do not accept that this amounts to a reversal of the panel's findings, nor a legal finding by the Appellate Body that an *a contrario* interpretation of the first paragraph of item (k) is permissible. This is because the Appellate Body explicitly stated that "[i]n making this observation, we wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5, or on the meaning of any other items in the Illustrative List." In light of this clarification by the Appellate Body, we consider that there is nothing in the Appellate Body statement that would cause us not to be guided by the abovementioned reasoning of the *Brazil – Aircraft – Article 21.5* panel.

7.198 Thus, in order to determine whether or not item (j) of the *Illustrative List* may be interpreted *a contrario*, we shall consider whether or not item (j) falls within the scope of footnote 5 of the *SCM Agreement*. That is to say, we shall consider whether item (j) contains any affirmative statement that a measure is *not* an export subsidy, or that a measure not satisfying the conditions of that paragraph is *not* prohibited. Item (j) contains no such affirmative statement. Item (j) merely describes certain circumstances in which particular programmes shall constitute export subsidies. Since item (j) therefore falls outside the scope of footnote 5, item (j) does not provide a basis on which to find that measures do not constitute prohibited export subsidies.

7.199 Although the EC rejects the application of item (j) on the basis of the facts of this case, the EC submits that in law item (j) could be read to include a proviso, and thereby "refer" to export credit guarantees as not constituting export subsidies to the extent that the premium rates cover the long-term operating costs and losses of the programmes. As indicated above, however, we consider that item (j) does not refer to measures as not constituting export subsidies. The terms of item (j) merely refer to export credit guarantees etc. at premium rates which are inadequate to cover long-term operating costs and losses. It contains no explicit reference to export credit guarantees etc. that are

[119] See *ibid.*, paras. 6.36-6.37.
[120] See *ibid.*, paras. 6.46-6.66.
[121] We therefore incorporate the reasoning set forth in paragraphs 6.33 – 6.41 of that panel's report into our findings.
[122] See Appellate Body Report, *Brazil – Aircraft – Article 21.*5, para. 80.

adequate to cover long-term operating costs and losses. There is therefore no basis for claiming that item (j) somehow incorporates a proviso that brings it within the scope of footnote 5.

7.200 Korea objects to the *Brazil – Aircraft – Article 21.5* panel's interpretation and application of footnote 5, which we apply here. Korea considers that such an application is overly narrow. Korea argues that the negotiating history of footnote 5 shows that the drafters intended to expand, rather than restrict, the scope of footnote 5. In this regard, Korea makes the same argument as was advanced by the United States in *Brazil – Aircraft – Article 21.5*. The *Brazil – Aircraft – Article 21.5* panel described and rejected this argument in the following terms:

> The United States advances arguments based on the negotiating history of footnote 5 in support of its broad interpretation of that footnote to apply to the first paragraph of item (k). In this respect, it points out that in a Chairman's text of the *SCM Agreement* known as *Cartland III*, footnote 5 provided as follows:
>
> "Measures *expressly* referred to as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." (emphasis added).
>
> As the United States correctly observes, a new Chairman's text (known as "Cartland IV") was released just a few days later. In that new text, the word "expressly" was dropped from the footnote, which took its present form. In the view of the United States, this change demonstrates that the drafters "intended to expand, rather than restrict" the scope of footnote 5, and that "they did not intend the sort of narrow construction of footnote 5 advanced by Canada and the EC."
>
> We agree with the United States that the deletion of the term "expressly" appears to have broadened the scope of footnote 5 in *Cartland IV* beyond its scope in *Cartland III*. We do not agree, however, that it served to broaden footnote 5 to the extent suggested by the United States. As we discussed above, the Illustrative List contains – and already contained at the time of *Cartland III* and *IV* – a number of provisions that include affirmative statements that arguably represent authorizations to use certain measures. The language of *Cartland III* ("expressly referred to") could have precluded asserting that footnote 5 applied to any of these provisions, and it may be that the purpose of the modification was to rectify this situation. If on the other hand the intention of the drafters in changing footnote 5 had been to extend the scope of that footnote to cover situations where the Illustrative List merely referred to things that *were* export subsidies, they might have been expected to modify the structure of the second part of the footnote, and not merely delete the word "expressly". At the very least, we conclude that the implications of the negotiating history referred to by the United States are inconclusive and cannot lead us to disregard the ordinary meaning of the footnote.
>
> Of course, it could be argued that, based on an *a contrario* argument, the Illustrative List permits admitted export subsidies *even where those subsidies do not fall within the scope of footnote 5*. As we have already indicated, however, the drafters have provided us with a specific textual provision that addresses the issue when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy. The fact that this footnote was adjusted on at least one occasion suggests that the drafters gave this issue consideration and provided the answer to this question. If we were to conclude that the Illustrative List by implication gave rise to

> "permitted" measures beyond those allowed by footnote, we would be calling into serious question the *raison d'être* of footnote 5.[123]

7.201 We find the panel's reasoning to be convincing. For this reason, and in light of the fact that Korea has not attempted to rebut it, we see no reason not to be guided by that reasoning in the present case. Although Korea notes that the Appellate Body has not opined on the *Brazil – Aircraft – Article 21.5* panel's reasoning,[124] this fact does not make the panel's reasoning any less convincing to us. On the basis of that reasoning, we reject Korea's argument concerning the negotiating history of footnote 5.

7.202 Korea also argues that the only purpose of item (j) is to indicate when export subsidies do not exist.[125] Korea submits that failure to permit an *a contrario* reading of item (j) and the first paragraph of item (k) would render those provisions meaningless, since a complaining party would never rely on them to demonstrate the existence of an export subsidy. According to Korea, this is because reliance on these provisions would require a complaining party to demonstrate more facts than the basic legal provision in Article 3. In particular, Korea argues that since one could establish a violation of Article 3.1(a) simply by showing export contingency, a complainant would never have recourse to item (j) to demonstrate export subsidization, because that would require the complainant to also demonstrate that premium rates are inadequate to cover the long-term operating costs of the relevant programme (i.e., that the conditions of item (j) are met).

7.203 We cannot accept Korea's argument that the only purpose of item (j) is to indicate when export subsidies do not exist. To accept this argument would require reading item (j) in a sense exactly opposite that of its plain language: on its face, item (j) defines certain circumstances in which export credit guarantee programmes are export subsidies. Item (j) simply does not address export guarantee programmes that do cover their long-term operating costs and losses. Indeed, what is the point of footnotes 1 and 5 being included in the *SCM Agreement* to clarify the relationship between Articles 1 and 3 of the *SCM Agreement* on the one hand, and the *Illustrative List* on the other, if footnotes 1 and 5 can ultimately be ignored and the *Illustrative List* read in a sense exactly the opposite of its plain language?

7.204 As for Korea's argument that item (j) would never be used by a complaining party to establish the existence of a prohibited export subsidy, we disagree. As item (j) provides, if a complaining party establishes that another Member's export guarantee programme fails overall to cover its long-term operating costs and losses, that is sufficient for a finding that the programme as a whole constitutes a prohibited export subsidy. Given the *per se* nature of the items set forth in the *Illustrative List*, no further separate analysis of the programme under Articles 1 and 3 would be necessary.[126] Furthermore, in arguing that all a party would need to do to pursue a claim under Article 3.1(a) is establish export contingency, Korea overlooks the need under Article 3.1(a) to demonstrate the existence of subsidization. Thus, a complainant cannot establish a violation of Article 3.1(a) simply by showing export contingency; the complainant must also demonstrate subsidization, and therefore benefit, on the basis of Article 1.1 of the *SCM* Agreement.

7.205 Furthermore, we recall that the *Brazil – Aircraft –Article 21.5* panel's reasoning was based explicitly on the structural disadvantages for developing country Members that would result from an *a contrario* interpretation of item (j). The panel found:

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[123] Panel Report, *Brazil – Aircraft – Article 21.5*, paras 6.39 – 6.41 (footnotes omitted).
[124] Korea's first written submission, para. 253.
[125] Korea's rebuttal submission, para. 103.
[126] This perhaps reflects the historical context of the *Illustrative List*, in the sense that it was first drafted before the definition of "subsidy" set forth in the *SCM Agreement* was introduced.

> 6.59 The same situation exists in respect of item (j) of the Illustrative List. Brazil argues that its interpretation of the first paragraph of item (k) is necessary to allow it to meet export credit terms provided by developed country Members through export credit guarantees. If footnote 5 is interpreted broadly to encompass the first paragraph of item (k), however, it presumably would also apply to item (j) and thus "permit" export credit guarantees at premium rates adequate to cover long-term operating costs and losses, even where the guarantees constituted a subsidy contingent upon export performance within the meaning of Article 3.1(a). As Canada points out, however, in the case of a government guarantee, a lending bank establishes financing terms in light of the risk of the guarantor government, not the borrower. Developed countries generally present a lower risk of default than developing countries, and a developing country may often be perceived as posing a higher risk than even the borrower to whom a guarantee might be extended. As a result, while developing countries in theory could utilise any "safe harbour" under item (j) to provide loan guarantees at the same premium rates as developed countries, the effect of guarantees by developing country Members on the interest rate of the guaranteed export credits would be minimal or non-existent in most cases. In other words, a broad reading of footnote 5 would, in respect of item (j), allow developed countries to support export credits at interest rates that would be consistently lower than those of export credits supported by developing countries.
>
> 6.60 If, on the other hand, we interpret footnote 5 in accordance with its ordinary meaning, and conclude that it does not apply to items such as the first paragraph of item (k) and item (j), then all WTO Members are faced with a common set of rules in respect of export credit practices. *First*, they can ensure that those practices do not confer a benefit within the meaning of Article 1 and are therefore not subsidies. Because the existence of benefit is determined based on the existence of a benefit to a recipient, and without regard to whether there is a cost to the government, all Members compete on a level playing field in respect of this assessment, *i.e.*, a measure which constitutes an export subsidy when provided by Brazil *ipso facto* will also constitute a subsidy when provided by Canada, and vice versa.[127]

7.206 We share that panel's concerns regarding the structural disadvantages that would result for developing country Members from an *a contrario* interpretation of item (j). As noted by that panel, an interpretation leading to such structural disadvantages "would be at odds with one of the objects and purposes of the *WTO Agreement* generally and the *SCM Agreement* specifically".[128]

7.207 In light of the above, we find that an *a contrario* interpretation of item (j) is not permissible. Strictly speaking, therefore, it is not necessary for us to continue with our analysis of the two remaining issues outlined above. For the sake of completeness, however, we shall do so.

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[127] See Panel Report, *Brazil – Aircraft – Article 21.5*, paras 6.59 – 6.60 (footnotes omitted).

[128] *Ibid*, para. 6.47. That panel noted that the preamble to the *WTO Agreement* recognises "that there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development." That panel also noted that "[t]his overarching concern of the *WTO Agreement* finds ample reflection in the *SCM Agreement*. Article 27 of that Agreement recognizes that 'subsidies may play an important role in economic development programmes of developing country Members' and provides substantial special and differential treatment for developing countries, including in respect of export subsidies" (*ibid*, note 49).

(ii) If an a contrario interpretation of item (j) were permissible, what conditions would need to be fulfilled?

7.208 Assuming *arguendo* that item (j) could operate as an affirmative defence (with which, as noted, we disagree), it would need to be demonstrated that the APRG programme constitutes an export credit guarantee or insurance programme, or an insurance or guarantee programme against increases in the cost of exported products or of exchange risk, that operates at premium rates which are adequate to cover the long-term operating costs and losses of that programme.

(iii) Are the relevant conditions for the application of item (j) as an affirmative defence fulfilled?

7.209 As the party seeking to rely on item (j) as an affirmative defence, the burden of proof is on Korea to establish that the relevant conditions have been fulfilled. Korea submits that KEXIM APRGs are export credit guarantees or, at least, guarantees against increases in the costs of exported products. Korea further submits that the APRG programme covers its long-term operating costs, as evidenced by the profitability of that programme from 1997 to 2002.

7.210 The EC contests Korea's assertion that APRGs are export credit guarantees, or guarantees against increases in the cost of exported products. The EC asserts that export credit guarantees are provided to banks or exporters in respect of credits they have provided to foreign customers, whereas APRGs involve guarantees provided to the foreign customers in respect of payments they have made to shipbuilders. The EC also asserts that APRGs guard against the overall expenses of the exporter or credit risks taken by the purchaser, not against increases in the cost of the exported product. The EC argues that Korea's broad interpretation would allow any subsidy to an exporter or to exported products that is formulated as a "guarantee programme" to be covered by item (j) since any such subsidy would tend to reduce the cost of manufacturing the exported goods for the exporter or of buying the exported goods for the purchaser.

7.211 The EC further asserts that, in making APRGs and preshipment loans, KEXIM assumes a risk that relates to the creditworthiness of the domestic exporters. The EC submits that the export credit financing referred to in item (j) concerns foreign risk. According to the EC, the underlying rationale of these provisions is that domestic banks typically do not have the means of assessing overseas risks of a potential buyer of an export product (or of recovering money abroad).

7.212 The EC does not challenge Korea's assertion regarding the long-term profitability of the APRG programme.

Do APRGs constitute export credit guarantees?

7.213 From a purely textual perspective, based entirely on the plain meaning of the words, we consider that an instrument may only be designated as an "export credit guarantee" if it guarantees an export credit. An instrument will guarantee an export credit if it covers default by a borrower in respect of an export credit provided to that borrower.

7.214 Korea has not explicitly argued that APRGs guarantee export credits. Rather, Korea has sought to establish a link between the APRGs and export credits by arguing that "APRGs are issued to protect the shipowner against a contractual default by the shipbuilder. It is not disputed that Korean exporters who export capital goods which qualify for loans under KEXIM policies on export loans are also eligible for APRGs. There is, therefore, a close connection between the export loan / credit financing and the APRGs even though there is no complete concurrence."[129] Thus, although Korea does not argue that APRGs guarantee export credits (Korea asserts, instead, that APRGs guarantee against contractual default by the shipbuilder), it argues that there is a sufficiently close connection

[129] Korea's first written submission, para. 263.

between credits to exporters[130] and APRGs for the latter to be treated as export credit guarantees. We note, however, that there is no direct connection between APRGs and loans to exporters, since there may well be cases in which APRGs are issued but no KEXIM loans (or, in theory at least, any loans at all) are provided to the exporters.

7.215 In reply to Question 59 from the Panel, Korea stated that "[t]he fact that APRGs may be granted when export credits in the narrow sense are not does not prevent APRGs from being qualified as export credit guarantees because it still is a guarantee accessory to an export transaction similar to a loan guarantee which covers a default by the borrower." If we understand Korea correctly, it is seeking to demonstrate a closer link between APRGs and loans to exporters by treating advance payments by the buyers as loans to exporters, and the APRGs as guarantees of those loans. We are unable to accept this argument. First, we see no basis for treating the advance payment as a loan to the shipbuilder. Receiving and making pre-payment is not the same as accepting and offering a loan. A loan is to be repaid, whereas a pre-payment is a payment for a good or service to be provided. Indeed, the fact that Korea merely argues that the APRG is "similar to" a loan guarantee suggests that Korea itself is not of the view that the advance payment constitutes a loan.[131] Second, even if the advance payment were treated as a loan, the mere fact that a guarantee is issued in respect of a loan in the context of (or "accessory to") an export transaction does not necessarily make that guarantee an export credit guarantee. An instrument will only constitute an export credit guarantee if it guarantees an "export credit". Korea has neither argued nor demonstrated that advance payments guaranteed by APRGs constitute "export credits".[132]

7.216 Korea submits that other Members' export credit agencies also provide APRGs. We understand Korea to argue that, because APRGs are offered by other Members' export credit agencies, they should be treated as export credit guarantees. Korea also asserts at note 34 to its replies to questions from the Panel after the second meeting that "if the EC's narrow and simplistic construct is correct, then a number of EC Member States are *prima facie* in violation of Part II of the *SCM Agreement* as their programs would be outside of the parameters of the *OECD Arrangement* and not protected by any safe harbors." The conformity of the practices of other Members with Part II of the *SCM Agreement* is not an issue in these proceedings. In resolving the present dispute, therefore, we take no account of the practices of other Members, nor of the potential implications of our findings for the practices of such Members.

7.217 For the above reasons, we find that KEXIM APRGs do not constitute export credit guarantees within the meaning of item (j) of the *Illustrative List.*

Do APRGs constitute guarantees against increases in the cost of the exported product?

7.218 Regarding the issue of guarantee against increases in cost, Korea asserts (response to Question 60 from the Panel) that an APRG guarantees against an increase in the cost associated with the working capital necessary to produce the ship, because the fact that the shipowner makes an advance payment (guaranteed by the APRG) reduces the amount of money that the shipyard needs to borrow to finance the cost of producing the vessel (i.e., the pre-payment serves as interest-free working capital).

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[130] For present purposes, we do not consider it necessary to determine whether or not a loan to an exporter constitutes an export credit.

[131] As noted below, Korea actually treats the advance payment covered by the APRG as interest-free working capital for the shipyard, and therefore not as a loan.

[132] Korea makes an argument at para. 262 of its first written submission that only applies "[i]f a credit to the shipyard qualifies as an export credit". We do not treat this hypothetical assertion as an argument that advance payments do constitute export credits. In any event, even if this could be interpreted as an argument by Korea that advance payments constitute "export credits", we find below that loans to exporters do not constitute export credits. Thus, even if advance payments could be treated as loans to exporters, they would not be "export credits".

7.219 The EC submits that item (j) does not apply to guarantees against increases in exporters' costs generally, but only to guarantees against increases in "the cost of exported products".

7.220 We note that item (j) applies to guarantee programmes against increases in the cost of "exported products". The fact that a shipyard has access to interest-free working capital (in the amount of the advance payments guaranteed by APRGs) has no bearing on whether or not the (total) cost of the vessel will increase. It provides neither a guarantee for the shipbuilder that the cost of production of the vessel will not increase, nor a guarantee to the buyer that the price of the vessel will not increase.[133] Irrespective of the pre-payment, the cost of the vessel could still increase. APRGs provide no guarantee that other costs, and therefore the (total) cost of the exported product, will not increase. Accordingly, there is no basis for us to find that APRGs constitute "guarantee programmes against increases in the cost of exported products" within the meaning of item (j) of the *Illustrative List*.

7.221 Although the above findings indicate that item (j) could not operate as an affirmative defence in the present case, for the sake of completeness we shall address the issue of the adequacy of APRG premium rates. In this regard, we note that the EC has not disputed Korea's assertion that the APRG premia are adequate to cover the long-term operating costs and losses of the programme. We therefore consider that Korea has established prima facie that this condition is fulfilled.

7.222 In light of our findings that item (j) may not be interpreted *a contrario*, and that APRGs are neither export credit guarantees nor guarantees against increases in the cost of exported products, we find that Korea has failed to demonstrate that item (j) is applicable as an affirmative defence for those individual APRGs found to be in violation of Article 3.1(a) of the *SCM* Agreement.[134]

(f) Conclusion

7.223 To conclude on the individual APRG transactions challenged by the EC, we find that the following KEXIM APRGS constitute prohibited export subsidies contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement*:

[BCI: Omitted from public version.]

5. Individual PSL transactions

7.224 The EC claims that a number of individual KEXIM PSLs constitute prohibited export subsidies, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.* The EC's claim is based on a comparison of the terms of individual PSLs with a market benchmark constructed primarily on the basis of an index of corporate bond prices.

7.225 Korea has made a number of arguments concerning the EC's proposed market benchmark. Korea has also proposed alternative market benchmarks of its own. In particular, Korea submits that the terms of KEXIM PSLs should be compared with the terms of other financing instruments used by the relevant shipyards, including corporate bonds issued by those shipyards. In the alternative, Korea submits that the individual PSL transactions benefit from a safe haven provided for in the first paragraph of item (k) of the *Illustrative List*. We shall examine the parties' arguments regarding the alternative market benchmarks proposed by Korea before addressing issues concerning the market benchmark proposed by the EC. Only then will we examine the individual transactions identified by

[133] The parties have made a number of arguments as to whether "the cost of the exported products" refers to cost of production or price. We do not consider it necessary to resolve this issue in order to decide whether APRGs constitute guarantees against increases in the cost of exported products.

[134] In light of this finding, it is not necessary for us to consider the EC's argument that any safe haven under item (j) of the *Illustrative List* could only operate as a defence for the APRG programme *per se*, but not the individual APRG transactions under that programme (see EC reply to Question 169 from the Panel).

the EC in its claim. In the event that we uphold any of the EC's claims against individual transactions, we shall then consider Korea's reliance on the first paragraph of item (k) of the *Illustrative List*.

(a) Alternative benchmarks proposed by Korea

(i) Corporate bonds issued by shipyards

7.226 Korea notes that the EC has proposed a market benchmark constructed on the basis of an index of corporate bond rates. Korea submits that, if a market benchmark is to be based on corporate bonds, it should at least be based on corporate bonds issued by the individual shipyards at issue. Accordingly, Korea has submitted data concerning corporate bonds issued by DHI/DSME, Samho, STX/Daedong, Hyundai Mipo and HHI.

7.227 The EC asserts that the bonds actually issued by the shipyards are not appropriate market benchmarks. The EC submits that many of the bonds issued were guaranteed, and that Korea failed to submit details regarding the terms of the guarantees. The EC also complains that Korea often failed to report the identity of the guarantor.[135]

7.228 In determining whether or not it is appropriate to use the corporate bond data submitted by Korea as a market benchmark, we shall examine the evidence provided by Korea for each shipyard separately.

DHI/DSME

7.229 In response to Question 17 from the EC, Korea provided a table containing information in respect of six corporate bonds issued by DHI/DSME in 1997 and 1998.[136] The table reports "N/A" in the "collateral / guarantee" column. It is unclear whether Korea intended to report "not applicable" or "not available". The EC argues that at least three of those bonds were guaranteed.[137] Although Korea has not disputed this, it has not provided information regarding the terms on which such guarantees were offered. Without this information, we are unable to use the bond data provided by Korea as a market benchmark. In particular, there is no means for us to ensure that the Korean corporate bond data and the PSL rates are directly comparable. Nor is there any means for us to make adjustments for any differences in guarantee / collateralization that may exist. In addition, information submitted by the EC also indicates that the guarantor for at least one of those bonds was KDB, which we have already found to be a public body.[138] This confirms our decision not to establish a market benchmark on the basis of this data, since there is a risk that corporate bonds guaranteed by public bodies are not a reliable indicator of market rates.

7.230 Korea also submitted corporate bond data for 1999 and 2000.[139] The data comprise quarterly balances, with average interest rates. The parties disagree as to whether or not such information constitutes a proper basis for a market benchmark.[140] We consider that we do not need to address this

[135] The EC also argued that Korea failed to provide information regarding yield rates in respect of bonds issued below par value. However, some such information was ultimately provided by Korea (see, for example, Exhibit KOREA – 68). The EC also argued that, because the data submitted by Korea reflects a quarterly summary of outstanding borrowings, they do not reflect interest rates at any given date, and may reflect bonds issued months or years before the quarter in which they were reported. In view of our decision to reject the data for other reasons, we do not consider it necessary to address this argument.

[136] See Exhibit KOREA-68.

[137] See Exhibit EC-129.

[138] See para. 7.172 *supra*.

[139] See Exhibit KOREA – 18.

[140] The EC also claims that such bonds were affected by the restructuring, and also for that reason should not be used as a market benchmark (para. 132, EC second written submission). Korea has not disputed this argument.

issue, however, as Korea has in any event failed to report details of any collateral or guarantees provided in respect of these bonds, even though Exhibit EC – 129 demonstrates that many DHI/DSME bonds were issued against guarantees. Again, the absence of such information precludes us from using such data as a market benchmark.

7.231 In light of the above, we are unable to use the data submitted by Korea in respect of corporate bonds issued by DHI/DSME as a reliable market benchmark.

Samho

7.232 Korea provided information regarding corporate bonds issued by Samho at para. 233 of its first written submission, and in response to question 17 from the EC.

7.233 The EC claims that the bonds cannot be used as a reliable market benchmark because they were guaranteed by **[BCI: Omitted from public version]**, thus reflecting the credit rating of **[BCI: Omitted from public version]** rather than Samho.

7.234 Korea has not rebutted the EC's argument regarding the **[BCI: Omitted from public version]** guarantee, nor has it provided any information regarding the terms of that guarantee. We are therefore unable to determine what the rate for the bonds would have been without the guarantee. Furthermore, Korea has reported two-year bond data, which cannot be readily compared with six-month PSL rates. In these circumstances, we are unable to use the Samho corporate bond data submitted by Korea as a basis for establishing a market benchmark against which to judge the KEXIM PSLs.

STX/Daedong

7.235 Korea provided information regarding corporate bonds issued by STX/Daedong at para. 236 of its first written submission, and in response to question 17 from the EC. Korea asserts that the STX/Daedong bonds constitute particularly appropriate market benchmarks, since they were collateralized, and could therefore be readily compared with the collateralized PSLs.

7.236 The EC notes that, according to the information provided by Korea, the STX/Daedong bonds were issued in Japanese yen. The EC submits that it is improper to compare the corporate bond interest rates quoted in Japanese yen with the PSL rates quoted in Korean won, as interest rates may differ greatly based on the underlying currency. The EC also asserts that the collateral backing the STX/Daedong bonds was the factory as a whole, whereas the factory was not used as collateral for PSLs.

7.237 We note that Korea has not rebutted the EC's arguments against the use of the STX/Daedong bond data as a market benchmark. We agree with the EC that yen rates for corporate bonds cannot be compared directly with won rates for PSLs. Furthermore, in the absence of additional information from Korea regarding the value of the collateral underlying the STX/Daedong bonds (i.e., factory) and PSLs (i.e., Yangdo Dambo) respectively, we are unable to ensure that any comparison of the corporate bond and PSL rates is not affected by differences in the value of the relevant collateral. In addition, we note that Korea has reported three-year bond data, which cannot be readily compared with six-month PSL rates. For these reasons, we are unable to use the STX/Daedong corporate bond data submitted by Korea as a basis for establishing a market benchmark against which to judge the STX/Daedong PSLs.

Hyundai / Mipo

7.238 Korea provided information regarding corporate bonds issued by Hyundai Mipo at para. 238 of its first written submission.

7.239 The EC submits that Korea's data should not be used as a market benchmark because Korea failed to provide any supporting evidence in the form of exhibits, or otherwise. The EC also argues that, even if the Panel considers Korea's proposed benchmark as relevant, the corporate bond rates proposed by Korea are generally higher than the rates of the KEXIM pre-shipment loans to Hyundai-MIPO.

7.240 First, we note that Korea failed to provide any detailed information regarding the Mipo bond rates. For example, it failed to provide any of the more detailed information (concerning quarterly average rates) that it had provided for other shipyards in the form of Exhibits KOREA 18 – 21. In addition, we note that Korea failed to inform the Panel whether any of the Mipo bonds were guaranteed or collateralized. For these reasons, we do not consider it appropriate to establish a market benchmark on the basis of the corporate bond information submitted by Korea.

HHI

7.241 Korea provided information regarding corporate bonds issued by HHI at para. 240 of its first written submission.

7.242 The EC asserts that the HHI PSL rates are lower than the HHI corporate bond rates submitted by Korea.

7.243 We note that Korea has reported three-year bond data, which it would be inappropriate to compare with six-month PSL rates (without further adjustment). For this reason, we are unable to establish a market benchmark on the basis of the HHI corporate bond data submitted by Korea.

Conclusion

7.244 For the above reasons, we are unable to establish a market benchmark on the basis of the data submitted by Korea regarding corporate bonds issued by the shipyards at issue.

(ii) Other benchmarks proposed by Korea

7.245 Korea submits that individual PSL transactions can be reviewed in light of usance letters of credit, overdraft loans, corporate bonds, commercial papers, facility loans and short-term borrowings taken / issued by the individual shipyards at issue.

7.246 The EC asserts that the other sources of financing mentioned by Korea should not be used as a market benchmark, as the EC is unaware of the conditions and collateral with which such financing was provided.

7.247 In our view, Korea has failed to provide enough information for us to use the abovementioned alternative instruments as a reliable market benchmark. With the exception of facility loans, the only information submitted by Korea regarding collateral requirements is that it "depend[s] on the financial strength of the borrower".[141] For facility loans, Korea reports a need for collateral in the form of "real properties, factory as a whole",[142] but provides no indication of the impact of such collateral on the facility loan spreads. Thus, there is not enough information for us to be sure that facility loans and KEXIM PSLs are comparable on the basis of collateralization (nor is there sufficient information for us to make any adjustments that might be required). The information provided in respect of the terms / maturity of these various instruments is similarly insufficient. The only concrete term information relates to usance letters of credit.[143] For the other instruments, Korea merely reports what terms

[141] See para. 226 of Korea's first written submission.
[142] See Korea's First Written Submission, para. 226.
[143] *Ibid.*

"normally" or approximately ("about") are applicable.[144] There is therefore no means for us to ensure that these other instruments and KEXIM PSLs are directly comparable in terms of maturity (nor is there sufficient information for us to make any adjustments that may be required). In addition, because Korea has not reported the identity of the providers of the abovementioned instruments, we are unable to establish whether or not they represent market (as opposed to public body) rates. Furthermore, we note that Korea has reported data in respect of usance letters of credit issued in US dollars for Hanjin.[145] We do not consider it appropriate to compare the terms of instruments issued in different currencies.

(iii) Conclusion

7.248 For the above reasons, we are unable to establish a market benchmark on the basis of the abovementioned alternative instruments.

(b) The EC's proposed market benchmark

7.249 The EC's claim is based on a comparison of the terms of individual PSLs with a market benchmark constructed primarily on the basis of an index of corporate bond prices.[146] For shipyards with a credit rating agency rating of BBB or higher (i.e., investment grade), the EC generally compares the actual KEXIM PSL rates with a market benchmark constructed on the basis of the Korea Stock Dealers Association ("KSDA") general index of six-month corporate bond prices, with certain adjustments for differences in maturity and collateral. For each investment grade shipyard, the EC identifies a credit rating agency rating, and applies KSDA index prices for corporate bonds with the same rating. For non-investment grade shipyards, having agency ratings lower than BBB, the EC compares the actual PSL rates with rates constructed on the basis of KEXIM's own Interest Rate Guidelines (generally using the KEXIM spreads for the relevant KEXIM rating), again with certain adjustments for differences in maturity and collateral.

7.250 Korea objects to the market benchmark proposed by the EC. Korea's objections concern alleged differences in the rating practices of KEXIM / private banks and corporate bond credit rating agencies, the use of indexed bond pricing, the choice of maturity of the KSDA index data, risk management under the PSL disbursement process, and the admissibility of certain EC arguments / data.

(i) Alleged differences in rating practices

7.251 Korea submits that the EC's methodology for investment grade transactions is flawed, as the credit rating assigned by KEXIM to a particular shipbuilder cannot be systematically matched to the credit ratings assigned to the same shipbuilder by corporate bond rating agencies. Korea asserts that corporate bond ratings and KEXIM's credit ratings are based on different levels of underlying credit risk.[147] In particular, Korea argues that the basic credit rating for an unsecured bond is the same as the credit rating for the issuing company, whereas the credit rating by KEXIM is based on a "facility rating", which includes not only the credit risk of the borrowing company, but also risk-reducing factors reflecting the structure of the facility concerned, including collateral. As a result of facility rating, Korea argues that the default rate for a bank credit rating (such as KEXIM's PSLs) is lower than that for the corresponding corporate bond rating. According to Korea, for the same corporate entity, the corporate bond rating must be higher than the bank credit rating in order to have equivalent risk. Korea submits that banks analyse three elements when assigning credit ratings: the probability of default, loss given (i.e., in the event of) default, and expected loss. Korea states, on the basis of a

[144] *Ibid*.
[145] See Exhibit KOREA-21.
[146] The latest version of the EC's analysis is set forth in Attachment EC-10.
[147] See Exhibit KOREA – 91.

KEXIM document,[148] that loss given default "is the critical element that distinguishes corporate bonds from bank loans, since corporate bond rating in Korea, which is generally targeting for unsecured senior bonds with long-term maturity, does not take into account [loss given default]". Korea asserts that there is therefore a significant difference in expected loss between bank loan rating and corporate bond rating, with the result that yields on corporate bonds should be higher than those of bank loans for the same entity.

7.252 Korea also argues that there is a fundamental difference between the rating practices of banks and those of credit rating agencies. Korea submits that banks generally employ a "point in time" approach, under which the time period for validity of a risk assessment is generally one year from the date of assessment. Korea states that private banks therefore analyse the risk in the "current situation". Korea asserts that credit rating agencies, on the other hand, rate corporate bonds on a "through the cycle" approach, covering the whole period of maturity, and taking into account the projected condition of the bond issuer in the projected worse part of the economic or industry cycle within that period. Korea therefore submits that the rating by credit ratings would be worse than that of banks.

7.253 The EC submits that the credit ratings by corporate bond credit rating agencies are comparable to credit ratings by KEXIM. With regard to DSME, the EC notes that most of the DSME bonds issued between 1997 and 1999 were guaranteed / collateralized. The EC argues that the rating of the bonds reflected the guarantee, just as KEXIM's ratings reflected the collateral for the PSL.

7.254 The EC also asserts that credit exposure from investment grade and BB rated private placement loans are comparable to credit exposure from public debt with the same rating. The EC argues that, in case of discrepancy, the more pessimistic rating is usually the one with the most predictive power. The EC argues that there should at least be correlation between corporate bond ratings and KEXIM ratings for ratings better than or equal to BB. The EC asserts that a credit rating assesses exposure risk in terms of the repayment capacity of the obligor, taking into account all possible collateral. The EC therefore submits that a private loan (such as a PSL) and a bond having the same ratings will present the same obligor repayment capacity and the same credit exposure risk, and should therefore be remunerated with the same interest rate.

7.255 Regarding rating practices, the EC asserts that Standard & Poor's definition of a rating does not refer to worst-case scenario projections. Instead, it refers to the creditworthiness of the obligor and guarantees. In addition, the EC states that KEXIM's rating must analyse more than the "current situation", otherwise it would not have continued issuing PSLs for DSME when it was bankrupt.

7.256 Regarding the relevance of guarantees in determining credit risk exposure, Korea states that most of the bonds issued in Korea are non-collateralized, and that the KSDA bond rates quoted by the EC are also non-collateralized. Korea also notes that the EC stated that the DSME corporate bonds were collateralized, just like the KEXIM PSLs, and queries why the DSME corporate bonds could not have been used as a benchmark.

7.257 With regard to the EC's argument that the credit exposure from investment grade and BB-rated private loans and public debt is comparable, Korea notes that the source relied on by the EC actually refers to the "worse incidence or default rates" for public placements, and "better loss severities on private placements". Korea also notes that the source further provides that private placement "offer superior experience with respect to all of incidence, severity and economic loss" than publicly issued bonds. Korea asserts that the EC's source therefore confirms Korea's position regarding the lower risk exposure of private placements *vis-à-vis* public placements with the same credit rating.

[148] Incompatibility of Bank Rating Systems and Agency Rating systems, KEXIM, July 2004, page 3 Exhibit KOREA-143.

7.258 In reviewing Korea's argument, we are struck by KEXIM's statement that loss given default "is the critical element that distinguishes corporate bonds from bank loans, since corporate bond rating in Korea, which is generally targeting for **unsecured senior bonds with long-term maturity**, does not take into account [loss given default]".[149] KEXIM states that loss given default depends in part on the conditions of the facility and protection measures, including "**collateral**, collateral margin requirements, ... and other support measures including **guarantees and insurances**".[150]

7.259 We also note Korea's reliance on a Moody's document which states:

> Moody's typically rates bank loans anywhere from on a par with a given borrower's senior implied rating to three refined categories above senior implied. The rating differential between a firm's bank loans and other debt obligations is not a reflection of a greater or lesser probability of default. Rather it is a consideration of higher expected recovery values for bank loans over the same borrower's bonds **as a result of loan structure and security**."[151]

7.260 To the extent that there are discrepancies between the rating practices of private banks and credit rating agencies, the above extracts from the KEXIM and Moody's documentation submitted by Korea indicates that such discrepancies are largely caused by differences in collateral / guarantee (in the sense that bank loans such as KEXIM PSLs are normally guaranteed / collateralized, whereas corporate bonds are not) and maturity (in the sense that corporate bonds generally have a longer maturity than private bank loans such as KEXIM PSLs).[152][153] We shall therefore examine to what extent differences in collateralization and maturity are addressed in the EC's proposed market benchmark.

7.261 Although the KSDA bond index is based on unsecured bonds, whereas KEXIM PSLs are collateralized, the EC's proposed market benchmark includes the same adjustment for collateral / guarantees as made by KEXIM in respect of PSLs (i.e., **[BCI: Omitted from public version]** per cent reduction in credit risk spread).[154] For the most part, therefore, we consider that any rating

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[149] Incompatibility of Bank Rating Systems and Agency Rating systems, KEXIM, July 2004, page 3, Exhibit KOREA-143, emphasis supplied.

[150] *Ibid*, page 3, emphasis supplied

[151] A Sense of Security, Moody's Investors Service, October 1997, Exhibit KOREA – 143, emphasis supplied.

[152] Our understanding that Korea's concern essentially relates to issues of collateral and maturity is confirmed by para. 236 of Korea's first written submission, where Korea stated that corporate bonds and PSLs are not directly comparable "due to, particularly, the difference in collaterals and maturity". Although this statement was made early in the Panel proceedings, it was never retracted by Korea, and should therefore inform Korea's subsequent arguments.

[153] The fact that the EC's proposed market benchmark may require adjustments for differences in collateral and maturity does not render that benchmark *ipso facto* unusable. Indeed, even the alternative benchmarks proposed by Korea would have required similar adjustments. As stated at para. 230 of Korea's first written submission, DSME "has used various types of financing and due to the difference in terms, direct comparison between the pre-shipment loan interest rate and the interest rates of other financing facilities is difficult." Of course, the fact that a comparison is difficult does not mean that it should not be made.

[154] During the Panel proceedings, Korea contested the manner in which the EC had adjusted the KSDA interest rate data to reflect the value of Yangdo Dambo provided as collateral for KEXIM PSLs (see Exhibit KOREA – 90, paras 6-9). The EC claimed to address Korea's concern in the recalculations set forth in Attachment EC 10 (see paras 40 and 41 of the EC's replies to the Panel's questions after the second substantive meeting.) Since there was no further reference to the EC's treatment of this adjustment in Korea's comments on Attachment EC- 10 (see page 20 of Korea's 9 July 2004 replies to the Panel's supplemental questions), we consider that there is no longer any dispute between the parties concerning this issue. Korea also complained that the EC failed to take account of the collateral value of joint and several personal liability guarantees. Since Korea stated in Exhibit KOREA – 90 that **[BCI: Omitted from public version]**, we see no reason why the EC

discrepancy caused by differences in collateralization between corporate bonds and KEXIM PSLs is appropriately addressed.

7.262 Regarding maturity, we note that the EC has incorporated six-month bond pricing data into its proposed benchmark. Since Korea claims that "the maturity of PSLs in general is not less than 6 months",[155] the alleged discrepancies in rating practices caused by differences in maturity should not arise when comparing the terms of those KEXIM PSLs with the KSDA bond index rates.

7.263 In any event, we note Moody's statement that bank loans may sometimes be rated on a par with other debt obligations.[156] This would suggest that, in certain cases, credit ratings for bank loans and other debt obligations can be compared directly, without any need for collateral or maturity adjustments. Given that adjustments may not be necessary in all cases, and given the approach to collateralization and maturity taken in the EC's proposed market benchmark, we consider that any discrepancies in the rating practices of credit rating agencies and private banks are adequately addressed in the EC's proposed market benchmark.

7.264 Korea has also argued that there is a fundamental difference between the rating practices of banks and those of credit rating agencies. Korea submits that banks generally employ a "point in time" approach, whereas credit rating agencies use a "through the cycle" / worst case scenario approach. Korea has submitted an extract from the abovementioned Moody's article, which compares point-in-time to through-the-cycle gradings. Although Korea relies on this article to argue that there is a fundamental difference between the rating practices of banks and credit rating agencies, we note that the article also states that "[a]gencies and banks both consider similar risk factors".[157] In addition, we note that the Standard & Poor's rating definition submitted by the EC contains no reference to either "through the cycle" or worst case scenario rating methodologies. Instead, that definition states that a rating "is a **current opinion** of the creditworthiness of an obligor".[158] We consider this to be consistent with KEXIM's point-in-time approach, which (according to Korea) "mainly focus[es] on the '**current condition**' of the borrower".[159] On the basis of the evidence before us, therefore, we are not persuaded by Korea's argument that there are fundamental differences between the rating practices of banks and those of credit rating agencies.

7.265 Furthermore, we note that KEXIM introduced its credit rating system in April 2001.[160] Between March 1998 and April 2001, KEXIM applied the ratings of credit rating agencies. This causes us to make two observations. First, many of the individual PSLs challenged by the EC were provided under KEXIM's pre-April 2001 corporate bond rating regime. Thus, the abovementioned issues raised by Korea do not apply in respect of those transactions. Second, the fact that KEXIM itself was using agency ratings up until April 2001 suggests to us that the rating practices of rating agencies and private banks are not incompatible (especially when adjustments are made for any differences in collateralization and maturity).

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should not do likewise in constructing its market benchmark. In any event, since Korea has failed to quantify the alleged value of such collateral, there is no basis for us to make any adjustment.

[155] See Korea's reply to Question 12 from the EC. The table included in para. 226 of Korea's first written submission states that the tem of PSLs is "about 6 months (average)".

[156] See para. 7.259 *supra*.

[157] A Sense of Security, Moody's Investors Service, October 1997, Exhibit KOREA – 143, page 911.

[158] *Ibid*, page 13, emphasis supplied.

[159] Incompatibility of Bank Rating Systems and Agency Rating systems, KEXIM, July 2004, Exhibit KOREA-143, page 5, emphasis supplied.

[160] See Attachment 6 to Korea's first written submission. Although this attachment refers to credit ratings in respect of APRGs, Korea argues that the same applies to PSLs (see para. 196 of Korea's first written submission).

7.266 For the above reasons, we do not accept Korea's arguments that alleged fundamental differences between the rating practices of banks and those of credit rating agencies preclude the use of the market benchmark proposed by the EC.

(ii) The use of indexed bond pricing

7.267 In its response to Question 73 from the Panel, Korea submits that the KSDA corporate bond data submitted by the EC does not constitute an appropriate market benchmark because it is a hypothetical index of bond prices. According to Korea, the corporate bond rates offered by the EC are the rates which the KSDA announces for the purposes of general indices. Korea asserts that, in order for KSDA to post corporate bond yield rates daily, the securities dealers of 10 securities houses designated by KSDA provide KSDA with the daily yield rates that are not based on the statistics of actual yield rates, but based on their own projections taking into account the market situations on that date. Korea asserts that KSDA simply averages those projected rates and posts it, so that the KSDA rates must also be projected / hypothetical ones. Korea also submits that the KSDA rates are general indices that do not reflect differences between industry sectors, nor the different financial strengths of individual issuers (e.g., whether the company is an affiliate of a Chaebol) of the actual corporate bonds being traded in the market. Korea asserts that, when looking at the individual companies even having the same credit ratings, the companies may be perceived and treated differently in the market considering various factors. According to Korea, therefore, the actual yield rates of the corporate bonds of the issuers with the same credit rating may be substantially different. Korea submits that there must therefore be differences or gaps between the KSDA rates and the actual corporate bond rates of individual companies. According to Korea, therefore, the KSDA Bond Matrix is only an index which indicates the market situations on a specific date. Korea submits that it does not reflect specific situations of the industry sector, the issuers, and the preferences in the market, and can in no event be a "price" at which a specific bond can be purchased.

7.268 The EC submits that the KSDA Bond Matrix is not a hypothetical or projected rated, but a reliable market benchmark to assess interest rates for loans. The EC asserts that, based on the definition provided by Bloomberg on KSDA Corporate Bond, "KSDA collects daily pricing for each sector from 10 major investment banks for tenors ranging from three months to five years. The indices are calculated daily and re-balanced weekly. All such changes are updated weekly in the Index Constituents so you can see the new underlying securities for each sector. Credit rating changes are updated monthly by the KSDA. […] The KSDA Bond Matrix is the accepted mark-to-market price for the domestic market".[161] The EC submits that, in short, the KSDA bond matrix is the accepted mark to market price, i.e. that it reflects the current market price of bonds, since bond prices and yields are updated daily based on data collected from a wide number of representative local securities houses.

7.269 We are required to establish a market benchmark in order to resolve the claims before us. We recall that Korea has failed to provide sufficient information to allow us to use any of the alternative market benchmarks that it has proposed. In these circumstances, and given the absence of any acceptable benchmark based on shipyard-specific data, we are prepared to use the KSDA index data, provided it does not give rise to manifestly inaccurate results. In this regard, we note that the KSDA index is based on input from a number of market operators, and is updated on a daily basis. We further note that Korea itself has acknowledged that the KSDA index "may be a preliminary indicator that an investor may use as a first reference before studying the market further".[162] As such, we do not consider that the use of the KSDA index would give rise to manifestly inaccurate results. Furthermore, since appropriate adjustments are made for factors such as collateralization, we consider that the KSDA index necessarily constitutes more than merely a "preliminary indicator", and becomes a reliable indicator of the terms on which the market would have offered PSLs to the shipyards.

[161] See Exhibit EC – 118, page 9.
[162] Korea's 9 July 2004 comment on Exhibit EC-148 regarding KSDA Bond Matrix, see Annex G-5.

(iii) The choice of maturity of the KSDA index data

7.270 Initially, the EC constructed its market benchmark on the basis of three-year KSDA corporate bond data. In response to arguments by Korea that PSLs had a maturity of six months, the EC then used one-year KSDA index data, adjusted to six-month levels. In response to additional comments by Korea, the EC constructed its proposed market benchmark primarily on the basis of six-month KSDA index data.[163] In Attachment EC – 10, however, the EC stated that it had continued to use one-year KSDA index data in cases "when the base rate applied by Kexim is superior to 6 months"[164] i.e., in cases where KEXIM had used one year, or one year six months, prime rates.

7.271 In its comments on Attachment EC – 10, Korea complained that:

> the EC now abruptly starts to allege that a benchmark with a 1-year duration should be used in certain cases. In support, the EC alleges that the base rates for certain instances of PSLs are **[BCI: Omitted from public version].** This is non-sensical. As has been established and thus far alleged by the EC itself, a proper benchmark must be a facility conferred with similar terms and conditions. The term must be assessed based on its duration, not the name of base rates.[165]

7.272 In the absence of any explanation by Korea why KEXIM chose to use one-year (or longer) base rates for certain PSLs, but six-month base rates for others, we consider it appropriate to construct a market benchmark using six-month KSDA data when reviewing PSLs issued on the basis of six-month base rates, and using one-year KSDA data when reviewing PSLs issued on the basis of one-year (or more) base rates. In this way, the data underlying the market benchmark is aligned with the data underlying the KEXIM PSLs. Furthermore, we note that, even though the EC adopted the same approach in respect of its earlier proposed market benchmark based on one-year KSDA data,[166] Korea did not object to this approach at that earlier stage of the Panel proceedings.[167] Korea's objection therefore lacks conviction. For all these reasons, we consider that the EC was entitled to use one-year KSDA index data in cases where the KEXIM base rate exceeded six months.

(iv) Risk management under the PSL disbursement process

7.273 Korea submits that KEXIM enjoys greater scope for risk management than corporate bond-holders. In particular, Korea asserts that, because PSLs are disbursed in instalments corresponding to the progress of the shipbuilding work, KEXIM is able to continuously monitor and review the development of any management and financial conditions of shipyards. Korea asserts that KEXIM is also able to immediately stop disbursing additional instalments, and take actions to promptly recover outstanding loans by disposing of collaterals or otherwise.

7.274 The EC concedes that Korea's risk management argument is to a certain extent valid but only if Kexim effectively adjusts the credit spread following the downgrading of a shipyard's financial situation. The EC submits that this is not the case, as evidenced by KEXIM's failure to adjust its credit risk spreads despite changes in certain shipyard credit ratings. The EC further asserts that even if KEXIM were really monitoring and managing this situation, the impact on the credit spread at issuance of the credit would be very limited.

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[163] Korea made a number of arguments concerning the EC's earlier reliance on data pertaining to corporate bonds with a maturity in excess of six months. Since the EC ultimately used a benchmark constructed primarily on six-month data, we do not consider it necessary to review all of these arguments in our findings.

[164] Attachment EC – 10, page 1.

[165] Korea's 9 July comment on Attachment EC-10, see Annex G-5.

[166] See Exhibit EC – 125, column (8), "AD duration".

[167] In particular, there is no reference to this issue in Exhibits KOREA 90 – 102.

7.275 Regarding the possible cessation of disbursements, the EC asserts that Korea has presented no evidence that KEXIM ever stopped disbursing additional instalments when the credit situations degraded. The EC also submits that because KEXIM's credit spreads already took into account the existence of collaterals by adjusting downward the (no collateral) credit spread, there is no reason why the above disbursement mechanism for PSLs should further mitigate KEXIM's risk. The EC also asserts that Korea's argument is flawed since, in the case of Yangdo Dambo, the collateral is supposed to increase in value as the total amount disbursed increases. However, the EC states that stopping disbursements will not increase the value of what will be recovered. The EC argues that the opposite will occur, as the ship will not be finished and will be more difficult to sell.

7.276 We consider that the EC has effectively rebutted Korea's argument that KEXIM has a greater capacity for risk management under the PSL disbursement process. Furthermore, we note Korea's failure to quantify the impact of KEXIM's allegedly greater capacity for risk management. We consider this to be especially important given the EC's assertion that any impact on the credit spread upon issuance of the credit would be very limited.[168] In the absence of any quantification by Korea, there is no basis for us to reject the EC's assertion that the impact would be very limited. For these reasons, we do not consider this to be an appropriate basis for rejecting the EC's proposed market benchmark.

(v) Admissibility of certain EC arguments and data

7.277 At para. 88 of its second oral statement, Korea claims that paragraphs 113-121 of the EC's second written submission should be disregarded and dismissed by the Panel. Korea argues that this part of the EC's submission is material purporting to support a *prima facie* case, rather than rebuttal evidence.

7.278 We assume that Korea's comment is based on paragraph 12 of the Panel's Working Procedures, whereby:

> Parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttals, answers to questions or comments made for purposes of rebutting answers provided by others. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment, as appropriate.

7.279 In paragraphs 113 to 121 of its second written submission, the EC is responding to arguments made by Korea (in its first written submission and during the Panel's first substantive meeting with the parties) concerning the market benchmark proposed in the EC's first written submission. As such, we consider that the factual information contained in those paragraphs constitutes "evidence necessary for purposes of rebuttals" within the meaning of paragraph 12 of our Working Procedures. For this reason, we decline Korea's request to dismiss or disregard this evidence.

(vi) Conclusion

7.280 In light of the above, we reject Korea's objections to the market benchmark proposed by the EC. We therefore consider it appropriate to apply that benchmark in order to determine whether the individual PSL transactions at issue confer a "benefit" and therefore constitute subsidies.

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[168] See para. 7.274 *supra*.

(c) The application of the EC's market benchmark to individual KEXIM PSL transactions

7.281 The EC has compared a number of KEXIM PSLs with its market benchmark. The PSLs were provided by KEXIM to DSME, Samho/Halla, STX/Daedong, Hyundai/MIPO, HHI. The EC claims that the majority of these PSLs conferred a benefit on the relevant shipyard. Korea has raised a number of issues regarding the shipbuilder-specific comparison undertaken by the EC. We examine these issues below.[169]

(i) DSME

7.282 On the basis of Attachment EC-10, the EC submits that a number of KEXIM PSLs to DSME conferred a benefit and therefore constitute subsidies. In applying its market benchmark, however, the EC did not use KEXIM's credit rating for DSME **[BCI: Omitted from public version]** when determining the KEXIM credit risk spread for certain PSLs provided in 2000 and 2001.[170] It used a KEXIM SM rating instead. The EC noted that credit rating agencies had rated DSME "C" during this period. The EC asserts that a credit rating agency's C rating equates to a KEXIM rating of SM (instead of the **[BCI: Omitted from public version]** used by KEXIM). The EC argues that credit rating agency ratings constitute a more appropriate benchmark than KEXIM's ratings. According to the EC, any discrepancy in credit ratings shows an unexplained difference between the credit rating of KEXIM and the private credit agencies.

7.283 Korea submits that the EC should have applied the KEXIM credit risk spread for KEXIM **[BCI: Omitted from public version]** ratings. In addition to arguing that credit rating agency ratings cannot be compared directly with KEXIM ratings, Korea denies that a credit rating agency "C" is equivalent to a KEXIM "SM" rating.

7.284 We note that, according to Exhibit KOREA – 92, KEXIM rated DHI/DSME **[BCI: Omitted from public version]** as of April 2001 (when KEXIM introduced its own credit rating system). In Exhibit KOREA – 99, Korea proposes to apply this **[BCI: Omitted from public version]** rating in respect of all PSLs issued as of June 1999. According to Exhibit KOREA - 92, however, credit rating agencies rated DHI/DSME BB+ in May 1999, but reduced their rating to C in August 1999.[171] This would reflect the fact that DHI/DSME's financial condition deteriorated during the course of 1999. By contrast, Korea purports to apply the same KEXIM credit rating as of June 1999, through August 1999, and into 2000. Given DHI's deteriorating financial position, we are unable to accept that a market-based approach to credit rating would have applied the same credit rating to DHI/DSME throughout this period.[172] For this reason, we have serious doubts as to the reliability (in terms of market consistency) of KEXIM's **[BCI: Omitted from public version]** rating of DHI/DSME during this period. In these circumstances, we consider that the starting point for the credit risk spread adjustment in the EC's market benchmark should be the C rating applied by the credit rating agencies.

7.285 In terms of establishing the KEXIM equivalent of a credit rating agency C rating, we note that Table 1 of Exhibit EC – 148[173] indicates that a KEXIM **[BCI: Omitted from public version]** credit risk spread equates to a BBB or BB credit risk agency credit spread. It does not equate to a C spread.

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[169] At this point, our findings are confined to the parties' arguments regarding the existence of benefit. They do not include issues regarding the amount of alleged benefit (such as, for example, Korea's argument regarding the actual duration of certain PSLs (see *inter alia* para. 283 of Korea's second written submission)).

[170] We note that the EC used actual KEXIM credit risk spreads when a shipyard's rating was below investment grade, as KSDA index data was not available for such ratings (see para. 7.249 *supra*).

[171] This is confirmed by para. 338 of Korea's first written submission, which states that "starting in 1999, the international credit rating of Daewoo group companies including DHI began to weaken".

[172] In response to Question 114 from the Panel, Korea notes that KEXIM improved DHI/DSME's rating after the workout. While this is true, it does not mean that KEXIM's P5 rating during the workout was accurate, or reflected market principles.

[173] See page 7.

Although Korea submits that Table 1 of Exhibit EC – 148 only refers to the chronology of the changes implemented by KEXIM in its credit rating system,[174] we nevertheless consider that it indicates that KEXIM itself considered that a **[BCI: Omitted from public version]** rating was broadly equivalent to a credit rating agency BBB or BB rating, as opposed to a C rating. This is confirmed by KEXIM's own definition of a **[BCI: Omitted from public version]** rating, which applies where **[BCI: Omitted from public version]**.[175] By contrast, a C-rated obligor has "no capacity for redemption",[176] i.e., no capacity to redeem its financial obligations. There is therefore a fundamental difference between a KEXIM **[BCI: Omitted from public version]** rating and a credit rating agency C rating (in terms of capacity to redeem obligations). In our view, a comparison of the relevant definitions indicates that an agency C rating is more appropriately compared with a KEXIM SM rating, since an SM obligor is similarly "vulnerable to non payment".[177]

7.286 In light of the above considerations, we find that KEXIM's **[BCI: Omitted from public version]** credit risk spread should not be used in the market benchmark in respect of DHI/DSME PSLs issued during the period that credit rating agencies applied a C rating for DHI/DSME. Instead, we consider it appropriate to apply KEXIM's SM credit risk spread to these transactions.

7.287 For these reasons, we uphold the comparison undertaken by the EC in Attachment EC-10 concerning KEXIM PSLs to DSME. Since that comparison demonstrates that these PSLs are made on terms more favourable than those available to DSME on the market, we find that those KEXIM PSLs confer a benefit, and therefore constitute subsidies.

(ii) Samho/Halla

7.288 On the basis of the comparison set forth in Attachment EC-10, the EC submits that a number of KEXIM PSLs to Samho/Halla conferred a benefit and therefore constitute subsidies. Korea submits that the EC failed to adjust its analysis of those PSLs to reflect the fact that they were **[BCI: Omitted from public version]**.

7.289 The EC submits that Korea never provided substantiated evidence of the existence and monitoring of collaterals and replied to the Panel[178] that it is not "Kexim's policy to keep and maintain any worksheet or similar documents"[179] necessary for the consideration of collaterals. According to the EC, there is, therefore, no justified reason to consider **[BCI: Omitted from public version]**. The EC asserts that, on the basis of best information available, the EC applied the same rule as for the Yangdo Dambo adjustment, i.e. a **[BCI: Omitted from public version]** per cent of the credit risk spread.

7.290 In addressing this issue, we consider that the onus should be on Korea, as the party seeking to establish a fact, to prove that KEXIM applied a lower credit risk spread in respect of transactions reported as being **[BCI: Omitted from public version]** than for transactions reported as being **[BCI: Omitted from public version]**. We do not consider that Korea has discharged this burden.

7.291 First, Korea has failed to cite to any provision of the KEXIM Interest Rate Guidelines concerning this matter. Second, there is nothing on the face of any other document submitted by Korea to indicate that an additional adjustment of the credit risk spread is made in respect of transactions reported as being **[BCI: Omitted from public version]** compared to transactions reported as being **[BCI: Omitted from public version]**.

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[174] See Korea's 9 July 2004 comment on the EC's reply to Supplemental Question 136 from the Panel.
[175] Responses to Annex V Questions, Answer 1.1(24)-2, Exhibit EC – 131.
[176] Moody's affiliate, Korea Investor Services, Bond ratings definitions, Exhibit EC – 9.
[177] Responses to Annex V Questions, Answer 1.1(24)-2, Exhibit EC – 131.
[178] See Reply by Korea to Panel Question 72 following the first substantive meeting.
[179] See Korea's reply to Question 67 from the Panel.

7.292 Korea asserts that "Exhibit Korea – 60 clearly show[s] that as to **[BCI: Omitted from public version]**. However, while it may be correct that **[BCI: Omitted from public version]**, Exhibit KOREA – 60 does not indicate how, if at all,[180] KEXIM reflected the value of **[BCI: Omitted from public version]** in its interest rate calculation. Indeed, Korea's reply to Question 72 from the Panel[181] – in the context of which Exhibit KOREA – 60 was provided – stated that "it is not KEXIM's policy to keep and maintain worksheets and other similar documents." Even if an additional adjustment were necessary, therefore, there is no basis for the Panel to determine what exactly that adjustment should be.

7.293 For the above reasons, we consider that the EC was entitled to make the same credit risk spread adjustment for transactions reported as being **[BCI: Omitted from public version]** as for transactions reported as being **[BCI: Omitted from public version]**.

7.294 We therefore uphold that part of the analysis set forth in Attachment EC-10 concerning KEXIM PSLs to Samho / Halla. Since that comparison demonstrates that these PSLs are made on terms more favourable than those available to Samho / Halla on the market, we find that those KEXIM PSLs conferred a benefit and therefore constitute subsidies.

(iii) STX/Daedong

7.295 On the basis of the comparison set forth in Attachment EC-10, the EC submits that a number of KEXIM PSLs to STX/Daedong conferred a benefit and therefore constitute subsidies.

7.296 Korea criticises the EC for having applied KSDA index data from BBB- rated companies. Korea notes that KEXIM rated STX **[BCI: Omitted from public version]** during the relevant period, and argues that a KEXIM P3 rating equates to an agency A- rating. Korea therefore asserts that the EC should have included KSDA index data from A- rated companies in its benchmark.

7.297 The EC submits that the BBB- rating it used for its analysis regarding STX/Daedong is the rating provided by private credit rating companies. The EC asserts that such ratings are more accurate than KEXIM's internal rating.

7.298 Consistent with its methodology for investment grade shipyards, the EC based its analysis of STX/Daedong PSLs on rating agency ratings and relevant KSDA index prices. Given our rejection of Korea's arguments against the use of rating agency ratings, and in the absence of any further arguments from Korea concerning the agency ratings of STX/Daedong in particular, we see no reason why those ratings should not be relied on by the EC.[182]

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[180] We note in this regard that KEXIM does not make an additional adjustment of the credit risk spread in respect of transactions reported as being **[BCI: Omitted from public version]** (Korea stated in Exhibit KOREA – 90 that **[BCI: Omitted from public version]**). There is no evidence to suggest that KEXIM applies a different approach in respect of **[BCI: Omitted from public version]**.

[181] Requesting, *inter alia*, "worksheets and other documentation showing calculations of the interest rate and other terms, including consideration of collateral" related to KEXIM's review / authorization of a particular Samho PSL.

[182] While we note (in relation to para. 235 of Korea's first written submission, which refers to the EC's treatment of Samho PSLs) that an A- agency rating was applied by the EC in respect of Samho, when that yard was rated **[BCI: Omitted from public version]** by KEXIM, this does not necessarily mean that the EC equates a KEXIM P3 rating with an agency A- rating. It simply means that Samho was rated A- by agencies and **[BCI: Omitted from public version]** by KEXIM at that time. Under the EC methodology, it would have applied a BBB+ rating if that is how the agencies had rated Samho at that time, even if the KEXIM **[BCI: Omitted from public version]** rating remained unchanged. There is, therefore, no methodological connection between the agency rating and the KEXIM rating in that particular case.

7.299 We therefore uphold that part of the analysis set forth in Attachment EC-10 concerning KEXIM PSLs to STX/Daedong. Since that comparison demonstrates that these PSLs are made on terms more favourable than those available to STX/Daedong on the market, we find that those KEXIM PSLs conferred a benefit and therefore constitute subsidies.

(iv) Hyundai/MIPO

7.300 Korea has not raised any transaction-specific objections regarding the EC's analysis of KEXIM PSLs to Hyundai / Mipo. We therefore uphold the EC's analysis of these PSLs in Attachment EC-10, and find that these PSLs - other than projects 000056P and 000116P[183] - are made on terms more favourable than those available to MIPO on the market. Those PSLs (other than projects 000056P and 000116P) therefore conferred a benefit, and constitute subsidies.

(v) Hanjin

7.301 Korea has not raised any transaction-specific objections regarding the EC's analysis of KEXIM PSLs to Hanjin. We therefore uphold the EC's analysis of these PSLs in Attachment EC-10, and find that projects 000108P, 000109P, 000130P, 000131P, 000132P, 010005P and 010073P conferred a benefit and therefore constitute subsidies.

(vi) Hyundai Heavy Industries

7.302 During the Panel proceedings, Korea complained that the EC had failed to apply the correct credit risk spreads in respect of certain KEXIM PSLs for HHI. Korea asserted that the credit risk spreads presented in the EC's first written submission for HHI were temporary non-collateral rates that were subsequently reduced upon the provision of collateral by Hyundai.

7.303 Since the EC confirmed in response to Question 137 that it had applied the reduced credit risk spread for the relevant HHI PSLs, we do not consider it necessary to address this issue further.

7.304 In the absence of any additional transaction-specific objections by Korea, we uphold the EC's analysis of KEXIM PSLs to HHI set forth in Attachment EC-10. We therefore find that projects 010019P, 010020P, 010021P, 010022P, 010023P, 010080P, 010081P, 010082P, 010083P, 010084P, 010154P, 010152P, 010153P, 010155P, 010157P, 010156P, 024838P, 024840P, 024842P, 024849P and 024852P conferred a benefit and therefore constitute subsidies.

(d) Export contingency

(i) Arguments of the parties

7.305 The EC submits that PSLs are provided for the specific purpose of assisting Korean companies with production of goods intended for export. The EC asserts that KEXIM PSLs are therefore contingent on export within the meaning of Article 3.1(a) of the *SCM Agreement.*

7.306 When asked by the Panel (Question 48) whether Korea contests the EC's claim that PSLs and APRGs under the KEXIM legal regime are contingent on export performance, Korea responded that it "has not taken any position as to whether [PSLs and APRGs] are contingent on export performance". In response to an oral question from the Panel at the second substantive meeting, Korea stated that it was not contesting the EC's claim of export contingency.

[183] The EC calculated negative benefit margins in respect of these transactions.

(ii) Evaluation by the Panel

7.307 We find that the EC has established a *prima facie* case that KEXIM PSLs are contingent on export performance. In light of Korea's decision not to contest the EC's arguments regarding this matter, we find that KEXIM PSLs are "contingent ... upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.

(e) Specificity

7.308 Pursuant to Article 1.2, the disciplines of the *SCM Agreement* only apply to subsidies that are "specific" within the meaning of Article 2 thereof. Article 2.3 of the *SCM Agreement* provides that "[a]ny subsidy falling under the provisions of Article 3 shall be deemed to be specific". Since export contingent subsidies fall under the provisions of Article 3 (paragraph 1(a)), they are "specific". Pursuant to Article 2.3, therefore, we conclude that those PSLs that we have found to be export subsidies are "specific".

(f) Defence under the first paragraph of item (k) of the *Illustrative List*

7.309 In light of our findings that certain PSLs constitute subsidies, and that such subsidies are contingent on export performance, we will be required to find that such PSLs are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* unless we uphold Korea's claim that they benefit from a safe haven provided for in the first paragraph of item (k) of the *Illustrative List*. As with Korea's earlier reliance on item (j) of the *Illustrative List* as a defence in respect of certain individual APRG transactions, Korea's defence raises the issue of whether or not the first paragraph of item (k) may be interpreted *a contrario* and, if so, whether or not the relevant conditions are fulfilled in the present case.

(i) Is an a contrario interpretation of the first paragraph of item (k) permissible?

7.310 We have already determined that an *a contrario* interpretation of item (j) is not permissible. We see no reason why we should not reach the same conclusion in respect of the first paragraph of item (k). Since the first paragraph of item (k) does not contain any affirmative statement that a measure is not an export subsidy, nor that a measure not satisfying the conditions of that paragraph is not prohibited, we consider that it does not fall within the scope of footnote 5 of the *SCM Agreement*. We note that this finding is consistent with the report of the *Brazil – Aircraft – Article 21.5* panel, with which we agree. In light of the above, we find that the first paragraph of item (k) may not be interpreted *a contrario*.

7.311 For the most part, Korea makes the same arguments concerning the *a contrario* interpretation of item (k), first para., as for item (j).[184] There is therefore no need for us to repeat our analysis of those arguments at this juncture. Korea also argued that a failure to permit an *a contrario* reading of the first paragraph of item (k) would render the "material advantage" clause ineffective. This argument was made by Brazil and the United States in the *Brazil – Aircraft – Article 21.5* case. The *Brazil – Aircraft – Article 21.5* panel described and rejected that argument in the following terms:

> Brazil, and the United States as third party, contend that a finding that the first paragraph of item (k) cannot be used *a contrario* to permit export credits and payments that are *not* used to secure a material advantage would render the "material advantage" clause ineffective. We do not agree. In our view, the primary role of the Illustrative List is not to provide guidance as to when measures are *not* prohibited export subsidies – although footnote 5 allows it to be used for this purpose in certain

[184] The EC submits that the first paragraph of item (k) – unlike item (j) (see para. 7.199 *supra*) - may not be interpreted *a contrario*.

> cases – but rather to provide clarity that certain measures *are* prohibited export subsidies. Thus, it would be possible to demonstrate that a measure falls within the scope of an item of the Illustrative List and was thus prohibited without being required to demonstrate that Article 3, and thus Article 1, was satisfied. To borrow a concept from the field of competition law, the Illustrative List could be seen as analogous to a list of *per se* violations. Seen in this light, the material advantage clause is not "ineffective", in the sense that it is reduced to redundancy or inutility, by a finding that the first paragraph of item (k) cannot be used *a contrario* to establish that a measure is permitted. To the contrary, the material advantage nevertheless continues to serve an important role by narrowing the range of measures that would otherwise be subject to the "*per se*" violation set forth in the first paragraph of item (k), as discussed below.
>
> Let us consider the first situation envisioned by the first paragraph of item (k), the grant by governments of export credits at rates below their cost of funds. It may generally be assumed that in such circumstances there will be a benefit to the recipient and thus a subsidy. This is however not always the case. Whenever a government's cost of funds is higher than that of the borrower, a loan at below the government's cost of funds may nevertheless fail to confer a benefit on the recipient. For example, Brazil argues in this dispute that its cost of funds is in excess of 13 per cent. By contrast, it is likely that many purchasers of Brazilian exports could obtain private export credit financing, not benefiting from government intervention of any kind, at an interest rate significantly lower than 13 per cent. Thus, direct financing by Brazil in these circumstances could well entail a cost to the government but provide no advantage, material or otherwise, to the recipient. Under these circumstances, and in the absence of the material advantage clause, Brazil would be prohibited from providing export credits at an interest rate lower than 13 per cent, even if the export credits provided no advantage whatsoever. The role of the material advantage clause in this situation is to narrow the scope of the *per se* prohibition in such cases.
>
> A similar situation could arise in cases of payments under the first paragraph of item (k). Without the material advantage clause, a complainant could demonstrate the existence of a prohibited subsidy merely by demonstrating the existence of a payment within the meaning of item (k). However, a financial institution in a developing country may have a higher cost of funds than financial institutions in developed countries, and thus be unable to provide export credits on terms competitive with those of foreign financial institutions. A payment by Brazil that allowed a Brazilian financial institution to provide export credits to an overseas customer on precisely the same terms as that customer could have obtained in international financial markets could, absent the material advantage clause, constitute a prohibited export subsidy, even though the borrower – and hence the exporter – was no better off than it would have been but for the payment. The material advantage clause narrows the scope of the "*per se*" violation in the first paragraph of item (k) and precludes this result.
>
> In light of the foregoing, we consider that the "material advantage" clause would not be rendered "ineffective" by a finding that the first paragraph of item (k) cannot serve as a basis to establish that a measure is "permitted".[185]

7.312 We find this reasoning to be convincing. We also note that Korea has not attempted to rebut it. In these circumstances, we shall be guided by this reasoning and on that basis reject Korea's

[185] Panel Report, *Brazil – Aircraft – Article 21.5*, paras 6.42 – 6.45 (footnotes omitted).

argument that a failure to permit an *a contrario* interpretation of the first paragraph of item (k) would render the material advantage clause of that provision meaningless.

7.313 Having found that an *a contrario* interpretation of the first paragraph of item (k) is not permissible, there is strictly speaking no need for us to consider the additional issues identified above. For the sake of completeness, however, we shall do so.

(ii) If an a contrario interpretation of the first paragraph of item (k) were permissible, what conditions would need to be fulfilled?

7.314 Assuming *arguendo* that the first paragraph of item (k) could operate as an affirmative defence in the present case (with which, as discussed, we disagree), it would need to be demonstrated that PSLs constitute "export credits", and are provided at rates above those which the government in question actually has to pay for the funds or, if the rates are below cost, at rates that nevertheless do not secure a material advantage in the field of export credit terms.

(iii) Are the relevant conditions fulfilled?

7.315 As the party seeking to rely on the first paragraph of item (k) as an affirmative defence, the burden of proof is on Korea to establish that the relevant conditions have been fulfilled. Korea submits that the PSLs constitute export credits, and that PSLs "are made at rates far higher than those the government has to pay for the funds so employed".[186] Korea also submits that the PSLs do not confer a material advantage.

7.316 The EC submits that PSLs are not export credits, since they are not extended to the foreign buyer. The EC bases its argument on the following definition set forth in the *Organization for Economic Cooperation and Development* ("*OECD*") Handbook on Export Credits:

> Broadly defined, an export credit is an insurance, guarantee or financing arrangement which enables a foreign buyer of exported goods and/or services to defer payment over a period of time. … Export credits may take the form of "supplier credits" extended by the exporter or of "buyer credits" where the exporter's bank or other financial institution lends to the buyer (or his bank).

7.317 Given the EC's argument that PSLs are not export credits in the meaning of the first paragraph of item (k), the EC does not address Korea's assertions that PSLs "are made at rates far higher than those the government has to pay for the funds so employed",[187] and that the PSLs do not confer a material advantage.

7.318 Korea asserts that the EC's definition of "export credit" is overly narrow. Korea relies on a broad interpretation of the concept of "export credit". Korea submits that a basis for such a broad interpretation is provided by the following *OECD* website definition:

> Broadly defined, an export credit arises whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credits are generally classified as short-term (repayment terms of usually under two years), medium term (usually two to five years) and long-term (over five years). Export credits may take the form of "supplier credits" or "buyer credits". "Supplier credits" are extended by an exporter directly to an overseas buyer. "Buyer credits" are extended by an exporter's bank or other financial institution as loans to the buyer (or his bank). OECD Member countries may give official support to both types of transactions through their export

[186] Korea's First Written Submission, para. 277.
[187] *Ibid*, para. 277.

> credit agencies, provided that such support is in accordance with the Arrangement on Guidelines for Officially Supported Export Credits.[188]

7.319 Korea also relies on Section 3 of the *OECD Sector Understanding on Export Credits for Ships*, whereby:

> The minimum interest rate will also apply to the credit granted with support by governments participating in the Understanding, in the shipbuilder's country to the shipbuilder or to any other party, to enable credit to be given to the shipowner or to any other party in the shipowner's country, whether this official support is given for the whole amount of the credit or only part of it.

7.320 Korea asserts that the EC's approach gives primacy to the *OECD* over the WTO.[189] The EC considers that the definition of "export credits" given by the *OECD* reflects the generally accepted meaning of term in the relevant circles, that the term "export credit" used in the second paragraph of item (k) has the meaning given to it in the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (*"OECD Arrangement*") and that in view of the close parallels between the first and second paragraph it must be assumed, in the absence of any indication to the contrary, that the term has the same meaning in both the first and second paragraphs.

7.321 We do not consider that the reference to "export credits" in the first paragraph of item (k) should necessarily be defined in the same way as the reference to "official export credits" in the second paragraph thereof. However, we note that both parties have referred to *OECD* sources in supporting their respective definitions of the term "export credit". Accordingly, we will have regard to *OECD* sources for the purpose of assessing the meaning of the term "export credit" in the first paragraph of item (k).

7.322 The basic issue raised by the parties' arguments is whether a loan will only constitute an "export credit" if it is conferred on the foreign buyer, or whether the term "export credit" also includes loans provided to exporters. The EC submits that loans to exporters are not "export credits". Korea relies on Section 3 of the Sector Understanding to argue that loans to shipbuilders may also be treated as "export credits". Failing that, Korea asserts that PSLs are "export credits" because they are "intricately linked" to supplier credits extended by the shipyard to its customer. The relevant "supplier credit" is the amount of money that the shipbuilder allows the foreign buyer to "defer" until the end of the contract. Korea establishes a link between the PSL and the "deferred" payment by arguing that the larger the payment at the end of the contract, the more credit the shipyard needs in terms of pre-shipment loans.

7.323 In addressing this issue, we note that both parties have relied on *OECD* definitions that indicate that the *OECD* only treats loans to foreign buyers (and not to exporters) as "export credits". Even the *OECD* website definition relied on by Korea states that "[e]xport credits may take the form of "supplier credits" or "buyer credits". "Supplier credits" are extended by an exporter directly **to an overseas buyer**. "Buyer credits" are extended by an exporter's bank or other financial institution as loans **to the buyer** (or his bank)" (emphasis supplied). Although Korea relies on Section 3 of the Sector Understanding, we first note that Section 2 thereof also indicates that "export credits" are loans to the foreign buyer. Thus, Section 2 refers to credits "granted with official support by the shipbuilder **to the buyer** (in a supplier-credit transaction) or by a bank or any other party in the shipbuilder's country **to the buyer** or any other party in the buyer's country" (emphasis supplied). The *OECD* materials submitted by both parties therefore indicate that the term "export credits" relates to credits provided to foreign buyers.

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[188] *Ibid*, para. 272.
[189] Korea's reply to Question 168 from the Panel.

7.324 Although Section 3 of the Sector Understanding indicates that the *OECD Arrangement*s minimum interest rate shall also apply to official credits granted "to the shipbuilder", this is only to the extent that such credit to the shipbuilder "enable[s] credit to be given to the shipowner or to any other party in the shipowner's country". Thus, a stand-alone credit to the shipbuilder would not be treated as an "export credit" even under Section 3 of the Sector Understanding. Section 3 therefore supports the view that credits to shipyards in and of themselves do not constitute "export credits".

7.325 Korea submits that, even if loans to exporters do not constitute "export credits", PSLs constitute "export credits" because they are "intricately linked" to supplier credits extended to the foreign buyer in the form of tail-heavy contracts. In this regard, we understand Korea to argue that the amount of money payable at the end of the contract is effectively an export credit from the shipyard/supplier to the foreign buyer. We further understand Korea to argue that PSLs are also therefore export credits because they are "intricately linked" to that export credit because the greater the amount of the PSL, the greater the amount of payment that can be delayed until the end of the contract, and therefore the greater the amount of the "export credit".[190]

7.326 We do not find Korea's argument convincing. First, we do not consider that a shipyard's agreement that certain money should only be paid upon termination of the contract should be treated as a loan, or credit, to the buyer, since nothing is lent or credited to the foreign buyer in the period leading up to termination of the contract. Second, there is no direct connection between the PSL and the payment terms, particularly as different parties are involved in each respective transaction. Third, even if the "delay" of payment until completion of the contract did operate as a loan, it does not provide for the deferral of payment. As noted above, the *OECD* definitions of export credits relied on by the parties refer to an arrangement that enables the foreign buyer to "defer payment" over time. In our view, this reference to deferral means post-shipment deferral of payment, whereas any delay in payment resulting from the availability of a PSL does not extend beyond termination of the contract.

7.327 According to Korea, the largest *OECD* member, the United States, has suggested interpreting the definitions in a more economically coherent manner to include guarantees to both the seller and the buyer. In this regard, Korea argues that the United States has proposed that the export credit disciplines envisaged by Article 10.2 of the *Agreement on Agriculture* should apply to "any other form of involvement, direct or indirect, by providers of official support".[191] We do not share Korea's interpretation of the US position. First, the United States refers to the involvement of "providers of official support". In response to a question from the Panel, the United States noted that the definition of "official support" in the *OECD Arrangement* is limited to support provided "for export", and would therefore "preclude pre-export financing to the *exporter*, such as the PSL program".[192] Second, the United States has explicitly argued before the Panel that APRGs are not export credit guarantees. Accordingly, we reject Korea's argument regarding the US proposal concerning Article 10.2 of the *Agreement on Agriculture*.

7.328 In light of the above, and having regard in particular to the fact that PSLs are credits to shipbuilders, rather than foreign buyers, we find that PSLs are not "export credits" in the sense of the first paragraph of item (k) of the *Illustrative List*. Thus, even though the EC has not contested Korea's

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[190] As with APRGs, Korea also argues that a number of export credit agencies offer instruments similar to PSLs (see Korea's reply to Question 168 from the Panel). We remain of the view that our findings should be based on our interpretation of the relevant provisions of the *SCM Agreement*, and not the practices of other Members (se para. 7.216 *supra*).

[191] Korea refers to the "US Position on Disciplines for Export Credits", allegedly submitted in early February 2003 to the WTO in relation to Article 10.2 of the WTO *Agreement on Agriculture* (see Korea's First Written Submission, para. 275).

[192] US response to question from the Panel following the second substantive meeting, para. 5, emphasis in original.

assertion that PSLs cover costs and do not confer a material advantage, PSLs would not fulfil the conditions for any *a contrario* application of the first paragraph of item (k).

7.329 For these reasons, we find that the abovementioned PSLs do not benefit from any safe haven provided for in the first paragraph of item (k) of the *Illustrative List*. First, we find that an *a contrario* reading of this provision is not permissible. Second, we find that, even if such a reading were permissible, some of the relevant conditions would not have been fulfilled by the PSLs at issue. Accordingly, we find that the abovementioned PSLs constitute prohibited export subsidies, in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement.*

(g) Conclusion

7.330 To conclude on the individual PSL transactions challenged by the EC, we find that the DSME, Samho/Halla, STX/Daedong and Hyundai/MIPO (except projects 000056P and 000116P) PSLs identified in Attachment EC-10, as well as PSLs 000108P, 000109P, 000130P, 000131P, 000132P, 010005P and 010073P provided to Hanjin, and PSLs 010019P, 010020P, 010021P, 010022P, 010023P, 010080P, 010081P, 010082P, 010083P, 010084P, 010154P, 010152P, 010153P, 010155P, 010157P, 010156P, 024838P, 024840P, 024842P, 024849P and 024852P provided to HHI, constitute prohibited export subsidies, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.*

6. Conclusion

7.331 For the above reasons, we reject the EC's claim that the KLR, the APRG programme, and the PSL programme, "as such" violates Articles 3.1(a) and 3.2 of the *SCM Agreement.* We uphold the EC's claim that the individual KEXIM APRGs identified at para. 7.223 *supra* constitute prohibited export subsidies, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.* We further find that the KEXIM PSLs identified at para. 7.330 supra constitute prohibited export subsidies, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.*

C. ALLEGED ACTIONABLE SUBSIDIES

7.332 The EC has challenged a number of alleged actionable subsidies under Article 5 of the *SCM Agreement.* In order for a complaint under Article 5 to prevail, it must be demonstrated that the measure is a subsidy, that it is specific, and that it causes adverse effects to the interests of another Member.

7.333 For the most part, these claims of the EC are concerned with the restructurings of Daewoo, Halla and Daedong. These claims also include an alleged tax concession to DSME and DHIM, and the individual APRG and PSL transactions addressed above.

7.334 In respect of the EC's Article 5 claims concerning these transactions, we recall that Korea has argued that it is "legally and factually impossible" for a given measure to be at the same time both a prohibited and an actionable subsidy. We do not accept Korea's legal argument, since nothing in the *SCM Agreement* precludes claims being brought under both Parts II and III in respect of the same measures. Thus, to the extent that a complaining Member is able to demonstrate that a measure is a prohibited export subsidy that causes adverse effects to the interests of other Member, we see no reason why simultaneous findings could not be made under both Articles 3 and 5 of the *SCM Agreement* in respect of that measure. In respect of the present dispute, we take up in section VII.D, *infra*, the factual analysis of whether the individual APRG and PSL transactions that we have found to be prohibited export subsidies cause serious prejudice to the interests of the EC.

7.335 We shall first provide a factual review of the three debt restructurings at issue in these proceedings. We shall then address the parties' arguments on whether or not these restructurings constitute "financial contributions" "by a government or public body" that confer a "benefit" in the

mean ing of Article 1.1 of the *SCM Agreement*. We shall next consider the parties' arguments regarding the alleged tax concession to DSME and DHIM. In the event that we find that any of these measures are subsidies, we shall consider whether or not they are "specific". If any of these measures are specific subsidies, we shall then consider whether they have caused adverse effects to the interests of the EC. We shall perform the same analysis in respect of the APRG and PSL transactions identified at para. 7.331 *supra*, which we have already found to be specific subsidies.

1. Debt restructurings

(a) Factual Review

(i) Daewoo workout

7.336 Daewoo Heavy Industry, or DHI, was restructured in 1999 under the workout procedure set forth in the Corporate Restructuring Agreement ("CRA"), after a failed attempt at a voluntary workout in 1998. As discussed in more detail *infra*, the CRA, which was signed by more than 200 private banks, established certain terms and procedures pertaining to corporate restructuring. The parties have differing views as to whether the CRA compelled banks to participate in such restructurings. Daewoo's creditors adopted a workout plan after Anjin, an accounting firm, reported that the going concern value of Daewoo exceeded its liquidation value. The workout plan comprised three elements: the spin-off from DHI of two new companies, DSME (shipbuilding) and DHIM (machinery); debt-for-equity swaps; and debt rescheduling.

7.337 DSME and DHIM were spun off from DHI on 23 October 2000. Each of the new companies received a portion of DHI's assets and capital stock, whereas much of the company's debt was left behind in DHI. The assets, liabilities, and capital stock of the new operating companies were determined based on their debt payment capability.

7.338 On 14 December 2000, a major portion of the debt still held by DSME was swapped by the creditors for equity in the newly established company. The terms of the debt-for-equity swaps varied according to the division of the company and the type of debt at issue (*i.e.*, secured or non-secured).

7.339 Daewoo-SME's debt obligations were also rescheduled. The debt rescheduling took three forms: extension of principal repayment due date; reduction of interest rates; and conversion of short-term loans into medium- and long-term loans.

(ii) Halla reorganization

7.340 The SHI/Halla corporate reorganization plan was crafted by creditors under the Corporate Reorganization Act, after a court confirmed the report by Rothschild, a consulting firm retained by Halla, that the going concern value of Halla exceeded its liquidation value. The reorganization plan (based on a proposal from Rothschild) comprised four elements: (i) debt forgiveness; (ii) a debt-for-equity swap; (iii) interest forgiveness; (iv) a conversion of short-term debt.

7.341 Under the reorganization plan, the assets of Halla were transferred to a new company, RHHI. Halla's debts were partly paid off using the proceeds from this sale, and Halla's remaining debts were assumed by RHHI. All of RHHI's shares were held by a single individual, although these shares were subsequently cancelled.[193]

[193] Korea asserts that, under Article 221(4) of the Corporate Reorganization Act, at least two-thirds of the shares held by the shareholder who influenced the directors in the mismanagement of a bankrupt company shall be written off. In the event, the court-appointed receiver proposed that all of the individual's shares should be written off (see Korea's reply to Question 38 from the EC after the first substantive meeting).

7.342 RHHI then issued 20,000,000 new shares to its creditors under a debt-for-equity swap of KRW 100 billion. At the same time, RHHI changed its name to Samho Heavy Industries ("Samho"). Samho received interest relief on its remaining debt (accrued interest was written off).

7.343 Samho then entered into a trusteeship agreement with Hyundai-HI, under which Hyundai-HI was entrusted with the management of Samho. When Hyundai-HI entered into the trusteeship agreement, it also executed a call option agreement with the shareholders of Samho, whereby Hyundai-HI received an option to purchase the shares of Samho at a specified price within the next five years. The call-price was the par value of the subject shares (*i.e.*, **[BCI: Omitted from public version]**). However, if the net asset value per share of Samho, as of the date of exercise of the call option, exceeded the par value of the subject shares, then **[BCI: Omitted from public version]** per cent of the difference would be added to the purchase price. Pursuant to the agreement, Hyundai-HI exercised its call option on 30 April 2002. Because the net asset value per share on that date was **[BCI: Omitted from public version]**, Hyundai exercised its call option at the price of **[BCI: Omitted from public version]**, as per the terms of the agreement. Hyundai then held **[BCI: Omitted from public version]** per cent of the shares in Samho, which changed its name to Hyundai Samho Heavy Industries, or Samho-HI. Samho then increased its capital by **[BCI: Omitted from public version]**, reducing Hyundai's shareholding to **[BCI: Omitted from public version**] per cent.

(iii) Daedong

7.344 Daedong was reorganized under the Corporate Reorganization Act, after the court established that the going concern value of Daedong exceeded its liquidation value. The reorganization plan comprised three elements: (i) debt restructuring / exemption from interest; (ii) a capital infusion; and (iii) the issuance of corporate bonds.

7.345 In August 2000, in accordance with the corporate reorganization plan, all shares owned by the then controlling shareholder were extinguished[194] and shares held by the remaining shareholders were consolidated at the rate of **[BCI: Omitted from public version]**. Daedong then began searching for an outside investor with the help of KPMG Financial Services Inc. ("KPMG"), its financial advisor. KMPG received final offers from five investors. KPMG determined that the offer from STX was most beneficial for Daedong and recommended that STX be granted the right of first negotiation on 22 August 2001. Accordingly, on 27 August 2001, the Seoul District Court selected STX Co. as the first negotiation party based on KPMG's recommendation.

7.346 STX submitted a preliminary proposal on 22 August 2001, with the key terms that (i) it would subscribe for and acquire common shares (new shares) corresponding to approximately **[BCI: Omitted from public version]**, (ii) subscribe for and acquire bonds with warrants corresponding to KRW 20 billion and immediately exercise these warrants to acquire new shares, and (iii) purchase additional bonds with warrants after amending the reorganization plan.

7.347 On 24 September 2001, STX submitted a definitive proposal on almost identical terms to those in the first proposal. Daedong accepted STX's proposal. On 28 September 2001, Daedong and STX executed a subscription agreement for the acquisition of new shares and bonds with warrants. On 24 October 2001, STX paid **[BCI: Omitted from public version]** and immediately thereafter exercised its warrants, resulting in a shareholding of **[BCI: Omitted from public version]** per cent in Daedong.

7.348 After it had acquired the Daedong shares as described above, STX acquired additional bonds issued by Daedong in the amount of **[BCI: Omitted from public version]**. This means that STX injected a total of **[BCI: Omitted from public version]** into Daedong's capital. With such funds, Daedong made an early repayment of **[BCI: Omitted from public version]** per cent of its liabilities

[194] *Ibid*.

(i.e., **[BCI: Omitted from public version]**), leaving only **[BCI: Omitted from public version]** outstanding (consisting of **[BCI: Omitted from public version]** for secured loans and **[BCI: Omitted from public version]** for unsecured loans). On 1January 2002, Daedong changed its corporate name to STX Shipbuilding Co., Ltd.(the "STX Shipbuilding"), its current corporate name.

7.349 STX made partial sell-off of its shares in STX Shipbuilding on two occasions (one for public offering and the other for private placement), leaving it with **[BCI: Omitted from public version]** per cent of the shares in STX Shipbuilding. Further, STX Shipbuilding listed its shares at the Korea Stock Exchange in September 2003.

(b) Financial Contribution Issues

7.350 The EC submits that the restructurings constitute "financial contributions" by public body creditors and private body creditors entrusted or directed by GOK. Korea denies that any of the creditors participating in the restructurings are public bodies.[195] Korea also denies that (private body) creditors were entrusted or directed by GOK to participate in the workout. In addition, Korea submits that the restructurings did not provide for any transfer of pecuniary value, and that in any event the creditors could not properly be found to have made "financial contributions" to companies in which they acquire ownership rights. Korea also submits that any "financial contributions" were not made "by" public bodies, in the sense that decisions were made pursuant to the authority of the creditors' council or courts under the relevant legislative provisions.

(i) Public Bodies

7.351 The EC claims that the following creditors participating in the relevant restructurings and workout are "public bodies" in the sense of Article 1.1(a)(1) of the *SCM Agreement*: Korea Asset Management Corporation ("KAMCO"), Korea Depository Insurance Company ("KDIC"), Bank of Korea ("BOK"), KDB, Industrial Bank of Korea ("IBK"), and KEXIM.

7.352 We recall[196] that we consider that an entity is a "public body" if it is controlled by the government.

KAMCO

7.353 We find that KAMCO is a public body. First, KAMCO is 100 per cent government-owned, a situation that is highly relevant to and often determinative of government control. We find further evidence of government control of KAMCO in the fact that government-appointed officials on the Management Committee are responsible *inter alia* for formulating KAMCO's operational policy and service plan, and assuming non-performing assets (Article 14 of the KAMCO Act).

7.354 Although we therefore find that KAMCO is a "public body", we note Korea's argument that KAMCO only became a Daewoo creditor (by virtue of its acquisition of the NPLs of other creditors) toward the middle of the workout process, after the workout plan had already been adopted by prior creditor financial institutions. We understand Korea to argue that KAMCO therefore did not actually participate in the workout. In its reply to Question 25 in the Annex V process, however, Korea stated that creditors "agreed to allow the holders of the 19 July Loan (including KAMCO which purchased

[195] Korea also repeats its argument (made above in the context of the KEXIM legal regime) that a transfer of funds by a public body or private body entrusted or directed by a government will only constitute a "financial contribution" if it involves a "government practice" or a function that would "normally be vested in the government" and "the practice, in no real sense, differs from practices normally followed by governments". Since we have already rejected that argument (see paras 7.28 - 7.31 *supra*, there is no need for us to consider it further at this juncture.

[196] See para. 7.50 *supra*. Since we have already reviewed the parties' arguments on this issue, there is no need for us to revisit these arguments at this juncture.

loans from other creditor financial institutions) to participate in the debt for equity swap". In light of Korea's statement that KAMCO participated in the debt-for-equity swap provided for under the Daewoo workout, we see no basis for finding that KAMCO did not participate in that workout.

KDB

7.355 We have already found, at para. 7.172 *supra*, that the KDB is a public body.

IBK

7.356 We find that the IBK is a "public body". Here, we give particular weight to the fact that the IBK is almost fully (95 per cent) government owned,[197] a highly relevant and arguably determinative fact for the question of government control of the IBK. In addition, we note that, pursuant to Article 35 of the IBK Act, both the IBK Business Plan and Operations Manual must be approved by a GOK minister, and the Operations Manual itself must contain detailed provisions regarding the operations of the IBK, including "the lending method, interest rates, loan terms, means of collection of loan principal and interest, and the maximum loan amount and payment guarantees to any one person".[198]

BOK and KDIC

7.357 Korea submits that BOK and KDIC did not participate in any of the three restructurings at issue in these proceedings. The EC has not responded to this argument. With regard to the Daewoo workout, we note that Attachment 3 to Annex 1 of the EC's replies to Panel questions after the first substantive meeting includes a list of DHI's creditors. This would appear to confirm Korea's argument that BOK and KDIC did not participate in the Daewoo workout. Bearing this in mind, and in the absence of any rebuttal of Korea's argument that BOK and KDIC did not participate in the two remaining restructurings, we find that BOK and KDIC did not participate in any of the restructurings at issue in these proceedings. For this reason, it is not necessary for us to determine whether BOK and KDIC constitute "public bodies".

(ii) Entrustment or Direction of Private Bodies?

Arguments of the parties

7.358 The EC submits that a number of private financial institutions involved as creditors in the restructuring of shipbuilders were subject to such a high degree of government influence that they were "entrust[ed] or direct[ed]" by the Korean Government in the sense of Article 1.1(a)(1)(iv). The EC asserts that their participation in the restructuring process should therefore be treated as a financial contribution by the Korean Government.

7.359 The EC argues that the Korean Government and its public bodies took advantage of their multiple roles as decision-maker/strategist, legislator, executive, regulator, shareholder/owner, capital injector, guarantor, and lender to ensure that commercial financial institutions acted to support the Korean shipbuilding industry pursuant to the entrustment and direction of the Government of Korea. The EC submits that, at the time that the commercial financial institutions were called upon to make restructuring decisions, they were themselves financially weak (as a result, in part, of their exposure to the shipbuilding industry) and in the process of being restructured, essentially dependent on the Government of Korea and its agencies and associated public bodies for their future liquidity.

[197] As of 2003, 51 per cent of IBK was owned by the GOK, 15.2 per cent by KEXIM, 15.6 by KIS (itself owned 12.08 per cent by the GOK and 86.61 per cent by KDIC), and 12.53 per cent by KDB (See Responses to Annex V Questions (BCI), Answer 2.1(1), at 23, Exhibit EC-39).

[198] Exhibit EC – 52.

According to the EC, the injection by the Korean Government and the six public bodies acting pursuant to the Government's policies of substantial sums into the private financial institutions (at a time that these institutions were themselves facing considerable financial difficulties) persuaded these institutions to participate in the corporate restructuring programmes of the shipbuilding industry.

7.360 Korea submits that the EC has failed to provide *prima facie* evidence of the existence of any direction or entrustment, since it has not even identified which commercial financial institutions are concerned. Korea asserts that the demonstration of direction or entrustment is a determination that must be made for each private body separately. Korea also asserts that the EC must prove government entrustment and direction in respect of each of the three restructuring procedures challenged by the EC, rather than making allegations regarding the general structure of the financial market.

7.361 Korea also submits that there cannot be direction or entrustment by the GOK for private banks to extend a financial contribution without an explic it and affirmative mandate to do so. Korea notes in this regard that the panel in *US - Export Restraints* concluded that "the ordinary meanings of the words 'entrusts' and 'directs' require an explicit and affirmative action of delegation or command."[199] Although the EC asserts that there is no basis for requiring "an explicit and affirmative action of delegation or command", Korea argues that such a requirement is needed to preserve the balance of rights and obligations arising under the *SCM Agreement.* According to Korea, allowing challenges to be made based on vague circumstantial evidence that does not amount to an explicit and affirmative action would likely impair the interests of the Member which is alleged to have provided subsidies.

7.362 Korea submits that the GOK simply intervened in the market, in consultation with the IMF, in order to stabilize the overall financial market. Korea relies on the following findings of the abovementioned panel to argue that there is a difference between government intervention and government entrustment or direction:

> Government entrustment or direction is thus very different from the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market.[200]

7.363 Korea notes that a part of its agreement with the IMF was that it would abstain from government direction.[201] Korea submits that private financial institutions participated in the restructuring process in their own commercial interest, especially as they would only receive capital injections from the government on the condition that they meet certain financial soundness targets.

7.364 According to the EC, there is no basis in the *SCM Agreement* for the *US – Export Restraints* panel having required that the *"element* of an explicit and affirmative action, be it delegation or command"[202] must be a formal action by the government. The EC asserts that if the panel were to interpret these terms as requiring a showing that a government made a formal or official command to the private entity, this would create a loophole because governments can use less formal—but no less effective—forms of influence to grant their subsidies. According to the EC, the analysis whether a

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[199] Panel Report, *US - Export Restraints*, para. 8.44.

[200] Panel Report, *US - Export Restraints*, para 8.31.

[201] In this regard, Korea notes that Letters of Intent ("LOIs") signed with the IMF required that specific workout procedures as applied to particular corporations should be carried out on a "voluntary (i.e., not government directed)" basis as well as on a "market oriented" basis. Attachment to the LOI of May 2, 1998, Attachment "Corporate Governance and Restructuring" section), Exhibit Korea - 23. The Panel notes that the LOI submitted as Exhibit EC – 102 also stated that Korea would "ensure that corporate debt restructuring takes place in a market-based manner, through voluntary workouts between corporations and their creditors".

[202] Panel Report, *US - Export Restraints*, para 8.29 (emphasis supplied).

financial contribution granted by a private body can be imputed to the government has to be made on a case by case basis, taking account of all the relevant elements influencing the decision-making of the private body that point towards government involvement.

Evaluation by the Panel

7.365 The parties disagree as to the circumstances under which an investigating authority could properly determine that a government has entrusted or directed a private body in the sense of Article 1.1(a)(1)(iv). Korea submits that an authority must demonstrate an explicit and affirmative government action addressed to a particular party to perform a particular task or duty. The EC considers that there is no need to have express proof of private body-by-private body, transaction-by-transaction, entrustment or direction, arguing that entrustment or direction can be established on the basis of broader evidence.

7.366 We recall that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled that the principles codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*") are such customary rules.[203] Thus, the task of interpreting Article 1.1(a)(1)(iv) a treaty provision must begin with its specific terms. Article 1.1(a)(1)(iv) provides that a financial contribution by a private body is covered by the *SCM Agreement* when:

> a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.

7.367 We note that the text of Article 1.1(a)(1)(iv) was interpreted by the *US – Export Restraints* panel. That panel found:

> 8.28 The dictionary meaning of the word "entrust" is, *inter alia*, to "give (a person, etc.) the responsibility for a task . . . Commit the . . . execution of (a task) *to* a person . . . ". The word "direct" is defined, *inter alia*, as to "[g]ive authoritative instructions to; order (a person) *to do* . . . order the performance of". In this regard, we consider significant the fact that, for "direct" when followed by "to" plus an infinitive (i. e., a verb), the dictionary gives as a meaning to "give a formal order or command to", as this is precisely the construction used in subparagraph (iv) (". . . entrusts or directs a private body *to carry out*. . .").
>
> 8.29 It follows from the ordinary meanings of the two words "entrust" and "direct" that the action of the government must contain a notion of delegation (in the case of entrustment) or command (in the case of direction). To our minds, both the act of entrusting and that of directing therefore necessarily carry with them the following three elements: (i) an explicit and affirmative action, be it delegation or command; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty. In other words, the ordinary meanings of the verbs "entrust" and "direct" comprise these elements – *something* is necessarily delegated, and it is necessarily delegated *to someone*; and, by the same token, *someone* is necessarily commanded, and he is necessarily commanded *to do something.* We therefore do not

[203] Article 31(1) of the *Vienna Convention* provides in relevant part that: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

> believe that either entrustment or direction could be said to have occurred until all of these three elements are present.
>
> 8.30 Having said that, it is clearly the first element – an explicit and affirmative action of delegation or command – that is determinative. The second and third elements – addressed to a particular party and of a particular task – are *aspects* of the first. Any assessment of whether delegation or command has occurred would necessarily be in reference to that which has been delegated or commanded and in reference to the one to whom it has been delegated or commanded. As aspects of and flowing from the first element of the definition, the second and third elements provide further support for our view that the action must be an explicit and affirmative act of delegation or command. We note, in this regard, that the "entrusts or directs" language in subparagraph (iv) is followed by the language "a private body to carry out . . . ", which is similar to that which we have used to describe the second and third elements of the definition of entrustment or direction. Thus, the subsequent language in subparagraph (iv) confirms our view of the requirement of an explicit and affirmative action.[204]

7.368 As noted by the panel in *US – Export Restraints*, the dictionary meaning of the word "entrust" is, *inter alia*, to "give (a person, etc.) the responsibility for a task . . . Commit the . . . execution of (a task) *to* a person . . . ".[205] The word "direct" is defined, *inter alia*, as to "[g]ive authoritative instructions to; order (a person) *to do* . . . order the performance of".[206] We agree with the *US – Export Restraints* panel that "[i]t follows from the ordinary meanings of the two words 'entrust' and 'direct' that the action of the government must contain a notion of delegation (in the case of entrustment) or command (in the case of direction)".

7.369 The *US – Export Restraints* panel also found that "both the act of entrusting and that of directing therefore necessarily carry with them the following three elements: (i) an explicit and affirmative action, be it delegation or command; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty".[207] The parties disagree on this aspect of the panel's findings. Korea relies on this finding to argue that there can be no finding of entrustment or direction in the absence of an explicit act whereby a particular task or duty is delegated to a specific person, or whereby a specific person is commanded to perform a particular task or duty. The EC denies that the act of delegation or command need be explicit, or addressed to a specific person.

7.370 Regarding the first element identified by the *US – Export Restraints* panel, we agree that the delegation or command inferred by the terms "entrustment" and "direction" must take the form of an affirmative act. The object of a Member's responsibility should be its acts, as such, rather than the reactions to or consequences of those acts, as alleged reactions and consequences may simply be the result of happenstance or chance.[208] That being said, we see nothing in the text of Article 1.1(a)(1)(iv) that would require the act of delegation or command to be "explicit". Although the particular facts of the *US – Export Restraints* case may have caused that panel to employ the term "explicit", no such qualification is included in the terms of Article 1.1(a)(1)(iv). In our view, the affirmative act of delegation or command could be explicit or implicit, formal or informal. [209]

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[204] Panel Report, *US – Export Restraints*, paras 8.28 – 8.30 (footnotes omitted).

[205] *The New Shorter Oxford English Dictionary*, Volume 1, 1993, Clarendon Press, Oxford.

[206] *Id.*

[207] Panel Report, *US – Export Restraints*, para. 8.29.

[208] Like the *US – Export Restraints* panel, "we do not see how the reaction of private entities to a given governmental measure can be the basis on which the Member's compliance with its treaty obligations under the WTO is established" (see *US – Export Restraints*, para. 8.34).

[209] Indeed, the utility of Article 1.1(a)(1)(iv) would be undermined if an "explicit and affirmative action of delegation or command" were required. That provision operates as a catch-all, so that indirect government

7.371 As to the issue of whether or not the act of delegation or command must be addressed to a specific individual, we agree with the *US – Export Restraints* panel that, of the three elements it identified in the extract cited above, the first element, i.e. the affirmative action of delegation or command, is determinative. As the panel noted, the second and third elements – addressed to a particular party and of a particular task – are aspects of the first, in the sense that the assessment of whether delegation or command has taken place would of necessity involve an examination of both who allegedly has been entrusted or directed to act, and what the action or task in question is.

7.372 Since the second and third elements identified by the *US – Export Restraints* panel are aspects of the first element, we consider that the manner, or degree of detail, in which the addressee and object of the act of delegation or command is specified will depend on the form that the act of delegation or command may take. Thus, while a greater degree of specificity may be expected in respect of explicit or formal acts of delegation or command,[210] this will not necessarily be the case in respect of implicit or informal acts. In our view, the fact that the addressee and object of the act of delegation or command is described in less detail does not preclude a finding of entrustment or direction, as a matter of law. Rather, it raises evidentiary issues. While the fact that an act of delegation or command is specifically addressed to a particular private body may make it easier, in terms of evidence, for a Member or investigating authority to establish the existence of entrustment or direction, the fact that an act of delegation or command is not specifically addressed to a particular private body does not necessarily mean that a finding of entrustment or direction in respect of that private body is precluded. It simply means that, as an evidentiary matter, it will be more difficult for a Member or investigating authority to properly demonstrate that such private party was entrusted or directed. Similarly, the fact that an act of delegation or command does not specify in great detail what must be done does not necessarily preclude a finding of entrustment or direction. It simply makes it more difficult for a complainant or investigating authority to properly demonstrate that a transaction undertaken by a private body was the object of governmental entrustment or direction. Thus, although the plain meaning of entrustment and direction requires that something must be delegated to someone, or that someone must be commanded to do something, the plain meaning of those terms does not require that such someone or something must necessarily be specified in great detail. That being said, the evidence of entrustment or direction must in all cases be probative and compelling. Thus, whatever the nature or form of the affirmative acts of delegation or command at issue, the evidence must demonstrate that each entity allegedly providing, or participating in, a financial contribution was entrusted or directed by the government to do so.[211]

7.373 For the most part, the EC does not rely on any explicit affirmative act of government delegation or command in respect of the three restructurings at issue in these proceedings. Instead, its arguments are largely based on alleged implicit and informal acts of delegation or command. For this reason, most of the evidence relied on by the EC is circumstantial in nature. There is no reason why a case of government entrustment or direction should not be premised on circumstantial evidence, provided that such evidence is probative and compelling, in the sense that it demonstrates that each of the private creditors participating in the restructurings was entrusted or directed to do so. Thus, the EC purports to build its claim on the following factors:

- GOK compelled commercial financial institutions to participate in the restructuring process by ruling that no public funds would be made available to banks which "are not certified by

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action does not fall outside the scope of the *SCM Agreement*. We are not prepared to read into Article 1.1(a)(1)(iv) terms that would allow such indirect government action to circumvent the WTO's subsidy disciplines.

[210] Of course, explicit and formal acts of delegation or command could also be drafted in very general terms, and addressed to a broadly defined group.

[211] Whatever the nature or form of the affirmative acts of delegation or command, and whatever the type of evidence relied upon, there must always be a determination to the effect that each of the private entities at issue was entrusted or directed by the government.

the FSC to be performing their role in the corporate restructuring process",[212] or "making adequate progress on implementation of sound corporate debt restructuring";[213]

- GOK controlled the workout of DHI/DSME at the level of the CRA;
- the enactment of Prime Ministerial Decree No. 408;
- one of Daewoo's creditors, Kookmin Bank, acknowledged that its commercial policy had been affected by government intervention;
- GOK guaranteed creditors against losses incurred in the restructurings at issue;
- the very fact that capital-deficient creditors restructured, rather than liquidated, the companies at issue; and
- many of the domestic creditors were partially or wholly owned by GOK.

7.374 Although reliance on such circumstantial evidence may make it more difficult for the EC to establish a *prima facie* case of entrustment or direction as a matter of fact, it does not exclude the EC's claim as a matter of law. In reviewing the EC's evidence, however, we would agree with the *US – Export Restraints* panel that:

> Government entrustment or direction is thus very different from the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market.[214]

7.375 Since the EC's Article 1.1(a)(1)(iv) claims are based on circumstantial evidence, we consider that it is particularly important not to confuse the concepts of government entrustment or direction on the one hand, and the government intervention in the market on the other. With this in mind, we shall now consider the circumstantial evidence relied on by the EC.

- Access to public funds

7.376 The EC submits that GOK was able to entrust or direct Korean private banks to participate in restructurings because they were financially weak and essentially dependent on government capital. The EC claims that GOK was able to compel financial institutions to participate in corporate restructurings by imposing conditions on their access to public funds. In particular, the EC submits that, in accordance with LOIs submitted to the IMF, no public funds would be made available to banks which were "not certified by the FSC to be performing their role in the corporate restructuring process",[215] or "making adequate progress on implementation of sound corporate debt restructuring".[216] The EC also asserts that banks that received public funds were limited in the way they could exercise their independence in participating in a restructuring. According to the EC, Article 18 of the Special Act on the Management of Public Funds obliges banks to enter into written agreements with the companies they wish to support the details of which are set out in a Presidential Decree. The EC further argues that banks are prohibited from providing funds if the agreements are not implemented or are not likely to be implemented.

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[212] Exhibit EC – 36.
[213] Exhibit EC – 102.
[214] Panel Report, *US - Export Restraints*, para 8.31.
[215] Exhibit EC – 36.
[216] Exhibit EC – 102.

7.377 The EC also submits that it would have been unthinkable for Daehan Investment Trust and Seoul Guarantee Insurance Co. not to participate in the Daewoo restructuring having been informed that they were eligible to receive substantial amounts of public funds. In support, the EC relies on a MOFE press release which, it claims, "announc[es] that Daehan Investment Trust Co. would receive KRW 1 trillion in public funds and that Seoul Guarantee Insurance Co. would receive public funds to guarantee Daewoo bond".[217]

7.378 According to Korea, the certification by the FSC referred to in the LOI was never implemented. Korea also submits that the EC's description of the *Special Act on the Management of Public Funds* is misleading. In response to Question 118 from the Panel, Korea submits that Article 18 does not apply in the context of the restructurings at issue in the present proceedings. According to Korea, Article 18 applies to a publicly-funded bank's individual lending activity. Thus, the restriction applies only when a publicly-funded financial institution decides to extend a new loan to an unsound company in an individual transaction between that particular bank and the unsound company as a borrower. According to Korea, therefore, the "restructuring agreement" referred to in Article 18 means an agreement between the lending bank and borrowing company (normally called a "Memorandum of Understanding", or "MOU") whereby the unsound borrower agrees to implement self-initiated actions, such as disposing of unnecessary assets or businesses or reducing labor costs, in order to make itself more accountable for the new borrowing. Korea asserts that Article 18 does not apply to the cases where the publicly-funded banks participate in a workout or court-receivership proceeding as a member of the creditors' council or other interested parties' meeting.

7.379 First, we note that the EC has not disputed Korea's argument that the FSC certification referred to in the LOI was never implemented. In addition, we note that the LOIs required that specific workout procedures as applied to particular corporations should be carried out on a "voluntary (i.e., not government directed)" basis as well as on a "market oriented" basis.[218] For these reasons, we are unable to accept the LOIs as evidence that GOK compelled banks to participate in corporate restructurings.[219]

7.380 Second, we are not persuaded that the Special Act on the Management of Public Funds is relevant to these proceedings. On the basis of the explanation provided by Korea, and in the absence of rebuttal by the EC, we do not consider that the restructurings under review are "restructuring[s]" referred to in Article 18 of the Special Act on the Management of Public Funds.[220]

7.381 Third, we note that the MOFE press release relied on by the EC in respect of the Korea Investment Trust Co. and Daehan Investment Trust Co. also contains a statement by the FSC chairperson that "the fiscal injection to these two ITCs is not directly related to Daewoo papers, rather it is an inevitable step needed to resolve financial problems aggravated over the years at these two companies".[221] Since the same document therefore both makes and refutes the EC's argument

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[217] MOFE Press Release, "Financial Market Stabilization Package Related to Daewoo Group Workout Plan", 4 November 1999, Exhibit EC – 60.

[218] Attachment to the LOI of May 2, 1998, Attachment "Corporate Governance and Restructuring" section), Exhibit Korea - 23. The LOI submitted as Exhibit EC – 102 also states that Korea would "ensure that corporate debt restructuring takes place in a market-based manner, through voluntary workouts between corporations and their creditors".

[219] We note that Korea has not sought to rely on its various agreements with the IMF as a general defence in these proceedings (see para. 46 of Korea's first written submission).

[220] Article 18(1) of the Special Act on the Management of Public Funds provides "[i]f a Financial Institution which received Public Funds pursuant to the provision of Article 17(1) intends to provide new funds to an unsound company as prescribed by the Presidential Decree, it shall enter into a written agreement with such unsound company, which shall include consents from the persons concerned with the restructuring of that company and other matters as prescribed by the Presidential Decree".

[221] MOFE Press Release, "Financial Market Stabilization Package Related to Daewoo Group Workout Plan", 4 November 1999, Exhibit EC – 60.

regarding these companies' access to public funds, we are unable to draw any conclusions on the basis of that document regarding the conditions on which those companies obtained access to public funds.

7.382 In light of the above, we are not persuaded by the EC's argument that restrictions on creditors' access to public funds provided GOK with sufficient leverage to entrust or direct creditors to participate in the Daewoo workout.

- Corporate Restructuring Agreement

7.383 The EC asserts that GOK controlled the Daewoo workout at the level of the CRA. According to the EC, the Government of Korea in mid-1998 forced all banks and financial institutions sign the CRA, under which these institutions explicitly committed themselves to such things as corporate restructuring (as opposed to liquidation) through debt-for-equity swaps and other measures, and subjected themselves to penalties for breach of the CRA. The EC asserts that banks essentially waived their rights to act as fully independent entities when signing the CRA.

7.384 Korea submits that the CRA is merely a framework agreement that did not in itself pose any substantive controversial issues. According to Korea, the CRA was a voluntary agreement and, in no event, mandated the banks to agree to a particular restructuring plan against market principles. Rather, the CRA provided a structure for workout once the creditor financial institutions had decided that workout of a given company was preferable to liquidation. Korea rejects the EC's argument that the CRA was government-mandated because it was implemented quickly. According to Korea, the speed of action, particularly in a financial crisis where everything moves quickly, is proof of nothing at all regarding independence.

7.385 The EC states that Korea's contention that the CRA was negotiated and signed voluntarily is doubtful. The EC asserts that the CRA was explained to only 28 financial institutions in June 1998, and was signed by 210 financial institutions only 6 days later. According to the EC, it is hard to believe that 210 institutions voluntarily negotiated and agreed to such an important document in less than one week without any governmental interference. Korea disputes the EC contention that the CRA was created over so short a period, stating that a task force had been at work on this question since April 1998.

7.386 We understand that the EC's argument concerns the structure and basic provisions of the CRA *per se*, rather than the application of the CRA in respect of the Daewoo workout in particular. The EC relies on Articles 1, 2 and 20 of the CRA in support of its argument. Turning to Article 1, we note that it states that the objective of the CRA is "to propel workout programs of companies ... and improve financial integrity of creditor financial institutions through an effective and activated propulsion of workout programs". We do not interpret this provision as an obligation on signatories to participate in restructurings. For example, in the event of a determination by creditors that the liquidation value of a company exceeds its going-concern value, nothing in Article 1 of the CRA requires those creditors to nevertheless restructure (rather than liquidate) the company. The CRA simply means that if restructuring is to take place, the provisions of the CRA shall apply. Article 2 merely contains definitions, and therefore imposes no substantive obligation on signatories to participate in restructurings. Article 20 provides for the imposition of penalties when financial institutions breach restructuring arrangements that have been negotiated under the CRA. Article 20 does not impose penalties on creditors that oppose a restructuring. Nor are penalties imposed if creditors collectively decide to liquidate rather than restructure a company. Accordingly, we do not consider that Articles 1, 2 and 20 of the CRA support a finding that the CRA *per se* obliges creditors

to participate in restructurings, or otherwise constitutes evidence of government entrustment or direction in respect of the Daewoo workout.[222]

7.387 Regarding the speed with which banks signed up to the CRA, we note[223] that work on the CRA commenced in April 1998, and that the basic concept and structure of the CRA as the framework agreement for workout was explained to 28 banks and financial institutions. Furthermore, a process of commenting and negotiations took place among the financial institutions through their trade associations between 19 June and 24 June 1998. We also note that, although the CRA was to take effect on 25 June 1998, it remained open for signature after that date. In these circumstances, and especially given the involvement of banks in the preparation of the CRA, we see nothing untoward in a large number of banks being in a position to sign the CRA within one week after it took effect.

7.388 In light of the above, we reject the EC's argument that the CRA constitutes evidence of entrustment or direction.

- Prime Ministerial Decree No. 408

7.389 The EC submits that GOK's control over private banks is demonstrated by Prime Ministerial Decree No. 408. The EC asserts that, while Article 6 of this Decree seems to guarantee the independence of banks in which the Government of Korea has a shareholding interest, Article 5 specifically requires these banks to co-operate with the Government of Korea "for the purpose of stability of the financial market" and "to attain the goals of financial policies." The EC states that it is even specified that instructions can be given orally or by telephone.

7.390 Korea submits that it is a duty of the government in any jurisdiction to adopt and implement financial policies and to ensure stability of the financial market. Korea asserts that financial institutions are typically subject to statutory obligations to comply with legitimate governmental orders or requests to implement such financial policies to stabilize the financial market. Korea submits that Article 5 of the Prime Minister's Decree only provides for procedures that the Government of Korea can follow to implement such legitimate governmental policies. Korea submits that the Prime Minister's Decree proves the opposite to what the EC purports to prove by referring to it, since the Decree was intended to guarantee the independence of banks in which the Government of Korea has a shareholding interest. Korea asserts that the Prime Minister's Decree in fact implemented the commitment of the Government of Korea to the IMF that:

> In the interim [i.e., pending re-privatization of government-owned commercial banks], banks will be operated on a fully commercial basis and the government will not be involved in the day-to-day management of the banks.[224]

7.391 We understand the EC's argument in respect of Prime Ministerial Decree No. 408 to be that the Decree gives the GOK "control" over private banks, i.e., that by virtue of the Decree, the GOK has the power to entrust or direct the banks to engage in corporate restructuring. We do not see anything in the Decree, however, to suggest that it has anything to do with any such power of the government to compel banks to participate in corporate restructuring. Rather, the Decree appears to be focused on measures to ensure the stability of the financial market as such.[225] We note that Article 1 of Prime Ministerial Decree No. 408 provides that its purpose is to "procure that the Government shall go

[222] Our conclusion is further supported by Article 10 of the CRA, which provides that dissatisfied creditors may resort to mediation.

[223] See Korea's reply to Question 120 from the Panel. The EC did not comment on the new factual information submitted by Korea in response to this question.

[224] Annex to Korea's 13 November 1998 Letter of Intent to the IMF, Exhibit EC – 117.

[225] We find it difficult to conceive of any country that does not have a legislative or regulatory framework enabling the government to intervene in the market for the purpose of maintaining financial stability.

through objective and transparent formalities in *establishing financial policies or conducting supervision over financial institutions*, and to exclude unfair outside intervention in management of financial institutions, etc. so that financial institutions, etc. can operate their businesses more independently, taking more responsibility" (emphasis added). We further note that Article 5.1 of the Decree provides that "[i]f the Financial Supervisory Agencies request cooperation or assistance of Financial Institutions, etc. *for the purpose of stability of the financial market*, etc. (excluding the request for data in relation to routine management activities), such request shall be made in writing or through a meeting" (emphasis added). Whereas Article 5.2 provides that in cases of urgency such request may be made orally or by telephone, it further provides that "[i]n this case, the Financial Supervisory Agencies shall notify such request to the relevant Financial Institutions, etc. in writing without delay". Pursuant to the Decree, therefore, the GOK does appear to have the power, in certain circumstances, to compel private banks to undertake certain actions related to maintaining stability in the financial markets. The EC has provided no evidence, however, that "stability in the financial markets" encompasses or is related to corporate restructuring.

7.392 In any event, we emphasize that the issue of entrustment or direction does not have to do with a government's power, in the abstract, to order economic actors to perform certain tasks or functions. It has instead to do with whether the government in question has *exercised* such power in a given situation subject to a dispute. In this regard, we note that the EC has provided no evidence that the Prime Ministerial Decree No. 408 was ever invoked or relied on by the GOK in the context of any restructuring.

7.393 For these reasons, we are not persuaded by the EC's reliance on Prime Ministerial Decree No. 408 as evidence of GOK entrustment or direction of private creditors in respect of the restructurings at issue in these proceedings.

- Kookmin Bank Statement

7.394 The EC submits that one of the creditors participating in the Daewoo workout, the Kookmin Bank, publicly stated that the Korean Government has indeed compelled banks to agree to restructuring measures that were not in accordance with their own credit review policies. In support, the EC refers to the following statement by Kookmin on 18 June 2002 in connection with a planned offering of shares on the New York Stock Exchange:

> The Korean government promotes lending to certain types of borrowers as a matter of policy, which we may feel compelled to follow. The Korean government has promoted, and, as a matter of policy, may continue to attempt to promote lending to certain types of borrowers. It generally has done this by requesting banks to participate in remedial programs for troubled corporate borrowers and by identifying sectors of the economy it wishes to promote and making low interest loans available to banks and financial institutions who lend to borrowers in these sectors. … government policy may influence us to lend to certain sectors or in a manner in which we otherwise would not in the absence of the government policy.[226]

7.395 Korea submits that the EC omitted the following extract from the abovementioned Kookmin statement:

> The government has in this manner promoted low-income mortgage lending and lending to technology companies. We expect that all loans made pursuant to government policies will be reviewed in accordance with our credit review policies.

[226] Kookmin Bank brochure, p. 22, (Exhibit EC-100).

7.396 According to Korea, the omitted text makes it clear that Kookmin's statement was actually made in respect of GOK promotion of low-income mortgages and lending to technology companies, rather than the shipbuilding sector. Korea also submitted a letter from Kookmin's lawyers explaining that the above statement "does not state, nor was it intended to imply, that the Korean government exercises control over the banking sector generally or over bank lending decisions either generally or with respect to particular borrowers such as Hynix".

7.397 Taking into account that part of the Kookmin statement omitted by the EC, we accept Korea's argument that it was actually made in respect of GOK promotion of low-income mortgages and lending to technology companies, rather than the shipbuilding sector. The statement therefore provides no evidence that Kookmin was entrusted or directed to participate in the restructuring of shipyards. In any event, we note that the statement refers to GOK "requesting" banks to participate in remedial programs for troubled corporate borrowers. In the absence of any other probative material, we do not consider that a government "request" should be treated as evidence of entrustment or direction, since it does not imply the requisite elements of delegation or command. Since we do not consider that the Kookmin statement constitutes evidence of government entrustment or direction in respect of the restructurings at issue in these proceedings, there is no need for us to consider the explanatory letter prepared by Kookmin's lawyers.

- 1998 December Agreement / Guarantee Against Loss

7.398 The EC submits that GOK further established its ability to entrust and direct the financial institutions' participation in the corporate restructuring by guaranteeing against losses arising from these workouts. The EC notes in this regard that the 1998 December Agreement for the Restructuring of the Top Five *Chaebols* ("December 1998 Agreement") stipulates that the Government "will monitor implementation of the agreed restructuring plan from the viewpoint of upholding soundness of financial institutions" and "support the restructuring efforts of corporate sector and financial institutions."[227]

7.399 Korea submits that the relevant Agreement did not apply to the restructurings at issue in these proceedings, and that it is unrelated to the CRA.

7.400 We do not consider that the December 1998 Agreement has any bearing on allegations of government entrustment or direction in respect of the restructurings at issue in these proceedings, since it did not apply to them. The December Agreement envisaged self-restructuring by the top five chaebols – including Daewoo – through *inter alia* Capital Structure Improvement Plans,[228] while they were still solvent. There are no such self-restructurings before us in these proceedings. Instead, these proceedings concerns restructurings required by creditors under the CRA and corporate reorganization procedures. Accordingly, the December 1998 Agreement is of no relevance to the question of whether or not GOK entrusted or directed creditors to participate in the restructurings of Daewoo, Halla and Daedong.

7.401 The EC submits that a precursor to the December 1998 Agreement was concluded between the top five chaebols and the President of Korea in January 1998. The EC requests an adverse inference under Annex V.7 of the *SCM Agreement*, on the basis that Korea failed to provide a copy of the January 1998 Agreement under the Annex V procedure. Korea submits that it did not provide a copy of the January 1998 Agreement because it has nothing to do with the corporate restructuring of insolvent companies. Korea asserts that the January 1998 Agreement ceased to apply to Daewoo after it became insolvent and entered the workout procedure. The EC alleges that the January 1998 Agreement was concluded between the top five chaebols and the President of Korea. The only restructuring at issue in these proceedings involving a chaebol is the Daewoo workout, dating from

[227] December 1998 Agreement, Articles 18, 20 (Exhibit EC-40).
[228] See Section 2(10) of the December 1998 Agreement, Exhibit EC-40.

2000. As the December 1998 Agreement is not relevant to our examination of the Daewoo workout, we fail to see how an earlier version of that agreement could be of greater probative value, especially as it was concluded over two years before the Daewoo workout. Furthermore, we note that the EC asserts that the January 1998 Agreement "shows the degree of intervention of the [GOK] in the corporate sector".[229] However, government intervention in the corporate sector does not necessarily amount to government entrustment or direction in respect of a particular restructuring. For these reasons, we decline to treat Korea's failure to provide the January 1998 Agreement in the context of the Annex V procedure as "non-cooperation" in the meaning of Annex V.7 of the *SCM Agreement*. We therefore reject the EC's request for an adverse inference under that provision.

- Liquidation as a source of capital

7.402 The EC asserts that proof of entrustment or direction lies in the fact that, under normal market conditions, the financial institutions' need for capital would have led them to pursue all means to increase cash inflows by *inter alia* liquidating – rather than restructuring - troubled borrowers. Thus, the EC submits that the very fact that these financial institutions engaged in restructuring is evidence of government entrustment or direction.

7.403 We are unable to accept this argument, since the question of whether or not market considerations would have caused creditors to liquidate, rather than restructure, Daewoo, Halla or Daedong relates more directly to the issue of "benefit".[230]

- Government ownership

7.404 The EC claims that further evidence of entrustment or direction lies in the fact that many of the domestic creditors participating in restructurings were partially or wholly owned by GOK.

7.405 Korea submits that government ownership is not the same as government entrustment or direction.

7.406 We are not prepared to accept that some degree of government ownership, by itself, constitutes proof of government entrustment or direction.[231] Although a government ownership share in an entity may increase the ability of a government to entrust or direct that entity, there must still be evidence of an affirmative act of delegation or command before a finding of entrustment or direction may be made.[232]

- Conclusion

7.407 In light of the above, we reject the EC's claim that private creditors were entrusted or directed to participate in the three restructurings at issue in these proceedings. Although the EC may have provided evidence of general GOK intervention in the financial services market, we do not consider

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[229] See EC First Written Submission, note 31.

[230] Since we find below that the EC fails to establish that market considerations would have required liquidation rather than restructuring, there would be no factual basis to the EC's argument even if it were considered as potential evidence of government entrustment or direction.

[231] We note that government ownership would seem to be more directly relevant, in the first instance, to the application of Article 1.1(a)(1) of the *SCM Agreement*, i.e., to whether or not the entity in question is or is not a "public body", rather than to entrustment or direction. That is, would the extent of government ownership be sufficient to confer government control, such that the relevant entity was a public body? Here, we recall that the EC has not alleged that any of the domestic creditors other than KAMCO, KDIC, BOK, KDB, IBK, AND KEXIM are public bodies.

[232] In addition, we note that, according to Attachment 3 to the EC's replies to the Panel's questions after the first substantive meeting, many of the private creditors participating in the restructurings at issue were not owned to any extent by GOK. The factual basis of the EC's argument is to some extent, therefore, undermined.

that the circumstantial evidence relied on by the EC indicates any affirmative act of delegation or command in respect of the three restructurings at issue. Similarly, even if the GOK had the authority and potential to entrust or direct private creditors to participate in the restructurings, the EC has not demonstrated that the GOK exercised such power.

(iii) Transfer of Pecuniary Value

Arguments of the parties

7.408 Korea submits that the debt-for-equity swaps, interest rate reductions, interest forgiveness and interest deferral at issue in these proceedings did not constitute "financial contributions" because there was no transfer of pecuniary value to the companies under workout or corporate reorganization, but rather an increase in the value of recovery by the financial institutions engaging in those transactions. Korea asserts that at the time of commencement of the workout or corporate reorganization procedures, Halla and Daedong went bankrupt and Daewoo was also insolvent, thereby reducing the actual value of the credits extended by the financial institutions to the level of the liquidation values of these distressed companies. Korea considers that, in this context, the creditor financial institutions did not forego anything of value, but undertook the debt-for-equity swaps and other debt restructuring as a means of preserving the going concern value which was determined to be higher than the liquidation value.

7.409 The EC asserts that, from the perspective of both the grantor and the grantee, a debt-for-equity swap is a financial contribution. First, it includes the element of debt forgiveness, as the creditor no longer can demand interest payments or repayment of debt principal after a debt-for-equity swap. Second, it also requires the purchase of equity in the company by the former creditor. These are both, independently, financial contributions to the recipient.

7.410 The EC also submits that Korea confuses financial contribution and benefit when it argues that the debt-for-equity swaps and other debt restructuring cannot constitute a financial contribution because the creditors agreed to these measures "as a means of preserving the going concern value which was determined to be higher than the liquidation value."[233] According to the EC, the question of whether the creditors received something in exchange for their financial contribution, such as the preservation of going concern value, is a question of benefit, not of financial contribution.

Evaluation by the Panel

7.411 We are not persuaded by Korea's arguments that debt-for-equity swaps and interest reductions and deferrals are not financial contributions. In the first place, we recall that there is a financial contribution in the sense of Article 1.1(a)(1)(i) of the *SCM Agreement* if there is a "direct transfer of funds", and that grants, loans and equity infusions are listed only as three possible examples of such transfers. Thus, we view Article 1.1(a)(1) as identifying in its respective subparagraphs the kinds of instruments or transactions that could be considered to be "financial contributions". Of course these instruments would only be covered by the Agreement if they were made "by a government or public body", and they would only be subsidies covered by the Agreement if they both conferred a benefit and were specific. Thus, the concept of financial contribution is but one in a set of cumulative, and independent, elements all of which must be present for a measure to be regulated by the *SCM Agreement.*

7.412 We find the examples listed in Article 1.1(a)(1)(i) to be illuminating in respect of the scope of the term "direct transfer of funds". Most importantly, considering the "medium of exchange" in the listed examples, we note that all of the examples involve transfers of money ("funds"), as opposed to in-kind transfers (of goods or services, in the sense of Article 1.1(a)(1)(iii)). The fact that the listed

[233] First Written Submission by Korea, 2 February 2004, para. 318.

kinds of direct transfers of funds (grants, loans and equity infusions) are identified as only examples clearly indicates that there may well be other types of instruments that would equally constitute direct transfers of funds in the sense of Article 1.1(a)(1)(i).

7.413 Turning to the particular cases of the transactions involved in the restructuring, we find that all of them are of the same nature as those explicitly listed in Article 1.1(a)(1)(i). First we note that interest reductions and deferrals are similar to new loans, as they involve a renegotiation / extension of the terms of the original loan. We see no reason why loans would constitute financial contributions while interest reductions and deferrals would not. Further, we consider that interest / debt forgiveness is comparable to a cash grant, as funds that were previously provided as a loan, against interest, are now provided for free, given the removal of the repayment obligation. All of these transactions therefore constitute direct transfers of funds in the sense of Article 1.1(a)(1)(i) of the *SCM Agreement*. Regarding debt-for-equity swaps, we note that equity infusions are explicitly listed as a type of direct transfer of funds in Article 1.1(a)(1)(i). Since we have also found that debt forgiveness constitutes a direct transfer of funds, we see no reason why a combination of equity infusion and debt forgiveness should fall outside the scope of that provision. The reason why creditors agree to such transactions (i.e., whether or not it is in order to preserve going concern value) is not relevant to the issue of whether or not the transactions constitute financial contributions. Rather, it relates to the issue of benefit (in the sense of whether or not creditors operating on market principles would have undertaken such transactions on the same terms).

(iv) Financial Contribution to Oneself

Arguments of the parties

7.414 Korea submits that the various debt restructurings challenged by the EC are not "financial contributions" since they involve transactions between companies and the owners of those companies. Korea submits that one cannot make a "financial contribution" to oneself. Korea argues that, in order for a "financial contribution" to exist, there must be at least two separate identifiable entities. According to Korea, the EC has failed to identify which party received the alleged financial contribution, because when the creditor financial institutions of the three Korean shipyards undertook a debt forgiveness or other debt rescheduling, they had already taken, or at least simultaneously took, the ownership or control of the subject companies. Thus, they have forgiven the debt of the companies which they owned or controlled and the beneficiaries of this debt forgiveness were the financial institutions themselves.

7.415 Korea asserts that its argument is based on the WTO case-law indicating that "any analysis of whether a benefit exists should be on 'legal or natural persons' instead of productive operations."[234] Korea submits that such case-law regarding the existence of benefit also has consequences regarding the definition and recipient of "financial contribution", in the sense that if one looks through the assets to the actual owners to determine if there is a benefit, one should also do so to determine if there is a financial contribution. According to Korea, this means that if the owner and the contributor are the same "person", the issue arises as to whether there has actually been a financial contribution at all.

7.416 The EC (and US) submit that Korea's argument is incorrect, because if the drafters of the *SCM Agreement* had contemplated having ownership of a company operate as an exemption from subsidies disciplines, they would not have listed equity infusions as an example of a form of financial contribution in Article 1.1(a)(1)(i). According to the EC and US, Korea's argument is therefore at odds with the text of the *SCM Agreement*.

7.417 The EC also argues that Article 14(a) of the *SCM Agreement* provides relevant context, as it permits an authority investigating the potential for imposing countervailing duties to find a benefit to

[234] Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 110.

recipients based on "government provision of equity capital." According to the EC, if the simultaneous action of the transfer of funds and the creation of equity interest in a company prevents a finding of financial contribution, then Article 14(a) would not have been included in the *SCM Agreement*.

7.418 Korea counters these arguments by distinguishing debt / equity swaps from equity infusions / government provision of equity capital. Thus, in response to the EC and US arguments that equity infusions by public entities can constitute financial contributions, Korea asserts[235] that "equity infusions are legally distinct from debt-for-equity swaps", and that "there is no logical relationship of debt-equity swaps to the term equity infusion". In particular, Korea asserts[236] that equity infusions are often covers for direct subsidies to cover operating losses, in the sense that the purported capital calls generally were mere shams reflected by the unwillingness of minority shareholders to respond. According to Korea, the issue in a debt-for-equity swap made in an insolvency situation is different. In such cases, where the company is insolvent and, therefore, in the hands of the creditors, the swap reflects a change in form of financial instrument. Korea asserts that in the present case, the creditor financial institutions were not holding cash which they could invest in a range of financial instruments; they were holding debt and the issue was what they could do with the debt in order to maximize their return.

Evaluation by the Panel

7.419 We do not agree with Korea's argument that a debt-for-equity swap should be treated as a transaction with oneself. Clearly, creditors and the debtor company are separate legal entities. In an insolvency situation, the creditors may decide to acquire ownership of the company in order to maximize the return on their debt-holding (or minimize their losses). One way of doing so is through a debt-for-equity swap. Such a transaction between separate legal entities results in a change in ownership of the debtor company, and the issue before the Panel is whether the changes in ownership of certain Korean shipyards conferred subsidies. Korea relies on WTO case-law[237] concerning the changes in ownership in the context of privatizations to argue that a financial contribution, like benefit, must be conferred on a legal or natural person, rather than on productive operations / assets. We are not persuaded that such case-law is relevant, however, since this is not a case involving privatization. In those privatization cases, the alleged subsidy took place prior to privatization, and the question was whether the benefit from those earlier subsidies was extinguished upon the change-in-ownership. The change in ownership in those cases was undertaken at arm's length, and for fair market value. In the present case, however, the change in ownership is the alleged subsidy. In any event, even the Appellate Body privatization case-law relied on by Korea has clarified that a distinction may be made between a company and its owners in certain cases, such that the owners of a company may be found to confer a benefit on that company.[238] That being the case, we see no reason why the owners of a company could not also provide a "financial contribution" to that company.[239]

7.420 Furthermore, we consider that the EC and US arguments regarding Articles 1.1(a)(1)(i) and 14(a) of the *SCM Agreement* are both compelling. In particular, the fact that equity infusions are explicitly designated as "financial contributions" suggests to us that the *SCM Agreement* does not preclude the owner of a company making a "financial contribution" to that company. Equity infusions and debt-for-equity swaps have the same effect, in the sense that equity changes hands

[235] See Korea's response to Question 22 from the EC.
[236] See Korea's response to Question 46 from the Panel.
[237] See, for example, Panel and Appellate Body Reports in *US – Lead and Bismuth I*,*US – Lead and Bismuth II*, *and US – Countervailing Measures on Certain EC Products*.
[238] See *US – Countervailing Measures on Certain EC Products*, para. 118.
[239] For instance, a government injecting equity into a government-owned enterprise, or a holding company injecting new capital into one of its subsidiaries, are examples of cases where the owner of a company provides a financial contribution to that company.

against consideration in both cases (and subsidization arises if the amount of consideration is less than the market would have provided). Also, a debt/equity swap comprises an element of equity infusion. Accordingly, we consider that the references to equity infusions in Articles 1.1(a)(1)(i) and 14(a) of the *SCM Agreement* provide a strong contextual basis for rejecting Korea's argument that there is no financial contribution because one cannot make a financial contribution to oneself.

7.421 Korea responds by seeking to distinguish equity infusions from debt-for-equity swaps. Korea's distinction, however, is premised on an assumption that "equity infusions" are necessarily subsidies, and that debt/equity swaps necessarily are not (since, according to Korea, they involve the maximization of return). Such an approach, however, prejudges the substantive issue before the Panel (i.e., was there subsidization?), and overlooks the fact that an equity infusion may be undertaken by a market operator on market terms (in which case there would be no subsidy).

7.422 Furthermore, Korea's argument would mean that a cash grant by a government to a government-owned company would not constitute a financial contribution (and therefore could never be a subsidy). Such an outcome would be absurd. Indeed, when this issue was put to Korea in Question 46 from the Panel, Korea did not actually answer the question. Instead of addressing the issue of government cash grants (which the Panel's question was about), Korea again reverted to the alleged distinction between equity infusions and debt/equity swaps. However, if there is truth in the statement that one cannot make a financial contribution to oneself, it should apply in all cases, including to cash grants.

7.423 In light of the above, we reject Korea's argument that the owners of a company are unable, in law, to make a financial contribution to that company.

(v) Financial contributions "by" public bodies

7.424 In respect of the Daewoo workout, Korea asserts that there were no financial contributions "by" individual public bodies or private bodies allegedly entrusted/directed by GOK because financial contributions were effected pursuant to the authority of the creditors' councils or meetings of interested parties. In respect of the reorganizations of Halla and Daedong, Korea submits that there were no financial contributions "by" public bodies or private bodies allegedly entrusted/directed by GOK since the reorganization of Halla was legally effected by the court's decision approving the corporate reorganization plan and not by the approval of individual creditors.

7.425 We are unable to accept Korea's argument, since entities participating in a financial contribution must assume responsibility for that participation. Thus, to the extent that a public body participates in a loan agreed by a creditors' council, that part of the loan attributable to the public body may be treated as an individual financial contribution by that public body falling within the scope of Article 1.1(a) of the *SCM Agreement*. Otherwise the disciplines of the *SCM Agreement* could be easily circumvented by groups of public bodies deciding collectively, or under court approval, to provide financial contributions.

(vi) Conclusion

7.426 For the above reasons, we conclude that KAMCO, KDIC, BOK, KDB, IBK, and KEXIM are "public bodies", and that their participation in the Daewoo, Halla and Daedong restructurings constitutes a "financial contribution" covered by the *SCM Agreement*. We further find that the private creditors participating in the restructurings were not entrusted or directed to do so, such that their participation does not constitute a "financial contribution" covered by the *SCM Agreement*.

(c) Benefit Issues

7.427 We recall that a "financial contribution" only constitutes a subsidy if it confers a "benefit". It is now well established that the existence of "benefit" is determined by reference to the market. Thus, there will be a "benefit" if a financial contribution is made available on terms more favourable than those that the recipient could obtain on the market. The parties' arguments on "benefit" are primarily concerned with the identification of appropriate market benchmarks against which to judge the conduct of the creditors engaging in the restructurings. Thereafter, the parties make specific arguments relating to each of the restructurings at issue.

7.428 Our approach to the issue of benefit in the context of the restructurings is to ask whether the EC has demonstrated that each of the restructurings was commercially unreasonable. In this context, the parties have advanced general horizontal arguments as to the participation of domestic versus foreign creditors in the restructurings, as well as company-specific arguments as to the decisions to restructure each of the companies and as to the terms of the restructurings as implemented. We consider all of this evidence in its totality in respect of each restructuring, taking up first the general, horizontal question of the creditors' participation, followed by the company specific arguments and evidence pertaining to the individual restructurings.

(i) The creditors' participation in the restructurings

7.429 The EC asserts that the assessment of the commercial reasonability of the restructurings should be based on the behaviour of foreign creditors / investors, because these were the only creditors / investors operating outside the influence of the GOK. The EC asserts that the decision by foreign creditors / investors not to participate in the relevant restructurings demonstrates that these restructurings were not conducted pursuant to market considerations.

7.430 Korea submits that foreign creditors' non-participation in the restructurings does not constitute an appropriate benchmark, because the alleged subsidy was provided by domestic Korean financial institutions. Korea asserts that the market-conformity of the restructurings was assured by determinations in each case that the going concern value of the restructured company exceeded its liquidation value.

7.431 We understand the EC to argue in the first instance that private domestic creditors / investors participated in the restructurings as a result of government entrustment or direction, rather than commercial principles. However, as discussed above, we have rejected the EC's claim of government entrustment or direction in respect of the private domestic creditors' participation in the restructurings.

7.432 We pursued this issue with the EC, in our Question 149:

> If the Panel were to reject the EC's claim of government entrustment / direction of private creditors, would this mean that those private creditors provide a reliable market benchmark for determining whether or not the restructurings at issue conferred a benefit? Please explain. Did the EC address this issue in its previous written and oral submissions to the Panel. If yes, please indicate precisely where it did so.

7.433 In response, the EC stated:

> The tremendous government influence over the actions of private creditors (even if the Panel were to find that it does not rise to the level of entrustment/direction), certainly raises strong doubts as to their ability to act according to market considerations (as is required for a valid benchmark). Thus, the Panel would still be

> required to look elsewhere for a market benchmark -- either to foreign investors, outside investors, or another reliable source.

7.434 We note that of course there could be circumstances in which a government influences the market to such an extent that it becomes distorted, so that private entities no longer operate pursuant to purely commercial principles.[240] In the case before us, however, the evidence on the reasons for and significance of the differing behaviour of domestic versus foreign creditors is mixed. We note that certain creditors did participate in the restructuring while others opted not to. We note that there was a certain generalized flight of foreign capital from Korea during the financial crisis, reflecting investors' wariness of the overall situation, and neither party has provided information as to whether the foreign creditors' decisions not to invest in the restructured shipbuilding companies were purely a reflection of this general wariness, or also reflected more specific concerns of these creditors over the prospects of the individual companies.

7.435 We next turn to the evidence and arguments on each of the individual restructurings at issue.

(ii) The Daewoo workout

The Anjin report

7.436 In response to the EC's argument that Daewoo's creditors failed to act pursuant to market considerations, Korea submits that Daewoo's creditors acted on the basis of a report by Anjin to the effect that the going concern value of Daewoo exceeded its liquidation value. Although the EC accepts that a proper going concern analysis might have provided a basis for establishing that the decision to restructure Daewoo was market-based,[241] the EC questions whether the report did constitute such a proper analysis, and further asserts that the 1999 Anjin report does not demonstrate whether or not the individual components of the workout were based on market principles.

7.437 We consider that the evidence and arguments concerning the Anjin report are very relevant to the commercial reasonableness of the decision to restructure Daewoo. In this respect, we first take up the Anjin report's conclusion that the going-concern value of Daewoo exceeded its liquidation value, and we then take up the individual elements of the workout. On the report, we consider the question whether a reasonable commercial actor could have use the report as the basis to decide that restructuring made better economic sense than liquidation. Here, our initial reaction is that the report on its face appears credible and *bona fide*. It was prepared at the time and in the context of the decision on whether to restructure Daewoo, and even the EC's expert consultant, Price Waterhouse Coopers ("PWC")[242] stated as a general observation that the report was good given the timeframe that Anjin had had to prepare it.[243]

7.438 Korea initially presented detailed argumentation in respect of the Anjin report in response to the EC's argument that independent commercial investors would not have restructured Daewoo, but instead would have opted for liquidation. According to Korea, the 1999 Anjin report was a thorough and comprehensive report based on in-depth analysis that gave the creditors reliable information in deciding to restructure DHI. Korea asserts that the Anjin report shows that when Anjin made its assessment, it considered carefully all of the relevant data and circumstances relating to the Korean economy, shipbuilding industry and individual shipbuilders, as well as the business plans of DHI, in order to provide an objective and independent assessment of the real situation of DHI and of the

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[240] Indeed, a similar consideration influenced the findings of the Appellate Body in *US – Softwood Lumber IV*, para. 103.

[241] See, in particular, the EC's reply to Question 23 from the Panel.

[242] Price Waterhouse Coopers was engaged by the EC as an expert consultant for purposes of this dispute. The EC submitted a number of critiques prepared by PWC of various aspects of the Anjin report. (Exhibits EC-112, 118, 133, 145 and 148).

[243] Exhibit EC-112 at 3.

various options available to the creditor financial institutions. Korea submits that creditor banks therefore acted prudently when they decided on the DHI restructuring taking into account the findings and recommendations contained in the report.

7.439 The EC challenges the integrity and substantive accuracy of Anjin's conclusion that the going concern value of Daewoo exceeded its liquidation value. The EC submits that the Anjin report (1) was commissioned by Daewoo-HI and its main creditor, KDB, a public body; (2) could not have been thoroughly reviewed before creditors voted on the workout plan for the first time; and (3) in any event did not properly demonstrate that the going concern value of DHI exceeded its liquidation value. The EC asserts that the Anjin report was "pre-cooked",[244] and that prudent creditors would not have agreed to any solution other than liquidation without requiring a much more in-depth analysis. Referring to a series of alleged errors / shortcomings identified by PWC in the context of this dispute, the EC asserts that the Anjin report was not a proper basis for market-driven creditors to decide to restructure DHI because the report did not make an adjustment for existing shareholders, and therefore assumed that all benefits from the restructuring would accrue to the creditors; the report double counted tax shield benefits; the report did not provide for sufficient investment to maintain residual value; the report used an excessively high EBIT margin of earnings before interest and taxes ("EBIT") for Daewoo in the going-concern projections; the report assumed an overly optimistic perpetual growth rate in the going-concerning projections; the report used incorrect interest coverage ratios; the report did not account for unbooked liabilities; and the report made no adjustment for payables and receivables from five affiliated companies. The EC submits that, if the Anjin report had not contained these errors, and if it had applied a perpetual growth rate of less than 2 per cent and a discount rate above 12 per cent, liquidation value would have been found to exceed going concern value. We shall examine each of the issues raised by the EC.[245]

- Commissioned by DHI and KDB

7.440 We understand the EC to argue that the Anjin report should not have been relied on by DHI's creditors since the report was commissioned by DHI and KDB, a public body, both of which had an interest in seeing DHI restructured rather than liquidated.

7.441 Korea submits that Anjin was retained by the KDB, on behalf of all creditors. Korea asserts that, although DHI was mentioned in the retainer agreement, this was only because DHI was responsible for paying Anjin's fees.

7.442 **[BCI: Omitted from public version.]**[246]

7.443 The EC has not challenged these statements by Anjin. In particular, the EC has not disputed that it is standard practice for companies under receivership / workout to pay the fees of professional advisors. Nor has the EC disputed that DHI "was not in a position to receive reports and/or updates thereof from Anjin". We also note that the cover letter accompanying Anjin's report was addressed exclusively to KDB, and not to DHI.[247] Since we have no reason to believe that DHI was in a position to influence the substance of Anjin's report, there is no reason to discredit the Anjin report merely because Anjin's fees were paid by DHI.

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[244] EC oral statement at first substantive meeting, para. 83.

[245] Korea submits that, since the EC's critique of the Anjin report is a central part of the EC's affirmative case, the Working Procedures and basic considerations of due process require that it should have been submitted earlier in the proceedings. We note, however, that the EC's critique of the Anjin report only became necessary after Korea sought to defend itself on the basis of that report, which it did in its first written submission. We have no objection, therefore, to the EC presenting a critique of the Anjin report in its second written submission.

[246] See Exhibit KOREA – 78.

[247] See English translation of Attachment 3.1(17) provided by Korea under the Annex V procedure.

7.444 Similarly, we do not believe that the integrity of the report is *ipso facto* impaired by the fact that it was commissioned by a public body. This is particularly so given that the KDB was the lead creditor, who was responsible for commissioning a report on behalf of all creditors. Since the EC has not disputed Korea's assertion that the KDB commissioned the report on behalf of all other creditors, and in the absence of any allegations of improper influence by the KDB over Anjin, we are not prepared to reject the integrity of the Anjin report merely on the basis that it was commissioned by the KDB (acting on behalf of all other creditors). In short, while the issue raised by the EC is not irrelevant, we do not find that the evidence before us on this point reaches the level of undermining the credibility of the report's conclusions.

- Amount of time for review

7.445 The EC submits that the Anjin report was not made available to creditors in sufficient time to allow for a thorough review before voting on the workout plan for the first time. In particular, the EC submits that the Anjin report was made available to creditors on the same day that they voted on it for the first time, and that all major decisions regarding the restructuring were taken only two days later.

7.446 Korea submits that Anjin actually began the due diligence of DHI on **[BCI: Omitted from public version]** when the initiation of the DHI workout procedure was announced by the creditor financial institutions. Anjin submitted its due diligence report concerning DHI and its foreign subsidiaries on 23 October 1999[248] and submitted a workout report in summary form to creditor financial institutions on 30 October 1999 (Exhibit Korea – 64). Korea asserts that these reports confirmed that the going concern value of Daewoo was higher than the liquidation value, and recommended that the creditor financial institutions proceed with a workout rather than liquidation. Korea states that, based on these reports, KDB as the lead bank prepared a workout plan and submitted it to the third Council of Creditor Financial Institutions ("CCFI") meeting held on 24 November 1999. Korea asserts that the fully-compiled workout report by Anjin was submitted to the KDB on 24 November 1999. According to Korea, therefore, the creditors were well briefed in advance of the third and fourth CCFI meetings on 24 and 26 November 1999 respectively.

7.447 The EC claims that there are inconsistencies regarding the timing of this newly presented report. The EC asserts that the Anjin report was assigned on 7 October 1999,[249] allowing only three weeks to perform the enormous task of evaluating Daewoo's financial affairs. Considering that Anjin was also assigned to prepare a due diligence report on Daewoo-HI's assets that needed to be completed before a workout analysis could begin, and that this report was submitted on 23 October 1999,[250] the EC asserts that the time remaining for the preparation of the summary workout report was effectively only one week (from 23 to 30 October). Furthermore, the EC asserts that Korea referred to an earlier KDB report provided to creditors. The EC asks the Panel to draw adverse inferences against Korea, given that Korea had failed to reveal the existence of that KDB report earlier in the proceedings. The EC also asserts that Korea stated that Anjin began work on the due diligence and workout reports on **[BCI: Omitted from public version]**, the day after the Daewoo group requested a workout,[251] although Anjin was not appointed as the financial advisor until 8 September 1999.[252] The EC also notes Korea's reference to Anjin's 30 October 1999 summary workout report. The EC requests the Panel to draw adverse inferences for Korea's failure to make an English version of that summary report available to the EC by the deadline for responses to the Panel's questions after the first substantive meeting.

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[248] *See* Korea Annex V Response Attachments 3.1(17)-2 &3.
[249] Exhibit Korea-64, p. 110.
[250] Responses to Questions from the Panel by Korea, 22 March 2004, Question 78.
[251] Responses to Questions from the Panel by Korea, 22 March 2004, Question 78, n. 4.
[252] First Written Submission by Korea, 2 February 2004, para 341.

7.448 Korea refers to the EC's request for adverse inferences against Korea for not providing the "KDB report" to the Panel. Korea asserts that there was no "KDB report", and denies having mentioned that there was one. Korea asserts that it merely stated that KDB proposed a DHI workout plan, and that this DHI workout proposal was based on the Anjin report. Korea submits that it disclosed to the EC the relevant information on KDB's proposed workout plan in the course of an earlier EC Trade Barriers Regulation proceeding.

7.449 In terms of timing, we do not consider that the fact that the KDB's proposed workout plan was presented to creditors at the fourth CCFI meeting (on 26 November 1999) means that creditors did not have a reasonable opportunity to review that plan (before adopting it at that same meeting), since KDB's proposed workout plan was based on the Anjin workout plan presented to creditors at the third CCFI meeting (on 24 November 1999).[253] Indeed, the KDB prepared its workout plan in response to creditors' opposition to the Anjin workout plan. Nor do we consider that creditors had not had sufficient time to review Anjin's (earlier) proposed workout plan, since although it was presented by Anjin at the third CCFI meeting on 24 November 1999, Anjin's due diligence report (concluding that the going concern value of DHI exceeded its liquidation value) was submitted to creditors on 23 October 1999,[254] and a workout report in summary form was presented to creditors on 30 October 1999. In cases involving the proposed restructuring of insolvent companies, it is to be expected that decisions will need to be made expeditiously. In such circumstances, parties may need to act with greater speed than they would otherwise want to do. As noted by the banking expert relied on by Korea, "[i]t is essential in circumstances such as these that reorganising and restructuring decisions are made as quickly as possible. This not only maintains direction, management confidence, morale and motivation within a company, but also quickly recreates confidence amongst the company's customers."[255] We also note that Anjin itself was acting under the "principle of promptness".[256] In light of these considerations, although DHI's creditors may have felt hard-pressed to review the Anjin report and various proposed workout plans in the time available to them, we do not consider that the time was so short that they could not have had sufficient time to conduct an adequate, market-based review of the relevant documents.[257]

7.450 We consider that the EC's request for adverse inferences regarding the "KDB report" is unfounded, since there is nothing on the record to suggest that any such report ever existed. In particular, Korea has never referred to any such report. Korea has merely referred to a workout plan proposed by the KDB (on 26 November 1999) on the basis of a workout report prepared by Anjin (submitted in final form on 24 November 1999).

7.451 Regarding the EC's request for adverse inferences concerning the 30 October 1999 summary workout earlier in these proceedings, we see no reason why, having submitted an English version of the full Anjin workout report under the Annex V procedure,[258] Korea should also have submitted an English version of the summary report. We note that Annex V question 3.1.3(17) merely requested a

[253] We acknowledge that Korea's description of the facts may cause some confusion, especially as Korea submits that the KDB presented its proposed workout plan at the third CCFI meeting. On the basis of Korea's first written submission, however, we understand that the KDB only presented its proposed workout plan at the fourth CCFI meeting, and that Anjin was the author of the proposed workout plan submitted at the third CCFI meeting.

[254] See Korea Annex V Response Attachments 3.1(17)-2 &3.

[255] See Exhibit KOREA – 105, page 3.

[256] See page 89 of the Anjin report, section 2.2.1.

[257] The EC asserts that there is an anomaly between the fact that Korea reports that Anjin commenced its due diligence work on 26 August 1999, whereas the retainer agreement was only concluded on 7 October 1999. Since there is no basis for us to doubt Korea's assertion that such procedure is normal practice, we do not consider this situation anomalous. Rather, it suggests that Anjin was conscious of the need to complete its work as early as possible.

[258] See Attachment 3.1(17) of Korea's Annex V response. That Attachment also includes a cover letter from Anjin to the KDB dated 24 November 1999.

copy of the "full report with all annexes", so we do not consider that Korea was required to provide a copy of the summary report under the Annex V procedure. As for whether or not Korea should in any event have submitted an English version of Anjin's summary report earlier in the Panel proceedings, we consider it appropriate that Korea only submitted the summary report when it sought to rely on it in response to a question from the Panel (which in turn was prompted by arguments from the EC). Since the report had not already been translated into English, we consider it reasonable that Korea would not be able to make an English version of that report available to the Panel until some time after the deadline for the reply to the Panel's question. For these reasons, we reject the EC's request for adverse inferences.

- Existing shareholder adjustment

7.452 The EC submits that, when comparing the present value of the cash flows generated on a going-concern basis with the liquidation value, Anjin's analysis should have taken into account the fact that the present value of the going concern cash flows should be shared with the shareholders, and that the financial lenders would only obtain approximately **[BCI: Omitted from public version]** per cent of these cash flows.

7.453 Korea submits that the EC confuses two distinct phases in Anjin's report. In Phase 1, Anjin estimated the liquidation value and going concern values of DHI, and compared the two to determine which one was greater. Then, having confirmed that the going concern value exceeded the liquidation value, Anjin undertook Phase 2, which involved an analysis of three alternative restructuring scenarios. According to Korea, Anjin therefore only considered the effects or implications of restructuring in the context of Phase 2. Korea submits that the EC is seeking to introduce (Phase 2) issues relating to the effects of restructuring into the analysis of Phase 1 of Anjin's report. In particular, Korea argues that, because DHI was insolvent in 1999, the adjusted equity value of DHI as of 31 July 1999 was **[BCI: Omitted from public version]**. Accordingly, creditor financial institutions had priority claims on DHI over the shareholders in both liquidation and going concern scenarios. Since this analysis was performed under Phase 1, there was no need for Anjin to consider what value may have accrued to shareholders under any of the three restructuring scenarios. Thus, there was no error in attributing **[BCI: Omitted from public version]** per cent of DHI's value to financial creditors prior to any restructuring scenario. Korea asserts that a partial allocation of value **[BCI: Omitted from public version]** to shareholders was, however, made under Phase 2.

7.454 The EC does not reply to this argument by Korea, and to us it appears that a value of zero could plausibly be attributed to shareholders in the context of a determination of whether to restructure an insolvent company.

- Tax Shield Effect

7.455 The EC alleges an error concerning the alleged double counting of a tax shield effect.

7.456 Korea accepts that Anjin did erroneously double count tax shield effects, and attributes that error to an electronic spreadsheet link error. Korea submits, however, that the correction of this error would not cause the liquidation value to exceed the going concern value, and thus that the basic conclusion of Phase 1 of the Anjin report remains unaffected.

7.457 Given the agreement between the parties on the substance of the EC's allegation, there is no need for us to consider this matter further. We note, however, that the EC has not contested Korea's assertion that this error alone would not undermine Anjin's conclusion that the going concern value of DHI exceeded its liquidation value.

- Investment amounts used in calculating DHI's residual value

7.458 The EC criticizes the Anjin report for having assumed, in its computation of the residual value of DHI, that investment amounts would be forever smaller than depreciation. According to the EC, in calculating a residual value, investment should be at least equal to depreciation (and greater when inflation is positive). The EC asserts that, when computing the value of a company on the basis of perpetual cash-flows, investments should be set at a higher level than depreciation to take into account the impact of inflation: depreciation expense is fixed over the depreciation period, whereas replacement investments get more and more expensive with time.

7.459 Korea responds that, in fact, the amount of investment used by Anjin in the residual value calculation effectively was not lower than depreciation. In particular, in 1998 DHI revalued its property, plant and equipment ("PPE") in accordance with Korea's Asset Revaluation Law. This revaluation increased the value of depreciable PPE without increasing the company's cash outflows, and increased as well the amount of depreciation as from the year 1998. According to Korea, if this additional depreciation resulting from the revaluation, which had no impact on cash flow, were excluded from the calculation, the capital investment and depreciation amounts used in the residual value calculation would be almost the same. Furthermore, Korea asserts that DHI presented a business plan to Anjin which assumed that a substantial amount of capital expenditures was treated as maintenance and repair expense, rather than capital expense, considering the nature of the business as heavy industry, with large investments in the beginning stage of business.

7.460 The EC responds that even if assets were revalued in the past, at some point in the future investments would need to be made to replace the existing asset base and these investments should be in line with the depreciation for the computation of the residual value. Korea contends that the investments to replace existing assets would be affected by the market value, foreign exchange rate and inflation at the time of replacement. According to Korea, the 1998 revaluations and the forecasts performed by Anjin were affected by the depreciation of the Korea Won against the US dollar, with the result that the replacement amount in Korean Won to be spent in the future would be smaller than the nominal value of the existing asset base.

7.461 We take note of the EC's point that generally in residual value calculations, amounts projected for future investments normally will be greater than amounts for depreciation, given inter alia the effects of inflation. We also take note, however, of the points raised by Korea, including the effects of the asset revaluation and of the Won's depreciation, points on which the EC did not provide a response. On the basis of this exchange of views, we do not consider that the EC has established that the lower level of projected investments than projected depreciation constitutes an error in the Anjin report.

- EBIT margin

7.462 The EC further criticizes Anjin's calculation of DHI's residual value for using a perpetual ratio of earnings before interest and taxes ("EBIT") that the EC considers is too high. The EC questions whether an EBIT margin of more than **[BCI: Omitted from public version]** per cent, the highest level of the forecast period, is a long-term sustainable margin.

7.463 Korea responds that, in forecasting DHI's future performance, Anjin assumed that DHI's operations would stabilize from 2003 forward, after gradually recovering from low levels during the initial two or three years of the forecasted period. Korea states that in respect of DHI's estimated EBIT ratios, Anjin considered the EBIT margins of major Korean competitors of DHI during 1997, 1998 and first-half 1999. These companies recorded averaged EBIT margins that were higher than the level forecast for DHI. According to Korea, Anjin's analysis and DHI's business plan supported the forecast that DHI would achieve comparable performance levels to those of its major Korean competitors.

7.464 The EC notes that the very high EBIT margins for DHI's major Korean competitors, used as the basis for the forecast for DHI, were based on a very short period, and that these levels probably were due to the fact that Korean shipbuilders were selling ships in dollars and buying inputs in Korean Won, and that the Won was under heavy pressure at the time. The EC argues that according to standard practice, residual values should be calculated when the period of competitive advantage has disappeared and the market is in equilibrium. For the EC, it is not clear that EBIT greater than **[BCI: Omitted from public version]** per cent is the "perpetual equilibrium", looking at EBIT margin before and after the period presented by Anjin and for other Asian companies active in the sector (the EC presents statistics for Korean companies Samsung, Hyundai, and Hanjin, and for Japanese companies Mitsubishi HI, Kawasaki HI and Hitachi HI, for 1994-2002).

7.465 Korea responds that the exchange rate effect on the estimated EBIT margin was limited -- exchange rates declined steadily while average EBIT margins increased from end-1997 through mid-1999. Korea also disputes the relevance of the EBIT margins of the Japanese companies cited by the EC, as the fact that these margins were substantially lower than those of the Korean shipyards suggests that the cost and profit structures of the two sets of companies were not comparable.

7.466 The EC responds to Korea's argument in respect of exchange rates by asserting that the effect on EBIT of the Korean Won's depreciation in 1997 could have been much greater than Korea asserts. In particular, the EC argues that the Won's depreciation alone could have created an EBIT margin of 34 per cent on US dollar contracts of one year or more signed before the financial crisis in 1997. Thus, the EC argues, the Won's depreciation could have explained the high EBIT margins realized by Korean shipbuilders in 1997-1999.

7.467 Korea disputes the EC's estimate of the effect of the Won's depreciation by arguing, first, that the EC assumes that costs would be entirely in Won and revenues entirely in dollars, whereas shipbuilders incur costs in both currencies. Korea also argues that although the currency depreciation only began in late 1997, the EBIT margins of Korean shipbuilders already had reached high levels during the course of that year, such that the depreciation could not have affected them more than minimally. Furthermore, Korea argues, the forecasted EBIT margins used for DHI were lower than those actually realized by the other major Korean shipyards.

7.468 We take note that, as the EC points out, the EBIT margins for other Korean shipbuilders, which were used by Anjin as the starting point for its forecasts for DHI's EBIT margin, were relatively high during the period considered by Anjin. To us, however, this by itself does not mean that these margins were incorrect or unrepresentative, particularly given that the EBIT used by Anjin in the projections for DHI was in any case below those of the comparator Korean companies. While the EC advances a number of theories and possible alternatives which would, if correct, result in a lower forecasted EBIT margin for DHI, the EC has not demonstrated that any of these is unequivocally superior, nor that Anjin's forecast is clearly wrong.

- Perpetual growth rate

7.469 The EC criticises Anjin for having applied a perpetual growth rate of **[BCI: Omitted from public version]** per cent for cash flows after 2004, whereas in 2002 Nomura and Credit Suisse First Boston analysts were using perpetual growth rates of 2.0 and 0 per cent respectively. The EC submits that, during a period of slow economic growth, Anjin should not have been using growth rates at least 50 per cent greater than those applied by the market during a period of better economic growth.

7.470 Korea submits that it was appropriate for Anjin to use a perpetual growth rate of **[BCI: Omitted from public version]** per cent since that was the rate forecast by Wharton Econometric Forecasting Associates ("WEFA") for 2005. Korea notes that Anjin chose the WEFA global growth rate, even though higher growth rate forecasts were available for the shipbuilding sector. Korea also

asserts that the Nomura and Credit Suisse First Boston 2002 forecasts were not available in 1999, and therefore could not have been taken into account by Anjin.

7.471 We see no reason to consider that Anjin erred in applying WEFA's forecast rate of world economic growth, as we see no evidence that WEFA rates are in any way unsatisfactory or unreliable. Furthermore, we note that the EC refers to market growth forecasts made in 2002, three years later than the forecasts made and relied on by Anjin. Given the propensity for economic conditions to change rapidly over relatively short periods of time, we are doubtful that these growth rates can be directly compared.

- Interest coverage ratio

7.472 The EC criticises the Anjin report on the basis that the interest coverage ratio reflected in the report, **[BCI: Omitted from public version]**, was comparable to that of non-investment grade companies (i.e., B and CCC rated companies).

7.473 Korea submits that the interest coverage ratio referred to in the Anjin report in respect of DHI was an assumed ratio used only to determine the size of debt restructuring, and was not directly related to any credit rating as suggested by PWC. Korea further argues that in fact the interest coverage ratios of DSME and DHIM in any event exceeded the ratio assumed in the report.

7.474 We understand the EC to argue that DHI should not have been restructured since the interest coverage ratio used in the Anjin report indicated that DHI and its eventual spin-off companies were below investment grade.[259] We note, however, Korea's explanation that the ratio of **[BCI: Omitted from public version]** was used to calculate the size of debt restructuring, rather than being directly related to a credit rating, a point that the EC acknowledges.[260] Moreover, there is no question that DHI was insolvent, and therefore below investment grade, at the time of Anjin's report, but this is a separate issue from whether it was economically unreasonable to restructure it.

- Unbooked liabilities

7.475 The EC criticises Anjin for not taking into account commissions owed by DHI to Daewoo London. The EC asserts that these liabilities should have been taken into account by Anjin since their omission resulted in an inflation of going concern value relative to liquidation value. According to the EC, if a claim of X KRW had been booked in DSME, the value computed under the going concern scenario would have reflected the future payment of the X KRW claim and hence would have been lower than the value presented in Anjin's report. The EC asserts that the value under the liquidation scenario on the other hand would not have been affected by the same amount, as most of the assets had been provided as collateral for loans. Thus, the addition of a new claim would have had a much lower impact on the value of the liquidation scenario (indeed, if 100 per cent of the assets had been provided as collateral, the impact on the liquidation value would have been zero).

7.476 Korea submits that these liabilities did not need to be booked since they had not been confirmed by Daewoo London. In addition, Anjin considered they would not make any difference to the analysis since they would have the same impact under both the liquidation and going concern scenarios. Furthermore, Korea asserts that the liabilities would not have had any impact on the going

[259] Our understanding is based on page 5 of Exhibit EC – 145, where PWC stated that "[t]he point we wanted to highlight was that at the time of the restructuring and for the first three years of the forecast period, the financial ratios ... were foreseen to be in the range of the ratios of US companies having below investment grade ratings..." (emphasis in original).

[260] The EC also acknowledges that the actual experience of DSME was better than had been forecast. "We understand that the interest coverage ratio was used to estimate the size of the debt restructuring and we appreciate that the actual results of DSME were better than foreseen." Exhibit EC-145 at 5.

concern value of the two spun-off companies, since only those assets and liabilities that were directly related to operating activities were allocated to them.

7.477 We agree with Korea that Anjin was not required to take into account the relevant liabilities towards Daewoo London, since they were not confirmed at the time of the report. We also note that the EC does not challenge[261] Korea's statement that such liabilities would in any event not have been allocated to DSME.

- Receivables from Daewoo Affiliates

7.478 The EC notes that DHI receivables from certain Daewoo affiliates were not included in the going concern value because, according to the Anjin report, of "the non-finalization of the due diligence investigations of affiliated companies".[262]

7.479 Korea submits that the relevant receivables were included under Phase 1 of Anjin's analysis, but were attributed a value of **[BCI: Omitted from public version]** when Anjin calculated the liquidation and going concern values because, at the time of valuation, Daewoo affiliates were undergoing due diligence review by other accounting firms. Korea submits that the exact amount reported for receivables from Daewoo affiliates does not affect the Phase 1 comparison of the liquidation with the going concern value, since in any event the same amount would be used for both the Phase 1 liquidation and going concern values. Korea submits that the recoverable amount of receivables from affiliates was valued at 30 per cent of receivables under Phase 2, and was included in both the liquidation and going concern scenarios under Phase 2. Again, Korea submits that the exact amount of value booked to receivables from affiliates does not really matter, provided the same amount is booked under both liquidation and going concern values.

7.480 The EC has not made any arguments to cause us to doubt Korea's assertion that the exact amount of receivables from affiliates would have had no impact on Anjin's Phase 1 and 2 analyses, provided the same amount was included in the liquidation and going concern values used for Phases 1 and 2 respectively. In particular, we note that the EC has not disputed Korea's argument in its comments on this issue in Exhibit EC – 158.

7.481 In Exhibit EC – 158, the EC instead asserts that the **[BCI: Omitted from public version]** per cent recovery rate on DHI assets was almost the same as the **[BCI: Omitted from public version]** per cent recovery rate on DSME/DHIM assets. The EC submits that this does not seem to reflect the objective of the restructuring. Korea submits that, in deciding whether or not to restructure a company, what matters is whether going concern value exceeds liquidation value. Korea asserts that the ratios of recovery from different business divisions in the event of liquidation are simply not relevant to the decision whether or not to restructure.

7.482 While we note that Table 3 on page 11 of Exhibit EC – 158 demonstrates that the recovery rate for DSME/DHIM in the event of liquidation would only be slightly better than the recovery rate for DHI under liquidation, we fail to see the significance of this to the case at hand, since it has no relevance to the issue of whether or not the going concern value of DHI exceeds the liquidation value of DHI (Anjin's Phase 1). Once a determination is made that the going concern value of DHI does exceed the liquidation value of DHI, the relevant issue becomes which of the restructuring scenarios would provide the greatest rate of return for creditors (Anjin's Phase 2). Again, the Table 3 is of no relevance to this issue, since Table 3 is based on asset recovery rates under liquidation, whereas Phase 2 of Anjin's report concerns the effect of different restructuring scenarios.

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[261] The EC's comments on Exhibit KOREA-141 do not address this issue (see Exhibit EC – 158, page 3).

[262] See Exhibit EC – 145, page 6.

- Conclusion

7.483 We recall that the EC has pointed to the decision of foreign creditors not to participate in the restructuring, as well as to certain alleged shortcomings or flaws of the Anjin report, in support of its argument that the decision to restructure Daewoo was not on market terms. As above, we approach the question of benefit from the Daewoo restructuring by considering whether the EC has demonstrated that the decision to restructure Daewoo was commercially unreasonable. As discussed above, the evidence concerning the reasons for the differing behaviour of domestic and foreign creditors is mixed. Furthermore, while the EC has raised certain questions and doubts about the Anjin report, we do not consider that the EC has demonstrated that any of these alleged flaws constitutes an unequivocal error or distortion such that the conclusion that Daewoo's value as a going concern exceeded its liquidation value was manifestly incorrect or biased, and the decision to restructure was clearly commercially unreasonable. While another analyst performing the same task might have used assumptions closer to those preferred by the EC, this does not mean that the assumptions used by Anjin are demonstrably incorrect. We therefore do not consider that the EC has established that the decision to restructure DHI instead of liquidating it was commercially unreasonable.

7.484 We recall that the EC also has argued that the terms of the DHI restructuring were not on market terms. We thus now turn to this issue.

The debt write-off / rescheduling

7.485 The EC submits that the write-off / rescheduling of DSME's debt constitutes a subsidy. Since the EC has not made any arguments regarding the terms on which DSME's debt was written-off / rescheduled, we understand that the EC's claim concerns only the fact that the write-off / rescheduling actually occurred. In other words, the EC claims that the write-off / rescheduling as such confers a benefit and therefore constitutes a subsidy because market operators – as was the case with foreign creditors – would not have participated in it.

7.486 Korea submits that the debt write-off / rescheduling did not constitute a subsidy since it was based on the Anjin report, and therefore consistent with market principles.

7.487 Regarding the issue of whether or not market operators would have participated in the debt write-off/rescheduling, we recall that the EC has relied on the decision of foreign creditors not to participate. As discussed above, while this is certainly relevant, we do not find it decisive on this issue. As the very essence of restructuring is the writing off and rescheduling of debts, we disagree with the EC that the fact that such write-offs and rescheduling took place, as such, conferred a benefit. The existence of a benefit would have to be determined on the particular terms and conditions of the write-off / rescheduling, about which the EC has presented no evidence or argument. We do not consider, therefore, that the EC has established that the debt write-off/rescheduling was commercially unreasonable under the circumstances at the time of the restructuring.

Debt-for-equity swap

7.488 The EC submits that the debt-for-equity swap constitutes a subsidy because it was not conducted on the basis of market principles. In particular, the EC submits that DSME's creditors overpaid for the equity in the debt-for-equity swap by **[BCI: Omitted from public version]** million, based on a comparison of the share value paid at time of the swap and when it was first publicly traded several months later. The EC asserts that the share price as valued by the stock market, which is the best approximation of a free and undistorted market, is the only available benchmark, even though it acknowledges that it is an imperfect (and conservative) benchmark. The EC also asserts that two months after the spin-off, an Australian investor offered to purchase Daewoo-SME for what it deemed to be the market price, based on the actual value of shares on the stock exchange at the time, which was lower than the price agreed in the context of the debt-for-equity swap.

7.489 Korea submits that the debt-for-equity swap could not have resulted in benefit because creditors merely exchanged their debt for equity, and therefore could not have overpaid for their equity. Korea asserts that the debt-for-equity swap was conducted on the basis of Anjin's market assessment of the value of DSME's equity. Korea rejects the EC's *ex post* comparison of the terms of the debt-for-equity swap with the price at which DSME shares were subsequently publicly traded. Korea asserts that DSME's share price exceeded the terms of the debt-for-equity swap soon after DSME's shares were publicly traded, and that the Australian investor referred to by the EC offered a price higher than that paid by DSME's creditors in the context of the debt-for-equity swap.

7.490 In principle, we accept the EC's argument that a benefit could be conferred through a debt-for-equity swap if creditors exchange too much debt for equity. Although Korea argues that creditors could not have overpaid since there was no more that they could have demanded, we consider that they could have overpaid by exchanging too much debt for a given amount of equity. This could occur if the equity were over-valued, which is precisely what the EC alleges in the present case.

7.491 Regarding the substance of the EC's claim, we consider that the terms of the debt-for-equity swap should not be analysed *ex post*, on the basis of the price at which DSME's shares were publicly traded, or the price offered by potential buyers of DSME. Instead, the terms of the debt-for-equity swap should be assessed in light of the facts before creditors at the time they decided upon them. This is because facts may change over time, to the extent that a market's assessment of the value of DSME shares on one day will not necessarily be the same as its assessment of the value of those shares on another day. Indeed, even the EC would appear to agree with such an approach, since it stated at the first substantive meeting with the parties that:

> Moreover, Korea cannot invoke in its favor the fact that the share value of the restructured yards increased over time. As also pointed out by the United States, there is no room for an *ex post* analysis. The only relevant question is whether a private creditor/investor would have agreed to the restructuring packages on the basis the information available to him *at the time of the restructuring.* [263] (italics in original)

7.492 We note that the EC has not presented any arguments against the terms of the debt-for-equity swap based on the information available to DSME's creditors at the time that they decided to participate in it. Although the EC has argued that market operators would have liquidated DHI rather than participate in the debt-for-equity swap, this argument is based on the EC's foreign creditor market benchmark that we have already rejected. In the absence of relevant argumentation by the EC, we reject the EC's claim against the DSME debt-for-equity restructuring.

Conclusion

7.493 We have found that the various instruments involved in the restructuring of DHI were financial contributions in the sense of Article 1.1(a)(1)(i) of the *SCM Agreement.* We also have found that certain creditors of DHI at the time of its insolvency and restructuring were public bodies, but that the EC has not established that the private creditors were entrusted or directed by the government to make financial contributions to DHI via their participation in the restructuring. In terms of whether the financial contributions by public bodies conferred a benefit, we have based our analysis on whether the EC has demonstrated that the decision to restructure DHI rather than liquidate it, and/or the terms of DHI's restructuring, were commercially unreasonable. In this regard we note that when a company is insolvent, a creditor operating on a commercially reasonable basis will be seeking to minimize its losses / maximize its recovery.

[263] EC's Oral Statement, para. 85, page 21.

7.494 Concerning the arguments advanced by the EC relevant to the commercial reasonableness of the decision to restructure rather than liquidate DHI, we have found that while the absence of foreign creditor participation in the restructuring is relevant, it is not determinative, given the mixed evidence as to the reasons for it, and its significance. We have further found that the EC, while raising a number of relevant points concerning the credibility and validity of the Anjin report's analysis and conclusions, has not demonstrated that any of them individually or all of them collectively represents manifest error to the point that no reasonable commercial investor would have relied upon the report in reaching the decision to restructure DHI. Finally, we have found that the EC has not demonstrated that the terms of the restructuring, in particular, the write-off and restructuring of debt, and the debt-for-equity swaps, were commercially unreasonable.

7.495 For the foregoing reasons we find that the EC has not demonstrated the existence of a benefit in respect of the restructuring of DHI, and therefore has not demonstrated that the restructuring involved subsidization. Accordingly, we reject this claim of the EC.

(iii) The Halla reorganization

The Rothschild determination – the decision to restructure

7.496 In response to the EC's argument that Halla's creditors failed to act pursuant to market considerations, based on the non-participation of foreign creditors in Halla's restructuring, Korea submits that the reorganization was market-oriented as it was based on a report from Rothschild, a consulting firm retained by Halla, that the going-concern value of Halla exceeded its liquidation value. Korea also argues that, in any event, any benefit resulting from the restructuring was extinguished when HHI acquired Samho at arm's length for fair market value.

7.497 We recall that our approach to determining whether the restructurings conferred benefits is to ask whether the EC has demonstrated that the decisions to restructure, and the terms of the restructurings, were commercially unreasonable. On the first point, Korea relies on Rothschild's determination that the going-concern value of HHI exceeded its liquidation value, and we note that the EC has not challenged this determination.[264] Accordingly, we do not consider that the EC has demonstrated that this determination was commercially unreasonable.

Terms of the restructuring

7.498 As for the second point, although the EC purports to challenge the terms of the Halla restructuring, it relies exclusively on the non-participation of foreign outside investors in support of this argument, and makes no detailed arguments regarding the terms of the debt forgiveness, debt-for-equity swap, interest forgiveness and conversion of short-term debt. For example, there is no suggestion by the EC that the value of equity provided in the debt/equity swap was excessive, as the EC claims in respect of the Daewoo workout. In the absence of such detailed arguments, we do not consider that a simple reference to the non-participation of foreign investors is sufficient to establish that the terms of the restructuring were commercially unreasonable, especially given our finding above that the evidence is mixed as to the reasons for and significance of this non-participation.

7.499 We note Korea's defence that any "benefit" resulting from the reorganization of Halla was extinguished when HHI acquired Samho's shares at arm's length for fair market value. In response,[265]

[264] The EC complains in reply to Question 150 from the Panel that Korea has not provided a full going concern / liquidation value analysis in respect of all members of the Halla group. However, since Halla-HI was the only part of that group to be restructured (the others were liquidated), we consider that only the going concern / liquidation value analysis conducted in respect of Halla-HI is relevant to the present proceedings.

[265] Paragraph 54 of the EC's second oral statement makes it clear that the EC's argument was made in response to Korea's alternative "extinction" argument: "the fact that Hyundai-HI's purchase of Samho took place at less than fair market value means that it did not extinguish the benefits from the subsides". This

the EC asserts that HHI's acquisition of Samho was not at arm's length for fair market value because HHI underpaid for the Samho shares. In light of our finding in the preceding paragraph, that the EC has not demonstrated that there was a benefit, there is no need for us to consider the parties' arguments regarding Korea's defence.

7.500 We have found that the various instruments involved in the restructuring of Halla were financial contributions in the sense of Article 1.1(a)(1)(i) of the *SCM Agreement*. We also have found that certain creditors of Halla at the time of its restructuring were public bodies, but that the EC has not established that the private creditors were entrusted or directed by the government to make financial contributions to Halla via their participation in the restructuring. In terms of whether the financial contributions by public bodies conferred a benefit, we have found that the EC has not demonstrated that the decision to restructure Halla rather than liquidate it, and/or the terms of Halla's restructuring, were commercially unreasonable.

7.501 For the foregoing reasons we find that the EC has not demonstrated the existence of a benefit in respect of the restructuring of Halla, and therefore has not demonstrated that the restructuring involved subsidization. Accordingly, we reject this claim of the EC.

(iv) The Daedong reorganization

7.502 In response to the EC's claim that the Daedong reorganization plan[266] was not market-based because creditors approved it despite Daedong not being creditworthy, Korea asserts that creditors participated on the basis of a determination that the going concern value of Daedong exceeded its liquidation value.

7.503 We recall our approach to the restructurings is to ask whether the EC has demonstrated that they were commercially unreasonable. Here, as a first issue, we note that the EC has not argued that the determination that the going concern value of Daedong exceeded its liquidation was not proper. We therefore consider that the EC has not established that this determination was commercially unreasonable.

7.504 Turning to the terms of the restructuring, although the EC purports to challenge the terms of the Daedong debt restructuring and interest exemption, it relies exclusively on the non-participation of foreign investors, as it also did in the case of the Halla restructuring. It does not make any detailed arguments regarding the terms of the debt restructuring or interest exemption. For the same reasons

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statement also makes it clear that the EC was concerned with "the subsidies" resulting from earlier transactions, rather than the terms of HHI's acquisition of Samho *per se*. Furthermore, the EC's request for establishment only refers to "corporate restructuring subsidies in the form of debt forgiveness, debt and interest relief and debt-to-equity swaps". It does not refer to subsidies resulting from straightforward share acquisitions.

[266] We note that the reorganization plan adopted by creditors envisaged three elements: (i) debt restructuring / exemption from interest; (ii) a capital infusion; and (iii) the issuance of corporate bonds. While the terms of the debt restructuring / interest exemption were determined by creditors when they adopted the reorganization plan, the creditors did not determine the terms of the capital infusion and issuance of corporate bonds. These were finalized after the reorganization plan was adopted, on the basis of advice from KPMG, and in negotiation with the providers of the new capital and the purchaser of the bonds, i.e., STX. The EC's claim against the Daedong reorganization plan, therefore, does not include the terms on which STX acquired the relevant shares and bonds. It is confined to the terms of the debt restructuring / interest exemption, and the decision to seek a capital infusion and issue corporate bonds. We consider that the terms of the share and bond acquisition are only relevant to these proceedings to the extent that Korea relies on them as a defence to argue that the share and bond transactions extinguished any benefit conferred by the debt restructuring/ interest exemption. Accordingly, we shall only examine the terms of the share and bond acquisition to the extent that we uphold the EC's claim against the debt restructuring/ interest exemption.

as enunciated above in respect of Halla, we reject the claim of the EC that the restructuring of Daedong involved subsidization.

2. Daewoo tax concessions

(a) Arguments of the parties

7.505 The EC claims that the Daewoo workout provided for subsidies in the form of tax concessions. The EC initially claimed that the tax concessions were provided pursuant to various provisions of the Special Tax Treatment Control Law ("STTCL") and Corporate Tax Act ("CTA"). In its rebuttal submission, however, the EC submits that its "core claim" concerned a KRW 236 billion tax concession provided under Article 45-2 of the STTCL and Article 46 of the CTA. The EC submits that Article 45-2 STTCL extended tax incentives provided under Article 46 CTA to spin-offs carried out under a workout program approved on or before 31 December 2000. The EC submits that the Article 45-2 exemption constitutes a financial contribution because "government revenue that is otherwise due is foregone or not collected" in the sense of Article 1.1(a)(1)(ii). The EC argues that the Appellate Body interpreted the phrase "government revenue that is otherwise due" in *US – FSC*, where it held that the term "otherwise" refers to a "normative benchmark" established by the tax rules applied by the Member in question.[267] The EC asserts that Daewoo-HI/Daewoo-SME would normally have been required to pay additional taxes (absent the STTCL), and that this is the normative benchmark against which the foregoing of revenue should be assessed. The EC argues that the fact that the tax exemption was not "normal" is shown by the fact that Article 45-2 did not apply to restructuring before 21 October 2000 or after 31 December 2000.

7.506 The EC also submits that the Anjin report did not analyse the tax consequences of the restructuring plan. According to the EC, this fact either adds to the flaws of the Anjin Report already identified by the European Communities and further reduces DHI's going concern value or it shows that the entire restructuring was precooked from the beginning with Anjin knowing about the tax exemption well before it was adopted.

7.507 Korea denies that the workout resulted in any subsidy under Article 45-2 of the STTCL. According to Korea, Article 45-2 STTCL states that if a domestic corporation divides itself in accordance with a workout plan, then the provisions of Article 46(1) CTA apply. Article 46(1) in turn provides that, if a spun-off company carries out a valuation of the assets it acquires from the original corporation, an amount equivalent to the valuation gains may be treated as losses for the purpose of calculating taxable income for the fiscal year in which the spin-off takes place. Korea emphasises that Article 46 CTA mandates specific tax treatment with respect to "gain" or "profit" realized to the spun-off company as a result of the "valuation" of assets conducted in the course of spin-off. Korea submits that, in the case of the DHI spin-off, there was no valuation gain or profit because the DHI assets were simply allocated at "book value" to the two spun-off companies and what remained of DHI. Korea asserts that, because the assets were simply moved from one entity to another, there was no taxable event and no forgoing of any government revenue that was otherwise due. Korea therefore submits that Article 45-2 did not confer a benefit.

7.508 Korea asserts that while DHI may have enjoyed a tax exemption under Article 99 of the CTA, the EC has not presented a claim under this provision. Korea also notes that any tax exemption under Article 99 of the CTA did not need to be taken into account in the Anjin report since it would not have affected DHI's going-concern value.

[267] Appellate Body Report, *US – FSC*, para. 90.

(b) Evaluation by the Panel

7.509 We note that the "focus"[268] of the EC's tax exemption claim concerns benefit allegedly accruing to the spun-off companies, DSME and DHIM, under Article 45-2 STTCL and Article 46 CTA. The EC states that Article 45-2 STTCL extended the tax incentives provided under Article 46 CTA to the spin-offs carried out under a workout. The EC states that if a newly spun-off company acquires the assets of an old company, Article 46 provides that an amount equivalent to the gain on the transfer of these assets may be treated as an expense in the accounts of the new company, thereby lowering the new company's taxable income. The parties therefore agree that Article 45-2 STTCL and Article 46 CTA provide for tax exemptions for spun-off entities in the event that they "gain" on the transfer of assets from the original company.

7.510 In the context of the Daewoo restructuring, the Spin-Off Balance Sheet at Appendix 10 of the Anjin report indicates the same total value of assets before and after the spin-off. This demonstrates that the assets were allocated between DHI and the two spun-off companies at book value. Since the transfer of assets took place at book value, the transfer did not result in any "gain" for DSME or DHIM. There was, therefore, no basis for any tax exemption under Article 45-2 STTCL and Article 46 CTA. The EC relies on a press article[269] to argue that a tax exemption was provided under these provisions. Even were that press article to have been sufficient to establish a *prima facie* case that a tax exemption was provided under these provisions, the above facts would rebut that *prima facie* case. In the absence of any more compelling evidence from the EC, we therefore reject the EC's claim under Article 45-2 STTCL and Article 46 CTA.[270]

7.511 In its reply to Question 116 from the Panel, Korea presented information suggesting that DHI may have benefited from a tax exemption under Article 90 of the CTA. However, we note that there is no reference to this provision in the EC's Request for Establishment of a panel.[271] Our terms of reference therefore do not include any claims under Article 90 of the CTA.

3. Specificity

7.512 Pursuant to Article 1.2 of the *SCM Agreement*, a subsidy is only subject to the disciplines of the *SCM Agreement* if it is "specific" in accordance with Article 2 thereof. Thus, we may only uphold the EC's actionable subsidy claims if we find that the relevant transactions are subsidies, and that such subsidies are specific.

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[268] See the EC's reply to Question 141 from the Panel.

[269] See Exhibit EC – 136.

[270] Although the EC's first written submission also refers to Article 38 of the STTCL, the EC's legal analysis does not set out any basis for a claim under that provision. To the extent that the EC makes any claim under Article 38, we therefore find that it has not established any *prima facie* case in support of that claim. We further note the EC's argument that taxation issues were not properly considered by Anjin in establishing DHI's going concern value. First, we note that the EC has not properly established that there were any tax issues to be considered. In particular, the EC has not demonstrated any tax concessions under Article 45-2 STTCL and Article 46 CTA. With regard to the possible tax concession under Article 90 CTA, we note Korea's explanation that any such tax concession would benefit DHI, rather than DSME and/or DHIM. Since DHI's going concern value was calculated on the basis of estimated cash flows from DSME and DHIM, and these cash flows have not been shown to have been affected by any tax concession under Article 45-2 STTCL or Article 46 CTL, and would not benefit from any tax concession (to DHI) under Article 90 CTA, we do not consider that DHI's going concern value would be affected by any tax concession provided to DHI under the latter provision.

[271] The relevant part of the request for establishment provides that "[t]he Special Tax Treatment Control Law, more specifically, the special taxation on in-kind contribution (Article 38) and the special taxation on spin-off (Article 45-2) scheme, establishes two tax programmes limited to companies under corporate restructuring and provides tax concessions to Daewoo, the combined benefit of which is estimated at won 78 billion." (WT/DS/273/2).

7.513 We only consider it necessary to address the issue of specificity in respect of those measures that we have found to constitute subsidies. Since we have rejected the EC's claims of subsidization in respect of the three corporate restructurings, and the alleged DHI tax concession, there is no need for us to consider whether they are specific in the meaning of Article 2 of the *SCM Agreement*.

7.514 We recall that we have already found that the individual APRG and PSL transactions identified at para. 7.331 *supra* are specific subsidies.[272] We made this finding in the context of the EC's prohibited export subsidy claims, on the basis of Article 2.3 of the *SCM Agreement*. Korea argues that such subsidies are not specific for the purpose of the EC's actionable subsidy claims, since the EC failed to argue any specificity other than Article 2.3 of the *SCM Agreement*. Korea asserts that such subsidies are therefore not actionable. In our view, however, the effect of Article 2.3 is not restricted to prohibited export subsidy claims. Rather, we consider that Article 2.3 applies in respect of the entirety of the *SCM Agreement*. Thus, a subsidy that is specific under Article 2.3 (as a result of export contingency) is specific for the purpose of both Part II (prohibited export subsidy) and Part III (actionable subsidy) claims.

4. Conclusion

7.515 For the above reasons, we reject the EC's claims that the restructuring of Daewoo, Halla and Daedong involved subsidization. We also reject the EC's claim that Daewoo received subsidies through tax concessions under Article 45-2 STTCL and Article 46 CTA. We recall that we have upheld the EC's prohibited subsidy claims in respect of certain individual APRGs and PSLs.

D. SERIOUS PREJUDICE

1. Annex V information

7.516 As discussed above, the EC invoked the procedures in Annex V to the *SCM Agreement* in this dispute. During the course of the proceedings, both parties submitted extensive material in response to questions posed to one another. We have relied on the parties to bring to our attention such of that material as each considers relevant to its case. In other words, we have not ourselves conducted our own review of this material since, were we to have done so, we would have run the very considerable risk of making one or the other party's case for it, which of course we must not do.

2. Summary of the claim

7.517 In its Request for Establishment of a Panel,[273] the European Communities refers to claims of serious prejudice based on price undercutting, price suppression, price depression, and lost sales. During the course of the dispute, the EC has clarified that it is pursuing its serious prejudice claim only on the basis of price suppression/price depression.[274] Thus, while the EC provides certain anecdotal evidence concerning instances in which it alleges that EC shipyards lost sales to Korean yards, it has explicitly confirmed that it has adduced this evidence to illustrate the suppressed and depressed price levels alleged to have been caused by subsidized Korean competition.[275]

7.518 The EC also has clarified that the focus of its price suppression/depression claim is three particular types of commercial vessels: container ships, product/chemical tankers (that is, tankers that can be used for either petroleum products or chemicals, rather than tankers dedicated exclusively to one or the other), and liquefied natural gas carriers, or "LNGs".[276] The EC has presented certain

[272] See paras 7.192 and 7.308 *supra*.
[273] WT/DS/273/2.
[274] First Oral Statement of the EC, para. 97.
[275] Response to Panel question 35, para. 152.
[276] First Written Submission of the EC, para. 417; First Oral Statement of the European Communities, para. 101; Second Written Submission of the EC, para. 275

information and argumentation in relation to the world commercial shipbuilding market as a whole, but states that in its view the Panel would need to evaluate the existence and causation of price suppression/depression for each of the three vessel types separately, rather than trying to assess them collectively.[277]

7.519 In this respect, in response to an oral question at the second meeting, the EC indicated that it was requesting the Panel to make three separate serious prejudice findings, one for each of the three vessel types. In the written version of its answer to this question, however, the EC indicated the reverse, stating that serious prejudice is to the interests of a WTO Member and that therefore there is no need for three separate serious prejudice findings.[278] The EC explained that; just as serious prejudice can be found based on various combinations of Article 6(a)-(d), it also can be based "on multiple findings of price depression and/or suppression in the global market (albeit in three different sub-markets of commercial vessels)".[279] According to the EC, the subsidies at issue were granted to shipyards that produce a variety of commercial vessels, such that the same subsidy caused price suppression and/or price depression in the three product markets at issue. Nevertheless, the EC argues, the finding of serious prejudice should be based on price suppression and/or price depression in the three "product markets", each of which is a "global geographic market".[280]

7.520 In respect of price suppression/price depression, the EC argues, first, that the alleged subsidies have enabled the Korean shipyards to reduce their prices or keep their prices stable, in spite of strong increases in demand and production costs which otherwise would have led to price increases.[281] Second, the EC argues, the market for each of the three types of ships is global,[282] and Korea is the global price leader.[283] Thus, the price pressure caused by the subsidies has set the world price levels for the three types of ships covered by the EC claim, leading EC shipyards either to become discouraged from bidding (given the high cost of preparing and submitting bids); or to lose bids that they do make, due to their inability to meet the Korean/world price level; or to earn less revenue and profits than they should on the bids that they win, due to the suppressed/depressed global price levels.

3. Scope of the claim

7.521 We note that the adverse effects claims (under part III of the *SCM Agreement*) that are before us are considerably narrower than was indicated in the EC's Request for Establishment of the Panel. In particular, the serious prejudice claim was narrowed to exclude price undercutting and lost sales, and thus is based exclusively on price suppression/price depression. In addition, the EC did not pursue its claim of injury to the EC domestic shipbuilding industry which was referred to in the Request for Establishment. Thus, under Part III of the *SCM Agreement*, the only claim before us is that of serious prejudice based on price suppression/price depression.

4. Legal framework

7.522 Before considering the details of the claims and arguments before us in this dispute, we first consider the legal framework that must be applied in determining whether a subsidy has caused serious prejudice to the interests of a Member.

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[277] First Written Submission of the EC, para. 455.

[278] Responses to Questions from the Panel by the EC, para. 120.

[279] Responses to Questions from the Panel by the EC, para. 121.

[280] *Id.*

[281] First Written Submission of the EC, paras. 446-455, for all types of vessels; *Ibid*., paras. 430-434 and 458, for LNGs; *Ibid*., paras. 460-463, for Container Ships; *Ibid*., paras. 469-473, for Product and Chemical Tankers.

[282] First Written Submission of the EC, para. 424.

[283] First Written Submission of the EC, para. 433 and 447, for LNGs; *Ibid*., para. 460, for Container Ships; *Ibid*., para. 470, for Product and Chemical Tankers.

(a) Article 5(c) – serious prejudice

7.523 Under the *SCM Agreement*, the legal basis of all adverse effects claims pursuant to Part III of the *Agreement* is Article 5, which identifies three possible kinds of adverse effects: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits of another Member, in particular of benefits from *GATT 1994* Article II bindings; and (c) serious prejudice to the interests of another Member. Given that the EC's adverse effects claim exclusively refers to serious prejudice (based on price suppression/price depression), the relevant part of Article 5 is Article 5(c), which reads:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> [...]
>
> (c) serious prejudice to the interests of another Member.[13]
>
> _____
>
> [13] The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

7.524 It is clear from the text of Article 5(c) that, in the first instance, a specific subsidy (i.e., a subsidy referred to in paragraphs 1 and 2 of *SCM* Article 1) must be found to exist. Our findings in respect of the EC's claims of subsidization are contained in section VII., *supra*.

(b) Article 6.3(c)

7.525 Article 6 provides certain specific guidance concerning the establishment of "serious prejudice" in the sense of Article 5(c). The particular provision cited by the EC in its claim is Article 6.3, and more specifically Article 6.3(c), which reads as follows:

> "6.3 Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:
>
> [...]
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression, or lost sales in the same market."

7.526 Significant price suppression or price depression is the particular basis of the serious prejudice to its interests alleged by the EC as a result of subsidies to Korean shipbuilders. While Article 6.3(c) also is the pertinent provision for serious prejudice based on price undercutting and lost sales, those parts of that provision are not before us, given the narrowing of the EC's claim.

7.527 The text of *SCM* Article 6.3(c) in respect of price suppression/price depression, taken as a whole, identifies a number of discrete elements, in respect of which the parties have argued extensively. The elements that have been addressed in the parties' arguments are:

- Price suppression or price depression;

- Significance (the price suppression or price depression must be "significant");

- Causation – "the effect of the subsidy" is, *inter alia*, significant price suppression/depression;

- Like product – The major threshold question joined by the parties in this dispute in respect of this element is whether the concept of like product applies in price suppression/depression cases;

- Same market – The price suppression/price depression caused by the subsidy must be "in the same market"; and

- Serious prejudice – Is significant price suppression/depression caused by a subsidy in itself serious prejudice? If not, what in addition must be established?

7.528 The parties have raised two main sets of issues in respect of the legal analysis or framework to be applied in respect of price suppression/price depression-based serious prejudice claims: First, how and on what basis is the existence of significant price suppression/price depression as the effect of a subsidy established? Second, if price suppression/price depression resulting from a subsidy is established, does this in itself constitute "serious prejudice" in the sense of Article 5(c), and if not, what else must be established?

7.529 We start with the text of the relevant provisions, to identify any guidance that they may contain in respect of both of these two main sets of issues. Concerning the establishment of significant price suppression or price depression as the result of a subsidy, Article 5(c) contains only the term "serious prejudice to the interests of another Member", while footnote 13 thereto states that this term is used in the same sense as in Article XVI:1 of *GATT 1994* and includes threat of serious prejudice. Neither the provision nor its footnote, however, defines or elaborates on this term, in general or as it pertains specifically to price suppression/price depression.

7.530 Turning next to Article 6.3, we note that this Article itself refers simply to "significant price suppression [or] price depression", without elaboration, and that it is the only provision in Article 6 dealing specifically with price suppression/price depression. The other parts of Article 6 either address certain aspects of serious prejudice in general, or other specific bases for serious prejudice. For example, Article 6.5 provides certain specific guidance in respect of the establishment of price undercutting in the sense of Article 6.3(c) (which of course is not before us).

7.531 As to the second main set of issues, Korea points to the word "may" in the chapeau of Article 6.3, i.e., that "[s]erious prejudice [...] *may* arise" where one or several of the situations listed in subparagraphs (a)-(d) applies. On the basis of the word "may", Korea argues that the existence of one or several of the listed situations is a necessary but not a sufficient condition for a finding of serious prejudice, in that serious prejudice is something that must be caused by one of the situations referred to in (a)-(d). The EC disagrees, stating that the situations in (a)-(d) (i.e., including significant price suppression/price depression resulting from a subsidy) themselves constitute serious prejudice.

7.532 Both parties have submitted extensive legal argumentation concerning the analysis that must be conducted to determine if subsidies have caused price suppression and/or price depression, and concerning the meaning of the term "serious prejudice". They then apply their respective legal interpretations to the factual situation. We take a similar approach, that is, we first consider and reach a conclusion in respect of the analytical framework that we must apply, and we then apply that framework to the facts and arguments as presented to us by the parties.

5. Meaning of price suppression or price depression

7.533 We begin our consideration of the legal, analytical framework with the terms "price suppression" and "price depression" themselves. We note that while the Agreement contains no

definitions or other interpretative guidance, these concepts seem more or less understandable on their own, and the parties do not seem to disagree over their meaning. In particular, both parties use the term "price suppression" to refer to the situation where prices have not increased when, or have increased less than, they otherwise would have. Both use the term "price depression" to refer to the situation where prices decline when they should have remained stable or increased.[284] In particular, the EC states that the dictionary definition of "depression" is "the action of pressing down; the fact or condition of being pressed down", such that price depression is where prices are pushed downward; and that the dictionary definition of "suppress" is to "prevent or inhibit (an action or phenomenon)", meaning that for price suppression there must be a showing that price increases have been inhibited. Korea agrees, and in fact quotes the EC on the meaning of the term "price suppression".[285]

7.534 Based on this reading, as a threshold issue the *existence* of lower than expected price increases, or of price reductions, would have to be established as a matter of fact, as one necessary condition for proving a claim of serious prejudice based on price suppression or price depression caused by subsidies. We emphasize here, however, that trends in prices would not themselves constitute price suppression or price depression : as discussed *infra*, we view these terms as implicitly including a certain built-in concept of causation.

7.535 A related issue is *whose* prices are to be examined to determine if there is price suppression or price depression. For Korea, serious prejudice to a Member based on price suppression or price depression must have to do primarily with that Member's prices for the product in question. The EC states that Korean prices have been suppressed or depressed by subsidies, that this in turn has suppressed or depressed *world* ship prices and EC shipyards' prices. For the EC, the suppression or price depression of world prices is "the critical element".[286] We understand this to mean that for the EC suppression or price depression of the *world* price for a product in respect of which the EC competes in itself constitutes or causes serious prejudice to the interests of the EC. Here the parties seem to agree that the subsidizer's prices *inter alia* also are relevant.

6. Existence of price suppression/depression

7.536 It may be relatively simple to establish that, as a threshold factual matter, the price of a particular product has decreased. Similarly, it may be relatively simple to establish that the price of a product has been flat or has increased only slightly. Conceptually, however, it is likely to be more difficult to show that prices should not have decreased, or should have increased by more than they did.

7.537 In particular, the existence of a flat or declining price trend, on its own, would not be a sufficient basis on which to conclude that prices were "suppressed" or "depressed". For such a conclusion to be reached, the *causes* of these observed trends would need to be examined. In other words, price depression is not simply a decline in prices but a situation where prices have been "pushed down" *by something.* Price suppression is where prices have been restrained *by something.* In other words, for a finding of "price suppression" or "price depression" in the sense of *SCM* Article 6.3(c), there must not only be a flattened or downward price trend as a prerequisite, but in addition this trend must be the result of an exogenous factor, namely the subsidy or subsidies in question. Thus, the analysis that seems to be called for by the Agreement (by virtue of the concepts of

[284] These concepts also are well-known in the area of trade remedies. In the context of anti-dumping and countervailing measures, for example, price suppression is described as the situation where "price increases, which otherwise would have occurred" are prevented "to a significant degree".

[285] At paragraph 522 of its First Submission, Korea, citing the EC submission states: "[...] price suppression can be defined as the prevention of price increases that otherwise would have occurred".

[286] EC response to question 35 from the Panel.

price suppression and price depression themselves), concerns what the price movements for the relevant ships *would have been* in the absence of (i.e., "but for") the subsidies at issue.[287]

7. Does the concept of "like product" apply in respect of price suppression/price depression?

(a) Arguments of the parties

7.538 The parties disagree as to whether the concept of "like product" applies in the context of price suppression/depression. For the EC, it is clear from the text of Article 6.3(c) that this concept does not apply in this context, and the EC therefore declines to define any "like products" in the sense that that term is used in the *SCM Agreement*. The EC nevertheless indicates that its adverse effects claims are in respect of the three identified kinds of ships (LNGs, product/chemical tankers, and container ships), which categories it says are "analogous" to like products. Korea takes the opposite view, arguing that the concept of like product does apply and that the EC, by not addressing the issue or defining "like products", has failed to meet its burden to establish a *prima facie* case of serious prejudice. Furthermore, for Korea, even if the EC had argued that the product categories it identifies were like products, these categories would be too broad to fit the Agreement's definition of like product.

7.539 The EC relies on the fact that in Article 6.3(c), the term "like product" appears only in connection with price undercutting, and not in connection with price suppression/price depression or lost sales. For the EC, this textual difference must have meaning, and in particular can be explained on the basis of economic logic: that products that are not identical, but broadly similar and in competition with one another, can and do influence one another's' prices.[288] The EC argues that by not referring to like product in the context of price suppression/depression, the negotiators created flexibility as to how to determine the "same market" in which price effects occur (which term for the EC has both a product and a geographic connotation). That is, according to the EC, *SCM* Article 6.3(c) allows the tailoring, on a case-by-case basis, of criteria appropriate to capture price developments in the relevant product and geographic market affected by subsidization. For the EC, it is precisely because the like product definition in the *SCM Agreement* is very narrow that the negotiators chose to omit it as a requirement for price suppression/depression analysis.

7.540 Korea disagrees, arguing that like product is a strict requirement for price suppression and price depression (as it explicitly is for price undercutting), and criticizing the EC for failing to address this required element. In particular, Korea argues that by declining to define a like product or to present evidence in respect thereof, the EC has omitted one of the key necessary elements of the price suppression/price depression analysis, and thus has failed to establish a *prima facie* case of serious prejudice. Korea argues that the Panel should dismiss the EC's serious prejudice claim on this basis.

7.541 Concerning the text at issue, Korea argues that the reason the words "like product" are not repeated in the second part of Article 6.3(c) (the part dealing with price suppression/price depression and lost sales), while the words "same market" are repeated there, is that repetition of the former would be "superfluous" while repetition of the latter is not. That is, the geographic markets to which the subparagraphs of Article 6.3 refer vary from one subparagraph to another, while the term "like product" retains the same meaning throughout Article 6.3. Korea then argues that if like product does

[287] We note that the panel in *Indonesia – Autos* applied an analogous "but for" analysis in its consideration of the claims of displacement and impedance of imports. We discuss this *infra* in connection with causation.

[288] Indeed, the EC argues as a theoretical point, although not as the basis for its claim, that the prices for all types of ships are sufficiently interlinked, due in particular to the broad capabilities of most shipyards to produce a wide range of different kinds of ships, that a price change for any one ship type will have rippling price effects on *all* other ship types. Responses by the EC to Question 29(c) from the Panel.

not apply in respect of price suppression/price depression, this would mean that a "new and undefined standard" has been introduced by negotiators for price suppression/price depression, but with no express words to that effect, a proposition that Korea does not find credible.

7.542 For Korea, the concept of like product is a cornerstone of the *SCM Agreement* and of the *WTO Agreement* as a whole. To not apply like product would imply, for Korea, a series of separate and distinct causation analyses under the different subparagraphs of Article 6.3, based not just on the different alleged subsidies but also with respect to every causal element (i.e., like product for some and "something else special" for price suppression and price depression).

(b) Evaluation by the Panel

7.543 Korea's argument that "like product" is a required element of price suppression/depression analysis seems to presuppose, in the first instance, the identification of a "subsidized product", which, in Korea's view, the product subject to the dispute must be "like". In particular, the question raised by Korea's argument is whether the adverse effects on the EC's interests in terms of price suppression/price depression must relate to a product that is "like" an identified "subsidized product".

7.544 We note that the Agreement contains a detailed definition of "like product", in footnote 46 to Article 15.1. We note further that this definition applies to the *SCM Agreement* in its entirety, as indicated by the definition's introductory phrase ("[t]hroughout this Agreement"):

> "Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is *identical*, i.e., alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has *characteristics closely resembling* those of the product under consideration." (Emphasis added.)

Thus, if the concept of like product does apply in respect of price suppression/price depression, it would have the meaning set forth in footnote 46.[289]

7.545 We start our consideration with the relevant text of the *SCM Agreement*, which we note is somewhat ambiguous as to the applicability of "like product" in the context of price suppression/price depression. In particular, in *SCM* Article 6.3(c) which covers price undercutting, price suppression, price depression, and lost sales, the term "like product" explicitly appears in conjunction *only* with price undercutting. To recall, the provision in its entirety reads:

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[289] The panel in *Indonesia – Autos*, in interpreting the term "like product" in the serious prejudice claims before it (which did not include price suppression/price depression), found the definition in footnote 46, including the term "characteristics closely resembling", to be quite narrow, and to be based principally on physical characteristics of the product. The panel then conducted a detailed analysis of the physical characteristics of the particular car models in the market segment that it was considering as the possible "like product" category. On the basis of this approach, the panel excluded as a "like product" a larger and more powerful car in an adjacent market segment to that of the subsidized car. The panel in *Indonesia – Autos* recognized that it could not feasibly limit the like product to strictly identical cars, but recognized as well that it would not make sense, and would not conform to the definition in SCM footnote 46, to identify the like product as "all passenger cars". Instead, the Panel considered the like product to be the market segment, as defined by a widely-used and well-respected market analysis firm, in which the subsidized Indonesian national car was classified. The market segments identified by the market analysis firm, although certainly encompassing non-identical cars, nevertheless were quite narrowly-defined, in terms of size and other basic physical characteristics, as well as other indicators such as price and customer perceptions which the Panel viewed as being based primarily on physical characteristics. The physical similarity of the cars within the segment found to be relevant by the panel, and the dissimilarity of these cars and cars in other segments, was considered and confirmed by the panel through further analysis of a number of key *physical* characteristics.

> "the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market".

7.546 Thus, Article 6.3(c) refers to "significant price undercutting" by the subsidized product in respect of a "*like product*" of another Member in the same market. By contrast, the provision then continues with the reference to price suppression/depression and lost sales, repeating the term "in the same market", but making no mention of "like product". Thus, the question is whether the lack of a reference to "like product" in the specific context of price suppression/depression means that like product is *not* a required element of price suppression/price depression analysis. The answer to this question would seem to have certain implications for the analysis that needs to be carried out.

7.547 In assessing the legal issue concerning the applicability of like product in respect of price suppression/price depression, we note first Article 6.3(c)'s lack of an explicit reference to like product in connection with price suppression/price depression. Thus, the text on its face does not explicitly impose a like product requirement. Clearly the question before us is whether this text nonetheless contains an implied reference to like product, as argued by Korea, or whether the absence of an explicit reference means that like product is not a required element of the analysis.

7.548 In respect of the text, we find significant that the term "the same market" is used twice in Article 6.3(c), including in connection with price suppression/price depression, while the term "like product" appears only once, not in connection price suppression/price depression. To us, the repetition of "same market" strongly suggests that the text also would repeat "like product" had this term been intended to apply in this connection.

7.549 Turning to the relevant context, the immediate context consists of the other subparagraphs of Article 6.3, all of which explicitly specify and require a particular product scope. Article 6.3(a) and 6.3(b) refer to "like product", and Article 6.3(d) refers to "a particular ... primary product or commodity". We view these references to product, variously defined, everywhere else in Article 6.3 as contextual support for the proposition that like product is not a legally required element in respect of price suppression/price depression analysis. In other words, we infer from the text that where it was intended that a product scope concept apply, this was made explicit. In this regard, we are not persuaded by Korea's argument that it would have been redundant to repeat the reference to "like product" in Article 6.3(c), while the existing repetition of "the same market" is not redundant. While it is true, as Korea argues, that the "markets" referred to elsewhere in Article 6.3 vary from one subparagraph to another ("the market of the subsidizing Member", "a third country market", "the world market"), this is clearly not the case *within* Article 6.3(c), which refers twice to "the same market". Whatever "the same market" means, it must mean the same thing in both places.

7.550 Korea points to *SCM* Article 15, which pertains to countervailing measures, as relevant context in support of the applicability of "like product" in respect of price suppression/price depression. While the relevant portion of Article 15.2 is phrased very similarly to that of Article 6.3(c), we do not see this by itself as determinative of this question. First, countervail and serious prejudice concern situations that are considerably different: material injury to a particular domestic industry producing a particular "like product", on the one hand, and adverse effects in the form of serious prejudice to a Member's "interests", on the other hand. Furthermore, unlike Article 6.3(c), Article 15 makes *explicit* that in the countervail context the price suppression or price depression referred to must be in respect of the "like product".[290]

[290] In particular, Article 15.1 requires an examination, *inter alia*, of "the effects of the subsidized imports *on prices in the domestic market for like products*", while Article 15.2 elaborates, with respect to the effect of the subsidized imports on prices (i.e., the analysis required by Article 15.1), that the authorities shall consider *whether the effect of the subsidized imports* is to depress prices to a significant degree or to prevent

7.551 We also find relevant the negotiating history of *SCM* Article 6.3(c). In the Uruguay Round, the first draft version of this provision linked the concept of price undercutting to the concepts of price suppression, depression and lost sales, as follows:

> "there is a significant price undercutting by the subsidized products as compared with the price of a like product of another signatory in the same market resulting in price suppression, price depression or lost sales;"[291]

In other words, in that early version of the text, a finding of price suppression or price depression could only result from a significant price undercutting by subsidized products of the like product. Had this language been retained, the causal linkage between price undercutting in respect of a like product and a consequent price suppression/price depression means that the price suppression/price depression also would have had to have been in respect of the like product.

7.552 The above-quoted original language was not retained in the final text, however, and the significant change incorporated in that final text is that price suppression, price depression and lost sales went from being downstream consequences of price undercutting to separate, independent bases for serious prejudice. In this respect, we find particularly significant that when these concepts were separated, the term "the same market", which had appeared only once in the original version, following price undercutting, was repeated so as to introduce it explicitly also in respect of price suppression, price depression and lost sales in the final version. No such change was made in respect of the term "like product", which in both the original draft and the final version of the provision appears only once, in the specific context of price undercutting.

7.553 On the basis of the foregoing considerations, we conclude that "like product" as defined in footnote 46 to Article 15 of the *SCM* Agreement is not a legal requirement for claims of price suppression/price depression pursuant to Article 6.3(c).

7.554 We now turn to the implications of this conclusion for the kind of analysis that needs to be conducted for price suppression/price depression cases. We recall here that Korea argues that if "like product" were not a required element, the subsidy disciplines would be undermined. We do not find this argument persuasive for the following reasons.

7.555 In particular, we first consider what the role of the "like product" concept, if applicable, would be in a price suppression/price depression analysis. We note here that the "like product" as referred to in the various subparagraphs of Article 6.3 is the product of a complaining Member that is "like" the subsidized product. In other words, the concept of "like product" presupposes that a "subsidized product" has been identified. Furthermore, where "like product" is referred to in Article 6.3, it is in the context of a comparison to be made between the subsidized product on the one hand and the like product on the other hand. Thus, under the first part of subparagraph 6.3(c), (price undercutting), the question to be answered is whether the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of the like product of the complaining Member. Similarly, under subparagraphs (a) and (b), the question to be answered is whether the effect of the subsidy is to displace or impede the imports or exports of the complaining Member's like product. Determining displacement or impedance in turn involves an analysis and comparison of relative levels and trends in volume and market share of the subsidized product and the complaining Member's like product.[292]

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price increases which otherwise would have occurred, to a significant degree. Linking these two provisions, the analysis therefore seems to be an examination of whether "the subsidized imports" have significantly suppressed or depressed the prices for "the domestic like product".

[291] MTN/GNG/NG10/W/38.

[292] SCM Article 6.4 provides certain guidance as to how this comparative analysis is to be performed.

7.556 Thus, if the concept of "like product" applied in respect of price suppression/price depression analysis, this would seem to imply that it would be necessary to identify and define, in the first instance, a "subsidized product", as only then could the product that is "like" the subsidized product be identified. In turn, in the context of price suppression/price depression, the logical reason to identify a product that is "like" the "subsidized product" would seem to be so that their respective price levels and trends could be compared. That is, if the concept of like product applies, its principal analytical purpose would seem to be to ensure that such a price-to-price comparison would be made in all cases.

7.557 The main implication of our conclusion that the concept of "like product" does not apply in respect of price suppression/price depression analysis thus would seem to be that such a structured price-to-price comparison would not be *required* in terms of the *SCM Agreement*. In other words, given that the relevant text is that "the effect of the subsidy is [...] significant price suppression [or] price depression", the basic analytical question would be how to demonstrate such a causal relationship between the subsidy or subsidies in question, on the one hand, and movements in the prices of the product of concern to the complaining Member in the relevant market, on the other hand. In our view, this means that a main focus of the analysis would be levels and trends in the price for the product in question, as a whole, in the relevant market (i.e., "the same market"), as a whole, and the various reasons behind them. In terms of the present dispute, this implies that we are not required to base our assessment of the EC's claim of price suppression/price depression on a product-by-product comparison of price levels and trends for identified subsidized Korean products and corresponding like products of EC shipyards.[293]

7.558 We must emphasize, however, that this does not mean that product considerations are irrelevant to our analysis. To the contrary, we view product as a necessary, and indeed inescapable, part of an analysis of price suppression/price depression. Simply put, a price must always be for some particular thing, which the complaining party must identify. Here we recall that the EC has alleged that subsidies to Korean shipyards have had the effect of suppressing and depressing the prices of three specified categories of ships of interest to the EC, and requests us to conduct our analysis in respect of each of these categories separately.

7.559 In terms of the breadth or narrowness of the description of the product whose prices allegedly are suppressed or depressed, and the relationship of the price levels and trends with the subsidy in question, we note that of course in any WTO dispute it is always for the complaining party to determine the basis and nature of its own complaint. Thus, a complaining party is free to *claim* that a given subsidy of another Member has caused price suppression or depression to the detriment of the complainant's interests. Obviously, the prices in question will have to be identified as prices for some product or products in particular, of interest to the complainant, in a specified market. It will then be the complainant's burden to demonstrate the causal relationship between the subsidy and the particular price effects that it alleges (i.e., in respect of the particular product or products, however defined, of interest to the complainant).[294] That is, we view the product issue ultimately as pertaining to the demonstration of causation, on the basis of such facts as may be relevant to the particular case.

7.560 In this regard, we would observe that the nature of the demonstration that the complainant will need to make to establish causation in any given case, and the difficulty of doing so, will depend on a number of factors and factual circumstances, including but not limited to the breadth of the description of the product on which the complainant brings its case. Such factors might include

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[293] We recall here that Korea considers that the EC is prohibited from advancing any arguments to the effect that Korea's prices are lower than the EC's for particular ships, as in Korea's view such arguments in fact constitute a revival of the EC's abandoned price undercutting claim.

[294] Given our view that product is an inherent element of price, we do not find it necessary to read the term "the same market" in the context of price suppression/price depression as combining both a geographic and a product element, as argued by the EC.

among others the nature of the subsidy, the way in which the subsidy operates, the extent to which the subsidy is provided in respect of a particular product or products, conditions in the market, the conceptual distance between the activities of the subsidy recipient and the products in respect of which price suppression/price depression is alleged.[295] Whatever the factual situation in a given case, the burden will be on the complainant to furnish specific factual evidence affirmatively demonstrating the causal link alleged, and the difficulty and ways of meeting this burden may be very different from one case to another.[296] In all cases, if the complainant fails to meet this evidentiary burden, its serious prejudice claim will fail. We note that issues of product definition as they relate to causation are before us in this case, and these issues are addressed in our analysis in section VII.D.12 and 13, *infra.*

8. Can "the same market" be the world market?

7.561 *SCM* Article 6.3(c) provides that price suppression/price depression must be in the "same market". The parties have different views as to the scope of the geographic market in which price suppression/price depression can be found, and in particular, whether the term "the same market" can refer to the world market as a whole.

(a) Arguments of the parties

7.562 On the possible scope of the relevant geographic "market", the EC argues that nothing in Article 6.3(c) would preclude defining the "world" market as the "same market" for purposes of price suppression/price depression analysis. In this regard, the EC cites our statement, in our decision declining to make a preliminary ruling on this issue, that "the same market" refers to "a market where Korean and EC producers of commercial vessels compete and where the alleged adverse effects of the subsidies on prices or sales will need to be substantiated". The EC argues in particular that unlike Articles 6.3(a) and 6.3(b) which explicitly refer only to national markets, Article 6.3(c) leaves the geographic scope of "the same market" undefined. The EC notes as well that there is precedent for a finding based on a world market, namely in the GATT *EC – Sugar Exports (Brazil)* dispute, where the panel found serious prejudice based on suppression/depression of the *world* market price level.[297]

7.563 In its request for preliminary rulings, Korea challenged the idea that "the same market" could be the world market and since then has reiterated this objection. Korea argues that "the same market" can only refer to a national market, not to the world market. Korea refers to Article 6.3(d), which does refer to "world market", as contextual support for this argument, by negative inference (i.e., the negotiators would have explicitly referred to the world market in Article 6.3(c), as they did in Article 6.3(d), if they had intended that it could be used as the market of reference there). Korea further argues, by way of context, that where the term "market" is used in Articles 6.3(a) and 6.3(b), this is a national market, and there is no reason to interpret the same word, "market", in Article 6.3(c) differently. According to Korea, the language "of the subsidizing Member" in Article 6.3(a) and "a third country" in Article 6.3(b) only designate "which" national market. For Korea, the term "market" itself is a "national market". The US agrees with Korea on this point, and takes issue with the EC's

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[295] Of course, factors such as these presumably would be relevant in all types of serious prejudice cases.

[296] For example, in a case involving alleged significant suppression or depression of the price for a given kind of narrowly-defined product due to product-specific subsidization of a physically identical product produced by another Member, product definition issues presumably would figure little if at all in respect of the evidence necessary to demonstrate causation. The situation presumably would be quite different where the alleged subsidy was in respect of an input product, while significant price suppression or depression was alleged in respect of a downstream product of the complainant, or where a subsidy in respect of one product was alleged to cause significant price suppression or depression in respect of a completely unrelated product. Clearly in the latter two cases, product definition issues would create a significant, if not insurmountable, evidentiary hurdle in respect of causation.

[297] Second Written Submission by the EC, para. 350, *citing* GATT Panel Report *EC – Sugar Exports (Brazil)*, paras. 4.28-4.29.

basic premise, arguing that no matter what the product at issue is, a purchaser always has the option of importing it from a number of countries, but that this does not change the scope of the market where the sale takes place.

(b) Evaluation by the Panel

7.564 We note in the first instance that Article 6.3(c) places no geographic limitations on the concept of "the same market". We find no basis in the text to construe this term as exclusively referring to "national markets". Nor are we persuaded that the explicit references to particular national markets in Articles 6.3(a) and 6.3(b), and the explicit reference to the "world market" in Article 6.3(d) mean, by implication, that "the same market" in Article 6.3(c) can only be a national market. Indeed, each of these other provisions refers to a particular "market" that is relevant to it, whether a national market or the world market. By contrast, we find the absence of any geographic modifier in respect of "the same market" to indicate that Article 6.3(c) leaves flexibility to define "the same market" broadly or narrowly depending on the facts of a given case. That is, we view the lack of modifiers to the term "the same market" in Article 6.3(c) as encompassing (at least) all of the possibilities referred to in the other subparagraphs of Article 6.3 (the national markets of the subsidizer, of the complaining Member, or of a third country, and the world market), leaving the particular market to be defined in accordance with the specifics of each case.[298] Given the very specific and carefully crafted references to particular geographic markets in the other subparagraphs of Article 6.3, we do not find it plausible that the absence of such a reference in Article 6.3(c) either was the result of an oversight by the drafters, or was intended to imply that the market in question could only be a national one.

7.565 Our view is consistent with the approach taken in the two GATT *Sugar* disputes[299], and the *US - Upland Cotton* dispute, in all of which serious prejudice was found based on suppression or depression of world market prices.

7.566 In sum, we reaffirm our statement from our 19 September 2003 decision in respect of certain requests for a preliminary ruling that however defined, to be "the same market", the market in question must be one in which the EC and Korea compete for sales of commercial vessels of particular types (para. 32). In this regard, it would seem to be for the EC first to substantiate the geographic scope in which it alleges that the European and Korean industries compete in respect of each of the three types of commercial vessels, rather than necessarily having to prove as a general matter that the overall market for commercial vessels is a global market. The submitted factual information and parties' arguments on this point are discussed in section VII.D.12, *infra*.

9. "Significant"

(a) Arguments of the parties

7.567 The text of *SCM* Article 6.3(c) refers to serious prejudice based on "significant" price suppression/price depression. Specifically, Article 6.3(c) provides that serious prejudice may arise where the effect of the subsidy is, *inter alia*, "significant" price suppression or price depression. The parties' views differ as to how this term should be interpreted.

7.568 The EC argues that the term "significant" price suppression/price depression means that "complainants must show only that the effect on price is large enough to meaningfully affect suppliers who compete with the producers of the subsidized products". In advancing this argument, the EC

[298] We wish to emphasize that we need not and do not here opine on the possibility that geographic markets of a different scope might be defined, for example, regional markets comprised of more than one national market.

[299] *EC – Sugar Exports (Brazil)* para. V.(f), and *EC – Sugar Exports (Australia)*, para. 4.9.

explicitly relies on the analysis of this term by the panel in *Indonesia – Autos*. In addition, the EC argues that this interpretation of the term is consistent with the object and purpose of Part III of the *SCM Agreement*, in the sense that the degree of price suppression or price depression must be "important" or "consequential" to be capable of "seriously prejudicing" another Member's interests.

7.569 Korea rejects the EC's argument as to the meaning of the term "significant" in Article 6.3(c). For Korea, there must first be an assessment of price levels for like products, i.e., a measurement of pricing trends for specific "like product" vessel types, and then a determination of whether any price suppression or price depression that may exist is "significant". For Korea, significance must be assessed on a case-by-case basis, taking into account specific features of the products and market involved. According to Korea, the standard to be applied in this case-by-case assessment must be "strict and high", because a finding of serious prejudice has to do with the effect of price suppression and price depression on the EC shipbuilding industry as well as on "the interests of the EC at large". Furthermore, Korea argues, because a finding of serious prejudice can be based on a single factor (price suppression/price depression) unlike the multiple factors (i.e., the injury indicators, such as production, employment, etc.) involved in an injury analysis (of which, Korea argues, price suppression/price depression is just one), there must be a greater degree of price suppression/price depression for a serious prejudice finding than would be required for an injury finding. Otherwise, according to Korea, it would be easier to prove serious prejudice than injury.

(b) Evaluation by the Panel

7.570 We note that the Agreement provides no guidance on the meaning of the term "significant" in the context of Article 6.3(c), and we note further that no other provision of Article 6 contains this term. The ordinary meaning of "significant" to us seems relatively straightforward, in the sense that something that is "significant" is important or consequential.[300] So a "significant" price suppression or price depression would be one that is "important" or "consequential". Put another way, a price suppression or price depression that is unimportant, or inconsequential would not be "significant" in the sense of Article 6.3(c).

7.571 Previous panels that have examined this issue have taken a similar approach. The panel in *Indonesia – Autos* (which had before it a price undercutting claim rather than a price suppression/price depression claim) found that "the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers [...] are not considered to give rise to serious prejudice".[301] Thus, the panel read the term "significant" as a *de minimis* concept intended to screen out very small, unimportant price effects that might be caused by subsidies but that would have no real impact in the market. The panel in *US – Upland Cotton*, in considering the claim of price suppression before it, noted similarly that the treaty language makes clear that it is the price suppression itself that must be "significant", in which case it is useful to consider the degree of price suppression in the context of the prices that have been affected.[302] Thus, the approach taken by the *US - Upland Cotton* panel was broadly consistent with that taken by the *Indonesia - Autos* panel. We agree, and are of the view that only price suppression or price depression of sufficient *magnitude* or degree, seen in the context of the particular product at issue, to be able to meaningfully affect suppliers should be found to be "significant" in the sense of *SCM* Article 6.3(c).

[300] *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), defines "substantial" in this way: "important, notable; consequential".
[301] Panel Report, *Indonesia – Autos*, para. 14.254.
[302] *US – Upland Cotton*, at para. 7.1328.

10. "Serious prejudice *may* arise"

(a) Arguments of the parties

7.572 Korea argues, on the basis of the word "may" in the chapeau of Article 6.3 that a two-step analysis is required to establish the existence of serious prejudice, i.e., that the situations listed in Articles 6.3(a) through (d) are necessary prerequisites to a finding of serious prejudice, but that they do not in themselves constitute serious prejudice. Korea argues that serious prejudice is a separate, distinct concept, which must be a *result* of the situations in Articles 6.3(a) through (d).

7.573 As for the nature of "serious prejudice", Korea argues that it is similar to, but more severe than, "material injury". To demonstrate the existence of serious prejudice, therefore, the EC must demonstrate the elements set forth in Articles 11-15 of the *SCM Agreement*, i.e., must conduct an injury analysis of the EC domestic industry such as that required for a countervailing duty investigation, but with a higher standard of damage than "material injury", namely a significant overall impairment of the EC shipbuilding industry (i.e., the same standard as for a safeguard measure).[303] Korea further argues that, because serious prejudice is "to the interests of another Member", the EC must also show that the economic survival of the shipbuilding industry is "vital" to the overall interests of the EC.

7.574 By contrast, the EC argues that Article 6 sets forth a self-contained regime defining the notion of serious prejudice, in which Article 6.1 established a (now-expired) presumption of serious prejudice in certain situations, Article 6.7 excludes the existence of serious prejudice in certain situations, and Article 6.3 *permits* a finding of serious prejudice where one or more of the paragraphs (a)-(d) applies. In other words, for the EC, "may" connotes permission. The EC also points to footnote 13 to Article 5(c), which provides that the term "serious prejudice" has the same sense as under Article XVI:1 of GATT 1994, and notes that the findings of serious prejudice by the *Sugar* and *Indonesia - Autos* panels were based solely on price depression and price undercutting, respectively. Thus, for the EC, the situations in Articles 6.3 (a) through (d) in themselves constitute serious prejudice.[304]

7.575 Among the third parties, the US, while agreeing with Korea that serious prejudice is a separate requirement that must be satisfied (and relying, like Korea, on the word "may" as the basis for this view), disagrees with Korea that the provisions of *SCM* Articles 11-15 are relevant to serious prejudice. For the US, the relevant requirements are those in Articles 5 and 6. The US argues that the word "may" functions to ensure that serious prejudice would not automatically be found in every case where subsidization gave rise to any market effects, no matter how small.

(b) Evaluation by the Panel

7.576 We see the fundamental issue raised by this aspect of Korea's argument to be whether, to demonstrate the existence of serious prejudice, the *SCM Agreement* requires additional elements beyond those referred to in Article 6, such as injury to the domestic industry, and/or the importance of that industry to the overall interests of the complaining party. In this respect, we find neither textual nor contextual support for Korea's argument that a finding of serious prejudice requires the establishment of something like "serious injury" to the domestic industry of the complaining Member, or of the relative importance of the industry to that Member, and we note that Korea offers none.

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[303] This argument is closely related to Korea's argument in relation to causation. In that context Korea argues that:

> "it is possible to consider both the causation and injury standards for countervailing duty investigations as lesser standards subsumed within the standards of Articles 5 and 6. Thus, proving the elements of injury and causation under Part V could be considered as necessary, but not sufficient, elements of demonstrating serious prejudice under Articles 5 and 6". (Korea's response to Panel Question 90)

[304] See EC response to Panel Question 101.

Rather, Korea's entire argument to this effect is based on the premise that the word "serious" connotes something stronger than the word "material", that material injury is a lesser standard subsumed within the standards of Articles 5 and 6, and that "serious" prejudice cannot be easier to prove than "material" injury. As an initial matter, given that the word "material" does not appear in the serious prejudice provisions of the *SCM Agreement*, we fail to see the relevance of the juxtaposition of terms proffered by Korea. Nor do we agree that the absence of a requirement for an injury-type analysis in the context of serious prejudice claims would necessarily make it easier to prove serious prejudice than material injury. Rather, we view these as two distinct concepts.

7.577 We recall that *SCM* Article 5, the general provision of the *SCM Agreement* covering all forms of "adverse effects" for purposes of the multilateral subsidy disciplines in Part III of the Agreement, clearly separates the concept of "injury to the domestic industry of another Member", in Article 5(a), from the concept of "serious prejudice to the interests of another Member", in Article 5(c). Given this explicit differentiation in this single provision of the *SCM Agreement* between "serious prejudice to the interests of another Member", on the one hand, and "injury to the domestic industry of another Member" on the other, we disagree that the former is simply a more severe form of the latter. If serious prejudice had been intended to refer to, encompass, or require a showing of, injury to a particular industry, such a separation would be unnecessary, and, furthermore, the negotiators would have made this explicit, as they did in the context of countervail.[305] Nor are we convinced that the term "serious injury" in the Agreement on Safeguards informs the meaning of the term "serious prejudice" in the *SCM Agreement*. While the adjective "serious" appears in both places, these are two separate Agreements, which contain no cross-references to one another. We see no basis to assimilate them as suggested by Korea.

7.578 In short, we see serious prejudice as an entirely different concept from injury. Rather than having to do with the condition of a particular domestic industry within the territory of a Member (the subject matter of injury analysis), in our view serious prejudice has to do in the first instance with negative effects on a Member's *trade interests* in respect of a product caused by another Member's subsidization. Article 6.3 demonstrates this in providing that the recognized "adverse effects" of subsides on these interests include, in the context of serious prejudice, lost import or export volume or market share in respect of a given product (displacement or impedance, more than equitable share), and adverse price effects (implying lost trade revenue/income in respect of the product), or some combination thereof, in variously-defined markets.

7.579 Of course, negative effects of this type on a Member's trading interests in a product also would tend to be felt in the performance of the domestic industry producing that product. In this regard, we do not mean to suggest that particular effects on a given industry (e.g., employment, profitability, etc.) could not be examined in the context of serious prejudice.[306] Indeed, it is likely that situations such as those referred to in *SCM* Article 6 could manifest themselves in an impact on the state of the industry in question, and this might constitute relevant information in a given case. In this regard, we note that in this dispute the EC has presented certain information about the state of its shipbuilding industry. Our point is, rather, that we disagree that establishment of something similar to serious injury in the sense of the Agreement on Safeguards to the industry producing the product in question is a *required* element for a finding of serious prejudice.

7.580 We find uniform and extensive support for this view in the text of the relevant provisions of the *SCM Agreement*, in prior dispute settlement concerning serious prejudice, and in the relevant negotiating history.

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[305] For example, in SCM Article 11.2, which requires applications to contain information on the "relevant factors having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 15".

[306] We note that the *US - Upland Cotton* panel (at para. 7.1392 and footnote 1493) took a similar view.

(i) Text

7.581 In the first place, we note the explicit cross-reference to Article 5(c) in the chapeau of Article 6.3: "Serious prejudice in the sense of Article 5(c)". The plain language of this cross-reference is a strong indication that the situations listed in Article 6.3(a)-(d) *are* serious prejudice "in the sense of Article 5(c).

7.582 Second, in respect of Article 6.3, the specific provision at issue, if the word "may" did not appear in the chapeau of this provision, the implication would be that serious prejudice inevitably would arise from any price or volume effect listed in Article 6.3 (a)-(d), without the need to consider the matter in depth. Given this, we see the word "may" in the chapeau as a general cross-reference to other specific requirements elsewhere in Article 6 for the establishment of serious prejudice on the basis of the price and/or volume effects referred to in subparagraphs (a)-(d) of Article 6.3. In particular, Article 6.4 establishes specific affirmative requirements for finding displacement or impedance of exports, while Article 6.7 sets forth particular situations where "displacement or impedance resulting in serious prejudice *shall not arise*" (emphasis added). Article 6.5 establishes methodological rules for price undercutting which must be followed before any finding of serious prejudice based on price undercutting can be made. In the same sense, we view the word "may" as a cross-reference to "significant" in Article 6.3(c), operating to rule out serious prejudice findings where any price suppression or price depression resulting from a subsidy is unimportant and inconsequential.

7.583 Another provision that we believe informs the nature of "serious prejudice" is Article 6.2, which establishes the basis on which the now-expired presumption of serious prejudice in Article 6.1 could be rebutted. In particular, Article 6.1 identified four situations of subsidization that were "deemed" or presumed, to give rise to serious prejudice.[307] In effect, this provision shifted the burden of proof from the complainant to the subsidizer as to whether the subsidies in question were causing serious prejudice. The four situations that gave rise to the presumption were: subsidization of a product by more than 5 per cent *ad valorem*; subsidization of operating losses of an industry; subsidization of operating losses of an individual enterprise, subject to certain exceptions; and direct forgiveness of debt. Thus, a complainant would, in the first instance, simply have to demonstrate the existence of any one of these kinds of subsidization to obtain a presumption that its interests had been seriously prejudiced by that subsidization. However, Article 6.2 provided that the subsidizer could rebut the presumption (in the sense that "serious prejudice shall not be found") by demonstrating that the subsidy in question had *not* resulted in any of the effects enumerated in Article 6.3 (displacement or impedance, price undercutting, price suppression/depression, lost sales). We thus view Article 6.2 as defining by implication the situations listed in Article 6.3 to be in themselves serious prejudice.

7.584 This reading is further supported by Article 27.8, which provided that no presumption of serious prejudice pursuant to Article 6.1 could arise in respect of developing country Members, and that instead such serious prejudice would need to have been demonstrated by "positive evidence, *in accordance with the provisions of paragraph 3 through 8 of Article 6*". The phrase "in accordance with the provisions of paragraph 3 through 8 of Article 6" further supports that those provisions identify both the situations constituting, and the evidence relevant to establishing, serious prejudice.

7.585 The provisions of the *SCM Agreement* governing the factual information relevant to serious prejudice disputes (Article 6.6 and Annex V – "Procedures for developing information concerning serious prejudice"), underscore that it is the trade effect, as such, on a Member in respect of a product, caused by another Member's subsidization that forms the substance of "serious prejudice". Article 6.6 requires any Member in whose market serious prejudice is alleged to have arisen to make available "all information that can be obtained as to the *changes in market shares* of the parties to the dispute as

[307] Article 6.1 lapsed on 31 December 1999, according to Article 31 of the *SCM Agreement*.

well as concerning *prices of the products* involved" (emphasis added). In similar vein, paragraph 5 of Annex V specifies that the information to be gathered through the Annex V process:

> "should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate the value of total sales of the subsidized firms), prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market in question and changes in market shares. It should also include rebuttal evidence [...]".

7.586 The provisions concerning rebuttal of serious prejudice also are relevant here. As mentioned, the former presumption of serious prejudice under Article 6.1 could be rebutted by demonstrating that the subsidy had "not resulted in" displacement or impedance of imports or exports in the sense of Article 6.3(a) or (b), or price undercutting, price suppression, price depression or lost sales in the sense of Article 6.3(c), or an increase in world market share of a primary product or commodity in the sense of Article 6.3(d). Similarly, the situations listed in Article 6.7 as rebutting a finding of displacement or impedance all are concerned with alternative reasons (including, for example, prohibition or restriction on exports, and situations of *force majeure* affecting production, qualities, quantities or prices of the product available for export) for declines in the overall volume and/or market share of the complaining Member *in respect of the product at issue*, that is, changes in trade flows.

7.587 In short, none of the information referred to in the Agreement as required for/relevant to either the establishment or the rebuttal of serious prejudice goes to the sorts of domestic industry "injury" indicators that would be relevant for a serious injury finding, and that Korea argues must be examined. Rather, the required information has to do with trade (volumes and/or prices) in the product at issue in particular markets. We conclude from this that serious prejudice to a Member's interests, in the sense of *SCM* Article 5(c), consists of adverse effects on that Member's trade in a particular product in a specified market, resulting from subsidization by another Member. That is, the situations listed in Article 6.3(a) –(d) in themselves constitute serious prejudice.

(ii) Prior dispute settlement

7.588 This view is fully consistent with the approach taken in all prior serious prejudice disputes. In this respect, we consider particularly relevant footnote 13 to Article 5(c):

> "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

7.589 This footnote does two things. First, it makes clear that the concept of serious prejudice includes threat of serious prejudice (just as the term "injury" in the *SCM Agreement* includes "threat of material injury"). Second, it states explicitly that the meaning of serious prejudice in the Uruguay Round Agreement is the same as under Article XVI:1 of *GATT 1994*. Turning to the text of Article XVI:1 of GATT 1994, we note that it contains no definition of serious prejudice. Instead, it provides for a right to consultation, with a view to limiting subsidization "in any case in which it is determined that *serious prejudice* to the interests of another contracting party is caused or threatened by any [...] subsidization" that "operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into" the territory of the subsidizing Member.

7.590 While the text of Article XVI:1 does not contain a definition or any guidance as to the meaning of the term "serious prejudice", there were two serious prejudice cases based on Article XVI:1 of GATT 1947. Both cases involved EC subsidies (in the form of export refunds) on sugar, and the bases for the claims of serious prejudice included price suppression/price depression in both cases. Thus, to the extent that these cases clarified the meaning of "serious prejudice" in the

sense of Article XVI:1 of GATT, we consider that footnote 13 brings that meaning into the *SCM Agreement*.

7.591 In the *EC – Sugar Exports (Australia)* case,[308] the panel found that the subsidies at issue had increased at a time when world sugar prices were declining sharply, and that there was no effective limit to the amounts available as sugar refunds (i.e., that the refunds were not capped). Therefore, the panel concluded, the refund system had contributed to depress world sugar prices, resulting indirectly in serious prejudice to Australia in terms of Article XVI:1. In other words, Australia's allegation was of serious prejudice to its interests from the EC sugar export refunds, and in spite of the absence of any definition of that concept, the panel found that price depression in itself had seriously prejudiced Australia's interests. The panel additionally found that the EC export refund scheme contained no pre-established limits on production, price or amounts of export refunds, and thus constituted a permanent source of uncertainty in world sugar markets which itself constituted a (further) threat of serious prejudice in terms of Article XVI:1.

7.592 The *EC – Sugar Exports (Brazil)* case brought the following year[309] resulted in very similar serious prejudice findings. First, the panel made an affirmative finding of actual serious prejudice in terms of Article XVI:1, on the same basis as in Australia's case (i.e., on the basis of depression of world sugar prices due in part to the EC subsidies). The panel also found a threat of serious prejudice to Brazil, on the basis that the export refund system contained no pre-established or operational effective limits on production, price or the amounts of export refunds. For the panel this meant that the refund system would not prevent the EC from having a more than equitable share of world trade in sugar, and that the system thus constituted a permanent source of uncertainty in world sugar markets, this in itself constituting a further threat of serious prejudice in terms of Article XVI:1.

7.593 It is clear that in both of these cases, the panels' affirmative serious prejudice determinations were based on a conception of serious prejudice the substance of which was the effect of subsidies on markets, and on trade, in respect of the product, rather than treating these effects simply as stepping stones to a separate and distinct concept of serious prejudice. In other words, the existence of price depression in the world market for sugar, to which the EC sugar refunds were contributing, was found in itself to constitute serious prejudice, in the sense of Article XVI:1, to the interests of Australia and Brazil. Furthermore, the permanent uncertainty created on world sugar markets by the export refund system, and the possibility that the EC might obtain a "more than equitable share of world trade" by reason of the system's operation, also were found, in themselves, to constitute threats of serious prejudice in the sense of Article XVI:1. In addition, although Australia and Brazil both were unsuccessful in claiming serious prejudice based on displacement or impedance of their sugar exports, the reason for the failure of these claims was that the facts did not demonstrate that such displacement or impedance had taken place.[310] In other words, the concept of displacement or impedance potentially constituting, itself, serious prejudice seems to have been accepted by the panels, but the factual evidence did not demonstrate that it was occurring in those particular cases.[311]

7.594 We note here that, as the *Sugar* cases were based on Article XVI:1 of GATT, they did not involve the issue of the word "may" with which we are confronted here, as this word does not appear in Article XVI:1. It might therefore be argued that those findings are not directly relevant to the matter before us, i.e., the implications of the word "may" for the meaning of "serious prejudice".

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[308] *EC – Sugar Exports (Australia)*.

[309] *EC – Sugar Exports (Brazil)*.

[310] *EC – Sugar Exports (Australia)*, para. 4.26; *EC – Sugar Exports (Brazil*) para. 4.14-4.15.

[311] In answering a question concerning the significance of the *Sugar* cases for the meaning of "serious prejudice", Korea attempted to distinguish them on the basis that they concerned export subsidies, which were the province of Article XVI:3. See Korea's Response to Panel Question 89(c). We note that although the subsidies at issue were export subsidies, the serious prejudice claims were based and resolved on Article XVI:1.

7.595 We recall that the two serious prejudice cases to date based on the *SCM Agreement* have taken an approach consistent with that taken in the pre-Uruguay Round cases. Both panels considered, implicitly or explicitly, that serious prejudice concerns the effects of subsidies on a complaining country's trade in a given product as such, i.e., the volumes and prices of such trade, in markets variously defined. Neither looked to specific situations of or effects on the domestic industry producing the product at issue, or to other consequential situations flowing from the trade effects, such as the importance of the producing industry to the overall "interests" of the complaining party.

7.596 In *Indonesia – Autos* the meaning of the word "may" did not arise. That panel treated the situations listed in Articles 6.3(a) through (d) as in themselves constituting serious prejudice. In the displacement/impedance claims, the question that the panel addressed was whether "the effect of the subsidies [...] [was] to displace or impede [...] exports [...] from the Indonesian market".[312] The panel concluded in the negative on those claims. In respect of the price undercutting claim, the question addressed by the panel was "whether serious prejudice [arose] from price undercutting".[313] The panel found in the negative in respect of the claim of the United States, but in the affirmative in respect of the claim by the EC. In particular, the panel first found that price undercutting existed, then found that the undercutting was of such magnitude as to be "significant", and then that the price undercutting was "the effect of the subsidy". (On this latter point, the panel noted that Indonesia had conceded that the subsidy in question was essentially responsible for the price undercutting that had been found to exist.) On the basis of all of these elements, the panel concluded that the effect of the subsidies was to cause serious prejudice through a significant price undercutting as compared with prices of like products of EC origin in the Indonesian market.[314] In other words, establishment of all of the elements referred to in the relevant portion of Article 6.3 was deemed sufficient by that panel for a finding of serious prejudice. The panel did not find any additional requirements beyond those explicitly referred to in the pertinent provisions of the Agreement.

7.597 The *US - Upland Cotton* panel took a similar approach, stating that:

> "the Article 6.3(c) examination is determinative [...] for a finding of serious prejudice under Article 5(c). That is, an affirmative conclusion that the effects-based situation in Article 6.3(c) exists is a sufficient basis for an affirmative conclusion that 'serious prejudice' exists for the purposes of Article 5(c) of the SCM Agreement."[315].

(iii) Negotiating history

7.598 We turn therefore to the origins of the phrase "serious prejudice may arise", to see whether this history sheds additional light on this issue. We recall that this phrase first appeared in the *SCM Agreement*'s predecessor, the Tokyo Round *Subsidies Code* (the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, or the "*Subsidies Code*").

7.599 The *Subsidies Code* rules on serious prejudice were found in its Articles 8:3 and 8:4. Article 8:3 was the analogue of *SCM* Article 5, containing the basic rules on adverse effects, including serious prejudice. Article 8:3 read as follows:

> "3. Signatories [...] agree that they shall seek to avoid causing, through the use of any subsidy:
>
> (a) injury to the domestic industry of another signatory, [footnote omitted]

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[312] *Indonesia – Autos*, para. 14.207.
[313] *Ibid*., para. 14.238.
[314] *Ibid*., paras. 14.255 and 14.256.
[315] Panel Report, *US – Upland Cotton*, para. 7.1390.

> (b) nullification or impairment of benefits accruing directly or indirectly to another signatory under the General Agreement, [footnote omitted] or
>
> (c) serious prejudice to the interests of another signatory.[25]
>
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>
> [25] Serious prejudice to the interests of another signatory is used in this Agreement in the same sense as it is used in Article XVI:1 of the General Agreement and includes threat of serious prejudice."

7.600 Article 8:4 of the Code, which provided certain guidance for interpreting Article 8:3, contained the term "may arise" in its chapeau, i.e. the same language that we are considering in the context of *SCM* Article 6.3. Article 8:4 read as follows:

> "4. The adverse effects to the interests of another signatory required to demonstrate nullification or impairment or serious prejudice *may arise* through
>
> (a) the effects of the subsidized imports in the domestic market of the importing signatory,
>
> (b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country, or
>
> (c) the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market." (emphasis added, footnotes omitted)

7.601 The construction of the chapeau of Article 8:4 of the *Subsidies Code* differs from that of *SCM* Article 6.3, yet the term "may arise" appears in both places. To us, it is clear that the function of this term in the context of Article 8:4 of the *Subsidies Code* was to indicate that the list in subparagraphs (a)-(c) was illustrative, not exhaustive. That is, this list consists of examples of some situations that constituted serious prejudice (and/or nullification or impairment), with the word "may" leaving open the possibility that other situations as well might give rise to or constitute serious prejudice. We find support for this view in the fact that the listed situations include some but not all of the situations that had previously been examined by the GATT 1947 serious prejudice panels. For example, price suppression/price depression are not listed in Article 8:4. That they nonetheless remained a valid basis for serious prejudice claims is confirmed by the fact that both are explicitly referred to in *SCM* Article 6.3(c).[316]

7.602 In this respect, we find footnote 25 to Article 8:3(c) of the *Subsidies Code* to be particularly important, and note that it is virtually identical to footnote 13 to Article 5(c) of the *SCM Agreement*. The Tokyo Round *Subsidies Code* was the first separate agreement interpreting Article XVI of GATT, and we believe that footnote 25 to Article 8:3(c) must mean *inter alia* (as we have indicated above in respect of footnote 13 to Article 5(c)), that the interpretations of the term "serious prejudice" that had previously been developed in disputes based on Article XVI:1 of GATT 1947 remained valid under the *Subsidies Code*. That is, the purpose of the footnote was to preserve and incorporate into the *Subsidies Code* the *status quo ante* concerning serious prejudice based on Article XVI:1 of GATT, including in particular the jurisprudence thereunder. Thus we see these footnotes as establishing an unbroken chain of consistent meaning for the term "serious prejudice", beginning with Article XVI:1 of GATT 1947, through the Tokyo Round *Subsidies Code*, and then carrying through to Article XVI:1 of GATT 1994 and Part III of the *SCM Agreement*. The fact that price suppression/price depression,

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[316] In the serious prejudice claim in *EC – Wheat Flour* brought under the Tokyo Round *Subsidies Code*, the panel took a similar approach to that taken by the *Sugar* panels, in the sense that it considered (although it did not issue a ruling on) the claim based on the alleged adverse trade effects, as such. The meaning of the term "may arise" was not an issue.

the basis for two Article XVI:1 serious prejudice findings, although not referred to in Article 8:4 of the *Subsidies Code*, now is explicitly included in *SCM* Article 6.3, confirms this.

7.603 We find it significant that the term "serious prejudice may arise" in *SCM* Article 6.3, chapeau, appears to have been directly imported from the Tokyo Round *Subsidies Code*. In particular, this phrase appeared in the chapeau of all versions of the negotiating text of what is now *SCM* Article 6.3 (i.e., in the so-called "Cartland" texts, MTN/GNG/NG10/W/38 and Revisions). We do not find it plausible that this directly-transposed phrase from the Code was intended to take on an entirely new meaning, for which the *SCM Agreement* contains neither explicit nor implicit basis. Again, if the intention had been to introduce substantial new and additional requirements, such as those advanced by Korea, we find it inconceivable that such a significant departure from all prior practice concerning serious prejudice would not have been expressed explicitly.

11. Causation

7.604 Concerning causation, Article 6.3(c) provides in relevant part that "the effect of the subsidy is [...] significant price suppression [or] price depression [...] in the same market". That is, there must be a causal relationship between the *subsidy* and the significant price suppression or price depression. The question before us is how to establish the existence of such a relationship.

(a) Main arguments of the parties

7.605 A threshold argument made by the EC in respect of causation is that as long as the subsidy is *a* cause of significant price suppression, depression or lost sales, the language of Article 6.3(c) is satisfied. In other words, the EC states, the text does not require that subsidies be the sole cause, but rather permits an affirmative finding where subsidies are one among multiple causes of serious prejudice. In support of this proposition, the EC cites *SCM* Article 15 as well as the Tokyo Round panel on *US – Norwegian Salmon CVD*.

7.606 As to the substance of the causal link, the EC argues that, given the similarity of language between *SCM* Article 6.3(c) on the one hand, and *SCM* Articles 15.5 and 15.2 on the other, the causation analysis should focus on the impact of "the subsidized product" on price suppression and price depression. Concerning the kind of subsidy that can potentially cause price suppression or price depression, the EC argues that Article 6.3(c) is not limited to subsidies that are tied to particular products or transactions, but also covers untied subsidies that benefit the total sales or production of a company. These latter subsidies, including "survival subsidies" such as debt forgiveness, tax incentives, capital infusions, or loans and guarantees, have the effect of maintaining or increasing capacity and lowering the firm's total costs, and "may be allocated pro-rata" to individual products or transactions. Given the fungibility of money, the EC argues, such cost reductions will enable price cuts across all products produced by the recipient firm, and these price cuts enabled by the subsidies can ultimately have the effect of significant price suppression or price depression. The EC argues, however, that it is not legally required to quantify the amount of subsidization.

7.607 Korea disagrees with the *"a* cause" standard advanced by the EC, arguing that whether or not other factors are present, the subsidization independently of these other factors must itself cause serious prejudice. For Korea, the causation analysis thus requires a quantification of the amount or degree of subsidization, which then should be compared to the degree of price suppression or price depression that may exist, to determine whether a causal link can be demonstrated. Furthermore, Korea argues that other causal factors, such as differences in productivity, differences in production costs, and need for restructuring, should be examined.

7.608 In answer to a question from the Panel concerning the kind of analysis that would be needed to determine the effects of subsidization independent of any other factors, Korea outlines a detailed

multi-step process of analysis, which can be summarized as follows.[317] First, the subsidy must be quantified with respect to each subsidized producer. Second, the effect of the subsidy on the prices of the subsidized shipbuilder ("the subsidy effect margin") must be quantified, by estimating the non-subsidized cost of the product and comparing this with the producer's price for the product. Third, a "price suppression and depression margin" must be quantified, i.e., the margin by which the prices of the complaining Member's like product have been suppressed or depressed. In this step, Korea argues, the effects of all other factors on prices (including cost reductions, competition from other, non-subsidized, sources, etc.) also must be identified and eliminated. In the course of this argument, Korea emphasizes in several places that because the EC has dropped its original *claim* of serious prejudice based on price undercutting, the EC is now legally barred from advancing any *argument* based on or referring to price undercutting.

7.609 Korea further argues that because *SCM* Articles 5 and 7.8 both refer to adverse effects of "any subsidy", and because *SCM* Article 6.3 refers in multiple places to "the subsidy", the complaining Member must prove the effect of each alleged subsidy individually, rather than the combined effect of the alleged subsidies together. In addition, Korea argues in this regard that at the implementation stage of a dispute, removal of one subsidy may be sufficient to eliminate the adverse effects of subsidization, but there would be no way to know this if no separate assessment of effects was made for each subsidy. Nonetheless, Korea states, after assessing each subsidy individually, it would still be possible to aggregate them for the "final causal assessment".

7.610 China's third party view is similar to that of Korea, in that China argues that in order to find a causal relationship between a subsidy and a significant price suppression or price depression, it should be found that the subsidy, independent of other factors, and through the suppressed or depressed prices of the subsidized product, causes significant suppression or depression of the price for the complaining party's like product in the same market. China also argues that the degree of price suppression or price depression should be compared with the extent of the subsidization, to determine whether a causal link can be established.

7.611 The US as third party takes issue with the basis (although not necessarily the conclusion) of the EC's argument, stating that the EC incorrectly focuses on the *SCM Agreement*'s countervail provisions for contextual support for understanding causation while, according to the US, the causation standard for countervail is quite different from that for serious prejudice. In particular, the US points to the fact that in respect of countervail, it must be shown that "the *subsidized imports* are, through the effects of subsidies" (in the sense of the effects of subsidized imports on the domestic market) "causing injury". By contrast, the US says, Article 6.3 requires a demonstration that price suppression or price depression is "the effect of the *subsidy*" (emphasis added).

(b) Evaluation by the Panel

7.612 As noted *supra*, we believe that the text of Article 6.3(c) implies a "but for" approach to causation in respect of price suppression/price depression. Price suppression is the situation where prices have been restrained by something, and price depression is the situation where prices have been pushed down by something. So the question to be answered is whether the "something" is subsidization. Looking at a counterfactual situation, i.e., trying to determine what prices would have been in the absence of the subsidy, seems to us the most logical and straightforward way to answer this question.

[317] Korea's response to Question 91 from the Panel. In its response, Korea notes a concern about burden shifting and recalls that a panel should not make a complainant's case for it. Thus, Korea reserves its rights so that its response cannot be interpreted as its agreement to assume a burden belonging to the complainant.

7.613 This "but for" approach is consistent with the approach taken in both *Indonesia – Autos* and *US – Upland Cotton*, the two prior serious prejudice disputes under *SCM* Article 6.3. Indeed, the *Indonesia - Autos* panel explicitly adopted such an approach, in respect of the displacement/impedance of imports claims. (There was no price suppression or price depression allegation in that dispute).[318] The panel made a negative displacement finding, noting that the complainants had not demonstrated that *but for* the subsidy, the complainants could have expected to participate proportionately in a growing market. The panel also made a negative impedance finding, specifically that the complainants had not demonstrated that but for the subsidies, their sales and/or market share would have increased, or would have increased more than they did in fact.

7.614 The *US – Upland Cotton* panel, while not referring to a "but for" analysis as such, nevertheless applied a similar framework. In particular, the panel found that increased production and supply of upland cotton which reaches the world markets has an effect on world prices, and further found that a number of the subsidies at issue were directly linked to world prices, thus insulating US producers from low world prices, and stimulating production that otherwise (in other words, *but for* the subsidies) would have been uneconomic.

7.615 Applying such a framework to the present dispute, the question to be answered in respect of the affirmative link between subsidies and prices is, in the case of alleged price depression, whether in the absence of the subsidies prices for ships would not have declined, or would have declined by less than was in fact the case. For price suppression, the question would be whether, in the absence of the subsidies, ship prices would have increased, or would have increased by more than was in fact the case. Such a framework implies also analyzing the various factors contributing to the particular market situation forming the subject of the complaint, i.e., supply and demand factors, production costs, relative efficiency, etc.

7.616 In conducting this "but for" analysis, we certainly will be mindful of the nature of the subsidies alleged to be causing price suppression and price depression, i.e., the individual APRG and PSL transactions, and in particular in relation to their alleged effects on general price levels for the ships at issue. That said, and while we have of course examined the APRG and PSL transactions individually to determine whether they involve subsidization, we do not agree with Korea that we are legally bound to separately determine the degree of price suppression or price depression that may be caused by each of these subsidies individually. We are unconvinced that references in the singular in *SCM* Articles 5 and 6 ("any subsidy", "the subsidy", etc.) constitute or give rise to such a legal requirement, and recall here that the opposite was true under Article 6.1(a) and Annex IV. Pursuant to these provisions, in determining the *ad valorem* subsidization of a product, subsidies under different programmes were to be aggregated. Any rebuttal under *SCM* Article 6.2 of a presumption of serious prejudice arising therefrom also presumably could have been presented in respect of the effects of the aggregate subsidies. Finally, we consider that Korea's concern over how eventually to "remove the adverse effects" does not pertain to an assessment of whether there are adverse effects arising from subsidies, but instead pertains to the issue of how to implement an eventual recommendation to remove any such effects.

7.617 We next consider the issue of non-attribution, in particular, whether and how to conduct a non-attribution analysis (i.e., an analysis to ensure that adverse effects caused by other factors are not attributed to subsidies). We note here that unlike the countervail provisions, *SCM* Articles 5 and 6 contain no specific non-attribution language, and we recall as well that in the *Sugar* cases, no such analysis was conducted. The panels in those cases instead found serious prejudice on the basis that

[318] The *Indonesia - Autos* panel also addressed a claim of price undercutting, the circumstances of which arguably were quite unique: the panel found that information provided by Indonesia in the Annex V process effectively conceded that the subsidies, which were transaction-specific tax and duty exemptions, reduced the price of the subsidized Indonesian automobile by an amount large enough to account for all or virtually all of the price undercutting that was found to exist.

the EC export refunds had *contributed* to depressing world sugar prices, and also constituted a permanent source of instability on world markets. The *US – Upland Cotton* panel, while noting the distinction between the countervail and serious prejudice provisions in general, and the lack of an explicit non-attribution requirement in the latter in particular, nonetheless analyzed other possible causal factors, with a view to determining whether such factors "would have the effect of attenuating [the] causal link, or of rendering not 'significant' the effect of the subsidy".

7.618 We consider the approach taken by the *US – Upland Cotton* panel to be logical and appropriate. In conducting our causation analysis, we too will bear in mind the need to take into account the effects of identified factors other than the subsidies, to determine whether such factors would attenuate any affirmative causal link that we may find, or render insignificant any price suppression or price depression effect of the subsidy that we may find.

7.619 We wish to emphasize that the aforementioned considerations make clear that there is no one single approach to determining causation for all claims of serious prejudice. Each case presents a unique combination of kinds of subsidies, of products, of markets, and of forms of serious prejudice, which operate together in a unique way. Causation analysis thus necessarily must be case-by-case, tailored to the particular situation presented in each individual dispute. The considerable variety of approaches taken by previous panels is simply a reflection of this reality.

7.620 In this respect we disagree with Korea's argument that the EC is legally barred from referring to the fact of price undercutting in support of its price suppression/price depression claims. Korea is certainly correct that the EC has not pursued its claim of price undercutting referred to in the Request for Establishment of the Panel, and we therefore conduct no analysis and reach no conclusions in respect of price undercutting as such, in the sense of *SCM* Articles 6.3(c) and 6.5. This is an entirely different issue, however, from what sorts of arguments and evidence the EC may advance in support of its claims. We see no basis in the WTO Agreement for proscribing the kinds of arguments that a party can make; any party to a dispute is entitled to make whatever *arguments* it wishes in presenting its affirmative or defensive case. The persuasiveness or relevance of these arguments is a separate issue.

7.621 We find it entirely plausible, and potentially highly relevant, that a complaining party claiming price suppression/price depression might in its arguments compare the trends *and* the levels of prices for the subsidized product with the trends and levels of prices for its own products. That said, we do not see that the relative price levels for the subsidized product and the complaining party's product in any case would be dispositive of a price suppression/price depression claim.

12. Summary of the EC's claims and general approach of the Panel

7.622 Having set out the legal and analytical framework that we will apply, we turn now to the specifics of the EC's claim. As noted above, the EC claims price suppression/price depression in respect of three categories of ships: LNGs, container ships and product/chemical tankers. We first will summarize the basic approach taken by the EC in setting forth its claims of serious prejudice, as well as the basic approach taken by Korea in its rebuttal arguments. We then will turn to a product-category-specific consideration of the parties' arguments concerning the EC's price suppression/price depression claims. Finally, we will present our assessment of those claims, on the basis of the subsidies that we have found (those in respect of certain APRGs and PSLs).

7.623 Concerning our presentation of the parties' arguments, we recall that we have rejected the EC's claims of subsidization in respect of the restructuring of Daewoo, STX/Daedong, and Samho/Halla. We have upheld the EC's claims that certain individual APRGs and PSLs are prohibited export subsidies. The EC alleges that the subsidized APRGs and PSLs have caused price suppression/price depression in respect of the three categories of ships at issue in this dispute, and its arguments in this regard are closely inter-related with its arguments concerning the alleged

restructuring subsidies. While we confine our analysis of the EC's serious prejudice claims to the relevant subsidized APRGs and PSLs, for ease of comprehension we summarize the EC's and Korea's arguments as to serious prejudice as they have presented them. Thus, to the extent that the parties' serious prejudice arguments in respect of APRGs and PSLs are interrelated with their arguments concerning restructuring, the restructuring-related arguments are included in the summary of arguments below.

7.624 We recall that the EC initially indicated that it wanted us to make separate serious prejudice findings in respect of each product category (LNGs, product/chemical tankers, and container ships), but subsequently changed its position, arguing that while we should analyse price suppression/price depression separately for each category, we should reach only a single serious prejudice finding.[319] The EC argues that whether we were to find price suppression/price depression in respect of one, two or all three product categories, our final conclusion would be the same, i.e., serious prejudice to the interests of the EC. Having considered this question carefully, we conclude that we should make separate serious prejudice findings in respect of each product category. We view this as necessary for analytical coherence, i.e., the scope of our final conclusions on serious prejudice will be consistent with the scope of our analysis of price suppression/price depression.

(a) Main arguments and general approach of the EC

7.625 Concerning the existence of price suppression/price depression, we recall that the EC allegation is at the level of *world* prices for each of the three types of ships. The EC argues that each of these ship types (as indeed commercial vessels generally) competes and is sold in a global market. The EC explains that by world market, or global market, it means that ships are by nature highly mobile (and transporting them is an insignificant cost compared to their value); that ships do not normally need to be imported, i.e. cleared through customs or subjected to duties; that regulations and standards are typically harmonised or international – and the existence of "open registries" and flags of convenience make attempts to impose significantly different national taxes and regulations unworkable; that shipbuilders operate on a large scale and are active throughout the "global market"; and that ship-owners are also large enterprises and are established in many different territories. The EC submits a number of documents that characterize shipbuilding in this way.[320]

7.626 The EC argues that world prices for LNGs have been depressed and suppressed by Korean subsidies, and that world prices for container ships and product/chemical tankers have been suppressed. As evidence that these prices should have increased, or increased more, the EC presents information showing increases in world order levels for each ship type, as well as increases in freight rates which, along with costs, are the main determinants of ship prices according to the EC. As evidence that Korean prices are lower than they should be, the EC presents indices of Korean prices versus estimated Korean costs for each ship type. Finally, the EC presents statistics on numbers of orders by country of building and by shipyard, as evidence that Korean shipyards have sufficient market share to exercise price leadership in the market for each ship type.

7.627 On Korean costs more specifically, the EC argues that ship prices must follow trends in costs, and must include cost escalation factors due to the several-year interval that normally elapses between the placing of an order and the delivery of a ship. The EC argues that the gap between Korean shipyards' prices and costs widened during the post-restructuring period, even after adjusting for any comparative advantages of the Korea yards. The cost of debt in particular was not taken into account by the Korean yards, given that the restructuring (which the EC alleges to be subsidized) had erased the debt from the restructured yards. In the absence of the restructuring, Korean shipyards' high cost structure and heavy debt burden would have driven some of them out of business, reducing Korean

[319] See para. 7.519, *supra*.

[320] See First Written Submission of the EC at paras. 426 and 427, and Exhibits EC-1 and EC-2. See also response of the EC to Panel Question 37(a).

capacity. Instead, the restructuring allowed that capacity not only to remain in operation but also allowed aggressive pricing by eliminating the debt cost from the companies involved. The EC, although arguing that it is not legally required to do so, presents some calculations of estimated per-transaction amounts of subsidies. On the basis of these calculations, the EC argues that current prevailing price levels for the ships at issue would be below the break-even point for the Korean producers if their debts had not been forgiven, i.e., if they had had to pay their debt servicing costs.

7.628 The EC also presents calculations estimating the degree of subsidization of certain APRGs and PSLs. In respect of these instruments, the EC argues that the APRGs and PSLs contributed to rescuing the shipyards and permitting them to aggressively pursue sales: the APRGs and PSLs had an impact that went beyond particular margins of benefit on individual transactions, in that they enabled the companies to fill their orderbooks. In the restructuring process, this in turn made the yards in question more attractive as "going concerns" than as facilities to be closed. In respect of the non-restructured yards, the EC argues that the APRGs and PSLs enabled these yards to compete at the new, lower price levels. Thus, the EC primarily characterizes the effects of the APRGs and PSLs in terms of overall effects on the relevant shipyards' ability to compete, as a complement to the effects of the restructuring, rather than approaching the issue in terms of a subsidized transaction-by-subsidized transaction analysis, or as a whole, in isolation from the alleged restructuring subsidies. That said, the EC also states that the *ad valorem* benefit from the subsidized financing was as much as 2 per cent, which the EC argues had a direct price effect on those transactions, and was an important factor in obtaining these orders.[321]

7.629 Concerning prices, the EC presents certain composite data characterized as representing *world* price levels and trends, but does not present a specific time series on EC shipyards' prices. It explains this by saying that, due to low prevailing world prices, EC shipyards have had very little success in winning the bids that they make, and in many cases therefore have become discouraged from even bidding (a very costly process), due to the suppressed and depressed world price levels. In other words, for the EC the suppression/depression of *world* prices constitutes serious prejudice to the *EC's* interests, because, due to the global nature of the market for ships, all shipyards must meet the prevailing world price level in order to make sales. The EC presents specific examples of individual bids it argues were lost to low-priced competition from Korea as evidence of the low and declining price levels confronted by EC shipyards.

7.630 The EC explains that its "interest" in the three ship types is particularly evident on the supply side in the sense that EC yards are capable of producing the full spectrum of sizes and particular types of ships in each category, and are interested in doing so, as evidenced by their attempts to win bids, and by information on EC shipyards' websites which identify these types of ships as within their product range. The EC argues that from a shipyard's perspective, ships are largely fungible, involving a series of steel panels to be welded together, and components and fittings to be assembled and installed. Thus, on the supply side, there is little product differentiation. The EC also provides information showing the participation by EC shipyards in various size ranges for each ship type, as evidence that the EC industry is active in all of the ship types at issue.

7.631 As for the pricing of ships of different sizes and characteristics within each category, the EC argues that on the demand side there is considerable potential for substitution. For example, a container ship owner can, from the technical point of view, equally operate a range of smaller to larger ships on a given route because these ships perform the same basic function. For this reason, the EC states, the decision as to which particular ship to operate on a given route has to do with operating

[321] In this regard, in response to our question, the EC confirmed in respect of alleged APRG and PSL subsidies that we correctly understand its main argument to be "that these instruments contributed to 'rescu[ing] th[e] shipyards from liquidation' by improving the attractiveness of keeping them in operation as opposed to shutting them down", while also stating that "the impact of [individual] APRGs or PSLs can indeed be very significant (up to 2% of the transaction price)" (EC response to Panel Question 40).

costs based on freight volume, not with fundamental functional differences between the different-sized ships. As a result, the EC argues, prices for different sizes of a given type of ship, e.g., container ships, tend to move together. On the supply side, as noted the EC argues that from the shipyard's perspective, there is little or no technical differentiation within ship categories (or even between them). The combination of these supply and demand factors means that a change in the price of one particular model of ship in a category will cause proportionate changes in all of the other models in that category.

7.632 In general terms, the EC argues that the basic factor leading to the alleged serious prejudice was the restructuring aid, which the EC terms "survival subsidies", complemented by the APRG and PSL subsidies, which also contributed to the keeping the yards in operation. In particular, the EC argues, the alleged subsidies maintained, on non-market terms, Korean capacity that otherwise would have been closed down, and also lowered the cost structure of the subsidized producers, enabling them to sell at prices that would have been impossible absent the subsidies. According to the EC the main reason for low world market prices is the subsidized overcapacity in Korea. The EC asserts that the three restructured yards have more than one-half of total global overcapacity which is estimated at 20 per cent. For the EC, it is not realistic to suggest, as Korea does, that this capacity would have remained in business even without the restructuring, as the other Korean yards could not have purchased these yards or their assets as they too were in financial difficulties. Nor did any foreign buyer express any interest in acquiring any of the yards or their assets.

7.633 The EC argues, citing the GATT 1947 *Sugar* cases and *Indonesia – Autos*, that correlation in time between an alleged subsidy and its effects is very important in establishing causation. In this regard, the EC argues that there is a clear coincidence in time between the alleged restructuring subsidies at issue and their price effects. According to the EC, the subsidies were massive, served to maintain capacity, and in turn brought down prices. For LNGs, for example, world prices declined when Daewoo entered the market in 1999, by which point Daewoo knew that it would be restructured.

7.634 The EC argues that the nature of the subsidies and the nature of the alleged serious prejudice also should be taken into account by the Panel when considering the methodology to use in determining causation. In particular, the EC states, its claim is an overall claim of price depression and suppression resulting *inter alia* from restructuring aids involving direct forgiveness of government held debt, as well as from KEXIM subsidies.[322] On the forgiveness of government-held debt, the EC argues that *SCM* Article 6.1 recognizes this as a particularly egregious form of subsidization.

7.635 Concerning price leadership by Korean shipyards, the EC refers to shipyard-specific statistics of orderbooks as of January 2004, as reported by Lloyd's Register, for three categories of ships.[323] According to the EC, these statistics show that Korea's shares of the world market for each ship type are very large. The data as referred to by the EC are set forth below:[324]

Container ships:	HHI 24.3 per cent; Samho-Halla 8.1 per cent; Daewoo 5.3 per cent; all Korea 65.7 per cent
Product tankers[325]:	STX-Daedong 14.5 per cent; HHI 5.6 per cent; Daewoo 3.1 per cent; all Korea 58.9 per cent

[322] Second written submission of the EC at para. 295.

[323] The EC indicates that the detailed Lloyd's Register data are reproduced in Attachment EC-2 to its answers to questions from the Panel following the first substantive meeting.

[324] Second written submission of the EC at paras. 371-374.

[325] We note that according to Attachment EC-2, the data on product tankers include but are not limited to product/chemical tankers.

LNGs:	Daewoo 29.3 per cent; Samsung 18.1 per cent; HHI 11.5 per cent; all Korea 58.9 per cent

According to the EC, with market shares of this magnitude it is clear that the Korean industry has the ability to set the world price level for the three ship types, which the EC argues in fact is the case. Concerning the fact that in some cases, the Korean yards with the largest market shares were not restructured (i.e., are not alleged to have received subsidies through restructuring), the EC argues that the restructuring affected the entire Korean industry, such that the restructured yards, even when not market share leaders, were price leaders, driving down prices for all Korean yards, which in turn pulled down world prices. First the EC argues that the three restructured shipyards account for around one-third of the orderbook in Korea as a whole, and 12 per cent of the global orderbook. More significant in terms of the effect on prices, according to the EC, is the behaviour of concentrations of capacity with intense competition among a limited number of companies operating in the most heavily contested market sectors suppressing prices. The EC further states that restructured yards "regularly appear amongst the small concentration of shipyards whose capacity is determining prices in many sectors".[326] The EC asserts that the low prices offered by the subsidised shipyards force competing Korean shipyards to offer low matching prices, irrespective of the long-term economic consequences that may not be evident until a number of years later. Otherwise, these competing shipyards will be unable to achieve the high volume of orders necessary to support their facilities, debt payments, and large workforces.[327] The EC further argues that the subsidized KEXIM financing helped to enable the non-restructured yards to follow the pricing lead of the restructured yards.[328]

7.636 On the basis of the foregoing arguments, we understand the EC's basic claim of serious prejudice to be: restructuring subsidies kept a huge amount of uneconomic capacity in the market, and greatly reduced the cost of operating that capacity, in particular by removing the companies' debt service burden. The removal of debt allowed the restructured yards to price aggressively in order to fill their excess capacity, which in turn led the other (non-structured) Korean yards to reduce their prices. The APRGs and PSLs, also played a role in maintaining excess Korean capacity on the market by improving the financial strength of shipyards threatened with closure, and in financing price cuts by both restructured and non-restructured shipyards. The large market shares and capacity of the Korean shipbuilders left shipbuilders in the rest of the world with no choice but to follow the formers' downward pricing lead. For the EC, this has meant that, as a result of the suppressed and depressed price levels, EC shipyards either lose bids that they make due to inability to meet the price level set by Korean competitors or, refrain from bidding at all, knowing that they will not in any case be able to compete at the prevailing price level. The suppressed and depressed world prices thus seriously prejudice the EC's interests.

(b) Main rebuttal arguments of Korea

7.637 Korea objects, first, to the EC characterization of the shipbuilding industry and market as "global". Korea argues that some markets are reserved for national producers (citing LNGs, and the US cabotage market, as particular examples). Korea further argues, as described above, that price suppression/price depression must be established in relation to (a) particular national market(s). Korea seems to imply that therefore a case based on a world market must fail on this basis alone.

7.638 Korea further argues that the price information presented by the EC is simply too broad-based to be meaningful. In particular, Korea argues that information should be presented on a "like product" basis, and suggests a number of detailed criteria to differentiate the like products within each ship category. At a minimum, prices should be broken out by size bands within each category which, if

[326] Attachment EC-2 at 4.
[327] Second written submission of the EC, para. 308.
[328] Second written submission of the EC, para. 270.

done, shows considerable price variation, with prices for some size bands in a given category increasing, some decreasing, and some staying flat.

7.639 Korea takes strong issue with the EC's characterization of the EC's shipbuilding interests. For Korea, EC yards simply do not compete head-to-head with Korean yards in any of the three categories. Instead, Korea states, EC yards are concentrated in smaller ship sizes than Korean yards, and in many cases are precluded from bidding for the largest ships by size constraints, and by lack of specialization and know-how that are important determinants of a yard's effective capabilities to build particular ships. Korea notes, and criticizes the fact, that the EC gave only a partial response the Panel's request for yard-specific information on EC capabilities and production history. For Korea, this confirms that the EC is unable to demonstrate that the EC and Korean yards directly compete.

7.640 Concerning the determinants of ship prices, Korea argues that there is no historical correlation with order levels. Furthermore according to Korea, compensated gross tons, the unit of measurement used by the EC to show the trend in orders, is misleading. If instead years of workload or number of ships were used, Korea argues that the trend would be fluctuating, rather than sharply increasing as alleged by the EC. Korea also takes issue with freight rates as a determinant of ship prices, arguing that currently the ship market is a buyers' market in spite of increases in freight rates.

7.641 On costs, Korea argues that its shipyards enjoy significant advantages in terms of materials (including for domestically sourced inputs, which are increasing in importance), wages and depreciation of the Won favouring exports, as well as productivity and economies of scale reflecting Korea's experience in producing in series.

7.642 Concerning the EC argument that the restructured yards pulled down the prices of all other Korean yards, Korea asks, "Why [...] stop at the Korean shipyards? If the subsidies triggered a price war, why then not also blame the Japanese shipyards or the Chinese shipyards or any other shipyards for that matter?"[329] According to Korea, the EC is claiming that the subsidies allegedly granted to Daewoo, Halla and Daedong have stimulated price competition among the Korean shipbuilders and that, therefore, the prices practiced by the other Korean shipbuilders have also caused price depression or suppression. For Korea, this is a "long stretch". Korea states that Article 6.3(c) requires that price depression or suppression must be *the* effect of *the* subsidies, and that the wording of this provision does not envisage that it would be sufficient that prices of non-subsidized shipbuilders caused price depression or suppression.

7.643 Korea argues that the "but for" analysis of capacity proposed by the EC falls far short of the standard required by Article 6.3. Rather, Korea states, the *SCM Agreement* explicitly requires the EC to demonstrate that the effect of the subsidy is significant price suppression or price depression, which has then caused serious prejudice. For Korea, this calls for the EC to present factual evidence as to the effects of the subsidy, rather than to try to establish serious prejudice via a "but for"-based conjecture. Furthermore, and in any case, Korea argues, the capacity in question would have remained in operation. Korea argues, first, that the restructuring was the most "market oriented" behaviour in the light of the circumstances at the time. Second, even if the companies had been liquidated rather than restructured, "liquidation" does not mean "termination" of the insolvent companies' business. Instead, for the creditors to recoup the "liquidation value" of the insolvent companies, normally they would repack and sell the production facilities to buyers who would use them for their original purposes. Therefore, contrary to the EC's allegation, the three shipbuilders' shipbuilding capacity would have remained in operation although the ownership of these facilities might have changed.

7.644 Korea asserts that the EC has not shown the effect of the subsidy on the alleged price suppression/price depression, which for Korea requires a quantification of the subsidy in relation to

[329] Second written submission by Korea, para. 261.

the amount of alleged suppression/depression. In this respect, Korea argues that a very detailed subsidy-by-subsidy, like product-by-like product analysis would be needed to determine what the theoretical price level for each ship would have been without the alleged subsidies, and after neutralizing the effect of all other factors influencing prices, compared with the actual, observed price. Thus, Korea rejects the notion that there is demand side substitutability of different ships within each ship category giving rise to mutual price influences. Korea also rejects the argument of general supply side fungibility of ships, arguing that EC yards in particular have significant physical and experience constraints that limit their participation in the full spectrum of ship sizes and types. As for the effect of the subsidies more generally on prices, Korea like the EC argues that only shipyards with sufficient market share in a given like product could affect prevailing price levels, but Korea disputes that any of the allegedly subsidized Korean yards have such shares.

7.645 Finally, Korea argues, the EC has not shown how the alleged price depression/price depression has seriously prejudiced the interests of the EC, including shipbuilders producing the three types of ships. As discussed above, Korea views "serious prejudice" as a separate requirement from price suppression/price depression.

13. Product-specific analysis

7.646 We turn now to our consideration of the EC's price depression claim in respect of LNGs. Here, as noted, while we present the parties' arguments as to both the restructuring and the APRGs and PSLs, we confine our analysis of alleged adverse effects to the APRGs and PSLs, given that we rejected the EC's subsidization claims in respect of the restructuring.

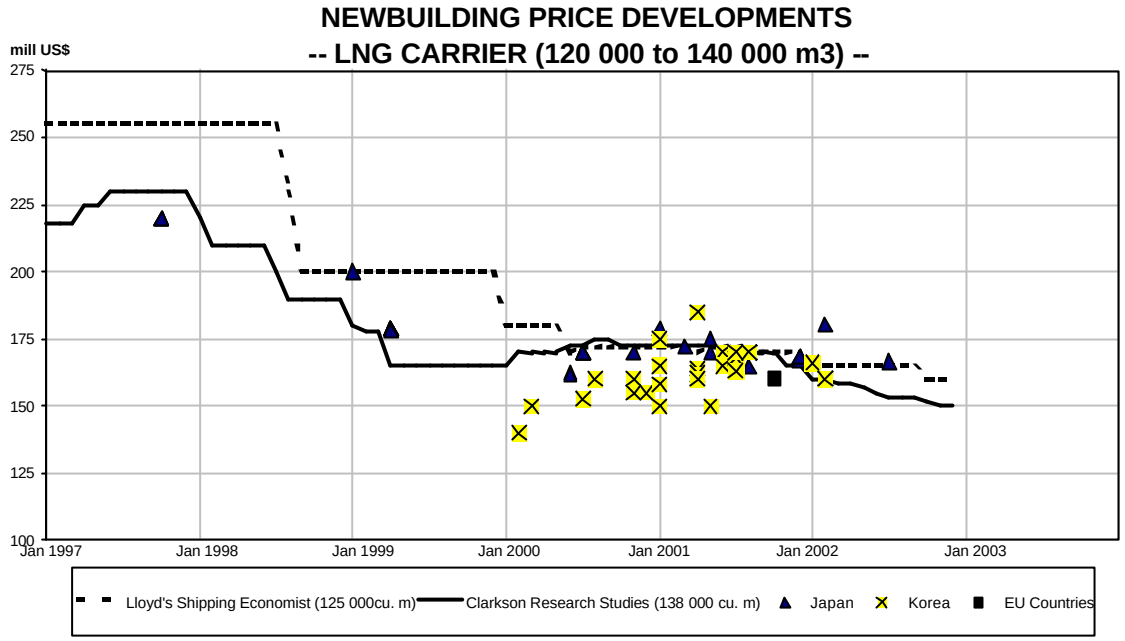
(a) Arguments of the parties

(i) LNGs

7.647 The EC argues that world prices for LNGs fell sharply between 1997 and 2000, stabilized for nearly two years, then continued their decline, in spite of a significant increase in the number of LNGs ordered. In support of this characterization of LNG prices, the EC presents Figure 30, entitled "newbuilding price developments" for LNG carriers from 1997 through 2002. The chart is reproduced below. As shown, the chart in Figure 30 consists of two price trend lines as well as price points for Japanese, Korean, and EC ships, for the period January 1997-December 2002. In answer to a question from the Panel, the EC indicates that this chart was published by Lloyd's register of shipping. We note that the same chart also appears as Figure D in the *OECD* document C/WP/SG(2003)10.[330]

[330] Exhibit EC-157.

FIGURE 30:[331]



7.648 The EC also presents a table showing the total number of LNGs ordered in each year from 1997-2002. This table is reproduced below. The EC states that the table shows that the number of LNGs ordered increased during the period shown. The EC argument is that world LNG prices declined, when they should have increased, given the substantial increase in orders. Korea does not dispute the accuracy of either the price chart or the information on the level of orders.

FIGURE 31: Number of ships ordered

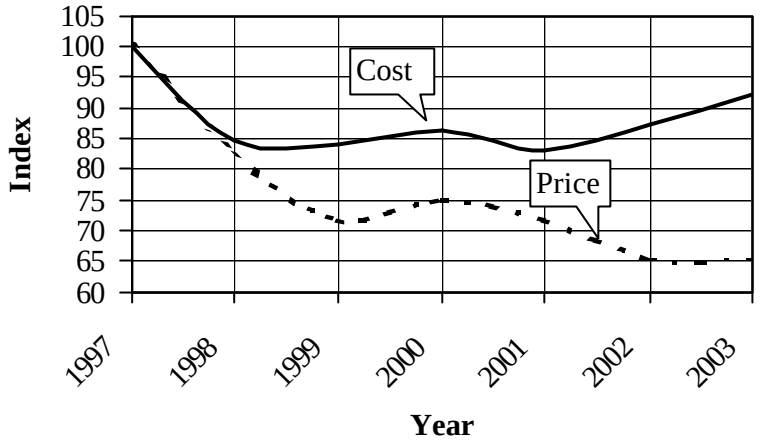
Number of ships ordered[332]	1997	1998	1999	2000	2001	2002
Total number of ships	**9**	**2**	**5**	**17**	**30**	**23**

7.649 The EC supplements this argument with price and cost indices for Korean LNGs, presented in Figure 38, reproduced below. According to the EC, costs of production for LNGs in Korea have risen since 2001, while prices have declined. Furthermore, the EC argues, freight rates also were increasing at the same time. Thus, the EC argues, the main price determining factors for LNGs – demand, costs, and freight rates – all were increasing yet prices declined. The EC argues that this situation, in particular the "dramatic" decline in the price of LNGs between 1997 and 2000, coincided with the industry restructuring in Korea.

[331] Source: Lloyds's register of Shipping.
[332] *Ibid.*

FIGURE 38

Cost and Price Indices for LNGs in Korea[333]



7.650 Korea rejects the EC arguments concerning LNGs for a number of reasons. First, Korea states that the apparent coincidence in time between the decrease in prices and Korea's first LNG sale on the world market is illusory, as the prices decreased before the first foreign order for an LNG was ever placed with a Korean shipyard. Moreover, Korea argues that these price declines began before the industry restructuring. On these points, the EC responds that even if prices began to decline before Korean yards entered the market, this does not mean that Korea was not responsible for price declines that occurred after that point. In addition, the EC states that Daewoo's price offer on the **[BCI: Omitted from public version]** project reflected the effect of the alleged subsidies, as Daewoo knew at the time that it made its winning bid that it would receive subsidies.[334]

7.651 Korea also disputes the causes of the price declines as presented by the EC. Korea points in particular to changes in size specifications to bigger ships than those produced in Europe, movement of LNGs from a specialty product to an increasingly standardized product, price pressure from owners, and technological improvements, as well as industry overcapacity. In this regard, Korea also disputes the EC's assertion that production costs in Korea are increasing. Korea states that, to the contrary, the Korean shipbuilding industry enjoys significant cost advantages compared to European shipyards, due to lower material and wage costs, higher productivity and the impact of the depreciation of the Won *vis-à-vis* the dollar, along with the appreciation of the euro, affecting the competitiveness of European yards. Korea states that every component of Korean costs fell further and faster than newbuilding prices. Korea argues that, at present, the market for LNGs is a buyers' market.

7.652 Furthermore, in Korea's view the EC must demonstrate that the shipyards benefiting from the alleged subsidies led the price declines for LNGs. In other words, Korea states that it is not sufficient to refer to the Korean industry as a whole.

7.653 On the latter point, the EC responds in part that because the Korean industry is highly competitive, the other Korean yards had to follow Daewoo's lead in cutting LNG prices. The EC states that these other yards received APRGs and PSLs, which partially offset the cost of the price cuts (up to 2 per cent of the selling price of a ship). Thus, for the EC, the alleged restructuring

[333] Source: FMI.

[334] Second submission of the EC at para. 368. "...the restructuring subsidies began to cause depression and suppression from the time when the shipyards first knew that they were expecting to receive benefit from the restructuring plans".

subsidies (along with subsidized KEXIM financing) to Daewoo have allowed it to set the prices for the Korean industry as a whole, with subsidized KEXIM financing to the non-restructured yards helping them to follow Daewoo's pricing lead. In turn, the subsidized low Korean price has forced down world LNG prices.

7.654 In respect of price leadership by Daewoo, and by Korea more generally, the EC argues that the low prices are a reflection of Daewoo's need to fill its capacity, which is capacity that would have exited the market if there had been no restructuring. In addition, the EC argues, the restructuring greatly reduced Daewoo's costs, by eliminating debt that otherwise would have had to be amortized over each vessel sold, and thus reflected in the ships' prices. Korea counters that even if Daewoo had been liquidated instead of restructured, its capacity would have stayed operational, as it was a modern facility for which a buyer would have come forward.

7.655 The EC also points to statistics comparing Korean and EC world market shares for LNGs. According to detailed order information on individual shipyards submitted by the EC, as at January 2004 Daewoo was the leading LNG producer in the world, accounting for 29.3 per cent of the market measured in terms of compensated gross tons, followed by Samsung with 18.1 per cent. HHI held a further 11.5 per cent share. Thus, the EC argues, the Korean industry accounts for 58.9 per cent of total outstanding orders of LNGs.

7.656 Korea objects that it is not possible to determine price leadership from market shares for LNGs. In particular, Korea argues that Koreas share of the LNG market has fluctuated greatly, from 0 to 73 per cent since it began selling LNGs. Korea says that it is therefore impossible to draw any conclusions as to price leadership from these market shares.

7.657 Finally, the EC presents a number of examples of LNG transactions to illustrate its price depression arguments. In these transactions, the EC states, EC shipyards bid against and lost to Korean yards, after a bidding process over the course of which the Korean offer prices were progressively reduced. According to the EC, in the end the EC yards were unable to reduce their prices sufficiently to win the orders. Concerning this EC argument, Korea objects in the first instance to what it sees as the EC's trying to reintroduce its abandoned price undercutting claim. Korea also argues that there is no link between the restructuring and the pricing by Korean yards for LNGs, because it was a non-restructured yard that obtained the first foreign order, because Daewoo's first LNG bid was made before it was restructured, and because non-restructured yards were offering similar prices at around the same time.

(ii) Product/chemical tankers

7.658 In respect of product/chemical tankers, the EC presents in Figure 42, reproduced below, a table concerning market shares, in terms of new orders, for the period 1993-2002.

Figure 42: Market Shares in Product and Chemical Tanker Sector for the period 1993-2002

	Average 93/97	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**Average 98/02**
EU	19%	12%	22%	11%	21%	22%	10%	3%	3%	7%	3%	5%
Skorea	19%	6%	16%	30%	12%	28%	46%	44%	51%	39%	35%	42%

Source: Lloyd's register of shipping

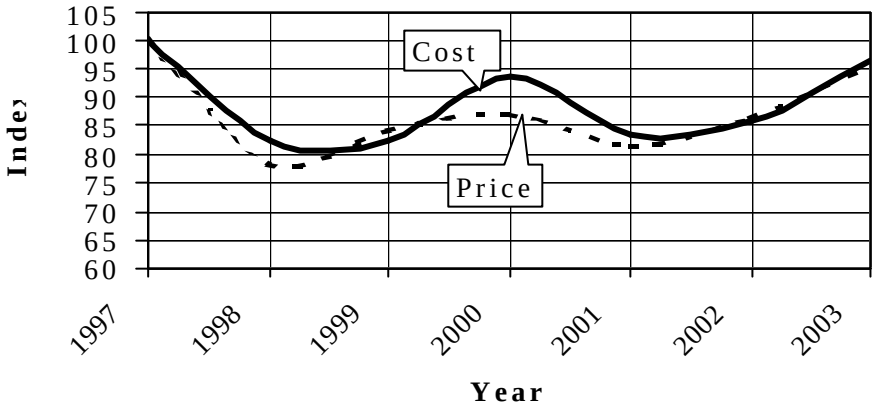
7.659 According to the EC, this table demonstrates that as from 1998, the year directly following the Won devaluation, Korean yards gained significant market shares and became market share leaders in this sector. In subsequent years, the EC argues, Korean yards consolidated their position, through a reckless low price policy, notwithstanding the recovery of the Won and increasing cost of production .

7.660 Korea rejects the EC's market share data, stating that these data do not support the allegation that Korea is the price and volume leader for product and chemical tankers, first because market share data lend no support for a conclusion on price leadership as a matter of course. In addition, Korea points out that the data in the EC's market share table reflect product tankers and chemical tankers, which the EC has admitted belong to different product categories. According to Korea, the EC's consultant FMI has admitted that the EC industry participates only in respect of chemical tankers, and that China has led chemical tanker prices since 2001.

7.661 The EC also presents in Figure 43, reproduced below, a chart comparing price and cost indices for certain product and chemical tankers produced in Korea.[335]

FIGURE 43[336]

Cost and Price Indices for Handysize Product and Chemical Tankers in Korea



7.662 According to the EC, the combination of rising demand, reflected in the high volume of orders for new ships and the higher freight rates, and the rising costs of Korean shipyards, should have caused the price of ships to increase, or to increase more steeply than they did. Korea argues in respect of costs that its industry enjoys significant cost advantages compared to European shipyards, due to lower material and wage costs, higher productivity and the impact of the depreciation of the Won *vis-à-vis* the dollar, along with the appreciation of the euro, affecting the competitiveness of European yards. Korea states that every component of Korean costs fell further and faster than newbuilding prices. Concerning freight rates, Korea argues that the information provided by the EC, which sets forth a single freight index tabulation, is uninformative. Korea argues that freight rates can vary by vessel segment and should be differentiated on that basis.

7.663 The EC asserts that the price suppression of which it complains is closely linked to price leadership that Korean shipyards have enjoyed since 1999.[337] The EC states that Korean prices are the starting point of sales negotiations in the shipbuilding industry, and are so low that EC producers often are not even requested to bid for contracts by brokers because the brokers are aware that EC shipyards will not be able to match the Korean price unless they sell at substantial loss.

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[335] According to the EC, the size of ship presented (around 47,000 dwt) is typical of the class built in numbers in Korea, and also is a class of ship that would be of great interest to EC shipyards if the price were not so low.

[336] Source: FMI.

[337] WTO Trade Policy Review Mechanism of 2000 (Exhibit EC-82).

7.664 In this regard, the European Communities provides certain examples of sales that it alleged were lost by EC shipyards to Korean shipyards in the product and chemical tanker sector. The EC indicates that it is not making a claim of lost sales, but rather presents the examples to illustrate the price leadership of Korean shipyards in this sector resulting in suppressed prices.

7.665 The EC asserts that this price leadership helps the Korean shipbuilding industry to make use of the excess capacity that it brought on line in the mid-1990s.[338] According to the EC, the alleged subsidies i.e., the restructuring aid and the export subsidies as well as the tax concessions, allowed the preservation of unneeded facilities, compelling a significant decline in prices with Korean yards willing to sell at any price above the variable cost of production.

7.666 Korea denies that Korean shipyards are the price leaders for product and chemical tankers, on the basis of the report of the EC's consultant, and argues that in some cases European prices are lower.. Furthermore, Korea states, the examples of lost sales alleged by the EC are irrelevant, *inter alia* because in some cases the Korean shipyards involved were not among the restructured ones, and because of technical limitations on the part of the certain of the European yards involved.

(iii) Container ships

7.667 The EC presents in Figure 39, reproduced below, a table on market shares, in terms of new orders, in the container ship sector for the period 1993-2002.

Figure 39: Market Shares container ship sector for the period 1993-2002

	Average 93/97	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**Average 98/02**
EU	23%	34%	22%	26%	13%	23%	15%	13%	12%	20%	10%	14%
Skorea	27%	31%	26%	34%	27%	14%	45%	62%	52%	32%	52%	48%

Source: Lloyd's register of shipping

7.668 According to the EC, this table indicates that, from 1998, the year directly following the won devaluation, the Korean yards gained significant market share and became price and volume leaders in this sector. Yet, despite the recovery of the won and the increasing cost of production, Korean prices continued to decrease thereafter, allowing Korean yards to consolidate their price leadership and market dominance in the sector.

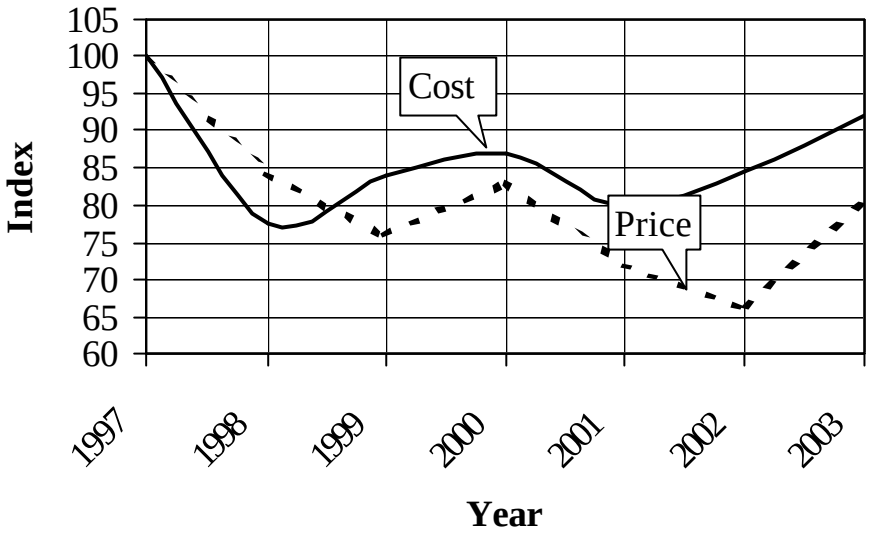
7.669 Korea disagrees, arguing that the market share data presented by the EC do not support the EC's allegation that Korea has become price and volume leader and that Korean prices continued to decrease thereafter. For Korea, in the first place market share data lend no support for a conclusion on price leadership as a matter of course. Furthermore, Korea argues that containerships cannot all be grouped together as the market share table does, because container ships do not constitute a single "like product". Rather, they show significant technical differences linked to their intended use and are perceived as such. According to Korea, the EC's own consultant, FMI, explicitly admitted that, as far as containerships are concerned, the Korean and European Communities' shipyards only compete for feeder containers where the prices have been led, again according to this consultant, by South Korea and China but with strong competition from Poland, Singapore and Taiwan. Korea argues that the European Communities are active in certain sizes of the feeder category, and the EC shipyards decreased their prices well before the appearance of Korean vessels of the same size on the market.

[338] FMI Background Report, at 23 (Exhibit EC-1).

7.670 The EC also presents in Figure 40, reproduced below, a chart comparing price and cost indices for 3,500 TEU container ships in Korea.[339]

Figure 40 Container ship

Cost and Price Indices for 3,500 TEU Container Ships in Korea (USD)[340]



7.671 The EC argues that the chart shows (in USD) that the price of, and the cost to produce, container ships declined sharply from 1997 until the middle of 1998. Since late 1998, the price has continued its general downward trend while costs have risen. The EC argues that the ability of the Korean shipyards to lower prices in the face of rising production costs is attributable to the alleged subsidies to the shipbuilding industry.

7.672 Korea's argument in respect of costs is that Korea has significant cost advantages compared to European shipyards, due to lower material and wage costs, higher productivity and the impact of the depreciation of the Won *vis-à-vis* the dollar, along with the appreciation of the euro, affecting the competitiveness of European yards. Korea states that every component of Korean costs fell further and faster than newbuilding prices. Concerning freight rates, Korea argues that the information provided by the EC, which sets forth a single freight index tabulation, is uninformative. Korea argues that freight rates can vary by vessel segment and should be differentiated on that basis.

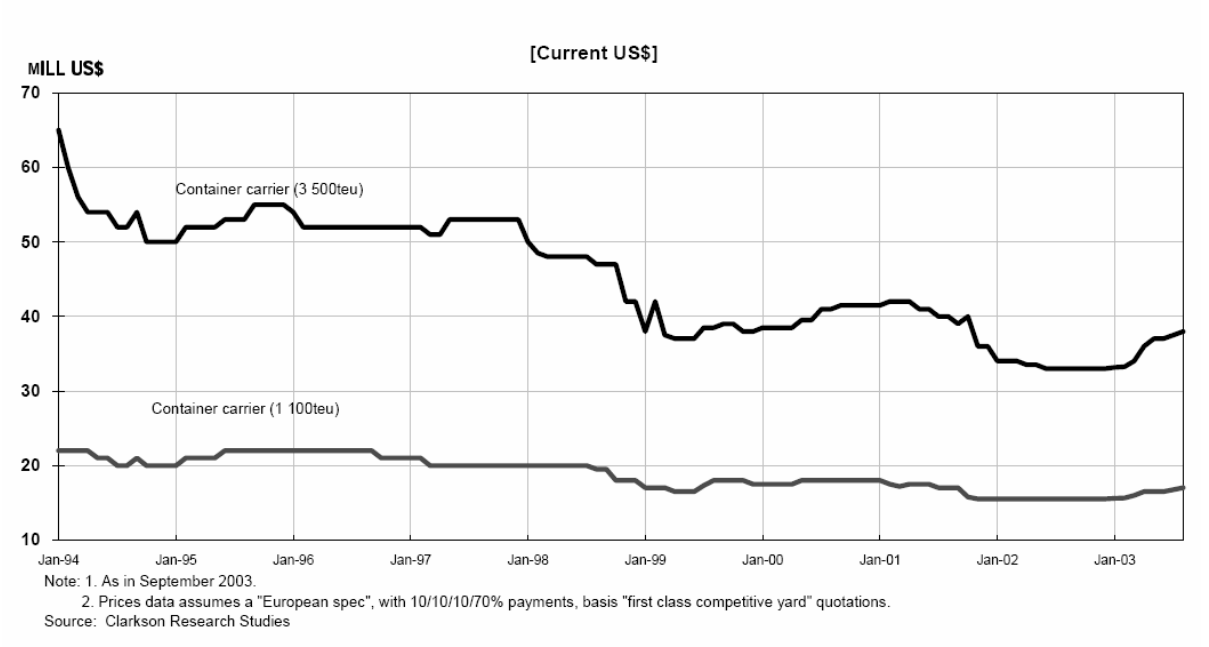
7.673 For the EC, Korea is the recognised world price leader: the downward trend of the prices charged by the Korean shipyards caused prices in the world market to decline as well. The EC submits a price index chart (Figure 41, reproduced below) in support of its argument that the world market price for container ships is declining. The price chart covers 3,500 TEU and 1,100 TEU containerships. According to the EC, competition between Korean and EC yards is particularly strong in the 3,500 TEU segment of container ships, while in the segment of smaller container ships Korean

[339] The EC notes that the term "TEU" stands for "twenty-foot equivalent unit", the key measurement of the cargo carrying capacity of a container ship.

[340] According to the EC, this is typical of the class of container ship for which there is strong competition between Korea and the European Communities. Since 1997, orders have been won by Daewoo, Halla, Hyundai Heavy, Samho and Samsung in Korea, and Volkswerft, HDW, and Odense in the European Communities.

yards are less active, explaining the less-pronounced price decrease for the latter class of container vessels.

Figure 41: World Market Price for Containerships



7.674 Korea counters with a chart of its own showing prices for feeder containerships, on the basis of which it argues that the EC shipyards depressed the price for feeder containership, well before the appearance of Korean vessels of the same size on the market.

7.675 The EC also submits an example of a sale of a container ship allegedly lost to a Korean shipyard, as illustration of price suppression by Korean shipyards in the container ship sector. According to the EC, Korean prices constitute the starting point of price negotiations, and no profit-seeking shipyard can meet these below-cost levels. Korea challenges the relevance of this example, arguing that one such order is does not constitute even *prima facie* evidence of significant price suppression, particularly when it is not demonstrated to be the effect of any existing subsidies.

(b) Evaluation by the Panel

7.676 We recall our findings that the EC has not demonstrated that the industry restructuring conferred subsidies on certain Korean shipyards. We also have found that the KEXIM legal regime as such, as well as the APRG and PSL programmes, as such, do not constitute prohibited export subsidies. We have, however, found that a number of individual APRGs and PSLs do confer subsidies. Some of these individual transactions involve the three types of ships that we are considering (LNGs, product/chemical tankers, and container ships), and some of these transactions involve other kinds of ships (e.g., crude oil tankers, bulk carriers, roll-on-roll-off vessels).

7.677 Thus, most of the alleged subsidies which the EC claims to cause adverse effects in fact cannot be considered in our serious prejudice analysis. The question that we must answer in respect of the EC's serious prejudice claim, therefore, is whether the EC has established that, in themselves, the relatively limited number of APRGs and PSLs that we *have* found to confer subsidies have caused significant price depression in respect of LNGs, and significant price suppression in respect of product/chemical tankers, and in respect of container ships. Applying the analytical framework that

we have described above, the question before us is whether the EC has established that but for these subsidized APRGs and PSLs, the prevailing market prices for these ships would have been significantly higher than they in fact were.

7.678 We recall here that the main premise of the EC's serious prejudice claim in respect of APRGs and PSLs is that this financing complemented the price depressive and suppressive effects of the allegedly subsidized industry restructuring. Thus, the EC alleges certain effects of these financing facilities as a whole, on the Korean shipbuilding industry as a whole, in the broader context of the industry restructuring which the EC alleged to confer subsidies. The EC's allegation in respect of the individual APRGs and PSLs thus is not based on an analysis of the subsidized transactions pertaining to LNGs, product/chemical tankers, and container ships in relation to the prevailing market prices for those categories of ships.[341] While the EC asserts that the individual subsidized APRGs and PSLs played a role in determining which shipyard obtained a particular contract, and states that the effect on the prices of the individual subsidized transactions was as much as two per cent *ad valorem*, for the EC the principal price effect of the subsidized financing was more generalized, i.e., assisting the restructured yards to maintain excess capacity in operation, which capacity in turn suppressed and depressed overall price levels for the three categories of ships, as well as, in general, helping to enable the non-restructured yards to follow the pricing lead of the restructured yards.[342] Thus, the EC does not distinguish, for purposes of its serious prejudice claims, between individual subsidized APRGs and PSLs on kinds of ships covered by those claims (LNGs, chemical/product tankers, and container ships), and on kinds of ships not covered by those claims (e.g., oil tankers, bulk carriers, and Roll-On-Roll-Off vessels, etc.).

7.679 In taking up the EC's claims concerning the APRGs and PSLs that we have found to be subsidized, we first must consider which of these subsidized transactions are relevant. In particular, we must decide whether to include or exclude from the subsidies whose effects we are considering the APRGs and PSLs on ship types other than LNGs, product/chemical tankers, and container ships. We understand that the EC's rationale for including them was that the availability of subsidized APRGs and PSLs in general had an impact on which shipyard obtained a sale and on the overall financial strength of the shipyards. While such an argument based on all subsidized APRGs and PSLs might have been plausible in the context of an affirmative finding of broad restructuring subsidies, we now are left with a relative handful of individual subsidized transactions involving a variety of ship types, some of which are not covered by the EC's price suppression/price depression claim. The EC has presented no evidence or argument seeking to demonstrate that subsidized financing of sales of ship types not covered by its claim (such as bulk carriers) had an identifiable impact on pricing for any of the ship types covered by its serious prejudice claims. In the absence of any such evidence or argument, we see no basis for taking into account in our analysis the subsidized financing of ship

[341] We recall the EC statement that its claim is "an overall claim of price depression and suppression on the world market resulting *inter alia* from restructuring aids involving direct forgiveness of government-held debt, as well as from KEXIM subsidies".

[342] The EC states in this regard that it is obvious that access to pre-shipment loans and APRGs at a time when private creditors either would not have provided such facilities, or, if they had, would have charged higher rates or fees based on market conditions, improved the shipyards' cash flows and profitability. The EC quotes from the 1998 KEXIM annual report in support of this argument as follows: "[KEXIM] as an export credit agency, played a rescue-operation role, transfusing emergency loans to Korean exporters and importers at the onset of the crisis *when the banking sector in Korea was nearly paralyzed*." The EC also cites the KEXIM Chairman's statement in the 1999 KEXIM Annual Report: "[KEXIM] contributed to the economic recovery by providing a variety of financing programs to exporters . . . who *experienced difficulty in obtaining adequate trade-related financing from commercial financial institutions*, due to the government-initiated restructuring plan in the financial and corporate sectors." Finally, the EC argues that KEXIM financing caused orders to be placed with the yards that later were restructured, which led to full orderbooks, which in turn led to optimistic sales projections for the purposes of establishing going concern value.

types other than LNGs, product/chemical tankers, and container ships. Rather, we consider that we should include in our analysis only the subsidized APRGs and PSLs that we know to relate to LNGs, product/chemical tankers, and container ships. These APRGs and PSLs are listed in Attachment 3.[343]

7.680 Furthermore, we recall that the EC has presented its serious prejudice case, and has asked us to conduct our analysis, in respect of each of the three categories of ships separately, and we will proceed on this basis, considering the possible effects on the prices for each ship category of the subsidized financing for ships in that category. In particular, we will consider first whether the evidence and arguments presented by the EC demonstrate a tangible relationship between the subsidized APRGs in respect of LNGs and the prevailing price for LNGs; between the subsidized APRGs and PSLs in respect of product/chemical tankers and the prevailing price for product/chemical tankers; and between the subsidized APRGs and PSLs in respect of container ships and the prevailing price for container ships. That is, we will look for evidence of a relationship between the subsidized transactions for a given ship type, on the one hand, and the prevailing market price for that ship type, on the other hand. If we find that there is evidence of such a relationship, we then will go on to consider in more detail questions of product definitions, geographic markets, timing of subsidization, movements in prices, evidence pertaining to costs, etc. for each product category, which would be needed for a full analysis of the serious prejudice claims.

(i) LNGs

7.681 Of the APRGs that we have found to be subsidized, three concern LNGs. These APRGs were contracted between 2000 and 2001, and expired between 2002 and 2004. We estimate the benefits of these subsidies to range from **[BCI: Omitted from public version]** per cent of the value of the ships involved. None of the PSLs that we have found to be subsidized concern LNGs. To put this into perspective, the EC has submitted data showing that as of January 2004, there were 62 LNGs on order around the world, 37 of them with Korean yards.[344]

7.682 While the estimated benefit amounts are relatively small, we do not doubt that even such modest subsidies may have played a role in obtaining the sales involved. In particular, we consider it entirely possible that they translated into equivalent price reductions on those specific transactions. That said, it is far from self-evident to us that a price reduction of **[BCI: Omitted from public version]** per cent on three transactions out of a much larger total would constitute, or lead to, "significant price depression" for LNGs as a whole.

7.683 Here we re-emphasize that in respect of this price depression claim, the appropriate focus of our analysis is the overall prevailing price level for the product category as a whole, and the possible link of the subsidized APRG transactions for LNGs to this price level. Indeed the EC's claim is based on overall price effects for this product category, and it asks us to resolve the claim on that basis. While we certainly accept the possibility that the subsidized financing affected the prices in the three individual transactions, we find nothing in the evidence and arguments before us demonstrating that the aggregate effect of the subsidized transactions is significant price depression for the entire product category of LNGs.

7.684 We therefore reject the EC's claim that subsidized APRGs have seriously prejudiced the EC's interests by causing significant price depression in respect of LNGs.

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[343] There are a number of APRGs and PSLs that we have found to be subsidized but for which we do not have information concerning the ship type involved, although we requested this information from the EC and the EC did not indicate that it was unavailable. (*See*, Question 139 from the Panel to the EC, and the EC response thereto.) Nevertheless, even if we were to assume that all of these unidentified transactions concerned either LNGs, product/chemical tankers, or container ships, this would not change our analysis and conclusions.

[344] EC Attachment 6, to answers to questions from the Panel following the first substantive meeting.

7.685 Given this, there is no need for us to consider the parties' detailed arguments as to product definitions, geographic markets, timing, etc. advanced in respect of LNGs.

(ii) Product/chemical tankers

7.686 Of the APRGs that we have found to be subsidized, two concern product/chemical tankers. These APRGs were contracted in 1999 and expired in 2001. We estimate the benefits of these subsidies to range from **[BCI: Omitted from public version]** per cent of the value of the ships involved. Of the PSLs that we have found to be subsidized, 24 concern product/chemical tankers. These PSLs were contracted between 2001 and 2002, and expired between 2001 and 2003. We estimate the benefits of these subsidies to range from **[BCI: Omitted from public version]** per centage points of interest on the loans involved. (No data are available as to these subsidy amounts restated on an *ad valorem* basis.) Data submitted by the EC show that as of January 2004, there were 370 tankers (including but not limited to product/chemical tankers) on order around the world, 218 of them with Korean yards.[345]

7.687 While the estimated benefit amounts are relatively small, we do not doubt that even such modest subsidies may have played a role in obtaining the sales involved. In particular, we consider it entirely possible that they translated into equivalent price reductions on those specific transactions. That said, it is far from self-evident to us that a price reduction of **[BCI: Omitted from public version]** per cent[346] on a relatively few transactions out of a much larger total would constitute, or lead to, "significant price suppression" for product/chemical tankers as a whole.

7.688 Here we re-emphasize that in respect of this price suppression claim, the appropriate focus of our analysis is the overall prevailing price level for the product category as a whole, and the possible link of the subsidized APRG and PSL transactions for product/chemical tankers to this price level. Indeed the EC's claim is based on overall price effects for this product category, and it asks us to resolve the claim on that basis. While we certainly accept the possibility that the subsidized financing affected the prices in the individual transactions, we find nothing in the evidence and arguments before us demonstrating that the aggregate effect of the subsidized transactions is significant price suppression for the entire product category of product/chemical tankers.

7.689 We therefore reject the EC's claim that subsidized APRGs and PSLs have caused serious prejudice to the EC's interests through price suppression in respect of product/chemical tankers.

7.690 Given this, there is no need for us to consider the parties' detailed arguments as to product definitions, geographic markets, timing, etc. advanced in respect of product/chemical tankers.

(iii) Container ships

7.691 Of the APRGs that we have found to be subsidized, eight concern container ships. These APRGs were contracted between 1997 and 2001, and expired between 1998 and 2003. We estimate the benefits of these subsidies to range from **[BCI: Omitted from public version]** per cent of the value of the ships involved. Of the PSLs that we have found to be subsidized, 21 concern container ships. These PSLs were contracted between 2001 and 2002, and expired between 2001 and 2003. We estimate the benefits of these subsidies to range from **[BCI: Omitted from public version]** percentage points of interest on the loans involved. (No data are available as to these subsidy amounts restated on an *ad valorem* basis.) Data submitted by the EC show that as of January 2004, there were 502 container ships on order around the world, 276 of them with Korean yards.

[345] Id.

[346] Because the figures cited are percentage points of interest, rather than *ad valorem* amounts, they would overstate the possible *ad valorem* impact of the subsidies involved to the extent that the financing in question was for less than 100 per cent of the contract value.

7.692 While the estimated benefit amounts are relatively small, we do not doubt that even such modest subsidies may have played a role in obtaining the sales involved. In particular, we consider it entirely possible that they translated into equivalent price reductions on those transactions. That said, it is far from self-evident to us that a price reduction of **[BCI: Omitted from public version]** per cent[347] on a small number of transactions out of a much larger total would constitute, or lead to, "significant price suppression" for container ships as a whole.

7.693 Here we re-emphasize that in respect of this price suppression claim, the appropriate focus of our analysis is the overall prevailing price level for the product category as a whole, and the possible link of the subsidized APRG and PSL transactions for container ships to this price level. Indeed the EC's claim is based on overall price effects for this product category, and it asks us to resolve the claim on this basis. While we certainly accept the possibility that the subsidized financing affected the prices in the individual transactions, we find nothing in the evidence and arguments before us demonstrating that the aggregate effect of the subsidized transactions is significant price suppression for the entire product category of container ships.

7.694 We therefore reject the EC's claim that subsidized APRGs and PSLs have seriously prejudiced the EC's interests by causing significant price suppression in respect of container ships.

7.695 Given this, there is no need for us to consider the parties' detailed arguments as to product definitions, geographic markets, timing, etc. advanced in respect of container ships.

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.696 For the above reasons, we uphold the EC's claim that Korea has provided prohibited export subsidies in the form of the individual KEXIM APRG transactions set forth at para. 7.223 *supra*, and the individual KEXIM PSL transactions set forth at para. 7.330 *supra*, contrary to Articles 3.1(a) and 3.2 of the *SCM Agreement.*

8.697 However, we reject the EC's claims that Korea is in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement* because prohibited export subsidies were and are provided pursuant to the KEXIM legal regime "as such", and the KEXIM APRG and PSL programmes "as such".

8.698 We also reject the EC's claim that Korea, by providing subsidies to Daewoo-SME/Daewoo-HI, Samho-HI/Halla-HI, and STX/Daedong through (i) workout plans and restructuring plans; (ii) tax concessions provided to Daewoo-HI/Daewoo-SME; and (iii) the grant of KEXIM APRGs and pre-shipment loans, has caused serious prejudice to the interests of the European Communities in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement.*

8.699 Pursuant to Article 4.7 of the *SCM Agreement,* we are required to recommend that Korea withdraw the abovementioned individual APRG and PSL subsidies without delay.

8.700 Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure must be withdrawn." Taking into account the procedures that may be required to implement our recommendation on the one hand, and the requirement that Korea withdraw its subsidies "without delay" on the other, we recommend that Korea withdraw the individual APRG and PSL subsidies within 90 days.

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[347] Because the upper end of this range reflects percentage points of interest, rather than an *ad valorem* amount, it would overstate the possible *ad valorem* impact of the subsidy involved to the extent that the financing in question was for less than 100 per cent of the contract value.

ATTACHMENT 1

KOREA – MEASURES AFFECTING TRADE IN COMMERCIAL VESSELS (DS273)

Procedure under Annex V of the Agreement on Subsidies and Countervailing Measures

Report to the Panel from the Designated Representative of the Dispute Settlement Body

A. BACKGROUND

1. On 21 July 2003, a Panel was established at the request of the European Communities with respect to the above matter. In its request for establishment of a panel,[1] the European Communities alleged, *inter alia*, serious prejudice in the sense of Article 6 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), and in this context requested initiation of the procedure for developing information concerning serious prejudice provided for in Annex V to that Agreement.

2. As provided for in paragraph 4 of Annex V, the Dispute Settlement Body ("DSB") designated a Representative, Mr. András Szepesi, to facilitate the Annex V information-gathering process. The Designated Representative was appointed by the DSB on 21 July 2003, i.e., the date on which the Panel was established. This date was also considered by the parties to be the date on which the matter was "referred to the DSB" in the sense of paragraph 5 of Annex V. This meant that the 60-day period established in that paragraph for completion of the information-gathering process would have ended on 19 September 2003.

3. Shortly after the Panel was established, the Designated Representative met with the parties (the European Communities and Korea) to determine a schedule and working procedures for the Annex V procedure. Also, throughout the duration of the information-gathering process, he remained at the disposal of the parties. As reported below, he was called upon on a number of occasions by one or both of the parties to assist them by providing guidance or, if applicable, rulings with respect to different procedural aspects involved in the process.

B. WORKING PROCEDURES AND SCHEDULE

4. It was recognized that Annex V does not describe all aspects of the procedures for developing information concerning serious prejudice. Paragraph 2 of Annex V clearly foresees the possibility that parties to a dispute may pose questions to one another. In addition, however, the task of the Designated Representative is to ensure the timely development of the information necessary to facilitate expeditious subsequent multilateral review of the dispute, and paragraph 5 contains a non-exhaustive list of such types of information.

5. In view of these provisions of Annex V, and following consultations with the parties at an organizational meeting on 23 July 2003, the Designated Representative adopted a procedure the first step of which would be the submission of questions by the parties to the Designated Representative. The second step in the process was the preparation and transmittal to the parties and third-country Members of a questionnaire by the Designated Representative. That questionnaire would be based on the questions posed by the parties, but those questions could be amended, deleted or supplemented by the Designated Representative. In response to comments made by Korea, the Designated Representative agreed to make a draft version of his questionnaire available to the parties for comment, to allow them to identify any lacunae in the questions. The third step was the submission by each party and third-country Member of answers to the questions directed to it. The fourth and

[1] Document WT/DS273/2.

final step was a brief interval for the submission of any follow-up questions (concerning the clarification of answers received in the prior step) and answers thereto.

6. The schedule for the process as outlined was:

1 August 2003	Parties to submit to the Designated Representative questions to be posed to one another and to third-country Members
11 August 2003	Transmittal of questionnaires to parties and third-country Members by the Designated Representative
8 September 2003	Replies to questionnaires due
15 September 2003	Submission by the parties of follow-up questions (concerning the clarification of answers received by 8 September)
18 September 2003	Replies to follow-up questions due
19 September 2003	End of 60-day period / Report by the Designated Representative to Panel

7. At a late stage in the 60-day period, in fact just a couple of days before its expiry, the above schedule had to be modified, with the agreement of the parties, as a result of the additional time needed for the parties to translate certain voluminous documentation into one of the three WTO working languages. The amended deadline for completion of the Annex V procedure was 10 November 2003. The Panel was immediately informed of these modifications and the causes thereof.

C. PROCEDURAL ISSUES

8. A number of procedural issues arose during the Annex V information-gathering procedure. Those issues concerned the adoption and application of additional procedures for the protection of business / strictly confidential information, third party access to information, the timing of the submission of questions, the scope and review of questions, a request for the suspension of the Annex V procedure, and the translation of documents into a WTO working language.

1. Adoption and application of additional procedures for the protection of business / strictly confidential information

9. On 22 July 2003, Korea asked the Designated Representative to adopt additional procedures for the protection of business / strictly confidential information ("B/SCI"). The European Communities acknowledged the need for such additional procedures at the organizational meeting on 23 July. Each party submitted draft additional procedures.

10. In a meeting on 13 August, the Designated Representative noted that, although he was in favour of using additional procedures for the protection of B/SCI, the parties had proposed procedures that covered both the Annex V and Panel proceedings. While he found this approach fully understandable and justified, he had to express the view that only the Panel had the authority to adopt procedures governing both the Annex V and Panel proceedings. As a result, the parties asked the Designated Representative to forward their submissions regarding B/SCI to the Panel. The Designated Representative complied with this request. The Panel adopted procedures for the protection of BCI on 4 September 2003.

11. Subsequently, in a letter dated 15 September 2003, the European Communities asserted that in providing information Korea had not exercised restraint in the designation of BCI. The European Communities requested the Designated Representative to intervene in a manner envisaged by paragraph 20 of the procedures for the protection of BCI. In a letter dated 16 September, Korea asserted that it had acted in good faith, and in accordance with the definition of BCI as provided in the procedures for the protection of BCI, by designating as BCI information "not otherwise available in the public domain".

12. In a letter dated 16 September, the Designated Representative noted that the majority of questions asked of Korea were designed to elicit information that was of a commercially sensitive nature, and that the European Communities had failed to argue that such information was already in the public domain. He therefore declined to find that Korea had failed to exercise restraint by designating much of its questionnaire response as BCI, and declined to intervene under paragraph 20 of the additional procedures for the protection of BCI.

2. Third party / third-country Member access to information

13. The European Communities asked the Designated Representative to make information gathered under the Annex V procedure, including B/SCI, available to third parties or, at the very least, to third-country Members participating in the Annex V process. Korea asserted that there was no basis for doing so. Following a preliminary indication to that effect on 24 July 2003, on 4 September the Designated Representative informed the parties that, in his view, information gathered under the Annex V procedure did not need to be made available to third parties. In accordance with Article 10.3 of the DSU, third parties were entitled to receive all the submissions made by the parties to the Panel up to the first meeting of the panel. Since information submitted under the Annex V procedure did not constitute a submission to the Panel, such information fell outside the scope of Article 10.3. The Designated Representative saw no basis in the DSU or Annex V for treating third-country Members (which were also third parties) any differently.

3. Timing of the submission of questions

14. In a letter dated 22 July 2003, Korea asked the Designated Representative to introduce a staggered questioning process, whereby the European Communities would be required to submit its questions to the Designated Representative seven days before Korea.

15. In a communication dated 24 July, and on the basis of comments made by Korea at the organizational meeting, the Designated Representative stated that he understood Korea's request to be motivated primarily by the concern that the European Communities would submit questions to third-country Members other than those identified in the European Communities' communication of 10 July 2003 (WT/DS273/3), i.e., China and Japan. The Designated Representative explained that, in view of the European Communities' communication of 10 July, it could be assumed that the European Communities would only address questions to those two third-country Members. He indicated that he would consider carefully whether or not it would be appropriate to include questions addressed by the European Communities to other third-country Members in his questionnaire. Accordingly, the Designated Representative concluded that there was no need for a staggered questioning process. In light of a further submission by Korea on 25 July, the Designated Representative informed the parties on 28 July that he would provide them with a brief opportunity to comment on his draft questionnaire, to ensure that no questions were overlooked.

4. Review and scope of questions

16. On 22 July 2003, Korea asked for an opportunity to review questions submitted by the European Communities, to determine whether or not they adequately identified the nature of its serious prejudice allegations, and to enable Korea to ensure that the scope of the

European Communities' questions was properly limited to matters necessary to establishing its claims.

17. On 24 July, the Designated Representative stated that there was useful guidance in Annex V for identifying the information that would be most relevant to the serious prejudice claims at issue in this dispute. He noted, however, that it was ultimately up to each party to decide how it would respond to questions put to it. Since paragraph 8 of Annex V implied that there may be circumstances in which unreasonable questions might be put, he concluded that Annex V did not require any formal step providing for the *ex ante* assessment of the reasonableness of questions. (The provision of a draft questionnaire to the parties was merely to allow them to identify any questions that might have been overlooked by the Designated Representative.) He noted, however, that each party would be free to include comments on the reasonableness of questions when formulating its replies.

18. On 5 August, Korea nevertheless submitted a number of comments regarding the questions proposed by the European Communities on 1 August (which the European Communities had copied to Korea directly on that date). The European Communities was invited to respond by 6 August. Since no *ex ante* review of proposed questions was envisaged, the Designated Representative did not respond to the comments made by the parties.

19. Independently of these comments, and in line with his prerogative specified in paragraph 5 above, the Designated Representative did however amend or delete a number of questions submitted by the European Communities, to ensure that those questions did not exceed the scope of the Annex V procedure. Incidentally, such amendments / deletions also addressed some of the concerns raised by Korea. In a letter dated 8 August 2003, the European Communities commented on the scope of the Designated Representative's draft questionnaire to Korea. The European Communities asserted that, although the Designated Representative had restricted questions to Korea regarding the KEXIM Act and programmes to matters involving trade in commercial vessels, the serious prejudice claim relating to the KEXIM Act and programmes was not confined to exporters involved in trade in those products or to the shipbuilding sector.

20. On 11 August 2003, the Designated Representative asserted that he considered it appropriate to focus questions primarily on issues relating to trade in commercial vessels in light of the scope of the European Communities' request for consultations (WT/DS273/1) and request for establishment of a panel (WT/DS273/2).

5. Request for the suspension of the Annex V procedure

21. Consistent with its abovementioned submissions, on 8 August 2003 Korea expressed concern regarding the scope of certain questions included in the Designated Representative's draft questionnaire, and proposed that the Annex V procedure be suspended pending resolution by the Panel of legal issues concerning the scope of questions. Alternatively, Korea submitted that the Annex V procedure could proceed, but with the questionnaire responses of the parties and third-country Members being provided only to the Designated Representative (who would in turn provide the information to the Panel, but not to the parties).

22. On 11 August 2003, the Designated Representative stated that he intended to complete the Annex V procedure in accordance with his mandate from the DSB. He therefore declined to follow either of the courses proposed by Korea. He added that his mandate was to "ensure the timely development of the information necessary to facilitate expeditious subsequent multilateral review of the dispute". He stated that this mandate necessarily required the exercise of discretion on his part, and that he had exercised that discretion by including information-gathering questions on all issues that seemed to him to relate to those parts of the dispute covered by the scope of Annex V. He asserted that it was then up to Korea to determine to what extent it was prepared to respond to those questions.

6. Translation into a WTO working language

23. During the course of the information-gathering procedure, on 8 September both parties submitted documents drafted in a language other than a WTO working language. In particular, nearly half of all annexes submitted by Korea were provided, in whole or in part, in the Korean language. In letters dated 8 and 16 September 2003, Korea asserted that it was not required to provide all information in a WTO working language. Korea recognised, however, that it could be instructed, either by the Designated Representative or by the Panel, to undertake the necessary translation. On 15 September, the European Communities asserted that provision of a document in a non-WTO language was tantamount to non-provision of that document, and therefore non-cooperation.

24. On 15 September 2003, the Designated Representative informed the parties of his view that, since the Annex V procedure was a special or additional rule or procedure in the meaning of Article 1.2 of the DSU, it was formally part WTO dispute settlement proceedings. He therefore concluded that the Annex V procedure must be conducted in one of the three working languages of the WTO.

25. With the consent of the parties, in a communication dated 17 September 2003 the Designated Representative extended the deadline for completion of the Annex V procedure in order to allow sufficient time for the translation of certain documentation into one of the working languages of the WTO. Additional time was also allowed for follow-up questions and answers regarding such documentation. The modified schedule drawn up by the Designated Representative is attached hereto as Attachment I.

26. The extension of the deadline obviously meant that the information-gathering process could not be completed within the deadline specified in paragraph 5 of Annex V of the SCM Agreement, and this would necessarily impact on the schedule established by the Panel. However, not only does Annex V fail to provide any guidance that could have been relied upon in addressing the problems encountered, but also the extension was the only viable option for ensuring that the information obtained could meet the requirements specified, in particular, in paragraphs 2 and 5 of Annex V, and be of immediate use to the parties and the Panel. Furthermore, the deadline was extended with the consent of the parties, who cooperated in respecting the modified schedule. Moreover, the Panel was immediately informed, and did not express any disapproval, of these developments.

D. INFORMATION GATHERED

27. Questionnaires were sent to the parties and two third-country Members (i.e., China and Japan). A substantial amount of information was submitted in response those questionnaires. The questionnaires, replies to questionnaires, follow-up questions and replies to follow-up questions are contained in Annexes I – IV to this report. These Annexes are organized as follows:

Annex I-A	Questionnaire to the European Communities
Annex I-B	Replies by the European Communities to questionnaire
Annex I-C	Follow-up questions to the European Communities
Annex I-D	Replies by the European Communities to follow-up questions
Annex II-A	Questionnaire to Korea
Annex II-B	Replies by Korea to questionnaire
Annex II-C	Follow-up questions to Korea

ATTACHMENT I

KOREA – MEASURES AFFECTING TRADE IN COMMERCIAL VESSELS (DS273)

MODIFIED SCHEDULE FOR THE COMPLETION OF THE ANNEX V PROCEDURE

Timetable for submission of document translations, and for follow-up questions and answers

15 September 2003	deadline for follow-up questions on information submitted 8 September 2003.
16 September 2003	provision of certain missing documents by Korea.
18 September 2003, COB[2]	deadline for answers to 15 September follow-up questions.
22 September 2003, by 10:00 AM	deadline for follow-up questions from EC on missing documents provided by Korea on 16 September.
26 September 2003, COB	deadline for answers of Korea to 22 September EC follow-up questions on the missing documents provided on 16 September 2003.
2 October 2003, COB	deadline for translations by the EC of EC documents as referred to in EC letter dated 15 September 2003. deadline for translations by Korea of documents identified in Attachment 1 to Korea's letter dated 16 September 2003 as requiring two weeks for translation.
6 October 2003, COB	deadline for follow-up questions on newly-translated documents submitted on 2 October 2003.
10 October 2003, COB	deadline for answers to 6 October 2003 follow-up questions.
16 October 2003, COB	deadline for translations by Korea of documents identified in Attachment 1 to Korea's letter dated 16 September 2003 as requiring four weeks for translation.
20 October 2003, COB	deadline for follow-up questions on newly-translated documents submitted on 16 October 2003.
24 October 2003, COB	deadline for answers to 20 October 2003 follow-up questions.
30 October 2003, COB	deadline for translations by Korea of documents identified in Attachment 1 to Korea's letter dated 16 September 2003 as requiring six weeks for translation.

[2] COB refers to "close-of-business", i.e., 5:30 p.m.

3 November 2003, COB	deadline for follow-up questions on newly-translated documents submitted on 30 October 2003.
7 November 2003, COB	deadline for answers to 3 November 2003 follow-up questions.
10 November 2003	submission of Designated Representative's report to the Panel.

ATTACHMENT 2

KOREA – MEASURES AFFECTING TRADE IN COMMERCIAL VESSELS (DS273)

PROCEDURES FOR THE PROTECTION OF BUSINESS CONFIDENTIAL INFORMATION

The following procedures apply to all business confidential information (BCI) submitted in the course of the Annex V procedure and the Panel process. These procedures will not apply to a party's treatment of its own BCI.

I. DEFINITIONS

1. "Approved persons" means:

   (i) representatives or outside advisors of a party, or employees of the Secretariat, when designated in accordance with the provisions of Article V of these Procedures;

   (ii) the Facilitator

   (iii) Panel members; and

   (iv) PGE members or experts appointed by the Panel who in the opinion of the Panel require access to the BCI.

2. **"Business Confidential information"** means any information that has been designated as Business Confidential by the party submitting the information, and that is not otherwise available in the public domain.

3. **"Conclusion of the Panel process"** means when:

   (i) pursuant to Article 16.4 of the DSU, the Panel report is adopted by the DSB, or the DSB decides by consensus not to adopt the report;

   (ii) pursuant to Articles 16.4 and 17.14 of the DSU, the Panel report is adopted (with modification, if any) with the report of the Appellate Body; or

   (iii) when the authority for establishment of the Panel lapses pursuant to Article 12.12 of the DSU.

4. **"Designated as Business Confidential"** means:

   (i) for printed information, clearly marked with the notation 'BUSINESS CONFIDENTIAL INFORMATION' and with the name of the party that submitted the document;

   (ii) for binary-encoded information, clearly marked with the notation 'BUSINESS CONFIDENTIAL INFORMATION' on a label on the storage medium, and clearly annotated with the notation 'BUSINESS CONFIDENTIAL INFORMATION' in the binary-encoded files; and

(iii) for uttered information, declared by the speaker to be "Business Confidential Information" prior to the disclosure.

5. **"Employee of the Secretariat"** means a person employed or appointed by the Secretariat who has been authorized by the Secretariat to work on the dispute, and includes translators and interpreters and transcribers present at the Panel meetings.

6. **"Facilitator"** means the Representative of the DSB appointed in accordance with paragraph 5 of Annex V of the *SCM Agreement*.

7. **"Outside advisor"** means a legal counsel or other advisor of a party, who has been authorized by a party to act on behalf of such party in the course of the dispute and whose authorization has been notified to the Chairman of the Panel and to the other party, but in no circumstances shall this definition include an employee, officer or agent (other than outside legal counsel who has represented a shipbuilder in connection with these WTO dispute settlement proceedings) of a private company engaged in the manufacture of commercial vessels.

8. **"Panel member"** means a person serving on the Panel.

9. **"Party"** means a disputing party.

10. "**PGE member**" means a person appointed to the Permanent Group of Experts established pursuant to SCM Agreement Article 24, and who has been requested to assist the Panel pursuant to Article 4.5 of the SCM Agreement.

11. **"Representative"** means an employee of a party or third party.

12. **"Secure location"** means a locked storage receptacle, to which only approved persons, or designated representatives of third parties, have access.

13. "**Third party**" means a Member having notified its interest in the dispute to the DSB pursuant to DSU Article 10.

II. ACCESS TO AND USE AND DISCLOSURE OF BCI

14. Access by parties to BCI:

(a) Only approved persons may have access to BCI submitted pursuant to these procedures.

(b) Documents or other recordings containing BCI submitted pursuant to these procedures shall not be copied in excess of the number of copies required by the approved persons. All copies of BCI shall be consecutively numbered. The making of electronic copies shall be avoided whenever possible.

15. Use and disclosure by parties and the Panel of BCI:

(a) Approved persons shall use BCI only for the purposes of the Annex V procedure, the Panel and possible subsequent appellate review proceedings and for no other purpose.

(b) No approved person shall disclose BCI, or allow it to be disclosed, to any person except another approved person or designated representative of a third party.

(c) The Panel shall not disclose BCI in its report, but may make statements or draw conclusion that are based on the information drawn from the BCI.

16. Access by Third Parties to BCI

(a) Only designated representatives of third parties may have access to BCI, and only to that BCI contained in the submissions of the parties to the dispute to the first meeting of the Panel, and only for the purpose of preparing their third party submissions and oral statements in the dispute. The third parties will provide the name(s) of the designated representative(s) to the parties and the Panel before the first submission of the complaining party. The procedures of Section IV of these procedures shall apply *mutatis mutandis* with respect to the third parties.

(b) The submissions of the parties to the dispute to the first meeting of the Panel containing BCI shall not be copied in excess of the number of copies required by the designated representatives. All copies of such submissions shall be consecutively numbered. The making of electronic copies shall be avoided whenever possible.

(c) No designated representative shall disclose BCI, or allow it to be disclosed, to any person except an approved person or another designated representative.

III. STORAGE

17. Approved persons and designated representatives of third parties shall store all documents or other recordings containing BCI in a secure location when not in use by an approved person or designated representative.

IV. DESIGNATION OF APPROVED PERSONS

18. Each party shall submit to the other party, to the Facilitator and to the Panel a list of the names and titles of its representatives and outside advisors who need access to BCI submitted by the other party and whom it wishes to have designated as approved persons. Each party shall keep the number of persons on its list as limited as possible, taking into account its administrative and political structures. The Director-General, or his designee, shall, in the same manner, submit to the parties, to the Facilitator, and to the Panel, a list of the employees of the Secretariat who need access to BCI in the dispute. The parties or the Director-General, or his designee, may submit amendments to their lists at any time.

19. Unless a party objects to the designation of an outside advisor of the other party on the lists submitted under paragraph 18, the Panel shall designate those persons as approved persons. If a party objects to the designation of an outside advisor of a party on the lists submitted, the Panel shall decide on the objection promptly. The possible grounds for objection to the designation of an approved person include a conflict of interest. If the Panel rejects the objection, no BCI of the party having objected to the designation may be disclosed to the person subject of the objection until that party has had a reasonable opportunity to withdraw the BCI. If that party decides to withdraw any BCI the Facilitator, the Panel and the other party shall promptly return the corresponding documents or other recordings, which contain the BCI in question, to the party submitting it.

V. SUBMISSION OF BCI BY A PARTY

20. Subject to the provisions of paragraph 21 and in accordance with the definition in paragraph 4, each party may designate what information contained in its responses to questions posed in accordance with Annex V of the *SCM Agreement* (hereinafter "responses to Annex V questions"), and/or its submissions, shall be treated as BCI. Each party shall act in good faith and exercise the

utmost restraint in designating information as BCI. The Faciliator and the Panel shall have the right to intervene, in any manner that they deem appropriate, if they are of the view that restraint in the designation of BCI is not being exercized.

21. To the extent possible, BCI should be submitted in an exhibit or annex to a response to an Annex V question, or to a submission. Under no circumstances shall an entire response to an Annex V question or an entire submission, or significant parts thereof, be designated as BCI.

22. A party or third party that wishes to submit or refer to BCI at a Panel meeting shall so inform the Panel prior to doing so. The Panel shall exclude persons who are not approved persons or designated representatives of a third party from the meeting for the duration of the submission and discussion of the BCI.

23. Where a submission by a party incorporates BCI first submitted by another party, the submission shall identify that information as BCI of another party.

VI. RESPONSIBILITY FOR COMPLIANCE

24. Each party and third party is responsible for ensuring that its approved persons and designated representatives comply with these procedures to protect BCI submitted by a/another party. The Secretariat shall take the appropriate steps to ensure that all other approved persons are aware of their obligations under these procedures.

VII. ADDITIONAL OR ALTERNATIVE PROCEDURES

25. At the request of a party, the Panel may apply any other procedures that it considers necessary to provide additional protections to the confidentiality of BCI.

26. The Panel may, with the consent of the parties, waive any part of these procedures.

VIII. RETURN OR DESTRUCTION

27. After the conclusion of the Panel process, within a period fixed by the Panel, the Panel and the parties shall return any documents or other recordings containing BCI. Alternatively, the parties may certify in writing to the Panel that the documents or other recordings will be destroyed consistent with the parties' record keeping obligations under their domestic laws. In the latter event the parties shall also certify in writing, at the appropriate time, that the documents or recordings containing BCI have been destroyed. At the conclusion of the third party session, the third parties shall return any documents or other recordings containing BCI. The Secretariat may retain one copy of the documents or other recordings containing the BCI for the archives of the WTO.

28. If the report of the Panel is appealed, the Secretariat shall transmit any documents or other recordings containing BCI to the Appellate Body as part of the record of the Panel proceedings. The Secretariat shall transmit such information to the Appellate Body separately from the rest of the record, wherever reasonably possible.

CONTAINS BUSINESS CONFIDENTIAL INFORMATION

ATTACHMENT 3
List of certain APRGs and PSLs in respect of sales of LNGs, product/chemical tankers and container ships

Description	Comm. Date	Expiry Date	Estimated Subsidy Amount
CONTAINERS			
PSLs			
[BCI: Omitted from public version]			
APRGs			
[BCI: Omitted from public version]			
LNGs			
PSLs - NONE			
APRGs			
[BCI: Omitted from public version]			
PRODUCT/CHEMICAL TANKER			
PSLs			
[BCI: Omitted from public version]			
APRGs			
[BCI: Omitted from public version]			

Source: Attachments EC-10, EC-11 and EC-12.