

## ANNEX D

### RESPONSES OF THE PARTIES TO QUESTIONS FOLLOWING THE FIRST MEETING OF THE PANEL

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## ANNEX D-1

### RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL

(22 March 2004)

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A. QUESTIONS TO EC

1. Question 1

**What makes an entity a public body? Is the power to regulate and tax a necessary and sufficient condition to qualify an entity as a public body?**

Response

1. The purpose of Article 1.1(a)(1) of the *SCM Agreement* providing that financial contributions can be made by “any public body” as well as by “a government” is to capture all use of State resources to influence the decisions of enterprises in pursuit of a public policy objective. Accordingly, the EC considers the following factors to be relevant in an assessment of whether an entity is a public body:

- Whether the entity is controlled by the government, be it through ownership or by a public statute establishing the body;
- Whether the entity pursues public policy objectives;
- Whether the entity has access to State resources either through the use of capital on which it is not obliged to secure a commercial return or through a government guarantee of debts or losses.

2. The Panel does not need to decide in this case whether it is sufficient that one of these conditions is fulfilled or whether all of these conditions need to be fulfilled cumulatively to make an entity a “public body”. All the entities claimed to be public by the EC in this case are established and controlled by the government through public statutes that set public policy purposes and give these bodies access to state resources.

3. The powers to regulate and tax are essential governmental powers. Thus, an entity that shares these powers can be considered to be part of the government. These powers may therefore be considered sufficient conditions to make an entity part of the government. These powers are not however necessary conditions for an entity to be a public body.

2. Question 2

**Para. 83 of the EC's first written submission describes the purpose of permitting prospective challenges against mandatory legislation. What would be the purpose of prospective challenges against non-mandatory legal instruments? What would Members protect themselves against by bringing a prospective challenge against another Member's law that allows, but does not require, the grant of prohibited export subsidies?**

Response

4. A power for a government to make grants obviously allows the grant of a prohibited export subsidy. But it would be an improper presumption of bad faith to assume that it would be so used.

5. However a law that provides a public body with explicit objective or instruction to promote exports or assist exporters with subsidised funding and a prohibition on competing with commercial banks goes further than simply allowing the grant of an export subsidy – it *specifically envisages* the grant of export subsidies. It is not an improper presumption of bad faith to assume that public bodies will do what they are created and instructed to do.

### 3. Question 3

Please comment on para. 119 of Korea's first written submission, regarding the interpretation of the word "maintain" set forth in Article 3.2 of the SCM Agreement.

### 4. Question 4

What is the basis for interpreting Article 3.2 in a manner that prohibits legislation containing a discretion to provide prohibited export subsidies?

#### Response (to questions 3 & 4)

6. The EC agrees that the word "maintain" implies continuance rather than prevention but believes that this argument misses the point.

7. The EC considers that the word "maintain" in Article 3.2 signifies that the prohibition of export subsidies applies not only to individual grants of subsidy but also to schemes (or programmes, to employ the term that is used in the *SCM Agreement*) under which they are granted. Individual subsidies are granted, not maintained. Subsidy schemes or programmes are maintained, not granted.

8. The fact that schemes or programmes are covered by the prohibition of export subsidies is confirmed by the other provisions of the *SCM Agreement*. For example, Article 28.1 refers to:

Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement ...

9. And, even more significantly, Articles 29.2 and 29.3 both refer to "subsidy programmes falling within the scope of Article 3".

10. Also, item (j) of the illustrative list of export subsidies in Annex I to the *SCM Agreement* deems to be an export subsidy prohibited by Article 3.1: "export credit guarantee or insurance programmes, of insurance or guarantee programmes". The ordinary meaning of the word "programme" is: "A plan or outline of (esp. intended) activities; *transf.* a planned series of activities or events".<sup>1</sup>

11. This definition does not imply that the programmed acts are "mandatory", only that they are planned or intended. Accordingly, the prohibition of export subsidy programmes applies not only to measures that "mandate" the grant of subsidies but also to measures that plan or intend, or, as the EC puts it, specifically envisage, the grant of individual export subsidies.

### 5. Question 5

What were the credit ratings, by Korean Investor Services, of each Korean shipyard alleged to have received subsidies, for each of the years 1997-2003, inclusive?

#### Response

12. The EC does not know the credit ratings accorded these companies by Korean Investor Services but presumes that these credit ratings are similar to those provided by Korea in

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<sup>1</sup> Shorter Oxford English Dictionary (4<sup>th</sup> edition, 1993), p. 2371.

attachment 1.1(24)-1 of its Annex V replies.<sup>2</sup> Indeed, as stated by Korea, prior to the new credit system adopted by KEXIM, KEXIM compared the credit ratings made by various credit information companies including the Korean Investor Services (attachment 1.1(24) to Korea's Annex V replies). However, the credit ratings were only provided for each of the years 1997-2002. Year 2003 is not available.

## 6. Question 6

**Is the EC of the view that finance / guarantee measures provided under the KEXIM legal regime would necessarily be inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement? Please explain.**

### Response

13. The EC considers that it is possible that measures taken by KEXIM (either a subsidy programme or an individual subsidy grant) would not be inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

14. The question before the Panel is however whether some 200 individual grants, the actual pre-shipment loan and APRG schemes described in the EC's first written submission and the KEXIM legal regime itself are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

15. The EC does not believe that a legal regime such as that of KEXIM will only be inconsistent with Article 3.1(a) and 3.2 *SCM Agreement* if it is absolutely inevitable or certain or "mandatory" (in the sense that Korea uses this term) that export subsidy programmes or individual export subsidy grants will arise in all cases. For the reasons explained above, it is sufficient if this is the intent or purpose of the measure.

## 7. Question 7

**The KEXIM 2002 Annual report (Exhibit EC-14) contains a chapter entitled Bank Operations. That chapter refers to a decline in KEXIM's export credit business. It states that "[m]ajor Korean exporters were reluctant to use bank loans, instead they preferred raising funds from direct markets which was possible due to their successful corporate restructuring". Does this suggest that KEXIM's export credit terms are less attractive to Korean exporters than the terms for competing financing from other sources? Please explain.**

### Response

16. The KEXIM 2002 Annual report uses the term "export credits" for loans to exporters - as evidenced by the reference to Korean exporters as the takers of these loans. Loans to foreign buyers - for which the term "export credit" is conventionally reserved - are referred to as "direct loans" in the Annual Report<sup>3</sup> and, in the same section as that referred to by the Panel, KEXIM reveals that it granted the first true export credit in its history in 2002.

17. Although the volume of these loans to exporters showed a decrease in 2002, they still represented 89.2 per cent of KEXIM's disbursements. (The same section of the report explains that it has decreased from 95 per cent to 89.2 per cent in 2002).

18. Thus, although it may be true that the major beneficiary of these loans - Korean shipbuilders - were able, due to the infusions of subsidised equity or loan capital or resulting improved access to

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<sup>2</sup> Exhibit EC - 30.

<sup>3</sup> Page 2 of KEXIM's Annual Report (Exhibit EC-54).

finance from the corporate bond market to reduce their use of short term pre-shipment loans from KEXIM, it is still clear that the amount of loans to exporters was still very high in 2002 – KRW 7,473 billion.

19. The statement does not therefore demonstrate that KEXIM's export loans are less attractive to Korean exporters than the terms for alternative finance. It only suggests that the margin of advantage involved in using KEXIM's export loans may have reduced due to alternative finance becoming easier. The high level of KEXIM's export loans shows that these are still offered at very attractive rates.

20. What is clear from the statement referred to is that it constitutes an admission by KEXIM that previously companies were unable to obtain finance on such favourable terms as available from KEXIM.

## 8. Question 8

**Para. 122 of the EC's first written submission states that the KEXIM legal regime, as "confirmed by KEXIM practice", provides for the grant of subsidies. Is the EC challenging "KEXIM practice" as well as the KEXIM legal regime as such, or does the EC rely on evidence regarding "KEXIM practice" in support of its claim against the KEXIM legal regime as such? If the latter, please explain how evidence regarding "KEXIM practice" is relevant to the Panel's assessment of whether the KEXIM legal regime as such is, or is not, in conformity with the SCM Agreement.**

### Response

21. The EC's position is that KEXIM's legal regime is inconsistent with Article 3 of the *SCM Agreement* because it *specifically envisages* the grant of export subsidies. The EC considers that this conclusion derives principally from:

- KEXIM's statutory objectives of promoting economic development and financing exports – Article 1 of the KEXIM Act;
- Financial contributions granted by KEXIM, pursuant to Article 18 of the KEXIM Act, are “for the purpose of facilitating exports of products”, and, therefore, contingent on export within the meaning of Article 3.1(b) of the *SCM Agreement*;
- The huge amount of new capital (over KRW 1.9 trillion between 1998 and 2003) provided by the Korean government<sup>4</sup> for free – Article 37 of the KEXIM Act provides that it is not to pay dividends to the Korean Government;
- The KEXIM Act, including Articles 19, 36(2), and 37 thereof, guarantees that KEXIM does not need to act on market terms or with proper regard to risk, and provides KEXIM with virtually unlimited funds from Korea;
- The KEXIM Act imposes no requirements that KEXIM take market conditions into account when disbursing funds. Instead, Article 24 of the KEXIM Act prohibits KEXIM from competing with other financial institutions, thereby providing a benefit that is not available on the market;
- Article 26 of the KEXIM Act provides that interest rates do *not* need to be set “to cover the operating expenses, commissions for undertaking of delegated operations,

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<sup>4</sup> Korea's Response to Annex V Questions, Attachment 1.1(11) (BCI).

interest on borrowed funds, and depreciation of assets” when “*inevitable for maintaining the international competitiveness to facilitate the export.*” This demonstrates that KEXIM values the “international competitiveness” of Korean export-oriented industries over its own financial condition, a condition that increases KEXIM’s ability to provide support on terms better than those available in the market.

➤ **[BCI: Omitted from public version.]**

22. KEXIM’s practice of granting pre-shipment loans and APRGs at subsidised rates confirms the soundness of this understanding of KEXIM’s legal regime.

23. The practices are however separate violations in their own right although these are linked to the violation inherent in KEXIM’s legal regime in the sense that the former is the consequence of – as well as confirmation of – the latter.

#### **9. Question 9**

**How does the EC's claim against the "APRG programme" as such differ from its claim against the KEXIM legal regime as such? Isn't the "APRG programme" based on the KEXIM legal regime? Is it conceivable to assess one of them differently from the other?**

#### Response

See answer to question 8 above.

#### **10. Question 10**

**Is the website document cited in footnote 109 of your submission the only basis for your statement that PSLs are not export credits?**

#### Response

24. The definition of “export credits” given by the OECD reflects the generally accepted meaning of term as evidenced by the documents cited to in paragraphs 57-59 in the EC Oral Statement.

25. In addition it is clear from the reference to the OECD Arrangement in paragraph 2 of item (k) that the term “export credit” used in the second paragraph has the meaning given to it in the OECD Arrangement.

26. 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.

#### **11. Question 11**

**How does the EC's claim against the "PSL programme" as such differ from its claim against the KEXIM legal regime as such? Isn't the "PSL programme" based on the KEXIM legal regime?**

#### Response

See answer to question 8 above.

## 12. Question 12

**Do the activities of KEXIM in the form of APRGs or PSLs constitute "government practice" in the sense of Article 1 of the SCM Agreement? Please explain.**

### Response

27. Yes, KEXIM's APRG and pre-shipment loan programmes constitute 'government practice' within the meaning of Article 1 of the *SCM Agreement*.

28. Article 1.1(a)(1) of the *SCM Agreement* lays down that the first component of a subsidy is:

a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government")

29. It makes clear therefore that wherever the word "government" appears in the Agreement, it means government or public body.

30. The first instance of a financial contribution that is given is:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

31. This therefore covers loans and guarantees made by governments (in the strict sense) and loans and guarantees made by public bodies.

32. Practice is defined by Oxford English Dictionary as "usual or customary action or performance".<sup>5</sup> Because KEXIM is a public body, its practice (i.e., "usual or customary action or performance") must be considered "government practice" because KEXIM is a public body, its loan and guarantee practices are financial contributions. Korea makes a fundamental error in paragraphs 161-163 of its first written submission when it defines "government practice" without reference to the fact that government is defined as both government and public body. For example, it states 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".<sup>6</sup> Korea forgets that government as defined in Article 1.1(a)(1) of the *SCM Agreement* also includes any public body.

## 13. Question 13

**In note 163 to its first written submission, Korea asserts that "no allegations have been made about APRGs having been extended by KEXIM to Hyundai and Hyundai Mipo". During the first oral hearing, however, the EC stated that it was challenging APRGs provided in respect of Hyundai commercial vessel transactions. Please confirm the EC's position in this regard.**

### Response

33. Note 163 to Korea's first written submission is incorrect.

34. First of all, the APRGs listed in figure 12 of the first written submission of the EC as benefiting Samho HI/Halla HI were still outstanding when Hyundai took complete control of that entity.

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<sup>5</sup> Shorter Oxford English Dictionary (4<sup>th</sup> edition, 1993) at p. 2317.

<sup>6</sup> First written submission of Korea, para. 161.

35. More generally however, the EC explained, in paragraph 173 of its first written submission, that “other Korean shipyards ... have paid significantly lower premiums for APRGs granted by KEXIM than for similar APRGs”.

36. It is true that the European Communities only proceeded to provide details in this section of APRGs to Hanjin and Samsung, but this was clearly by way of example. (In the case of pre-shipment loans, the examples included Hyundai Mipo and Hyundai HI but not Samsung.) Contrary to what is suggested by Korea in its footnote 163, there is no implication that Hyundai Mipo and Hyundai HI did not benefit from APRGs at subsidised rates. This is also clear from the conclusion in paragraph 182, where the EC stated that it had “detailed the specific grants of APRGs and pre-shipment loans of which it is aware”.

37. The EC’s claim against the pre-shipment loan and APRG schemes as such are not, by their nature, limited to these shipyards but relate to the schemes.

38. The EC is not however asking the Panel to rule that any specific APRGs granted to Hyundai Mipo and Hyundai HI (apart from APRGs to Samho which were outstanding when it became part of Hyundai HI) are prohibited export subsidies.

39. Although Hyundai and Hyundai Mipo have received APRGs almost exclusively from KEXIM, the EC cannot establish what the benefit is since it lacks the necessary information.

#### 14. Question 14

**Regarding your argument at para. 239 of your first written submission that GOK will guarantee losses by private financial institutions participating in the chaebol-restructuring process, please indicate precisely which provisions of the Chaebol Restructuring Plan explicitly provide for such guarantee.**

#### Response

40. The Agreement for the Restructuring of the top 5 chaebols of December 1998<sup>7</sup> refers in point 18 to the GOK

upholding the soundness of the financial institutions in connection with the implementation of the agreed restructuring plan.

41. Even if the agreement does not use the term “guarantee” the language used in policy notes have effectively constituted one. A normal reading of the provision by a bank means that they can proceed with the restructuring without being constrained by possible financial losses.<sup>8</sup>

42. In other instances, the Korean Government was even more explicit. For example, with regard to investment trust companies which were holders of Daewoo bonds (and creditors of DHI) the

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<sup>7</sup> Exhibit EC-40.

<sup>8</sup> The 1998 December Agreement for the Restructuring of the Top 5 Chaebols was preceded by an Agreement in January 1998 and followed by a third in August 1999.

The EC cannot provide the content of these agreements as the Government of Korea refused to provide to the European Communities, in the context of the Annex V procedure, a copy claiming that “*the question [was] irrelevant*”. However, the European Communities considers that this document is quite relevant to this dispute because it shows the degree of intervention of the Government of Korea in the corporate sector. The European Communities therefore asks the Panel to draw adverse inferences from Korea’s refusal to provide a copy of the January Agreement

Ministry of Finance promised that it would “pump public funds” into market stabilization funds with a view to buying “unlimited amounts of corporate bonds from the investment trust firms” which are exposed to the dismantled Daewoo Group. In particular, it stated that:

In a bid to stabilize interest rates, the government will inject 20 trillion won in bond-market stabilization funds into the financial market by October 15. The funds will be used to buy out corporate bonds that investment trust firms, which are exposed to the dismantled Daewoo Group, may sell to raise the funds necessary to cope with possible massive redemption from their depositors. If needed, the government will also expand the size of funds to buy unlimited amounts of corporate bonds from the investment trust firms. ....

If investment trust firms face fund shortages, the government will pump public funds into those firms to guarantee the payments to their investors.<sup>9</sup>

43. Furthermore, Korea explained in detail the massive action plan taken by GOK to assist financial institutions including the

Restructuring and recapitalization of financial institutions based on sound rehabilitation or closing where needed and with mergers including with foreign financial institutions if needed and the acceleration of non-performing loans as well.<sup>10</sup>

44. In fact, the Korean Government pumped into the financial institutions over **[BCI: Omitted from public version]**.

45. Thus, financial institutions depended on GOK for their liquidity and/or survival.

46. Moreover, the GOK made access to this liquidity assistance subject to a number of conditions, the most important of which was participation of banks to corporate restructuring. These conditions were clearly spelled out in Korea’s policy statements to the IMF. For example, the Letter of Intent (LOI) of 24 September 1998:

Government confirms that public funds will be used only: .....- where the bank is making adequate process on implementation of sound corporate debt restructuring....<sup>11</sup>

47. This condition was further refined in the LOI of 13 November 1998 where it was made clear that there would be no KAMCO purchasing of bad debts, no capital injections to banks which do not wish to participate in the restructuring of troubled firms.

In order to enhance the incentives for banks to participate fully in the corporate restructuring process, no public funds, whether by way of KAMCO purchases or capital injections or other means, shall be made available to banks which are not certified by the FSC to be performing their role in the corporate sector restructuring process.<sup>12</sup>

48. The above condition was included in all of Korea’s policy notes to the IMF until at least July 2000. Thus, Korea effectively ensured that only financial institutions which participated in the restructuring effort would have access to public funds.

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<sup>9</sup> MOFE press release – published on MOFE website on 6 October 2000 (Exhibit EC – 101).

<sup>10</sup> Attachment 5 of First written Submission by Korea.

<sup>11</sup> Korea Letter of Intent to IMF of 24/09/1998 (Exhibit EC-102).

<sup>12</sup> Exhibit EC-36.

**15. Question 15**

**Please provide the Panel with an estimate of the magnitude of the total amount of subsidization resulting from the measures identified in your Article 5(c) claims, along with an explanation and demonstration of how this estimate was derived. Please relate this estimate to the degree of price suppression / depression alleged by the EC.**

Response

49. The EC attaches an estimation of the magnitude of the amount of subsidisation resulting from the measures identified in the EC's Article 5(c) claims in **Attachment 1** to this submission. The EC also attaches as **Attachment 2** an estimation of price depression and suppression together with other relevant information prepared by the EC's consultants, First Marine International.

50. However, the EC maintains that there is no obligation to quantify the amount of subsidisation and its relation to price depression and suppression for all serious prejudice claims. . **[Add text]**

**16. Question 16**

**In its third party submission in the US – Export Restraints case, the EC argued that there is no government entrustment or direction in a case where freedom of action is "limited", but not "curtailed", i.e., where "the producer can still make choices". Does the EC consider that the freedom of action of private financial institutions participating in the restructuring process was (i) "limited" or (ii) "curtailed"? Were those companies able to make choices regarding their participation in the restructuring process? Please explain.**

Response

51. The *US - Export Restraints* case related to a rather particular situation. It concerned the rather contorted position taken by the US in its countervailing duty practice that export restraints constitute the entrustment or direction of private parties to sell more goods on the domestic market than they would otherwise. The panel in that case was therefore considering a very different situation to that prevailing in this case which relates not to a general legislative measure but to specific measures taken with regard to the policies of banks. Obviously, operators who cannot export are not entrusted or directed to sell more domestically. They can simply not produce that which they would have exported if this were allowed.

52. The EC would approach the application of Article 1 of the *SCM Agreement* to the present case by interpreting the words of that provision according to their ordinary meaning and in the light of their context and purpose rather than interpreting words used to describe the way the provision might apply in a very different case.

**17. Question 17**

**Are you arguing in paragraph 73 of your oral statement that the banks that participated in the Corporate Restructuring Agreement thereby legally committed themselves up front to follow the direction of the government? Did such undertaking(s) by the banks affect all of the restructurings referred to in your complaint? Please elaborate and provide specific evidence.**

Response

53. Yes, under the Corporate Restructuring Agreement (CRA), banks explicitly legally committed themselves to

- restructuring (as opposed to liquidation) through debt-for equity swap and other measures listed in the Agreement.<sup>13</sup>
- certain procedures, i.e., leader bank will chair meetings thereby influencing the process, majority voting.<sup>14</sup>
- shorter time for decision-taking.<sup>15</sup>

54. Korea themselves admits in its First Written Submission that by entering into this Agreement, domestic banks limited their ability to behave "independently and in their own self-interest" as opposed to (foreign) banks which did not sign the CRA.<sup>16</sup>

55. Hence, the CRA already generally curtailed the discretion of individual private banks in deciding how to use their rights as creditors, e.g., in the restructuring for Daewoo.

56. Furthermore, the signing of the CRA by banks under Government pressure should not be seen in isolation. Already the Agreement for the Restructuring of the top 5 Chaebols of December 1998<sup>17</sup> (originally also foreseen for Daewoo) reflects the Korean Government's policy of resolving the corporate crisis **through debt/equity swaps**.

57. Through the *Agreement for the Restructuring of the top Five Chaebols* of December 1998 major creditor institutions<sup>18</sup> agreed with the Korean government to support the restructuring of the top 5 chaebol particularly through debt/equity swaps.

58. Point 17 of the 1998 December *Agreement for the Restructuring of the Top Five Chaebols* provides:

(17) Creditor banks will have primary responsibility for examining and monitoring implementation. Also, the creditor banks shall carry out pledges toward providing support to restructuring, such as debt/equity swap.

59. However, as explained by the European Communities in its First Written Submission and its Oral Statement, the discretion of Korean banks was then further curtailed by a number of "stick-and-carrot- measures".<sup>19</sup>

60. The EC in its Oral Statement has already produced evidence from private banks showing how the government was ready to use its influence with private banks to privilege certain sectors.<sup>20</sup>

"by requesting banks to participate in remedial programmes for troubled corporate borrowers and

by identifying sectors of the economy it wishes to promote and

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<sup>13</sup> See Articles 1 and 2.2 of the CRA (Exhibit-EC 42).

<sup>14</sup> See Article 15.2 of the CRA.

<sup>15</sup> 4-6 months, see first written submission of Korea, at para. 302

<sup>16</sup> First written submission by Korea at para 355.

<sup>17</sup> Exhibit EC-40.

<sup>18</sup> The agreement was signed by the Korea Development Bank, the Commercial Bank of Korea, the Korea First Bank, Hanil Bank and the Korea Exchange Bank.

<sup>19</sup> First written submission by the European Communities at paras 231 to 243

<sup>20</sup> Oral statement by the European Communities at para 75.

by 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".<sup>21</sup>

61. In addition, the EC noted at the first substantive meeting with the parties that these banks were at the time of the restructuring in an immediate need of capital in order to ensure their survival. Therefore, one would have expected them to pursue all means to increase cash inflows including the liquidation of troubled borrowers. This was even more so for banks which were in possession of secured credits.

62. Under normal market considerations this fact would have tilted the decision of the banks towards liquidation as opposed to restructuring. Debt and equity do not have the same value. Debt is supposed to be repaid in full with interest while the return on shares and their value are highly volatile. A debt requires interest payment and repayment at a fixed moment in time. The swap into equity relieves the debtor from these obligations. The risk is entirely on the equity-holder whether the value of the shares rises and he receives dividends. The return is volatile and uncertain.

63. Thus, from the perspective of the creditor bank, debt-to-equity swaps not only do not generate any capital for the bank but also further reduce capital inflows as debt needs no longer be repaid; they are, thus, rather a luxury enjoyed by healthy banks which can afford to wait and see if the swap will eventually produce any benefits in the future.

64. Korean banks which participated in the restructuring of the shipyards were in exactly such an onerous situation. A careful examination of the situation of each of DHI's creditors reveals that almost all of the creditors were facing at the time severe financial difficulties which led to government intervention. This intervention took many forms depending on the type of the financial institution involved and its particular needs such as:

- capital injections (in most cases leading to the Government of Korea obtaining important shareholdings - in some cases up to 100 per cent),
- assurance of government intervention in case of liquidity problems, or
- the outright provision of public funds.

65. On top of the above tailor-made measures all of DHI creditors benefited from the Korean Government's assistance through KAMCO, i.e., from KAMCO's purchases of their bad loans which led to KAMCO obtaining 26 per cent of DSME shares after the debt-to-equity swap.

66. EC submits separately an **Attachment 3** which shows in what way each DHI creditor was assisted by the Korean Government.

67. In the above circumstances, where the above financial institutions depended on the Korean Government for their survival, it is highly questionable to what extent these institutions could maintain views which departed from those of the Korean Government concerning the restructuring.

68. Finally, banks which had received public funds were limited in the way they could exercise their independence in participating in a restructuring. Article 18 of the *Special Act on the Management of Public funds*<sup>22</sup> obliges banks to enter into written agreements with the companies

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<sup>21</sup> Kookmin Bank brochure, p. 22, (Exhibit EC-100).

<sup>22</sup> Special Act on the Management of Public funds (Exhibit EC-103).

they wish to support the details of which are set out in a Presidential Decree.<sup>23</sup> Furthermore, banks are prohibited from providing funds if the agreements are not implemented or are not likely to be implemented.

69. In short, the banks already curtailed their choice between liquidation and restructuring through debt-for-equity swaps by signing the CRA . Their discretion how and when to provide funds to companies was then further curtailed by the other measures described above, which together form a clear demonstration of government involvement on the banks' financing decisions.

70. As the CRA framework was only set up in the first half of 1998, it was too late to be used by **Halla** and **Daedong** which faced problems already in 1997 and which were obliged to follow the then existing framework (court-supervised corporate reorganisation proceeding). Daedong applied for it on 10 February 1997 and Halla on 6 December 1997. This, however, did not change their situation as explained above and in question 21.

## 18. Question 18

**How did the Daewoo debt-for-equity swap constitute a financial contribution by a public body, and on whom was any resultant benefit conferred? Is there evidence that debts were swapped for less than fair market value, or that equity was obtained for a price greater than its market value?**

### Response

71. The Daewoo debt-for-equity swap constituted a financial contribution because it involved forgiveness of debt and a debt-for-equity swap and therefore direct transfers of funds through grants and equity infusions within the meaning of Article 1.1(a)(1) of the *SCM Agreement*.

72. As has been explained in responses to Questions 14 and 17 above, the creditors deciding on the debt-for-equity swap were public bodies or private bodies entrusted or directed by the government within the meaning of Article 1.1(a)(1) of the *SCM Agreement*. Thus, the debt-for-equity swap constitutes a financial contribution.

73. The resulting benefit of this creation subsidy was conferred on the restructured company, Daewoo.

74. As to its amount, it is important to note that from the perspective of the recipient, i.e., the restructured Daewoo, a debt-for equity swap is not simply a reorganization of the balance sheet not involving flow of new money.

75. First, debt and equity do not have the same value, a debt is supposed to be repaid in full with interest while the return on shares and their value are highly volatile. Thus, formalistically, one could see a debt-for equity swap *per se* as conferring a benefit, in particular if the recipient is an insolvent company or is in such a poor financial state that no private investor would have participated in such an action. A debt requires interest payment and repayment at a fixed moment in time. The swap into equity relieves the debtor from these obligations. The risk is entirely on the equity-holder whether the value of the shares rises and he receives dividends. The return is volatile and uncertain. Having said this, it is difficult to generalize about these issues, as the facts of each individual case will vary. The existence of a subsidy and the amount of the benefit will depend on the circumstances of each case.

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<sup>23</sup> During the Annex V process, Korea refused to provide the Presidential Decree stating that a translated copy of the Decree was not available; see Korea's response to the EC follow-up questions of 20 October 2003 under the section "attachment 2.1(6) at pages 7 and 8.

76. The *SCM Agreement* is not drafted in terms of flows of money. Article 1 provides for the existence of a financial contribution in the event of certain *actions* by a government, or by private parties acting at its behest. The existence of a benefit is determined in relation to what could have been obtained by the recipient on the market in arm's length transaction. The amount of benefit must also be assessed on that basis, as indicated in Article 14 of the *SCM Agreement*.

77. As evidenced by the calculations in **Attachment 1** to these responses, the creditors of Daewoo overpaid for the equity in the debt for equity swap on 14 December 2000 by KRW 649,089 million when compared to the price of the stock when it was first publicly traded on 2 February 2001.<sup>24</sup>

78. However, the EC wishes to clarify that the calculation of the benefit resulting from the debt-for-equity swap assumes that the restructuring plan itself was market based. Yet, the EC maintains and will further develop its argument that the market as evidenced by the foreign creditors would not have agreed to the restructuring plan including the debt-for-equity swap at all and that therefore, the amount of the benefit to Daewoo is significantly higher. (See response to Question 15 and exhibit 112).

## 19. Question 19

**Please comment on para. 56 of Korea's oral statement, regarding the impact of changes-in-ownership on the benefit analysis.**

### Response

79. Korea's argument, if the EC understands correctly, is that the restructured yards did not receive a benefit because the restructuring process involved changes-in-ownership. However, the reference to the privatization cases is entirely misplaced. The fundamental rationale behind the privatisation cases is that it cannot be presumed that a privatised company continues to benefit from financial contributions provided to a former state-owned holder of the assets where the sale was at arm's length and for market value. In such a case, the benefit no longer accrues to the privatised company but to the former owner of the assets and if this is the government itself the subsidy is effectively withdrawn.

80. The situation is very different in the case before this Panel. The change in ownership **and** the subsidy constitute one and the same measure and it is the successor company that is the only recipient of the benefit; the predecessor company never receives a benefit. Moreover, the change in ownership was not at arm's length and indeed is part of the measure that constitutes the subsidy.

## 20. Question 20

**The EC asserts (first written submission, para. 281) that KAMCO purchased non-secured loans held by foreign creditors of DHI on terms more favourable than those offered to domestic creditors. How is this relevant to the Panel's examination of the issues of whether or not there was a financial contribution and benefit to the restructured company?**

### Response

81. Over the period August 1999 to June 2000 KAMCO purchased [BCI: Omitted from public version] worth of Non performing loans (NPLs) of DHI.<sup>25</sup> From financial institutions of which [BCI:

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<sup>24</sup> First written submission of the European Communities, paras. 258 and 284.

<sup>25</sup> Responses by Korea to the Annex V Questions (Business-Confidential Version) (Exhibit EC-39), response to question 30 at page 80.

**Omitted from public version]** related to Daewoo-SME<sup>26</sup> and became a creditor of DAEWOO-SME holding **[BCI: Omitted from public version]** of the shares after the swap.<sup>27</sup>

82. KAMCO bought Non-Performing Loans at rates of **[BCI: Omitted from public version]** from foreign creditors and **[BCI: Omitted from public version]** from domestic creditors of Daewoo-HI. KAMCO's purchase of non-secured loans at a discount is a financial contribution in the meaning of a grant/equity infusion in DSME.

83. The purchase by KAMCO proves that independently and market oriented behaving foreign creditors did not agree to restructuring. As Korea stated in para. 356 of its first written submission, the foreign creditors could have obstructed the liquidation. The purchase at a higher rate can be seen as evidence that the foreign creditors were "bought out".

84. Even according to the Arthur Andersen Report the total recoverable value compared to the creditors outstanding claims was only claimed to be:

- **[BCI: Omitted from public version]** under the Liquidation value scenario
- **[BCI: Omitted from public version]** under the "going concern value" scenario.<sup>28</sup>

85. KAMCO's purchase of more than **[BCI: Omitted from public version]** of DHI non-performing loans<sup>29</sup> provided a benefit to the restructured Daewoo Shipbuilding Company, because:

- it cleansed the balance sheets of DHI creditors which could not otherwise have agreed to proceed to a debt/equity swap given their precarious situation;<sup>30</sup>
- it enabled a public body (KAMCO) to swap debt for up to **[BCI: Omitted from public version]** of DSME's capital; and
- it allowed a substantial amount of DHI debt to remain idle in the hands of KAMCO until it is resold as opposed to remaining in the hands of creditors which would have pursued all available legal means to obtain repayment including through the liquidation of troubled borrowers.

86. In sum, these financial contributions were not made directly to Daewoo but did benefit it by facilitating its restructuring and allowing it to emerge with a healthier balance sheet than would otherwise have been the case.

## 21. Question 21

**In paragraph 296 of its submission, Korea defends its action in the restructuring in the context of both workout proceedings and corporate reorganizations on the basis that they were subject to the majority votes of secured and unsecured creditors; and in the case of corporate reorganizations, Korea argues in addition that these were effected by court decision. Please comment.**

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<sup>26</sup> Responses by Korea to the Annex V Questions (Business-Confidential Version) (Exhibit EC-39), response to question 36 at page 52.

<sup>27</sup> Attachment 3.1(13) of Responses by Korea to the Annex V Questions (Business-Confidential Version).

<sup>28</sup> The total recoverable Korea states in para. 348 of its First Written Submission.

<sup>29</sup> Korea's Responses to Annex V Questions (Exhibit EC-39) (BCI) question 30 at page 80.

<sup>30</sup> See reply to Question 17 above.

Response

87. With respect to the DHI workout, the EC has explained above (response to question 17) how creditors were directed by the Korean government in their decisions.

88. With regard to court-supervised proceedings, the EC would point out that the court only examines whether a number of conditions for opening of the restructuring proceeding, the approval of the restructuring plan and the closing of the restructuring proceeding are fulfilled. One of them is whether the creditors agreed with a 2/3 (for secured creditors) and 3/4 (for unsecured creditors) majority respectively to the restructuring plan.<sup>31</sup> Thus, it is the creditors that exercise the discretion. Without their agreement, the court cannot take a decision.

89. Thus, the fact that the restructuring of these firms was supervised by the court does not mean that there is no subsidy since the role of the court was merely to ensure that creditors had followed the proper procedures. Nowhere in the information submitted, it is even suggested that the court interfered with the decision making process or that it substituted its opinion for that of the creditors. On the contrary, Korea has repeatedly stated that creditors took decisions in these cases on the basis of their own interests.

90. Also, the fact that the Halla/Samho and Daedong restructurings took place under an existing legal framework (as opposed to the para-legal nature of the workouts) does not preclude a finding that a subsidy might have been granted. If such a view was to prevail, it would preclude the application of the *SCM Agreement* on any restructuring/bankruptcy proceedings – a result certainly not foreseen by the spirit or letter of that WTO Agreement.

**22. Question 22**

**Please elaborate on your argument concerning the alleged specificity of the corporate restructuring, as referred to in paragraphs 87-89 of your oral statement. That is, setting aside the issues of financial contribution and benefit, what is the basis for your allegation that the restructuring was specific? Do you argue *de jure* or *de facto* specificity in this regard?**

Response

91. The corporate restructuring subsidies are specific under Articles 2 (a) and (b) of the *SCM Agreement* because they are individual measures only applying to the restructured yard and are *per se* not generally available to all enterprises. The availability of the corporate restructuring subsidies is limited by law to individual enterprises, because it selectively benefits certain enterprises, as opposed to a broad economic policy measure, such as the reduction of corporate taxes.

92. More specifically, the amount of the benefit granted to, e.g., Daewoo, does *not* result from an automatic application of objective criteria within the meaning of Article 2(b) and footnote 2 of the *SCM Agreement*. These provisions state in relevant part:

In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

- (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

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<sup>31</sup> First written submission of Korea, para. 302.

- (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions<sup>2</sup> governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

<sup>2</sup> Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

93. The benefit resulting from a restructuring decision, e.g., the one in the case of Daewoo is nowhere laid down as “objective criteria” in the way required by Article 2(b) of the *SCM Agreement* and footnote 2. In particular, the *specific amount* of the subsidy and the eligibility criteria are not generally described and automatically applied to all other firms that apply for a restructuring proceeding. No Korean legislation or any other measures, and in particular not the CRA provide that all companies in difficulty are (i) restructured as is Daewoo and the (ii) receive the same *specific amount* of benefit resulting from debt-forgiveness, interest rebates, debt rescheduling and finally debt-for-equity swap enjoyed by Daewoo. Rather, the rules governing workout proceedings and restructuring are entirely procedural and leave the discretion of whether and how to restructure to the creditors in each individual case.

94. The individual nature of, e.g., the Daewoo restructuring measures is further corroborated by the fact that the eligibility criteria for work-out were in any case not strictly applied. The first “disqualifying criterion”<sup>32</sup>, whereby an applicant “may be disqualified” is

A company whose outstanding debts significantly exceeds its sales revenue and profitability of its core business.

95. It is evident from the Arthur Anderson report that this was very far from being the case for DHI.

**[BCI: Omitted from public version.]**

96. Indeed Korea agreed in the responses to the Annex V questions that this criterion was not fulfilled) and further admitted that these eligibility criteria were not strictly applied but are rather “factors to be considered in determining whether companies may be disqualified as candidates for a workout. None of these factors in isolation is decisive.”<sup>33</sup>

### 23. Question 23

**Is it your position, as Korea argues, that all insolvent companies should be liquidated and wound up, rather than restructured? If not, what criteria should determine whether to keep an insolvent company in operation? In this context, what weight or importance should be given to a going concern analysis or assessment?**

#### Response

97. No, the EC fully accepts that bankruptcy law is a necessary part of a market economy and that a properly conducted bankruptcy proceeding would normally not give rise to a subsidy. However,

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<sup>32</sup> First written submission of Korea, attachment 8, p. 2, last paragraph and p. 3.

<sup>33</sup> Korea’s Response to Annex V Question (BCI) 3.1.2. 11, p.69.

where the outcome of a bankruptcy proceeding or a corporate restructuring is determined by public bodies - or private bodies acting under their direction – and leads to a more beneficial outcome for the enterprise than would have arisen if the creditors had acted according to market principles, all of the components of a subsidy are present. There is no basis in the *SCM Agreement* to allow insolvency to be a loophole in the subsidy disciplines.

98. The relevant criteria to determine whether to keep an insolvent company in operation are:

- Whether a market creditor/investor in similar circumstances, given probable market developments and the position of the undertaking would have acted in the same way, i.e., agreed to waive or reschedule debts. With respect to a debt for equity swap, it should be considered whether a rationale private investor operating in a market economy would have purchased the equity at the price provided in the restructuring plan.
- Whether a restructuring plan exists that restores the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions. The restructuring plan should also describe the circumstances that led to the company's difficulties, thereby providing a basis for assessing whether the proposed measures are appropriate.
- Whether the recipient is able to make a significant contribution to the restructuring plan from its own resources, including through the sale of assets that are not essential to the firm's survival, or from external financing at market conditions. Such contribution is a sign that the markets believe in the feasibility of the return to viability.

99. As to evidence, the EC considers that the primordial indicia is the behaviour of actual other creditors that were not influenced by the government (in this case foreign creditors). Moreover, the ability of the company to obtain credit or attract investment on the market is highly relevant. The existence of a going concern analysis can be an indicia that a hypothetical private creditor would have acted in the same manner, if that analysis contains the above elements and was provided to the creditors in sufficient time so as to take an informed decision.

#### 24. Question 24

**Where a government entity is a creditor of an insolvent company being restructured, will the restructuring always result in a subsidy? Why or why not?**

##### Response

100. The restructuring will always result in a financial contribution where it consists of debt-forgiveness, debt-rescheduling or a debt-for-equity swap. However, such financial contribution would not necessarily always result in a benefit and therefore a subsidy. The existence of a benefit depends on whether the government creditor acted like private creditor would have done on the basis of the elements described in response to question 23.

#### 25. Question 25

**In your view, does the concept of "like product" apply in respect of claims of price suppression/depression? Please explain your view, including the textual basis and any other elements that you deem relevant.**

Response

101. The relevant portion of Article 6.3(c) of the *SCM Agreement* does not refer to “like product” with respect to price depression and suppression. The EC considers that the Agreement therefore intends to give flexibility as to how to determine the “same market” in which price effects occur.

102. Thus, Article 6.3(c) of the *SCM Agreement* provides for the tailoring of criteria appropriate to grasp price developments in the relevant product and geographic market affected by subsidisation taking on a case-to-case basis.

**26. Question 26**

**You have argued that a "product segmentation" approach should be applied in this case. In what respects, if at all, does this concept differ from "like product" as defined in footnote 46 of the SCM Agreement?**

Response

103. The EC noted with approval the statement of the Panel in *Indonesia Cars* that a market segmentation approach is consistent with the criteria for a like product analysis under the *SCM Agreement* (as opposed to a like product analysis under Articles III:2, III:4, of the GATT 1994 as argued by Korea).

104. Footnote 46 of the *SCM Agreement* provides in relevant part:

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

105. Products belonging to one market segment will generally have characteristics closely resembling each other, because buyers and sellers will consider that the products have the same or similar end-uses. Accordingly there will be a strong correlation between prices of products with the same end use. Hence, changes in price by one producer will affect the prices of other producers of that product. Generally, the goal of like product analyses is to assess precisely the effects of a subsidy given to the producer of one product on the prices for products produced by other producers. Thus, *in effect*, a market segmentation analysis involves similar questions as posed in a like product analysis under the *SCM Agreement*.

**27. Question 27**

**Korea argues that there is considerable variation or diversity of products within each of the product segments proposed by you, meaning that these product segments are too broad and should be broken down, for example, at least into different size ranges. Please comment on the diversity of products within each of the product segments that you propose, and in this context please respond specifically to Korea's arguments on this point.**

Response

106. Korea contents itself with generally questioning the three market segments identified by the European Communities (LNGs, container ships and product tankers)<sup>34</sup> without any substantiated argument, why these should not be correct. If at all, Korea asserts that the market segments should be further broken down according to different sizes within these ship types.<sup>35</sup>

107. As already explained in our Oral Statement there are no standard classifications for ships. The difficulty of classifying ships results from the fact that they are customized and made-to-order product and thus show a considerable variety of technical specifications.

108. Within the OECD Working Party on Shipbuilding, there is not even consensus as to whether there is

*One single market for all ship types or a number of market segments based on the main vessel types (i.e., a tanker market, a cruise market etc.). In defining the product market, there was a commonality of views among experts that demand substitutability and supply substitutability should both be considered.*<sup>36</sup>

109. Curiously, Korea in that forum claims that “the level of supply substitutability was so high to make shipbuilding a single market for all vessel types” and invoked the “ability of shipbuilders to switch easily from the production of one vessel type to another as a strong evidence of high supply substitutability” while EC with other economies claimed that “the shipbuilding market [is] fragmented into ship type segments...”.

110. For the purpose of this WTO dispute which requires an identification of markets in which the effects of subsidies can be felt, the EC has explained in its Oral Statement why both the perspective of the ship-owner (demand side) and the perspective of the shipbuilder (supply side) should be considered.

111. The EC submits that all analysts in this industry make the distinction between major ship types, and so do the Korean yards on the product pages of their web sites.<sup>37</sup> These support the use of the main types proposed by the European Communities for the purpose of this dispute, i.e., LNGs, market definition in container ships and product/chemical tankers.

112. However, contrary to what Korea argues, there is no basis of further segmenting relevant markets according to size. First, there standard size by which ships within these main types could be meaningfully distinguished. Indeed, curiously, Korea itself refers to different size bands even in its First Written Submission. Thus, for example, it refers to the “market in container vessels up to 1,999 TEU” and the “market in container vessels from 2,000 to 3,999 TEU” in para. 19 of its First Written Submission while then citing with approval to the vessel categories used in an analysis of FMI which looked at “container feeder vessels (up to about 3,500 TEU)” in para. 515 of its First Written Submission.

113. Any further segmentation of the main types according to size does not answer the question which ships serve the same end uses and are therefore substitutable from the perspective of the shipowner. The European Communities refers to figures 2.2 and 3.2 contained in Attachment 2.

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<sup>34</sup> First written submission of the European Communities, paras. 417, 418. See also Oral Statement, paras. 101-110.

<sup>35</sup> First written submission of Korea, paras. 514.

<sup>36</sup> OECD Council Working Party on Shipbuilding, Report by the Chairman of the Informal Experts Group Held on 1-2 March 2004 (C/WP6/SNG(2004)5, (Exhibit EC – 104) (Emphasis added).

<sup>37</sup> See compilation of products listed on websites of Korean and EC producers in **Attachment 4**.

They present a histogram of the frequency of all product tanker and container ship orders placed between 1997 and 2002 (based on Lloyd's Register data), distributed by deadweight.

114. While figure 2.2 shows certain peaks for product tankers, these size bands, e.g., between 32,000 dwt and 40,000 dwt cannot be seen as strict standards for sizes demarking a line for substitutability or end uses. Thus, a 31,000 dwt product tanker is fully substitutable to a 32,000 dwt tanker, for the purpose of end uses. With respect to container ships, this is even clearer, because figure 3.2 does not even reflect any clear peaks, and hence any subdivision as to sizes would be arbitrary.

115. As the European Communities explained in its Oral Statement, from the perspective of ship-owners size may *limit* full substitutability, however, both for container ships and product tankers there is a significant overlap between the end uses of ships of all sizes.<sup>38</sup> Indeed, there is no market, e.g., for a container to be transported through the Panama or Suez Channel or between main hubs and smaller ports. Shipping companies run networks of routes and exchange ships according to routes which are constantly adapted to market needs.

116. In any case, from the perspective of the shipbuilder, the distinction between even ship types is less important as the production technology is largely the same for all commercial vessels and in particular between the main types identified by the European Communities. Under no circumstances can one say that size plays a significant role from the perspective of the shipbuilders.<sup>39</sup>

117. In short, the market segmentation proposed by the EC is sound both from the demand and supply side perspective.

## 28. Question 28

**Please comment on Korea's statement that "the Korean and EC shipbuilders have and continue to operate in totally different segments of the shipbuilding market and that the segments where certain competition may exist are marginal and demand for those segments has shown slackening" (para. 19, Korea's first written submission).**

### Response

118. In paragraph 19 of its submission, Korea provides a snapshot picture and tries to minimise actual *participation* or *operation* of EC yards in certain selected size ranges within the three markets. However, for the purpose of a price depression or suppression claim it is not relevant whether EC and Korean producers actually "operate" or "participate" in the same market as argued by Korea. What is required is that EC producers compete for all the products and are able to build them.

119. In this respect it is important to recall that competition between yards materialises at the stage of tendering for a contract. Tendering involves first technical specifications and a price offer. It often also includes financing aspects and comes at substantial costs for the tendering yard. Hence, the absence of an order does not indicate an absence of competition in the market. EC shipyards are well experienced in all the contested market segments and are actively seeking opportunities to win orders in all sectors.

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<sup>38</sup> Oral Statement by the European Communities at the First Substantive Meeting with the Panel, paras. 105-107.

<sup>39</sup> Oral Statement by the European Communities at the First Substantive Meeting with the Panel, paras. 108-109.

120. This can first be proven by the list of available standard product categories on their websites.<sup>40</sup>

121. Moreover, Korea itself recognises that EC yards and Korean yards compete in the same market segments and makes it clear in its recent Panel request in the case DS 301 of 6 February 2004 where Korea considers that

the EC and its Member State measures referred to above are in breach of the EC and its Member State obligations under the following provisions: Articles I:1 and III:4 of GATT 1994 because the TDM Regulation and Member State implementing measures involving the bestowal of German, Danish, Dutch, French and Spanish grants to shipyards on a vessel-specific and product-related basis, *adversely modify conditions of competition between Korean commercial vessels and the like vessels built in third countries and Korean commercial vessels and the like vessels built in the EC, respectively*".

**29. Question 29**

**You argue that there are three market "segments" relevant to your price suppression/depression claim: LNGs, chemical/product tankers, and container ships.**

- (a) **Is the implication of this that in your view, price suppression/depression should be found in respect of each of these segments separately?**

Response

122. Yes.

- (b) **If so, what is the relevance of figures 33-36 of your submission? That is, please explain what conclusions about price and cost trends in respect of the particular kinds of ships referred to in your claim can be drawn from these graphs, which appear to represent averages for all ships of all types.**

Response

123. Paragraphs 443-453 of our First Written Submission and Figures 33-36 deal with price suppression at an aggregate level before addressing price/cost developments in the three particular segments. The under-lying principles are the same whether considered at the aggregate level or specifically for the three market segments as further elaborated above: Newbuilding prices have disconnected from the key economic drivers, namely order volume (i.e. demand), freight rates and costs of production.

124. The EC also notes that major shipbuilding consultants maintain a composite ship newbuilding price index, along with their more specific price information for particular ship-types. Also, the OECD issues regularly its own newbuilding price analysis which contains a composite price index with a timeline.

- (c) **Do you agree with Japan's argument that a low price for any individual transaction will put downward pressure on all types of ships, whether substitutable or not? If so, why? Does a decline in the price of a ship of a certain type, for instance a container ship, cause a decline in the price of ship of another type, e.g., a tanker or passenger ship? Is it not more defensible to argue**

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<sup>40</sup> See Attachment 4.

**that a decline in the price of one ship causes a decline in the price of another ship with the same end-use?**

Response

125. Yes we agree. As explained in the answer to question 30 below, the end use of the ship is to a large degree irrelevant to the shipbuilder, just as the end use of a building is largely incidental to the business of a construction company. It is common practice in shipbuilding for shipyards to shift their focus between market segments to respond to shifts in the market. Because of this ability, or even necessity, to shift, it is a misconception to assume that shipyards are only affected if they are competing directly for the ship types that are the subject of accusations of price suppression.

126. Therefore, a decline in prices for one ship-type will *de facto* always go hand in hand with price developments for another. However, the correlation between price developments will be higher for ships with the same end-use.

**30. Question 30**

**In general, how much flexibility does a typical shipyard have to produce all or a broad range of ship types? What are the physical and other constraints on any given shipyard's potential product range? How important is prior experience to a shipyard's production cost and capability to build a particular type of ship? With reference to the above considerations, please describe the capabilities and experience of each EC shipyard that produces or is capable of producing some or all of the kinds of commercial vessels cited in your serious prejudice claim.**

Response

127. All shipyards are ultimately constrained only by size. From the point of view of a shipbuilder, however, within this size constraint there is a great deal of flexibility for substitution between products.

128. In the eyes of a shipbuilder a ship is an assembly of steel panels, into which is fitted machinery, pipes, cables, accommodation and so on, and the ultimate function of the ship is largely irrelevant. In the eyes of a shipbuilder a tanker, a dry bulk carrier and a container ship are broadly similar products, even though the arrangement and proportions of the parts that are assembled differ in each product. Whilst shipbuilders seek to improve economic efficiency by series building similar products, very few shipyards specialise in a single product type, although there are examples of this. Thus, for example, Hyundai Heavy Industries, within the same shipyard, currently has orders for tankers of different sizes, container ships of different sizes, LPG tankers, dry bulk carriers and LNG tankers. Similarly, Daewoo is currently constructing tankers, LNG carriers, LPG carriers, car carriers and container ships within broadly the same facilities. Most shipyards take orders in this way, building a wide range of ship types.

129. In this respect shipbuilding can best be compared to the construction industry whereby a construction company will be capable of building a wide range of building types and the end use is of little relevance to the building process. The characteristics of the interim products produced by the shipyard from which the ships are assembled will be broadly similar between the different ship types and the assembly and outfitting processes will also be broadly similar, even though the final product assemblies will have widely different shipping functions.

130. Specific prior experience is of limited significance for most ship types. The exceptions to this are LNG tankers and cruise ships where entry costs are high and a significant amount of development will be needed to gain market entry.

131. The number of relevant EU shipyards is too many to be specific about the final part of this question. LNG tankers are on order in shipyards experienced in this sector in France (Chantiers de l'Atlantique) and Spain (Izar), and the market has been competed strongly by Finnish shipyards also well experienced in building LNG carriers, although as yet without an order. Container ships are built throughout Europe in all size ranges, with German and Danish shipyards concentrating in particular in the larger size ranges. Similarly there is a wide experience of building product tankers throughout EU shipbuilding, although with few orders won by European yards in the face of low price competition in recent years.

### 31. Question 31

**Is "head-to-head" competition a necessary precondition for any finding of serious prejudice based on price suppression or depression? If not, why not? If so, how can such head-to-head competition in respect of various kinds of ships be observed? Please provide or refer to any relevant evidence to illustrate your response.**

#### Response

132. Whilst there are numerous examples within EU shipbuilding of contracts lost in head to head competition with the disputed Korean shipyards, this is not a necessary precondition for finding serious prejudice based on price depression or suppression.

133. As explained in response to Question 29 it is sufficient to establish that producers of the complainant and defendant compete on the market segments for which serious prejudice is alleged. The ability and the willingness to produce vessels of any kind or size is the decisive factor and should not be confused with the actual regular success to secure specific orders in the market. Thus, the realistic presence of a yard (in terms of available facilities, technology and building slots) in a certain market segment is sufficient to establish the market mechanisms. Typically, brokers would be able to name yards that were invited to make a quote. The fact that brokers would consider a yard as a potential bidder, would prove presence in the market, irrespective whether the yard has recently been active in the market segment or not.

134. Ultimately shipyards will stop tendering for orders that they know they are incapable of winning, because the cost of tendering is so high. The exit of a shipyard in this way is the ultimate expression of serious prejudice resulting from price suppression and depression, but this will not be identified through an analysis of contracts lost in head to head competition.

### 32. Question 32

**Please identify in as precise terms as possible the products, within each of the product segments that you propose, for which the European and Korean shipyards compete most directly. Please describe the nature of the competition between European and Korean ships of each of these types.**

#### Response

135. The EC refers to **Attachment 6** which describes the ordering and market shares within the three product segments.

(a) *Product tankers*<sup>41</sup>

136. Within this market one can distinguish three sub-types bands above 20,000 dwt: handysize, handymax and panamax. These three types are demonstrated in figure 2.2 of **Attachment 2** which shows peaks in the size bands of:

- 32,000 to 40,000 dwt (*Handysize*)
- 44,000 to 51,000 dwt (*Handymax*)
- 69,000 to 76,000 dwt (*Panamax*)

137. As to the nature of the competition between European and Korean ships within the product tanker segment, the EC refers to the further information in **Attachment 6**. Korea dominates all three sub-sectors, whilst EU shipyards have lost almost all share of the market in the face of low prices. There are currently four handysize ships on order in Italy and one in Spain. There are no ships of the two larger types on order in the EU. In the past this has been an important market sector for EU shipyards, with a considerable track record invested in EU shipyards.

(b) *LNG carriers*

138. Whilst there are, technically speaking, two variants of the LNG tanker, the spherical and the membrane type, the size of ships, at least up to now, has been fairly uniform (and there is no difference in the use of these two variants). This is demonstrated by figure 1.2 of Attachment 2 which presents a histogram of the frequency of all LNG tanker orders placed between 1997 and 2002 (based on Lloyd's Register data), distributed by deadweight. There are a very small number of ships built outside this range (four were ordered outside this range out of 86 total LNG carrier orders placed between 1997 and 2002), but the majority of ships lie in a relatively narrow band around 140,000 to 150,000 cubic metres cargo capacity.

139. As to the nature of competition within this segment, the EC refers to **Attachment 6**. Korea dominates, with almost 60 per cent market share, with very limited opportunities for EU shipyards to take orders. There are currently three ships in order in France, two in Spain, with a total market share of 7.3 per cent.<sup>42</sup> The capability to produce this ship type is inherent in a number of EU shipyards. The failure of European builders to gain any appreciable market share in this sector in the face of very low prices, and despite strenuous efforts at product development and cost reduction, has been the source of considerable frustration.

(c) *Container ships*

140. The container ship market is less clearly demarcated in terms of sub-classes by size, than the other disputed ship types, as is evidenced by figure 3.2 in Attachment 2 which presents a histogram of the frequency of all container ship orders placed between 1997 and 2002 (based on Lloyd's Register data), distributed by TEU.

141. Above the size band for feeder ships (ca. 500-3500 TEU), peaks can be seen for:

- *Panamax ships (between about 4,000 and 5,000 TEU)*
- *Post-panamax ships (above about 5,000 TEU)*

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<sup>41</sup> As clarified in para. 103 of the Oral Statement by the European Communities, the claim relating to product and chemical tankers does not cover pure chemical tankers. Therefore, the EC will henceforth refer to this segment collectively as the "product tanker market".

<sup>42</sup> (Note: the very small ship on order in Netherlands is an unusual variant of this ship type and is not included in the general market for large LNG tankers of around 150,000 m3).

142. The nature of competition is described in **Attachment 6**. Korea takes around three-quarters of orders for both panamax and post-panamax ships. EU shipyards have lost all share of the post-panamax sector and retain less than 1 per cent of the panamax sector. This is despite considerable efforts at marketing in these sectors and a good track record of production. In the feeder sector Korea has the highest market share but without dominance. EU shipyards retain around one quarter of orders, primarily in German shipyards. Denmark and the Netherlands participate in this sector but only to a limited degree.

### 33. Question 33

**Please provide the data underlying your estimates of 2002 EC market share referred to at paragraph 15 of your submission (i.e., 17 per cent of worldwide CGT, and one-third of world turnover for ships). How many ships of which types do these figures represent?**

#### Response

143. The information on market share is based on Lloyd's Register data comes from the OECD.<sup>43</sup> The OECD does not refer to numbers of ships and only uses cgt as reference.

144. The economic and employment data for the EC shipbuilding industry are contained in the AWES (Association of European Shipbuilders and Ship Repairers) Annual Report for 2002.<sup>44</sup> AWES also has Norway, Poland, Romania and Croatia as members. The figures for these countries have not been included in the EC totals.

145. In terms of production (delivered ships in 2002) the AWES countries, excluding Norway, Poland, Romania and Croatia had an output of 289 ships. In its statistics AWES does not differentiate by country and ship type. Therefore the following breakdown refers to all AWES countries (total of 425 ships):

#### Deliveries in 2002 by ship type:

Oil tankers	4
Product/chemical tankers	22
Bulk carriers	3
General cargo ships	46
Containerships	66
RoRo ships	8
Car carriers	9
LPG tankers	1
Ferries	27
Passenger ships	28
Fishing vessels	66
Other	145

### 34. Question 34

**As a general matter, please describe the precise nature of the analysis that you believe is required to establish serious prejudice through price suppression/price depression, including the following issues:**

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<sup>43</sup> OECD document C/WP6/SG(2003) 3 "WORLD SHIPBUILDING ACTIVITIES IN 2002". (Exhibit EC – 105).

<sup>44</sup> AWES – Annual Report 2002-2003 (Exhibit EC – 106).

- (a) **Must there be (at least *inter alia*) a demonstration that the prices for the complaining party's products have been suppressed or depressed, or is the focus of the analysis instead the prices for the allegedly subsidizing party's product? Or are both sets of prices relevant?**

Response

146. The EC believes that there is serious prejudice in the form of price depression or suppression where prices are depressed or suppressed on any market in which the products of the complaining Member compete with those of the subsidising Member. As noted above, this competition can be “head-to-head” or simply at the level of being potentially able to tender for contracts to build the same ships. Thus price depression or suppression on a market may lead the suppliers of the complaining Member not to go to considerable expense of tendering for contracts at depressed or suppressed prices.

147. In other words price depression or suppression describes a condition of the overall market. (Establishing price undercutting on the other hand may require evidence of actual sales by the respective suppliers.)

148. Since the market for ships is a global one, price depression or suppression is not limited to one region. Rather all prices offered anywhere in the world may lead to price depression or suppression throughout the global market.

- (b) **How if at all should these two sets of prices be juxtaposed against or related to one another?**

Response

149. As stated above, price depression or suppression has to be established on a market where the products of the complaining Member compete with those of the subsidising Member. Since, in the view of the EC, this is the global market, it is sufficient to show price depression or suppression of any prices. The EC has shown with its graphs price depression/suppression for Korean shipbuilders (prices not following the evolution of costs) and also price throughout the world (prices not responding to increased demand). Since Korean shipbuilders are the price leaders, price depression/suppression in Korea is particularly important. It affects, that is depresses/suppresses the prices of all shipbuilders throughout the world.

- (c) **How similar must the complaining party's and allegedly subsidizing party's products be?**

Response

150. They need only be sufficiently similar that changes in the price of one affects the price of the other.

**35. Question 35**

**The nature of your basic argument as to price suppression/depression in this case, and particularly as to the role and significance of Korean ship prices, is not fully clear. Please comment on the following:**

- (a) **Is it your argument on price suppression/price depression that Korean prices have dropped, or failed to increase, in spite of various factors that should have caused them to increase, and that this situation (these trends in Korean prices)**

itself constitutes the "price suppression" or "price depression" referred to in SCM Article 6.3(c)?

- (b) Or is your argument that Korean prices have caused EC shipyards' prices to decline or have prevented them from increasing?
- (c) Or is your argument rather that Korean prices have caused "world prices" for ships either to decrease or have prevented them from increasing, and that these trends in world prices constitute the price suppression or depression referred to in Article 6.3(c)?
- (d) How do the examples described as "lost sales" in your first submission specifically relate to and support your allegations of price suppression/depression?

Response

151. All of the phenomena described in (a), (b) and (c) have occurred. The critical element is probably that described in point (c). This has been caused by the phenomenon described in (a) and has caused that described in (b).

152. Lost sales (d) were for purely illustrative purposes showing the actual effect of Korean prices on EC prices.

**36. Question 36**

**Assuming that there is a world market that allows competition between all suppliers for the sale of a particular ship, is it your position that if a bid goes to, say, a Finnish or German or Japanese shipyard, the reason for the lower price of the winning bid is a natural competitive advantage (i.e., lower cost or higher productivity), while if the winning bidder is a Korean shipyard, you exclude such a possibility? Please explain.**

Response

153. The EC accepts that different yards have different competitive advantages, also within a specific shipbuilding country or region. However, by systematically excluding certain cost factors such as debt servicing or inflation, Korean yards are able to offer prices that cannot be matched by any competitor. Shipbuilding costs are quite transparent and reasonable assumptions about key costs and profitability of yards can be made.

154. It should be remembered that the real costs of production appear only years after the tendering for and contracting of a vessel. Yards can make unreasonable quotes without needing a subsidy instantly. The EC alleges that the Korean subsidies have allowed certain yards to stay in the market and assume price leadership by setting artificially low prices that then became the new benchmark.

155. Furthermore, Japan in its Third Party submission clearly indicates<sup>45</sup> that "Japanese shipbuilders experienced a number of lost sales of LNGs carriers in competition with offers made by Korean shipbuilders at the prices that were 10 to 27 per cent lower....Japanese shipbuilders also reported lost sales of some container vessels, since the prices offered by Korean competitors were 15 to 17 per cent lower". Japan makes clear that for certain shiptypes, only Korean shipyards made very low offers preventing other competitors to win bids.

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<sup>45</sup> See Third Party submission of Japan, para 18.

156. The EC would recall however that it is not claiming prejudice in the form of specific instances of lost sales. It is rather complaining that prices have been depressed or suppressed significantly and this is due to a subsidisation of a number of Korean yards.

**37. Question 37**

**You argue that "in the same market" refers to any market in which there is competition between the subsidizer and the complaining party, and that in the case of ships, which are not in any meaningful sense imported, the only relevant market in this sense is the global market. Concerning "the same market" you also quote with approval, at paragraph 392, the Panel's statement in its 19 September 2003 response to Korea's request for preliminary ruling, that "the same market" 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 established".**

- (a) **What in your view distinguishes a "global market" from a series of national or perhaps regional markets, and how would price suppression/price depression analysis for a "global market" differ from such an analysis for a national or regional market? Please respond to the US argument that a purchaser of any product 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.**

Response

157. National or regional markets are often distinct because buyers are not entirely free to purchase wherever they wish and sellers not entirely able to sell wherever they wish under the same conditions because of the existence of tariffs, different regulatory regimes or simply the costs of buying or selling far from home. None of these restrictions apply in the shipbuilding market. For example:

- Ships are by nature highly mobile (and transporting them is an insignificant cost compared to their value);
- Ships do not normally need to be imported, i.e. cleared through customs or subjected to duties;
- 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;
- Shipbuilders operate on a large scale and are active throughout the “global market”;
- Ship-owners are also large enterprises and are established in many different territories.

158. Contrary to the US suggestion, the situation is significantly different for most other goods.

- (b) **Are ships in each of the "product segments" identified by the EC purchased in all regions/countries in the world?**

Response

159. Yes. Ships in the three product segments identified by the EC are indeed purchased in all regions/countries in the world. This is demonstrated by the table contained in **Attachment 7**, showing the number of vessels ordered in the period January 1997 to December 2002, broken down per

“country of economic benefit”<sup>46</sup> (where such information is available). The table clearly indicates that the three relevant ship types are indeed purchased by a wide variety of countries.

(c) **Do/have EC shipyards bid for business in all of these regions/countries for all of these product segments?**

(d) **Do/have the Korean shipyards?**

#### Joint Response

160. Yes. The tables in **Attachment 7** also separate orders secured by EU yards and those secured by South Korean yards. From these tables, it appears that the orders secured by EU and Korean yards have been placed by a wide variety of countries, and that a significant part of those countries have purchased vessels both from EU and Korean yards.

161. It is recalled that in many cases the orders for vessels are the result of a tendering process by which all interested yards are free to make an offer, whatever their nationality. In case a ship broker is involved, he might guide the owner in his choice of a yard. For this purpose, the reputation of a yard for building a specific ship type and possibly the availability of an established standard ship may play a role, but the nationality of the yard is not a relevant criteria here. Indeed, most major yards worldwide will offer an acceptable design and quality for the relevant ships in their product mix.

162. In addition to the above mentioned tables, showing that both EU and Korean yards compete on a worldwide basis, the EC has also provided – in the framework of the annex V procedure – example of cases where EC yards have, in various instances, submitted a price offer for the three relevant sectors, but for which the order was subsequently placed with a Korean yard.<sup>47</sup> This was namely the case for most of the major orders placed for LNG’s. This again demonstrates that there are bids by EC and Korean yards for the same projects, and that therefore both EC and Korean yards compete in the three relevant sectors.

(e) **Are there any technical or legal constraints on the EC industry's (or individual EC shipyards') ability to compete for the full spectrum of this business?**

#### Response

163. In principle, no.

164. However, only six EC yards have a track record in LNG carrier construction and currently only three of them participate actively in this market which requires extensive know-how and facility investment.

165. Eastern German shipyards which have a strong focus on container ships are still subject to capacity (i.e. cgt output) restrictions following the approval of earlier restructuring aid, but there is no known instance where these restrictions would have prohibited yards to participate in tenders for container ships. Rather, the restrictions have kept the concerned yards from seeking cruise ships contracts as this ship type has a significantly higher cgt contents than container ships or other non-passenger vessels.

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<sup>46</sup> This term refers to the owner that derives benefit from the operation of the ship. Lloyd’s Register now uses the term ‘country of economic benefit’ to designate the best country in which to count ownership, based on beneficial ownership. Indeed, whilst at first glance it may appear that the registered ownership may be the best guide to the owner of the ship there are a number of complications that cloud this category: registered owner may be a finance company, a web company that is registered offshore, etc.

<sup>47</sup> See EC reply to the annex V procedure, annex 7.

**38. Question 38**

**In arguing, on the basis of US – Norwegian Salmon CVD and Article 15 of the SCM Agreement that an "a cause" standard is sufficient for a finding of serious prejudice, are you implying that the causation standard for serious prejudice is the same as that for a countervailing measure? If so, what is the textual basis for such an argument? If not, what is the relevance to this dispute of either SCM Article 15 or the standard applied by the Salmon CVD panel? In this context, please respond to the US comment pointing to the difference in drafting between SCM Article 6.3(c) and SCM Article 15 ("the effect of the subsidy [...]" versus "the effects of the subsidized imports [...]", respectively).**

Response

166. The EC referred to Article 15 of the *SCM Agreement* as contextual support for its argument that the subsidies do not have to be the *sole* cause of the price depression or suppression, but rather *a* cause. Article 15 of the *SCM Agreement* distinguishes more precisely between the “effects of subsidies” as opposed to other possible causes (15.5) and the “effect/impact of the subsidised imports” on prices in the domestic market (15.1, 4, 6). This corroborates that the phrase “effect of the subsidy” must not be read to require that subsidies are the exclusive cause of price depression or suppression, as also agreed by the United States.<sup>48</sup>

**39. Question 39**

**In Figures 11-25 of your first submission, you list individual APRGs and PSLs to Korean shipbuilders that you allege were made at below-market terms. Is it your contention that EC shipyards competed with the Korean shipyards for each of these sales? If so please provide details. If not please explain the significance to your adverse effects claims of these instances of financing.**

Response

167. The listed transactions are produced as examples of KEXIM export subsidies and thus cover almost all major ship sectors including sectors not referred to in the actionable subsidies part such as oil tankers, Ro-Ros etc.

168. EC yards compete in all of these sectors. However, given that the information was only provided by Korea as BCI in the context of the Annex V process, the EC could not share this information with EU yards to verify whether they participated in any bidding relating to these transactions.

**40. Question 40**

**You make no argument concerning the effects of individual APRGs or PSLs on the prices of the individual transactions in which those instruments were used. Instead, you seem to limit your argument in respect of the alleged adverse effects of APRGs and PSLs to the more general point 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.**

- (a) **Is this a correct understanding of your argument as to the alleged adverse effects of the APRGs and PSLs?**

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<sup>48</sup> Third Party Submission by the United States, para. 50.

Response

169. Yes.

170. The EC wishes to clarify alleged adverse effects with respect to the APRG and PSL scheme merely indeed but not limited to specific transactions.

171. The EC does not accept that APRGs or PSLs have no effect on the prices of individual transactions in which those instruments were used. However, their effect is very difficult to calculate in the absence of the precise details of the transactions. In that respect, Korea has refused to provide the EC with key data such as the contract prices, the payment terms or the dates of deliveries of ships. (See Korea's response of 10 October 2003 at para. 3).

172. Nevertheless, the EC has produced in Attachment 5 an example of what the impact of an APRG and a PSL would be on a couple of transactions using best information available. The examples show that the impact of APRGs or PSLs can indeed be very significant (up to 2 per cent of the transaction price).

173. The EC, however, wants to underline the impact of the availability of these instruments on the market in general as the impossibility for a yard to offer an APRG to a buyer would more often than not lead buyers to shipyards which can offer such a guarantee.

174. Indeed, the availability of an APRG is so essential for a shipyard that Arthur Andersen in their reviewal of DHI's causes of financial distress<sup>49</sup> pointed to the refusal of Korean banks to provide APRGs to DHI and to the increase in the premia demanded by foreign banks as a principle cause of this financial distress. In particular, Arthur Andersen explained that the non availability of the APRGs (or the availability of expensive APRGs) led to DHI orders being cancelled or delayed.

175. Similarly, the availability of PSL means that a yard can offer a buyer heavy-tail payment terms (which buyers generally prefer as they need to advance less cash for the ship) without worrying about financing the construction costs.

**(b) If so, what if any impact does the timing of individual APRGs and PSLs have on the analysis? If not, please explain.**

Response

176. Both the APRGs and PSLs produce their impact at the time of the negotiations with the buyer as their availability influences the choice of the yard and the payment terms a yard can offer the buyer.

**41. Question 41**

**Please respond to Korea's argument that you allege subsidization of some but not all Korean shipyards, that only shipyards receiving any alleged subsidies could possibly cause serious prejudice, but that nevertheless the information you present in the context of serious prejudice concerning the Korean industry covers the industry as a whole.**

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<sup>49</sup> Exhibit EC-64 at page 40.

Response

177. To respond to this argument it is necessary to understand the nature of the current competitive situation in shipbuilding in South Korea.

178. All shipyards are faced with an imperative to keep the order-book well stocked to support expensive facilities, potentially high debts and large workforces. This imperative is reinforced in South Korea by the search for high volume to try to counteract the effects of low prices through seeking economies of scale. For this reason shipyards are forced to take as high a share as possible of their chosen market sectors. With the major shipyards in South Korea targeting broadly the same market sectors, that is those that present the greatest opportunity for volume coupled to the (perceived) highest value, intense internal competition within South Korea results.

179. In the most heavily contested market sectors, where shipyards perceive the greatest value to be, up to three-quarters of the market can be controlled by as few as four shipyards. The dominance of a small number of suppliers has a significant effect on the market and, in particular, prices. It is competition against these major suppliers that a shipyard will have in view when setting the price of a contract. Detailed order-book statistics are attached in Attachments 2 and 6. They show South Korean shipbuilding being in a dominant position in all the disputed market segments, and the disputed shipyards being amongst the dominating yards in each sector.

180. Against this pattern of competition the low prices offered by the subsidised yards forces competitors to offer low matching prices, irrespective of the long-term economic consequences. It should be kept in mind that the economic consequences of taking an order will be felt in two to three years time when production takes place, not at the time of taking the order.

181. The ultimate determinant of the price of a ship is not 'the market' but the contract between the shipyard and the ship owner. This raises the question at what price can a shipyard afford to take an order? Surely the answer to this can not be at any price, irrespective of the effect on long term profitability and liquidity.

**42. Question 42**

**Please respond to Korea's argument that the effect of any alleged subsidy must be "current", and thus that past subsidies should not be taken into account unless they can be shown to have such a current effect.**

Response

182. As the EC explained at the first meeting with the Panel, there is no rule in the WTO that provides that a violation is forgiven once it is in the past. Obligations are drafted in the present tense to express the intention that they should apply all the time – in the past, in the present and in the future! However, it is also clear to the EC that Korean subsidisation is still having adverse effects in the form of prices depression/suppression on the world shipbuilding market. The EC presents in **Attachments 1, 2 and 5** to these responses analyses of the quantitative effect of the subsidies and the effects in terms of price depression/suppression of these subsidies. It will develop further in its rebuttal submission its explanation of the relationship between these phenomena, taking into account also the information produced by Korea in response to the questions put to it.

**43. Question 43**

**Please comment on the US statement that your basis for asserting that the alleged price suppression/depression is "significant" is that EC shipyards are facing large problems as a result of suppressed/depressed world prices. Is this a correct characterization of your**

**argument? If so, please explain its textual and other bases. If not, please clarify the basis on which you assert that the alleged price suppression/depression is "significant".**

Response

183. While the US is correct in stating that the EC shipyards are facing large problems due to suppressed and depressed world prices for ships, this is not the full extent of the EC's argument.

184. The EC has explained that price depression and suppression are significant.

185. The adjective "significant" only relates to the terms "price suppression and "price depression" (as opposed to the phrase "effect of the subsidy". Thus, there must be a decline in prices or absence of price increases which is noticeable as opposed to insignificant.

186. The fact that price falls were not only "significant" in themselves, but even drove us out the market only illustrates how significant these price falls were.

**44. Question 44**

**We note that Article 6.3(c) establishes that price suppression or depression must be "significant" for any finding of serious prejudice on that basis to be made. How can the Panel know whether the effect of the alleged subsidies is significant if we do not know what price(s) would have prevailed in the absence of subsidies? On what basis can the Panel make any such judgement? Is not the size of the alleged subsidy relevant to this issue?**

Response

187. The EC presents **Attachments 1, 2 and 5** to these responses to provide a further basis for establishing price depression/suppression resulting from the subsidies. However, the EC maintains that quantifying the effect of the particular types of subsidies at issue (which include forgiveness of government-held debt in several restructuring process) does not assist in fully understanding the effects of these subsidies. Article 6.1(d) of the *SCM Agreement* laid down a direct presumption of serious prejudice in case of direct forgiveness of debt *in addition* to the quantitative avenue provided for under Article 6.1(a) of the *SCM Agreement*.

188. The EC reiterates that the preservation of capacity in South Korea has led to very heavy competition between the major Korean shipyards, with shipyards having to offer matching low prices to achieve orders. Detailed cost modelling underlying the EC price suppression claim has revealed that this has led shipyards to ignore future profitability in the pursuit of order volumes. In particular prices have, in general, been found to not cover inflation, debt servicing costs and profit. It may be assumed that a balance of capacity and demand would have led the shipyards in South Korea into a position whereby they could fully cover costs, including debt commitments and inflation, and make a profit of 5 per cent profit. Thus, for example, for LNGs a price of around \$168 million could have been expected. This compares to an indicated price \$155 million at year end 2003. In its rebuttal submission the EC will seek to further assist the Panel in making the judgment it is called upon to make by drawing on this information and taking account of that produced by Korea in response to the questions put to it.

**45. Question 45**

**Please comment on China's argument, in paragraph 46 of its written submission, that if the total amount of a subsidy is ten dollars only, it cannot be successfully demonstrated that the effect of such a subsidy is to significantly suppress or depress the price of a one-billion-dollar vessel.**

Response

189. China's reads too much into the term "significant". That term relates exclusively to the degree of price depression or suppression. The amount of the subsidy is not directly relevant in that respect. Therefore, the term "significant" is no basis for an obligation to quantify the effect of the subsidy and to relate it to the degree of price depression or suppression. In any case, the hypothetical is unreal, because a \$10 subsidy is unlikely to significantly depress the price of vessels that usually cost \$1 bio.

B. QUESTIONS TO BOTH PARTIES

95. Question 95

Article 11-2 of the Guidelines for Interest and Fees (Amended) (Exhibit EC-13) provides that [BCI: Omitted from public version].

- (a) **To Korea: Does this suggest that KEXIM considers that foreign financial markets constitute an appropriate market benchmark? Please explain.**
- (b) **To EC: What impact, if any, does this provision have on the EC's argument that KEXIM is not required to act on commercial principles? Please explain.**

Response

190. KEXIM's interest rates are made up of a number of elements some of which involve some limited discretion. Article 11 relates to the base rates, which is the starting point for the calculation of actual rates. The principle that appears from Article 11 is that the base rate corresponds to the rate at which KEXIM is able to borrow funds on the financial markets (the "Export-Import Financing Bond" is issued by KEXIM for this purpose) – that is its cost of funds.

191. KEXIM's cost of funds does not however correspond to the market rate applicable to its clients for the kind of financing that they obtain from KEXIM. And the extent to which this rate can be adjusted upwards (or downwards) to take account of actual market rates offered by other financial institutions is limited to 0.5 per cent.

192. The provision does not therefore indicate either that KEXIM is required to or that it does in fact act **on commercial principles**.

96. Question 96

**Can footnote 5 of the SCM Agreement be used to justify an *a contrario* reading of item (j) and the first paragraph of item (k) of the Illustrative List of Export Subsidies? Please explain.**

Response

193. No. Footnote 5 has to be interpreted according to its terms which are that Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

194. Therefore only measures "referred to in Annex I as not constituting export subsidies" benefit from what is known as a "safe haven".

195. A generalised *a contrario* reading of footnote 5 would conflict with the fact that it is list of measures that are *deemed to be* prohibited export subsidy (whether or not they would otherwise fall under Article 3.1(a))<sup>50</sup> and that this list is only *illustrative*.

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<sup>50</sup> This reading was confirmed, for example, by the panel in *Canada – Regional Aircraft* para. 7.395, where it held "item (j) sets out the circumstances in which the grant of loan guarantees is per se deemed to be an export subsidy" and the Appellate Body in *Brazil - Aircraft*, para. 179, where the Appellate Body held that "[t]he first paragraph of item (k) describes a type of subsidy that is deemed to be a prohibited export subsidy".

196. The Illustrative List, by its very terms, is not intended to be an exhaustive list of export subsidies. “Illustrative” is defined as “providing an illustration or example”.<sup>51</sup> An *a contrario* reading of the list as “permitting” measures that otherwise falls under the definition of export subsidy under Article 3.1(a), would be the equivalent of treating the Illustrative List as an exhaustive list of export subsidies and conflict with the terms of Article 3.1(a) which prohibits all subsidies contingent upon export performance *including those illustrated in Annex I*.

197. The first paragraph of item (k) does not ‘refer to’ any measures as ‘not constituting export subsidies’, and therefore can not be read in an *a contrario* manner. This is particularly clear from the context formed by the second paragraph, which clearly does refer to measures not being export subsidies. It would be bizarre for a single provision which explicitly refers to certain measures not being export subsidies to be interpreted *a contrario* as referring to all measures not falling under its terms not to be export subsidies. Where a provision is intended to be read *a contrario* as authorising that which is not prohibited, it would not include an explicit exception. Indeed, where if there is an explicit exception, it could equally be considered that the exception must be read *a contrario*, which would then completely undermine the distinction between principle and exception.

198. The fact that the focus must be on whether there is a “reference” to a measure not being an export subsidy was confirmed by panel in *Brazil – Aircraft*, Second Recourse to 21.5 which stated that “the first paragraph of item (k) does not ‘refer to’ any measures as ‘not constituting export subsidies’ within the meaning of the footnote [5]”.<sup>52</sup>

199. Korea relies heavily on a statement by the Appellate Body in *Brazil-Aircraft*. Whatever the Appellate Body meant by that statement, it was not an interpretation of footnote 5 since it stated “[w]e 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.” Moreover, the Appellate Body’s statement was an *obiter dictum* because it relied for its finding on the fact that the payments at issue were used to secure a material advantage.

200. The context of item (j) is very different from item (k) and it would seem possible to consider that the words “at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes” constitute a proviso and thus refer to export credit guarantees at premium rates that cover the long-term operating costs and losses of the programmes as not constituting export subsidies.

## 97. Question 97

**What is the meaning of the term "material advantage" in the first paragraph of item (k) of the Illustrative List of Export Subsidies?**

### Response

201. The EC does not believe that this question arises in this case since item (k) is not applicable to pre-shipment loans.

202. In any event it is admitted by Korea that its pre-shipment loans do not qualify as export credits under the second paragraph of item (k) and therefore the EC does not believe that the CIRR rate used in the OECD understanding provides a relevant benchmark. Indeed there is no CIRR corresponding to loans of the duration of pre-shipment loans.

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<sup>51</sup> The New Shorter Oxford English Dictionary (1993), p. 1311.

<sup>52</sup> In paras. 5.274 and 5.275. See also the *obiter dictum* in the first panel report *Canada - Aircraft*, para. 9.117.

203. The Appellate Body in *Brazil – Aircraft (Article 21.5)* considered that it was necessary for a WTO Member which claimed that it was not providing a “material advantage” through the use of export credits to prove, first, that it has identified an appropriate “market benchmark”; and, second, that the rates it applied are at or above that benchmark.<sup>53</sup> Korea has done neither.

**98. Question 98**

**As a legal matter, does the definition of export credits used by the OECD in the context of the Export Credit Arrangement govern the meaning of this term in the first paragraph of item (k) of the Illustrative List of Export Subsidies? Why/why not?**

Response

204. As already indicated in response to question 10, 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 has the meaning given to it in the 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.

**99. Question 99**

**Would you provide us with the rationale behind your definition of export credits and export credit guarantees? Does an export credit have always to be a credit extended by the exporter or a financial institution to the buyer, and does an export credit guarantee always have to be a guarantee of such a credit? PSLs are loans extended by KEXIM to the shipbuilder, not to the buyer. APRGs are guarantees extended by KEXIM to the buyer, not to guarantee a credit given by the exporter or by a private financial institution to the buyer, but to guarantee that an advance payment by the buyer to the exporter shall be refunded in case of a contractual default. Does this exclude APRGs and PSLs from the realm of export credits/export credit guarantees?**

Response

205. Yes, pre-shipment loans and APRGs are not export credits/export credit guarantees.

206. The justification or rationale for providing special rules for export credits and export credit guarantees and insurance (including a safe haven in the second paragraph of item (k)) is that special rules and conventions for this form of export subsidy have been developed internationally, in particular at the OECD. The principles that are applied are harmonisation and transparency.

207. This justification and rationale does not apply to pre-shipment loans and APRGs as developed by Korea, for which no international consensus ...

208. Indeed, if the intention was that “export credits” were to include all types of state assistance which has some relevance to exports, then automatically all export subsidies would constitute export credits making the distinction between “export subsidy” and “export credit” obsolete.

**100. Question 100**

**In the Indonesia – Autos dispute (the only circulated panel report to date addressing serious prejudice claims), the panel in analysing the claims of displacement or impedance of**

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<sup>53</sup> Appellate Body Report, *Brazil-Aircraft (Article 21.5)*, para. 69.

imports into the Indonesian market applied a "but for" approach. In particular, the panel asked the question whether, "but for" the subsidies, the complaining parties' sales volumes and/or market shares in the Indonesian market either would not have declined, or would have increased by more than they in fact did.

**Would an analogous approach be appropriate here? That is, in assessing the price suppression/depression claims, should the Panel seek to answer the question whether, but for the subsidies, the prices in question either would not have declined, or would have increased more than they in fact did?**

**If so, what sorts of considerations should the Panel take into account in trying to determine what the price movements would have been in the absence of the alleged subsidies? If not, why not, and what other approach should be used?**

Response

209. Yes. In accordance with *EC – Sugar* and *Indonesia – Cars*, the Panel should consider whether the subsidies established by the EC are a contributing or amplifying cause of the significant price depression and suppression demonstrated by the EC. This can only be done on a case to case basis. The Panel can consider factors such as price trends of the products over time, the evolution of prices of different ship types, the price behaviour of different shipyards, the evolution of prices compared to costs and the evolution of prices compared with that of demand.

210. The EC had provided further data in **Attachment 2** and will elaborate further in its second written submission in the light also of information to be submitted by Korea in response to the questions addressed to it. The EC also refers to its response to Question 44.

**101. Question 101**

**Does the word "may" in the chapeau of Article 6.3 mean that a complainant of a "serious prejudice" must prove something more than the existence of price suppression/depression?**

**If so, what is it that the complainant has to prove beyond price suppression/depression, and what is the basis in the text for any such additional requirements?**

**If not, what is the significance of the word "may"?**

Response

211. As explained in the EC Oral Statement, there is no requirement in Article 6.3 of the *SCM Agreement* to prove anything beyond the existence of price suppression or depression. The EC will explain in more detail below that the term "may" in the *chapeau* of Article 6.3 of the *SCM Agreement* is consistent with that interpretation.

212. The ordinary meaning of the term "may" is "to express possibility, opportunity, or permission".<sup>54</sup> The structure of Article 6 of the *SCM Agreement* confirms that the term "may" is used in Article 6.3(c) of the *SCM Agreement* to express "permission". Thus, Article 6 sets forth a self-contained regime defining the notion of serious prejudice. While Article 6.1 *presumed* the existence of serious prejudice is presumed in certain situations and Article 6.7 *excludes* the existence of serious prejudice in certain situations, Art. 6.3 *permits* a finding of serious prejudice if the complainant establishes that one or more of paragraphs of 6.3(a)-(d) apply.

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<sup>54</sup> Random House Dictionary, cited in US submission at para. 38.

213. This interpretation is confirmed by the immediate context of the term “may” in Art. 6.3 (c), which uses the phrase “in *any* case where one of several” of paragraphs (a)-(d) apply. Therefore, a WTO Member can pursue subsidies as actionable under Article 6.3(c) in all cases where one of the effects described in Article 6.3(c), e.g., price depression or suppression is given.<sup>55</sup>

214. Furthermore, footnote 13 to Article 5(c) of the *SCM Agreement* clarifies that the term “serious prejudice” is used in the same sense as used in paragraph 1 of Article XVI of the GATT 1994. GATT (and WTO) Panels already found “serious prejudice” based solely on price depression and price undercutting, respectively.<sup>56</sup>

## 102. Question 102

**In its arguments concerning price suppression/depression, the EC has focused on demand side factors. Korea, on the other hand, has focused on the supply side. Is it not more correct that the two aspects should be taken together. Please explain the impact of such an approach on your argument concerning price suppression/depression.**

### Response

215. The EC has made its price depression and suppression argument taking account of both demand and supply side factors because it considers that both are relevant in determining the markets for the products at hand and their prices.

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<sup>55</sup> This also is confirmed by the Spanish language version : “en cualquier caso” and French “dès lors qu’il existe l’une ou plusieurs des situations ci-après”.

<sup>56</sup> *EC-Refunds on Exports of Sugar* (p. 24, para. V.f) and the WTO Panel on *Indonesia – Autos* (paras. 14.254-14.246),

### **LIST OF ATTACHMENTS**

- Attachment 1 Quantitative analysis of restructuring subsidies
- Attachment 2 Estimation of price suppression and suppression prepared by First Marine International
- Attachment 3 Analysis of DHI creditors' situation
- Attachment 4 Compilation of Products listed on websites of Korean and EC Producers
- Attachment 5 *Ad valorem* impact of APRG and pre-shipment loans
- Attachment 6 Further information on the nature of competition in shipbuilding
- Attachment 7 Number of vessels ordered per "country of economic benefit"

### **LIST OF EXHIBITS**

- EC - 101 MOFE press release of 6 October 2000 – published on MOFE website
- EC - 102 Korea Letter of Intent to IMF of 24/09/1998
- EC – 103 Special Act on the Management of Public funds
- EC – 104 OECD Council Working Party on Shipbuilding, Report by the Chairman of the Informal Experts Group Held on 1-2 March 2004 (C/WP6/SNG (2004)5
- EC – 105 OECD Council Working Party on Shipbuilding, World Shipbuilding Activities in 2002 – 4 March 2003 (C/WP6/SG(2003)3
- EC – 106 AWES – Annual Report 2002-2003
- EC – 107 DHI 1999 Audited Accounts
- EC – 108 DSME 2000 Audited Accounts
- EC – 109 DSME 2001 Audited Accounts
- EC – 110 Balance Sheets of DHI as of September 30, 2000
- EC – 111 HHI Income Statement for 2002 and 2003
- EC – 112 PriceWaterhouseCoopers' Analysis of the Arthur Andersen Report

## ANNEX D-2

### RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM KOREA

(22 March 2004)

#### Question 1

**In the EC's view is an entity a "public body" for all purposes?**

##### Response

1. Yes, an entity is either a public body or it is not.

#### Question 2

**Are all State Trading (as per Article XVII of the GATT 1994) entities "public bodies"?  
For all activities?**

##### Response

2. The EC does not see any necessary connection between these concepts. Its position on public bodies is set out in response to question 1 from the Panel.

#### Question 3

**Regarding the previous question, if not, what are the criteria for distinguishing: (a) State Trading entities that are "public bodies" from those that are not? (b) "public body" related activities from those that are not?**

##### Response

3. See EC response to Panel question 1.

#### Question 4

**The EC argues that the Appellate Body's findings in Japan -- Apples provides that it does not have to prove every fact it asserts. Can the EC identify which facts it considers it must prove and which it does not have to prove?**

##### Response

4. The question as posed is too general. The EC has explained its position most recently at paras. 9 to 15 of its oral statement.

### Question 5

**What criteria does the EC propose for determining which facts it must prove and those with respect to which it considers it has no burden?**

#### Response

5. See answer to question 4 above.

### Question 6

**In its oral statement, the EC stated that it was “not necessary to prove the obvious”. Recognizing that in the context of a dispute, it is possible that not all parties or the Panel might consider the same issues as “obvious”, please identify those elements of its case which the EC considers “obvious” and that it is, therefore, not required to prove.**

#### Response

6. An example is offered at para. 11 of EC’s oral statement.

### Question 7

**Is the EC referring to the same concept in paragraph 10 of its Opening Statement and paragraph 61 of its first submission?**

#### Response

7. If the question refers to the “prima facie” concept, the EC has explained that it accepts it has the burden of presenting a “prima facie” case. The EC considers that it has met this burden.

### Question 8

**Is empirical evidence of application of a measure of any legal relevance in establishing whether a measure “on its face” is inconsistent with WTO law?**

#### Response

8. The notion of ‘empirical evidence’ is not clear. A government practice can be a separate violation in its own right and this can be evidenced by its actual application in individual instances. See the EC’s response to question 8 of the Panel.

### Question 9

**If a measure provided a “benefit” at one point in time or in a particular instance, but not at another, can it be considered “on its face” inconsistent with WTO law?**

#### Response

9. Yes, for example, if a government rules that export loans are to be granted in all cases (i.e. independently of the creditworthiness of the recipient) at a fixed rate of, say, 5 per cent a benefit will be granted with respect to some recipients but not necessarily with other recipients. Such a measure would be on its face inconsistent with WTO law.

### Question 10

**If a measure as applied is considered inconsistent with WTO law at an earlier period, but is not proved to be inconsistent in the most recent period, what would the remedy be under Article 4 of the SCM Agreement?**

#### Response

10. The question of remedies is a separate issue from that of the existence of the violation and is one on which the Panel has not been asked to rule.

### Question 11

**Please identify and quantify all adjustments to reflect such factors as different time periods, security interests and redemption priorities that the EC made in its comparison of corporate bonds with pre-shipment loans?**

### Question 12

**If the EC made no adjustments to reflect such factors, please explain the legal basis for comparability.**

#### Response to questions 11 and 12

11. The EC has set out its views on the comparability of the benchmark in its first written submission, if Korea considers that adjustments are needed it should explain why and provide a basis for making them.

### Question 13

**Does the EC have any evidence of currently applicable extensions of APRGs that it considers confer a benefit on any Korean person? If so, please identify all such APRGs.**

#### Response

12. The EC has provided evidence of subsidized transactions of which it is aware. The EC has no information to indicate that KEXIM has stopped issuing APRGS at subsidized rates. Please also refer to the EC response to question 42 of the Panel.

### Question 14

**Does the EC have any evidence of currently applicable extensions of pre-shipment loans that it considers confer a benefit on any Korean person? If so, please identify all such pre-shipment loans.**

#### Response

13. The EC has provided evidence of subsidized transactions of which it is aware. The EC has no information to indicate that KEXIM has stopped issuing pre-shipment loans at subsidized rates. Please also refer to the EC response to question 42 of the Panel.

### Question 15

**In terms of benefit analysis, should the analysis in a debt-to-equity swap case be conducted from the perspective of the private investor or the perspective of a creditor holding distressed assets?**

#### Response

14. A benefit analysis is in principle conducted from the point of view of the recipient. The EC has set out its views on the issue in response to question 18 from the Panel.

### Question 16

**Does the EC argue that the Daewoo creditors received (i) too high or, (ii) too low a return on their Daewoo debt?**

#### Response

15. The public bodies and entrusted private bodies received too low a return And would not have agreed to the restructuring under market conditions.

### Question 17

**Please quantify the over or undervaluation you are alleging.**

#### Response

16. See reply to Question 15 of the Panel.

### Question 18

**In the case of an insolvent company, does the EC believe that the option to sell its debt as followed by the foreign lenders was reasonably available to all creditors?**

#### Response

17. The EC notes that KAMCO in fact bought the debt of foreign creditors separately and are more favourable conditions than it bought debt from Korean creditors.

### Question 19

**Did any EC shipyards bid on any Japanese LNG contracts? If so, please identify the bidders and the level of their bids?**

#### Response

18. The EC does not understand the relevance of this question since the EC does not allege that Japanese shipyards are subsidized and causing serious prejudice.

## Question 20

**If the EC is no longer supporting the point made regarding the Japanese market in the Sixth Report from the Commission to the Council on the situation in world shipbuilding<sup>1</sup>, is the EC repudiating the Commission's conclusions there? If so, please identify the facts that cause the EC to view the situation differently now.**

### Response

19. The EC's shipbuilding reports are political analyses of the situation in the world shipbuilding industry. They are not *strictu sensu* economic analyses. The chapter Korea refers to deals with the response in certain shipbuilding regions to market developments in the course of 2002. With regard to Japan the report states that Japanese yards are being restructured and that synergies have resulted from that. In particular the series production of bulk carriers (which are not subject to the EC claim of adverse effects) is mentioned, together with the fact that for these ships 50 per cent of the orders in Japan are of domestic origin. As a matter of fact, by the end of 2003, Japanese owners had 12 container ships, 2 oil tankers and 2 LNG carriers on order from Korean yards.

## Question 21

**Is the US market open to all ships in the product categories the EC proposes?**

## Question 22

**If the US market is not open to all products, please provide data demonstrating what portion of the product categories are closed due to US import restrictions on a product-by-product basis.**

### Response to questions 21 and 22

20. Yes. Only the US cabotage market is not available to non-US yards, but this market comprises less than 1/3 of the orders from US owners, i.e. US owners place 3 times as many orders abroad as they place with US yards. According to Lloyd's Register the total orderbook backlog in the US end December 2003 amounted 0,8 mio CGT. In the meantime the orders for US owners worldwide amounted 2,7 mio CGT. US cabotage laws do not affect LNG carriers at all, and latest figures indicate that almost all of US foreign sea borne trade is done by non-US built vessels. The trades affected by US cabotage legislation are mainly to/from Alaska and Hawaii, and are thus limited in size and demand for vessels.

## Question 23

**Please itemize which factors should be taken into account in defining a product category?**

### Response

21. It is impossible to answer this question in the abstract. However, the EC has set out its position on the appropriate market segments to be used in this case in the oral statement and in its response to question 27 of the Panel.

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<sup>1</sup> COM(2002)622 final, 13 November 2002, Section 2.2.3, page 8. See also Seventh Report from the Commission to the Council on the Situation in World Shipbuilding, COM(2003)232 final, 6 May 2003, Section 2.1.1, page 5.

#### Question 24

**How did the EC take into consideration technical differences, payment terms, delivery terms and other differences in its causation analysis?**

#### Question 25

**How did the EC factor out ships built in countries other than in Korea in its causation analysis?**

#### Joint Response to questions 24 and 25

22. Please refer to the EC answers to questions 34 to 39 of the Panel.

#### Question 26

**How did the EC factor out Korean ships that were built by yards that were not restructured?**

#### Response

23. Please refer to the EC response to question 41 of the Panel.

#### Question 27

**What is the EC's position with regard to the conclusion of its expert, FMI, that EC and Korean yards compete only as regards feeder container vessels and chemical tankers?**

#### Question 28

**What is the EC's position on FMI's conclusion that even in these segments, it is impossible to identify Korea as price leader since they are characterized by significant competition from other countries practicing low prices?**

#### Response to questions 27 and 28

24. The EC has explained, most recently in response to question 28 of the Panel that EC and Korean shipyards compete across the entire range of the product segments the subject of this dispute. As regards chemical tankers, the EC has clarified at the first substantive meeting that these are not subject to its claim. See also question 27.

#### Question 29

**In the same vein, what is the EC's position vis-à-vis the table shown at page 4 of Korea's first submission indicating the EC and Korean vessels are only present in the segments below 100,000 GT (with a small presence in the segment between 150,000 and 200,000 GT but which is characterized by a sizeable presence of Japanese yards)?**

#### Response

25. Please refer to the EC oral statement at paras. 109 and 110 as well as to the EC response to question 28 of the Panel.

### Question 30

**Considering this segmentation, please explain how the alleged corporate restructuring subsidies depressed or suppressed prices in all size segments?**

#### Response

26. Please refer to the EC response to question 29 of the Panel.

### Question 31

**Do LNGs compete with any other vessels?**

#### Response

27. Not directly, but please refer to the EC response to question 29 of the Panel on inter-segment relationships.

### Question 32

**Please identify all EC shipyards that produce LNGs or that the EC regards as capable of producing LNGs.**

#### Response

28. Chantiers de l'Atlantique (Fr), Izar (S) and Kvaener Masa (FIN) have been active on the market in terms of bidding and/or orders. All other major EC shipyards would also be interested in building LNG's if the price level were not so depressed.

### Question 33

**Please confirm that the EC shipyards saw declining profitability in 1997 and 1998 and increasing profitability for 1999 through 2001. Please provide breakdown by shipyard and product and provide supporting data. Please also provide such data for 2002 and 2003.**

#### Response

29. EC shipyard profitability figures were already provided to Korea in the framework of the Annex V procedure - see reply to Korea's question 4 (and accompanying Annex 4a and 4b).

### Question 34

**Does the EC consider that serious prejudice can exist in a shipyard that is making vessels not subject to competition from Korean shipyards? If so, please specify the market mechanism that transmits such effects.**

### Question 35

**If not, what level of competitive overlap between Korean products and the EC shipyards' products is necessary for a subsidy to be a cause of serious prejudice?**

Joint Response to questions 34 and 35

30. It is WTO Members that need to be shown to suffer serious prejudice, not individual shipyards. For a better understanding of inter-segment relations please refer to the EC response to question 29 of the Panel.

**Question 36**

**Please explain in detail how the EC measures capacity in the shipbuilding industry?**

Response

31. Capacity in shipbuilding is extremely difficult to measure, as it depends on the production facilities and the production portfolio.

32. In order to efficiently use their technical and human resources yards try to maintain a product mix. At the same time they try to fill their berths with ship types they are specialised in. This makes the actual production capacity dependent on the orders contracted and it may therefore change from year to year. Capacity in shipbuilding should be related to actual or historical production output (measured in cgt - compensated gross tonnes), as it is extremely difficult to derive an abstract production volume from the extent of the physical construction facilities. Physical construction facilities are generally defined by, among others, available steel cutting lines, dock space and crange, but the same facilities can be used for simple ships (giving a small cgt figure) or for highly sophisticated ships (giving a high cgt figure). Therefore, the most appropriate means of a yard's production capacity is its maximum historical production output of the existing facility.

## ANNEX D-3

### RESPONSES OF KOREA TO QUESTIONS FROM THE PANEL

(22 March 2004)

#### I. QUESTIONS TO KOREA

##### A. GENERAL

**46. Is there a financial contribution if a government provides a cash grant to a government-owned company? Please explain in light of Korea's argument that one cannot make a financial contribution to oneself (para. 319 of Korea's first written submission).**

At the outset, Korea notes that, while the issues of financial contribution and benefit are legally distinct, many of the same facts and arguments are relevant to the two issues. The issue in this regard arises from the privatization cases wherein the EC argued for an absolute rule of looking through the assets to the actual owners to determine if there is a benefit. Necessarily, 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. There are indeed, some interesting legal issues arising from the reasoning championed by the EC in the privatization cases. The EC apparently wants one rule that applies to them in the situation of privatization they face and another that applies to the rest of the world when it is convenient for the EC. Of course, this cannot be the case; the WTO rules apply to every Member uniformly.

The Panel does not face such a sweeping issue in this dispute, however. To take just one example, Korea is of the view that so-called equity infusions into a government majority-owned entity can be a financial contribution. So-called "equity infusions" are often covers for direct subsidies to cover operating losses. As an illustration, over a long period of time the French government has made so-called equity infusions into their aircraft engine company, SNECMA. The purported capital calls generally were mere shams reflected by the unwillingness of minority shareholders to respond. The issue in a debt-for-equity swap made in an insolvency situation is different, however. 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. 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. More specifically, the creditors were holding debt in distressed companies in a country facing a financial crisis. The EC's odd diversion at the First Substantive Meeting into an elementary description of the different characteristics of the two forms of financial instruments was completely beside the point.

Thus, it does not automatically follow from this that any transfer of funds by the Government-owned company into a private company involves a financial contribution under Article 1.1 of the *SCM Agreement*. The EC again fails to apply the correct consequences of the WTO case-law indicating that "any analysis of whether a benefit exists should be on 'legal or natural persons' instead

of productive operations.”<sup>1</sup> In this case, the benefit analysis adopted by the Appellate Body in the privatization cases has necessary logical implications for the issue of financial contribution.

B. KEXIM LEGAL REGIME

**47. At Attachment 1, page 4, of its first written submission, Korea states that "KEXIM's interest rates and guarantee conditions started from a market base rate to which different spreads were added". Does Korea claim that KEXIM provides financing and guarantees at above-market rates?**

As a threshold issue, it is necessary to clarify what the “market rate” is supposed to mean. There is no single “market interest rate” or “market premium”. Rather, the market rate exists in the form of certain “ranges” or “bands” of different interest rates or premia. Otherwise, there can be no competition among banks in terms of interest rates or premia. Therefore, in Korea’s view, the question is whether the KEXIM rates are within the ranges or bands prevailing in the relevant market.

Next, in order to answer the question, the structure for determining the interest rates and premia must be borne in mind. As Korea submitted in its First Written Submission and stated at the First Substantive Meeting, KEXIM’s interest rates and fees are determined by adding up the base rate plus spreads such as “credit risk spread”, “target margin”, “Market Adjustment Rate”, etc.

With respect to the interest rates, KEXIM sets the base rate differently depending on whether the loan is denominated in Korean won or in a foreign currency as well as whether the interest rate is fixed or floating as stipulated in the Interest Rate Guidelines (Articles 10, 11 & 11-2, Korea Annex V Response Attachment 1.1(15), Exhibit EC-13). Below is a chart summarizing the base rates currently in force for loans extended by KEXIM.

**[BCI: Omitted from public version.]**

While the base rates thus obtained are not the final rates at which KEXIM loans are extended, because various spreads are to be added thereto, the base rate by itself is designed to adequately reflect the prevailing level of interest rates in the financial market at the time of the loan as well as KEXIM’s cost of procuring the required funds (e.g., overseas borrowing and the issuance of KEXIM bonds). Further, it is a standard market practice for all Korean commercial banks to use LIBOR rates or CD yield rates as the base rates for their floating rate loans (Korea notes that loans with floating interest rates account for the absolute majority of all loans extended by KEXIM). In light of this, KEXIM’s interest rate structure ensures that the KEXIM interest rates fall within the “range” or “band” prevailing in the relevant market. In connection with this, Korea has not claimed that KEXIM interest rates are necessarily above “market rates”.

With respect to the guarantee fees, until the occurrence of the Asian Financial Crisis, all participants in the APRG market, including KEXIM, had applied similar premia ranging from **[BCI: Omitted from public version]**. KEXIM offered premia within this range based on its past experience in this field and also taking into account the competition in the market. For the periods during and immediately following the crisis, however, other financial institutions seldom participated in the market. Therefore, there existed virtually no comparable premia offered by other financial institutions in Korea. During the crisis, KEXIM introduced the fee structure composed of the base rate and credit risk spread. The base rate was calculated mainly based on the historical cost associated with the provision of guarantees, and the credit risk spread was introduced to reflect credit risks involved in individual transactions. As the financial market has been stabilized after the crisis (more specifically since 2002), other commercial banks re-entered the market, bringing about competitions in the APRG market again. In response to this change in the market, KEXIM introduced another spread factor

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<sup>1</sup> Appellate Body Report, *US – Countervailing Measures on Certain Products from the EC*, para. 110.

called the “Market Adjustment Rate” which gives the KEXIM managers flexibility to react to the market situations and reflect customer relationship. As a result, KEXIM’s fee rate structure ensures that the premia charged fall within the range of “market premia”.

- 48. In para. 133 of its first written submission, Korea "denies that the KEXIM Act, Decree and Interest Rate Guidelines provide for the provision of subsidies within the meaning of the *SCM Agreement*, let alone prohibited subsidies contingent upon export performance, within the meaning of Article 3(1)(a) of the *SCM Agreement*." Does Korea contest the EC's claim that loans and guarantees provided under the KEXIM legal regime are contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*?**

In the above-mentioned paragraph, Korea intended to emphasize simply that the KEXIM Act, Decree and Interest Guidelines as such cannot constitute subsidies within the meaning of the SCM Agreement and, thus, it was not necessary to discuss further any “export contingency” of such alleged subsidies. Korea has not taken any position as to whether such loans and guarantees are contingent on export performance.

- 49. Regarding para. 158 of Korea's first written submission, please provide evidence to support Korea's argument that GOK made capital injections into KEXIM in order to "avoid negative credit ratings" rather than to cover losses. If capital injections were made for this purpose, what impact would this have on Korea's assertion that KEXIM's operations are always profitable? In particular, why would KEXIM's credit rating have been at risk if its operations were always profitable?**

As Korea submits in its First Written Submission, the capital injections into KEXIM were necessary for maintaining good credit rating as well as sound BIS adequacy ratio as KEXIM relied on overseas borrowings for procuring its required funds. **[BCI: Omitted from public version]** whereas other export credit agencies in Japan or the US procure 80~100 per cent out of their total required funds through borrowings from their governments. Therefore, maintaining high credit rating and the sound BIS adequacy ratio was key to the KEXIM operations.

As the BIS adequacy ratio is defined as the ratio of the “equity capital” of a company to “risk-weighted assets” that the company is exposed to (i.e., it is the product of equity capital divided by risk-weighted assets x 100 per cent), the operating profits have no direct relation or impact to the BIS adequacy ratio unless and until such operating profits are converted into the equity capital by way of “capitalization of reserves”. Further, given the size of “risk-weighted assets” and “equity capital”, the ultimate impact of the operating profits being converted into equity capital to the BIS adequacy ratio is generally insubstantial.

At the time KEXIM increased its capital in 1998 and 1999, the risk-weighted assets of KEXIM rose to a substantial degree as, among others, the majority of loans extended by KEXIM was composed of foreign currency denominated loans and the won-dollar exchange rates were extremely high. In addition, KEXIM anticipated that the demands for foreign currency denominated loans would substantially increase given the market situations.

Under these circumstances, KEXIM’s BIS ratio and credit rating were expected to decline despite its overall profitability. Thus, KEXIM had to increase its capitals to sustain these indicators. For the reference purposes, Korea submits the credit rating changes by S&P for the relevant periods and the operating profits of KEXIM from its establishment.

**[BCI: Omitted from public version.]**

**50. Does KEXIM's profitability of operations exclude the possibility that it has provided subsidies?**

The issue of KEXIM's profitability really goes to two different questions.

First, Korea has not claimed that the profitability of KEXIM operations necessarily excludes the possibility that it has provided subsidies. However, the overall profitability of KEXIM operations directly refutes the EC argument that KEXIM has been required by certain provisions of the KEXIM Act and related guidelines to provide loans and guarantees at loss-making rates or without regard to commercial or market principles. As the market principle is to generate profits, Korea believes that KEXIM's continuous profitability shows that it has acted according to market principles.

Second, in response to the point raised by the United States that cost to government issues are determinative of the issue of benefit to the recipient, Korea has both pointed out the legally irrelevant nature of cost to benefit and then has followed up by showing that, in any event, KEXIM always has shown a profit indicating that as a factual matter, it does not operate at below cost.<sup>2</sup>

**51. Regarding para. 159 of Korea's first written submission, what is the reason for conferring on GOK a status that is less preferential than other shareholders? Is this not suggestive of some form of special relationship between KEXIM and GOK?**

The provision of Article 36 of the KEXIM Act as such does not suggest any special relationship between KEXIM and GOK. It would give a better understanding of this provision if it is read in the context of Article 4 of the KEXIM Act which lists the entities that can contribute capital to KEXIM. When the KEXIM Act was enacted on 28 July 1969, it was considered that only the Government would inject the equity capital to KEXIM. However, Article 4 of the KEXIM Act was amended on 24 December 1974 in order to induce commercial financial institutions and other entities to participate in capital contributions into KEXIM. With a view of encouraging those commercial financial institutions and other entities to invest in KEXIM, Article 36 was also amended to provide differential treatments between the Government shareholder and other non-Government shareholders. Moreover, it is not uncommon in private corporations that the major shareholders receive less dividends and take more risks than other minor shareholders.

**52. In paragraph 128 of its submission the EC quotes from the KEXIM "On-Line Road Show" to the effect that KEXIM states that one part of its mission is to serve "a complementary but pioneering role and function for the national economy, which would be hard for commercial banks to shoulder". Is this not evidence of below-market financing by KEXIM?**

The "On-Line Road Show" was prepared mainly to cater to the potential investors who subscribe for the bonds issued by KEXIM. In the above-mentioned On-Line Road Show, KEXIM attempted to describe the specialized role and function being performed by it as an export credit agency (ECA). Export credit agencies, such as KEXIM, generally provide specialized trade-related financing. Such financing typically involves 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. Given these peculiarities and specialties of the ECA financing, it is not inaccurate to say that there is "a complementary but pioneering" role and function which commercial banks find difficult to perform. Particularly, the long term export credit financing provided on deferred payment basis is the area in which only KEXIM specializes. However, it is

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<sup>2</sup> For purposes of clarity regarding the response to this question, Korea notes that it is arguing in the alternative. In referring to cost to government, Korea does not concede that KEXIM is a public body. Korea would like to note that this issue of arguing in the alternative arises in numerous places through the answers and Korea requests that this reservation be accepted generally without the need to repeat it in each instance.

equally true that, as Korea explained at the First Substantive Meeting, commercial banks have advanced to most of the financing areas in which KEXIM operates and they are now competing with KEXIM pursuant to market terms. It is important to remember the context of the establishment of KEXIM. Korea was a developing country with inadequately formed capital markets, among other things. It is quite typical in such situations for specialist banks to be set up to provide such pioneering expertise. Thus, it is a matter of technical specialization and, as the Korean economy matures and expands, such expertise spreads, too, diluting the “pioneering role”.

The “On-Line Road Show” has been presented against such background. It is simply irrelevant to the question of below-market financing by KEXIM.

**53. Please explain your understanding of the "non-competition" clause in the KEXIM legal framework. What in practice does it mean to not compete with commercial banks? What does Korea mean when it argues that KEXIM does compete with commercial banks? You seem to explain this clause in terms of different maturities of KEXIM and commercial loans. Yet PSLs are for a period of 90-180 days, which falls squarely within the range of commercial bank terms. Further, APRGs are given for not less than 6 months and not more than 25 years, which covers a wide range in which commercial banks are operating. Please comment.**

As Korea stated at the First Substantive Meeting, in order to properly understand the meaning and relation of Article 24 vis-à-vis Article 25.2, it is necessary to understand the major financial services provided by KEXIM. KEXIM financial services can roughly be categorized into the four (4) areas referred to below:

- (1) *Export financing*: export loans; bans on deferred payment terms regulated by the OECD Arrangement; pre-shipment loans (which are the measure at issue);
- (2) *Overseas investment credits*: These are the long-term credits extended by KEXIM in conjunction with overseas investment. Generally, these credits mature after 2~5 years;
- (3) *Import credits*: These are also long-term credits extended in conjunction with imports of capital goods; and
- (4) *Guarantees*: KEXIM extends performance guarantees, bid bonds, retention bond, warranty bonds and APRGs (which are the measure at issue).

These financial services generally involve longer-term trade-related financings and they also involve foreign-currency loans. When KEXIM was established in 1976, there were not many financial institutions to provide these types of financial services. Therefore, the principal purpose of establishing KEXIM was to provide such longer-term, trade-related financial services for which there was no competition from commercial banks at that time. Against this background, Article 24 was introduced to describe the specialized nature of KEXIM business. But the general “non-competition” statement in Article 24, by nature, was not intended to provide a very precise definition of the KEXIM operations. In this regard, Article 25.2 describes the KEXIM financial services in terms of the length of loan maturity by stating that the maturity of KEXIM loans should be between 6 months and 25 years. Of course, this provision was not intended to implement the “non-competition” statement in Article 24, as the ‘6 month-to-25 years’ maturity is so broad that most of the financing services provided by other commercial financial institutions will fall within this ‘6 month-to-25 years’ maturity. However, the 25 year maturity is a very long term for which few commercial banks provide financing. In this regard, Article 25.2 still indicates the special role of KEXIM focusing on very long term financing where commercial banks do not normally operate. In any event, it should be noted that none of these provisions is intended to prohibit other financial institutions to participate in long-term,

trade-related financial services extended by KEXIM or to require KEXIM to exit the market for these financial facilities as soon as they are provided by other financial institutions.

After KEXIM was incorporated, the Korean financial market has developed and commercial financial institutions began to provide the specialized financing services in which KEXIM had operated. Thus, at present KEXIM is in competition with commercial banks in all areas of financial services, except the long-term export credits with deferred payment terms which are regulated by the OECD Arrangement. As for the pre-shipments loans, KEXIM competes with other financial institutions which provide “general loans” or other short term loans. In the field of overseas investment credits, as the foreign exchange regulations were amended to allow commercial banks to provide such overseas investment credits, all financial institutions can now freely extend such credits. As for the APRGs, KEXIM took only a small portion of the market share (less than 20 per cent) prior to the Asian Financial Crisis, as Korea submitted.

Furthermore, the true meaning of Article 24 of the KEXIM Act can be clearly explained by reference to the changes in Article 18 of the KEXIM Act which directly enumerates the types of operations to be carried out by KEXIM. Prior to 16 September 1998, Article 18 provided that “KEXIM may engage in the operations prescribed in [each subparagraph of Article 18] that are not normally conductible by other financial institutions”. In other words, Article 18 was clearly confining KEXIM’s operations to those financial services that could not be provided by other financial institutions. However, by way of the 16 September 1998 amendment, such “non-competition” restriction on KEXIM’s business scope was eliminated and Article 18 now provides that KEXIM “may engage in the operations prescribed in the [subparagraphs of Article 18]” without any limitations (please refer to Amendments to KEXIM Act and Decree, Korea Annex V Response Attachment 1.1(1)-3, Exhibit EC-12). This amendment explains how Article 24 of the KEXIM Act has been understood and applied.

As the situation in the financial market has changed since the enactment of the KEXIM Act, and in light of the above amendment to Article 18, the non-competition clause of Article 24 of the KEXIM Act should have been repealed. In fact, for this reason, KEXIM has been contemplating proposing the repeal of or amendment to Article 24 of the KEXIM Act. This is nothing unusual. Every jurisdiction in every WTO Member has some outdated statutory provisions on the books that should be changed, but sometimes are not in the press of crowded legislative agendas.

- 54. At para. 170, Korea asserts that Article 24 of the KEXIM Act should be read in conjunction with Article 25.2 thereof. In the absence of any explicit linkage between these provisions, please provide support in respect of this argument (such as the negotiating history of Article 24, for example). If Korea's assertion regarding the relationship between these provisions is correct, and if Article 25.2 explicitly sets restrictions on the term of financing that KEXIM may provide, what is the purpose of Article 24, i.e., what does it add to Article 25.2?**

Please refer to Korea’s responses to Question 53 above.

- 55. Regarding Article 26 of the KEXIM Act, Korea suggested at the oral hearing that this provision should be interpreted in the context of the entirety of that legal instrument. What other provisions of the KEXIM Act have a bearing on the interpretation of Article 26? Please explain.**

Article 26 has no purpose other than to provide that all fees and rates must cover “at least” the costs when KEXIM provides financing. It does not prohibit KEXIM from earning profits and, instead, effectively requires it to carry on profitable operations. In fact, KEXIM has earned substantial amounts of operating profits since its establishment as shown in the response to Question 49 above. Further, other relevant provisions of the KEXIM Decree effectively require KEXIM to carry on its

business for profit. More specifically, Articles 17-3 through 17-13 of the KEXIM Decree provide the parameters for sound and profitable management of KEXIM. In addition, the Interest Rate Guidelines of KEXIM provides for the mechanism of determining interest rates and fees which is structured to align KEXIM rates always with market rates (see Chapters 2, 3 & 4 of the Interest Rate Guidelines).

**56. Article 26 of the KEXIM Act provides, in particular, that except where "inevitable for maintaining the international competitiveness to facilitate [...] export [...]", interest rates shall be set so as to cover *inter alia* operating expenses.**

- (a) **What is the meaning of the phrase "inevitable for maintaining the international competitiveness"?**
- (b) **How is this phrase applied in practice? In any such case, where the interest rate is reduced to maintain international competitiveness, would this not imply that the final rate is below market?**

As Korea noted during the First Substantive Meeting, the phrase mentioned above was included in the KEXIM Act in order to allow KEXIM the option to provide financing at below-cost level in exceptional situations when KEXIM faces severe 'rates' competition from foreign financial institutions. A typical example is a situation where KEXIM has to apply "matching" as permitted under the OECD Arrangement. Under the OECD Arrangement, if a counterpart export credit agency deviates from the guidelines under the OECD Arrangement, other export credit agencies are permitted to lower their interest rates to match such interest rates of their counterpart. In order to provide for such possibility, Article 26 was introduced into the KEXIM Act. However, as this "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, KEXIM has interpreted this Matching mechanism in such a restrictive manner that it can be applied only for matching of [BCI: Omitted from public version.] (see Article 43 of the Interest Rate Guidelines).

In any event, Korea believes that the Panel's sub-question (b) does not appear to be relevant with the definition of subsidy or market benchmark. Because the benefit is not determined by reference to the cost of the granting authority, but to the advantages received by the beneficiary of the subsidy, a fact that KEXIM's interest rate may in exceptional cases go below its "operating expenses" referred to in Article 26 has nothing to do with the finding of a 'benefit' or a 'subsidy'. Instead, as long as Article 26 permits KEXIM to match the low interest rates applied by other competing financial institutions, KEXIM will always end up applying the market benchmark, whether or not the KEXIM rate is below or above its "operating expenses". In sum, Article 26 does not imply that the final KEXIM rate is "below market".

C. APRG PROGRAMME

**57. Are we correct in understanding that the Market Adjustment Rate means an upward or downward adjustment, toward the market rate, of the base rate plus spreads? Does this not mean that applying a Market Adjustment Rate could result in a below-market rate? Please explain.**

First of all, as explained in its response to Question 47 above, Korea would like to clarify that the "market rate" should exist in the form of "range" or "band", not a single rate.

The Market Adjustment Rate is one of the spreads (or premium) that is to be applied upward or downward to the base rate in addition to other spreads such as "credit risk spread" and "target margin". [BCI: Omitted from public version.]

It is commercially reasonable and fully market-oriented that the rates of other competing financial institutions are considered in determining the final rates or that a borrower who has a long relationship with KEXIM and a good track record may obtain lower interest rates and/or fees. Korea would like to note that applying such Market Adjustment Rate or similar spreads is a market practice applied by all other commercial financial institutions.

**[BCI: Omitted from public version.]**

Korea does not believe that this Market Adjustment Rate causes the final fee rate to be set below the market rates. It is because the base rate and the spreads, including the Market Adjustment Rate, are determined and applied according to the market-oriented criteria and it is always assumed that the final rate will stay within the range of 'market rates'.

**58. Please provide examples of KEXIM APRGs provided to purchasers of commercial vessels where the Market Adjustment Rate has been (i) upwards, (ii) downwards, and (iii) zero/neutral. During 2003, what proportion of the totality (i.e., shipping sector and beyond) of KEXIM's APRGs involved (i) upward, (ii) downward, and (iii) zero/neutral Market Adjustment Rates?**

**[BCI: Omitted from public version.]**

**59. In transactions in which there is no "export credit" to the Korean exporter, is the argument set forth in para. 263 of Korea's first written submission (that Korean exporters who export capital goods which qualify for loans under KEXIM policies on export loans also are eligible for APRGs) relevant? Would the APRG still constitute an "export credit guarantee" in such circumstances? Please explain.**

Korea raised this issue as part of its arguments in the alternative relating to the safe harbors provided by Items (j) and (k) of Annex I. Korea invoked the similarity in eligibility criteria for export credits and APRGs as an additional indicator to support its conclusion that APRGs are export credit guarantees. The 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. Moreover, in the opinion of Korea, APRGs are guarantees against increases in the cost of the exported products in the sense of Item (j) of Annex I for the reasons explained in paras 265 to 267 of its First Written Submission.

**60. Regarding the argument in para. 266 of Korea's first written submission, (that APRGs provide a safeguard against increases in the cost of production of a vessel, by relieving the shipbuilder of the need to borrow working capital) is it Korea's position that the provision of an APRG precludes any increase in the cost of producing a commercial vessel?**

No Korea is not arguing that in the broadest sense that it precludes "any" increases in costs. The APRG programme is fairly limited. It only applies with respect to the cost associated with the working capital necessary to produce the ship. The reference to the guarantee against increases of costs also demonstrates that item (j) is not limited to guarantees extended directly to buyers, for the reference to "costs" – which are more closely associated with risks carried by the seller – is the term used rather than the reference to being a safeguard against increases in "prices", which would more clearly indicate a focus on buyers.

D. PSL PROGRAMME

- 61. In light of paras. 260 and 271 of Korea's first written submission, is it Korea's position that any official measure to promote exports constitutes an official export credit? Please explain.**

Korea did not mean to imply that any official measure to promote exports constitutes an official export credit when it referred in paragraph 260 of its First Written Submission to Section 4 of the Sector Understanding for Export Credits for Ships. Korea also referred to Section 3 of the OECD Arrangement in paragraph 259 to clarify that export credits may be given in the form of direct credits/financing, refinancing, interest rate support, guarantee or insurance. Korea nevertheless invoked Section 4 in support of its argument that the concept of “export credit” and “export credit guarantee” should not be given an unduly restricted interpretation that would exclude APRGs from Item (j) while these show a close connection with the financing that the shipowner obtains for the building of the vessel covered by the APRGs. Korea also notes that the term “official export credit” is found only in the second paragraph of Item (k) and provides part of the definition of a narrow exception to the broader language in the first paragraph of Item (k). Thus, whatever would be an “official export credit” for purposes of the second paragraph of Item (k) necessarily would be included within the provisions of the first paragraph. The OECD references are illustrative here.

- 62. Regarding para. 272 of Korea's first written submission, do shipyards necessarily grant credits to buyers in every case that they avail themselves of a PSL?**

Yes, in the sense that a shipowner is never required to settle the price for the vessel at once but in installments of which the time period and amounts vary depending on the negotiations between the shipbuilders and the shipowners. Hence, the shipowners are always allowed to defer payment as mentioned in the quotation in paragraph 272 of Korea's First Written Submission. The larger the amount that the shipowner is entitled to defer during the building of the vessel as a result of the payment term agreed upon, the greater the likely need of the shipbuilder for a pre-shipment loan or an equivalent financing facility for financing the purchase of materials and the building of the vessel concerned.

- 63. At paragraph 159 of its submission the EC quotes a statement by KEXIM that the PSL programme involves “larger credits and longer repayment terms than what suppliers or commercial banks would provide”. Why is this not evidence that PSLs are provided on below-market terms?**

Korea notes that Exhibit EC-21 referred to in footnote 116 at paragraph 159 does not contain the phrase quoted above. Further, Korea is not able to locate the quoted phrase in any other exhibits the EC provided. Hence, Korea is not in a position to respond to this Question at this time. Korea also notes that the sentence quoted does not, in any event, lead to the suggested conclusion. For example, providing a longer term than is generally available does not mean that the rates are below market. It depends on how they are adjusted to reflect the different terms. The size of a credit may or may not require different rates; it depends on factors extraneous to size alone. Therefore, that part of the statement would seem completely beside the point.

- 64. Please provide details of two Base Rate calculations for two fixed rate loans to Korean shipyards, taking into account and making reference to the component elements thereof referred to in the Interest Rate Guidelines.**

As noted in the response to Question 47 above, the loans with fixed interest rate are rather exceptional. Nonetheless, Korea submits the details for two loans with fixed interest rate as below. [BCI: Omitted from public version.]

- 65. At para. 199 of its first written submission, Korea states that the terms of PSLs normally do not exceed 6 months. At para. 277, Korea asserts that the usual maturity of PSLs is between 90 and 180 days. Please explain these different descriptions of the maturity of PSLs. What is the typical maturity of a PSL?**

Korea notes that the above two statements describe the same fact in a slightly different form. In terms of maturity of disbursements of PSLs, there is no “typical” maturity of a PSL. [BCI: Omitted from public version.]

- 66. Are all PSLs at floating rates? Are any made at fixed rates?**

PSLs may take either floating rates or fixed rates. Korea submits examples of fixed rate PSLs in its response to Question 64 above.

E. INDIVIDUAL APRG TRANSACTIONS

- 67. Please provide internal documentation concerning KEXIM's review / authorization of the APRG issue d on [BCI: Omitted from public version]. Please include in particular the worksheets and other documentation showing calculations of the interest rate and other terms, including consideration of collateral, related to KEXIM's review / authorization of this APRG.**

Korea submits in Exhibit Korea - 57 the relevant minutes of the Board of Directors Meeting and related documents authorizing the APRG transaction concerned. Korea notes that it is not KEXIM's policy to keep and maintain worksheets and similar documents. Hence, Korea cannot provide such documents.

[BCI: Omitted from public version.]

- 68. Regarding para. 207 of Korea's first written submission, please explain the basis for Korea's assertion that the EC "confirmed" that the market which provides other alternatives available to the recipient must be confined to the domestic market.**

Korea's statement in paragraph 207 of its First Written Submission, referred to in paragraph 145 of the EC's First Written Submission where the EC stated that the KEXIM APRGs confer a benefit to Korean exporters “by providing financial support on more advantageous terms than they otherwise would be able to obtain in the Korean financial market.”

- 69. Regarding para. 213 of Korea's first written submission, please provide an example (with supporting documentation) of two instances in which different Korean shipyards were not able to select the APRG provider themselves. Please also provide supporting documentation for the instance referred to in note 161 to Korea's first written submission.**

[BCI: Omitted from public version.]

- 70. Regarding the last sentence of the quote contained in note 157 to Korea's first written submission, is it only when "physical" collateral is provided that "the credit rating of the borrower will not influence the determination of the spread"? Please explain.**

Attachment 1 of the Interest Rate Guidelines provides for the application of different credit risk spreads depending on the types of security interests provided. According to this Attachment, [BCI: Omitted from public version.]

- 71. Regarding the second sentences of paras. 218 and 221 of Korea's first written submission, and the third sentence of para. 223, please specify precisely which APRGs by which domestic financial institutions Korea considers would constitute a more appropriate market benchmark, and provide details thereof.**

First, Korea re-emphasizes that the EC bears the burden of proof to establish the appropriate market benchmarks and has, so far, failed to do so and thereby failed to establish a *prima facie* case on export subsidies. However, for the purpose of showing that the EC has in fact selected and provided misleading data, Korea submits below certain APRG rates charged by other financial institutions which can be compared with the rates charged by KEXIM at the comparable time.

**[BCI: Omitted from public version.]**

F. INDIVIDUAL PSL TRANSACTIONS

- 72. Please provide internal documentation concerning KEXIM's review / authorization of PSL [BCI: Omitted from public version]. Please include in particular the worksheets and other documentation showing calculations of the interest rate and other terms, including consideration of collateral, related to KEXIM's review / authorization of this PSL.**

Korea submits in Exhibit Korea - 60 the relevant minutes of the Board of Directors Meeting and related documents authorizing the PSL transaction concerned. Korea notes that it is not KEXIM's policy to keep and maintain worksheets and other similar documents. Hence, Korea cannot provide such documents.

- 73. Regarding paras. 233 and 240 of Korea's first written submission, please explain precisely how the collateralization and difference in maturity of the relevant PSLs accounted for the difference between the rates for those corporate bonds and the KEXIM PSL rates, which sometimes was as much as [BCI: Omitted from public version]. Please comment on Attachment 1 to the KEXIM Interest Rate Guidelines in this respect.**

First of all, Korea notes that the corporate bond rates offered by the EC are hypothetical ones and, thus, cannot constitute comparable benchmarks to PSLs. The corporate bond rates offered by the EC are the rates which the Korea Securities Dealers Association ("KSDA") announces for the purposes of general indices. More specifically, 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 which 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. In turn, KSDA simply averages those rates and posts it. Thus, the KSDA rates must also be hypothetical ones. The KSDA rates do not reflect the difference in the industry sectors which the issuing company belongs to, the different financial strengths of individual issuers (e.g., whether the company is an affiliate of a Chaebol), and, most importantly, the specific terms and conditions (especially the maturities and collateral) of the actual corporate bonds being traded in the market. When looking at the individual companies even having the same credit ratings, the companies may be perceived and treated differentially in the market considering various factors. Accordingly, the actual yield rates of the corporate bonds of the issuers with the same credit rating may be substantially different. Considering all these, there must be differences or gaps between the KSDA rates and the actual corporate bond rates of individual companies. Hence, Korea doubts, from the outset, whether the KSDA rates themselves can constitute appropriate benchmarks for PSLs, let alone the discussion on different terms and conditions (particularly the maturities and the collaterals).

Further, Korea notes that the collateralization substantially affects the application of credit risk spreads as explained in the response to Question 70 above, which in turn causes substantial differences in the final interest rates. **[BCI: Omitted from public version.]**

Further, as the graph attached hereto (Exhibit Korea - 62) clearly shows, the interest rates of loans with longer term maturity were generally higher than the loans with shorter term maturity. Also, KEXIM has applied higher credit risk spreads for the loans having over 1 year maturity than the spreads for the loans having 1 year or less maturity (see Attachment 1 to the Interest Rate Guideline). Thus, the difference in maturity also clearly affects the overall interest rate although the degree of such differences has varied from time to time.

**74. Regarding para. 241 of Korea's first written submission, please provide a copy of the relevant agreement between KEXIM and Hyundai Heavy Industries.**

Korea submits herewith KEXIM's notice of approval relating to the transaction as Exhibit Korea - 63.

**75. Regarding paras. 272 and 273 of Korea's first written submission, do the terms on which PSLs are provided vary according to the amount, duration or terms of any credit provided by the Korean exporter to its customers? Please explain, and provide supporting documentation where relevant.**

If the payment term agreed upon between the Korean exporter and its customer is tail-heavy, i.e., most of the purchase price is paid at a later stage during the manufacture of the product concerned and after its delivery, it means that the shipbuilder must procure the production cost through its own financing (e.g., PSLs), rather than through advance payment from the ship buyer (i.e., payments received prior to the delivery of the vessel concerned). Therefore, at least the 'amount' of the PSLs will vary according to the 'amount' and the "duration" of the credit provided by the shipbuilder to its customer. This will influence the term spread taken by KEXIM when granting the PSL.

However, Korea has no document that shows a clear linkage between the terms of PSLs and the terms of supplier credits to ship buyers.

**G. ACTIONABLE SUBSIDIES**

**76. Does Korea accept the EC's argument that the Korea Depository Insurance Corporation and the Bank of Korea constitute "public" bodies in the sense of Article 1.1(a)(1) of the SCM Agreement? Please answer yes or no, and give reasons. If yes, what characteristics do these entities have that KEXIM does not? Do these entities have the authority to regulate and / or tax?**

- (a) Yes, Korea agrees that at least the Bank of Korea constitutes a "public" body in the sense of Article 1.1(a)(1) of the SCM Agreement. As explained below, the Bank of Korea possesses the essential powers characterizing the exercise of 'governmental' authority, that is, authority to 'regulate', 'restrain', 'supervise' or 'control'. Further, the Bank of Korea is not engaged in the supply of goods or services on commercial terms on markets which are open to private operators. KEXIM (and KDB and IBK as well) do not have such powers and characteristics.

The main powers and characteristics of the Bank of Korea include the following:

- As the central bank of the Republic of Korea, it issues the legal currency of Korea;

- It establishes and enforces the monetary and credit policies, controlling the amount and flow of money and stabilizing the prices;
- It acts as the “bank of the banks”, receiving deposits from and extending loans to banks and other financial institutions, in order to sustain the systemic operation and security of the Korean financial market;
- It acts as the bank of the Government, receiving and paying the tax and other government revenues and keeping the Government-owned securities in custody;
- It operates and manages the nation-wide payment settlement system;
- It possesses and manages foreign currency-denominated assets of the Government and advises the Government on its foreign exchange policies;
- It maintains the stability and soundness of the national financial system by analysing and inspecting the operations of banks;
- It carries out the inspection and research of the overall status and development of the national economy and issues various statistical reports on the national economy;
- It represents the Korean Government in connection with any affairs, negotiations and transactions with international monetary or financial bodies of which the Republic of Korea is a member;
- In carrying out these powers, the Bank of Korea can exercise the power to order other banks and financial institutions to submit necessary materials and information;
- The Governor, Vice Governor, Auditor and employees of the Bank of Korea are treated as ‘public servants’ for the purpose of applying the criminal law and the penal provisions of other laws;
- The Bank of Korea is in principle prohibited from engaging, directly or indirectly, in any commercial (profit-generating) activities, and from receiving deposits from or lending money to individuals and corporations other than the Government, government agencies and financial institutions.

(b) The main powers and characteristics of the KDIC include the following:

- The KDIC is vested with two main functions: (i) operate the ‘deposit insurance system’ to protect depositors with the banks and financial institutions by paying deposits from a deposit insurance fund when the banks or financial institutions become unable to pay deposits to the depositors due to bankruptcy, etc.; and (ii) arrange for merger or assignment of business of ‘unsound’ financial institutions and provide financing in relation to such merger or business assignment;
- In carrying out such functions, the KDIC exercises the power to (i) require materials from, and inspect the financial institutions covered by the deposit insurances of the KDIC; (ii) institute legal actions against the directors, officers and employees of ‘unsound’ financial institutions, the directors,

officers, employees and major shareholders of the debtor company, or any other third parties which are believed to have contributed to the financial institution becoming 'unsound' (collectively the "responsible parties"); and (iii) require materials from and inspect the business and assets of the responsible parties;

- Any person who fails to submit the required materials or submits false materials to the KDIC or who refuses, interferes with or avoids the inspection by the KDIC will be punished by imprisonment or fine;
- The directors, officers and employers of the KDIC are treated as 'public servants' for the purpose of applying the applicable provisions of the criminal code.

**77. If a loan is denominated in US dollars, isn't it appropriate to have regard to the US market in order to determine the prevailing market rate for such a loan?**

KEXIM has carried on financing businesses in the Korean domestic markets in terms of customers and competing financial institutions. Therefore, KEXIM does not consider the US market rate as the prevailing market rate for KEXIM's US dollar denominated loans. [BCI: Omitted from public version.]

**78. Regarding para. 347 of Korea's first written submission, was the liquidation / going-concern value assessment of Daewoo made on the assumption that there would be a particular restructuring (e.g., the restructuring proposed by Arthur Andersen), or instead on the assumption that no restructuring would take place? If the going concern value was based on the assumption of a given prospective workout or CRP process, what would be the value of your statement that in every case of restructuring of a ship producer, the going concern value was greater than the liquidation value? Is it not the case that with certain assumptions regarding the content of the restructuring process, any company however insolvent could be made to have a higher going concern value than liquidation value?**

- (a) It is not correct that the liquidation / going-concern value assessment of Daewoo Heavy Industry ("DHI") was made on the assumption that there would be a particular restructuring. The reverse was true. That is, Arthur Andersen proposed the restructuring of DHI after it had confirmed that the going concern value of DHI was greater than its liquidation value. The main responsibility of Arthur Andersen at the time was to carry out due diligence examination of DHI's assets and liabilities, to assess whether the going concern value was greater than the liquidation value, and, if the going concern value was found to be greater than the liquidation value, then to propose a feasible restructuring plan. Therefore, there could be no particular assumption of restructuring when Arthur Andersen made the liquidation/going-concern value assessment of DHI.
- This fact can be established by the history of Arthur Andersen's involvement and its role in the DHI workout. As clearly stated in Section 2(a) of the World Bank SAL II Policy Matrix on Corporate Restructuring (Exhibit Korea - 30), the role of the financial advisor was to indicate "*how best to maximize the return to creditors – i.e., through voluntary workout, composition, reorganization or liquidation*", after the workout procedure had been initiated by the CCFI. Based on the professional assessment of this financial

advisor, the Lead Bank either proceeds with the preparation of a workout plan or proposes that the CCFI terminate the workout procedure initiated.<sup>3</sup>

- **[BCI: Omitted from public version.]**

These facts show that Arthur Andersen discharged its professional duty to analyze “how best to maximize the return to creditors – i.e., through voluntary workout, composition, reorganization or liquidation”, without any pre-established assumption of the workout.

- (b) In calculating the going-concern value of DHI, Arthur Andersen applied the ‘discounted cash flow’ (DCF) method whereby the enterprise value of the company is determined by discounting, with appropriate discount rate, the estimated cash flows to be generated by the company in future. (see Exhibit EC-64, Arthur Andersen Corporate Workout Report on DHI, pp. 103-104). In accordance with the modern financial management theory, the DCF method calculates the enterprise value (free cash flows) mainly based on the operational aspects (i.e., operating assets and operating liabilities). The assumption for the DCF valuation of the enterprise value is that the company continues as a going concern, but a “particular restructuring (e.g., the debt restructuring proposed by Arthur Andersen) was not considered at the stage of the assessment of DHI’s enterprise value as a going concern.

Under the DCF valuation method, the going concern value of a company can be either higher or lower than its liquidation value, depending on the profitability and cash flows of the company’s business operation. For example assume that a company holds operating assets (book value) of 1,000, operation liabilities (book value) of 300, interest bearing debt of 400 and equity of 300, with discount rate (WACC) of 10 per cent. And also assumes that in the case of liquidation, the company is expected to have liquidation value of 700. The comparison between the company’s going concern value and the liquidation value is as follows:

1. In the case of annual operating cash flows being 100, the going concern value of the company would be  $100/0.1=1,000$ , which is greater than the liquidation value of 700.
2. In the case of annual operating cash flows being 70, the going concern value of the company would be  $70/0.1=1,000$ , which is the same than the liquidation value of 700.
3. In the case of annual operating cash flows being 50, the going concern value of the company would be  $50/0.1=1,000$ , which is less than the liquidation value of 700

**79. The EC states, at footnote 31 of the its submission, that Korea refused to provide a copy of the January 1998 Agreement with the top 5 chaebols on the grounds that this Agreement was “irrelevant”. Is this correct? If so, please explain why this Agreement is irrelevant.**

It is true that Korea did not provide copies of the agreements relating to the self-restructuring of the top five chaebol (hereinafter, “top-5 chaebols agreements”). Korea believed and still believes that the EC was making another fishing expedition by asking for documents which were irrelevant to the present dispute.

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<sup>3</sup> Attachment 8 to Korea’s First Written Submission, “Description of the Workout Procedures pursuant to the CRA.”

The top-5 chaebols agreements are irrelevant to the present dispute because:

- These agreements provided for some principles of the so-called “self-restructuring”, which was to be implemented voluntarily by each of those top-5 chaebols *outside of* the workout procedures under the Corporate Restructuring Agreement (CRA) framework or the court-supervised insolvency procedures. None of the corporate restructuring measures at issue in the present dispute was taken in the form of such “self-restructuring”. Therefore, there was no reason for the EC to ask for the agreements relating to such self-restructuring.
- The EC argued, at footnote 31 of its First Written Submission, that “this agreement is quite relevant to this dispute because it shows the degree to intervention of the Government of Korea in the corporate sector.” The EC attempts to mislead the Panel by intentionally using such vague words as “intervention ... in the corporate sector.” But the role of the Korean Government was confined to encouraging the top-5 chaebols to take self-initiated actions to enhance their management transparency, eliminate cross guarantees, improve financial structures (e.g., reduce debt/equity ratios), and dispose of non-viable affiliates and focus on core businesses.
- Such a limited role of the Korean Government in connection with self-restructuring by the top 5 chaebols was also clearly stated in section 3(h) of the World Bank Policy Matrix on Corporate Restructuring attached to the LOI between IMF and Korea (Exhibit Korea-30). It should be noted that this reference in the LOI to the top 5 chaebols’ self-restructuring was made in the context of the corporate restructuring ‘principles’ set out in the LOI: i.e., “*All corporate restructuring should be voluntary (i.e., not government directed) and market oriented .....*” (See Exhibit EC-36, the LOI of 2 May 1992 between IMF and Korea, Attachment “Korea – Updated Memorandum on the Economic Program for the Second Quarterly Review, 1998”). Therefore, it is obvious that the top 5 chaebol agreements do not indicate the intervention of the Korean Government in the “corporate restructuring”.

Furthermore, it is now clear that when the EC requested Korea to provide the January 1998 Agreement, it had already possessed the top 5 chaebols agreement of 7 December 1998 and understood what the top 5 chaebols agreements were all about (see Exhibit EC-40). Moreover, in its Annex V responses, Korea provided sufficient information on the contents of these agreements that clearly shows the irrelevance of these agreements to the present dispute (see Korean’s Annex V Response, Sections 2.2 (20), (21) and (22)). In this regard, the EC’s allegation of adverse inferences is baseless.

Despite the irrelevance of the top 5 chaebols agreements to the present dispute, Korea hereby submits the January 1998 Agreement as Exhibit Korea – 65.

**80. Please explain the different debt-recovery rates paid by KAMCO for unsecured loans held by Daewoo's domestic and foreign creditors respectively.**

[BCI: Omitted from public version.]

**81. You argue that the restructuring was not specific, because many companies underwent restructuring during the same period as the shipbuilders. Is your argument that the restructuring packages and work-outs were essentially standardized, and subject to "objective criteria or conditions governing the eligibility for, and the amount of" the measures involved, and that such criteria and conditions were "strictly adhered to"?**

**Or is it the case that each restructuring or work-out was tailor-made to the particular company involved? Please explain.**

Our argument is two-fold: First, assuming for the sake of argument that each of the creditor financial institutions of the three restructured Korean shipbuilders constitutes the “granting authority” as referred to in Articles 2.1(a) and (b) of the *SCM Agreement*, the granting authority, or the legislation pursuant to which the granting authority operates (i.e., the CRA and the Corporate Reorganization Act), did not explicitly limit access to an alleged subsidy to shipbuilders. Instead, the restructuring legislation or scheme provides for standardized sets of rules and procedures and is generally applicable to all companies irrespective of their industrial sectors. Therefore, no specificity can be found pursuant to the principle laid down in Article 2.1(a).

Second, we also argue that the restructuring legislation or scheme established “objective criteria or conditions governing the eligibility for, and the amount of, a subsidy” and, therefore, the non-existence of specificity can be established by virtue of Article 2.1(b). Footnote 2 of the *SCM Agreement* enumerates ‘number of employees’ or ‘size of enterprise’ as examples of ‘objective criteria or conditions’ as used in Article 2.1(b). However, ‘objective criteria or conditions’ is more broadly defined to mean “criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application.”

The CRA and the Corporate Reorganization Act, which constitute legal frameworks for the workout and corporate reorganization proceeding, respectively, authorized the creditor financial institutions or the court to grant the restructuring measures to any corporation which was insolvent or suffering liquidity problems but whose going concern value is greater than liquidation value. Korea believes that these criteria clearly govern the eligibility for the restructuring measures, and constitute “objective criteria or conditions” as defined in the footnote 2 of the *SCM Agreement*. Furthermore, according to the Operational Guidelines for Workout Agreement, if a request for workout is filed by a company, the lead bank must set up an independent Workout Eligibility Review Committee to review the eligibility of the subject company. The Review Committee is required to review the applicant’s financial and management status to assess the viability of that company.

Although the amount of the alleged subsidy itself was not spelled out in the restructuring legislation or scheme in terms of numerical figures, the above going concern value standard would also constitute objective criteria or conditions ‘governing’ the amount of the alleged subsidy, in the sense that the alleged subsidy amount should be limited to the extent necessary for restructuring to realize the established going concern value and maximize returns to the creditors.

H. **SERIOUS PREJUDICE**

**82. Please comment on the EC's assertion that the competition complaint filed by Samsung demonstrates the unfair pricing advantage enjoyed by restructured Korean shipyards.**

The Ministry of Commerce, Industry and Energy (“MOCIE”) intervened in the Hamburg Süd case in accordance with the provisions of the Overseas Trade Act. Article 43 of the Act authorizes the MOCIE to issue to exporters of goods a “coordination order” with respect to the terms of export (including without limitation prices, quantity, and quality), if, among others, the exporters engage in any of the following types of behavior and if it is deemed necessary to prevent acts which threaten to disturb fair competition in the export of goods or to impair Korea's external credit and reputation:

1. If an exporter unreasonably excludes other traders in connection with export of goods;
2. If an exporter unreasonably induces or coerces the counterpart of another trader to refuse to deal with that trader in connection with export of goods; or

3. If an exporter unreasonably interferes with the overseas business activity of other traders in connection with export of goods.

As can be seen from the above provision, this provision is a special *competition law provision* applicable specifically to export trade transactions. In common law jurisdictions it is closer to so-called tortious interference than competition law.

**[BCI: Omitted from public version.]** The MOCIE was not concerned with whether prices offered by the shipbuilders involved were high or low, but just looked into the way or fashion in which the competition was taking place. The MOCIE considered that the behaviour was problematic in light of the provisions of Article 43 of the Overseas Trade Act. As a result, the MOCIE issued the coordination order to stop unreasonable competition. This coordination order dealt with the unique situation of a particular case from a Korean competition law perspective, and in no respect supports the serious prejudice argument of the EC.

**83. Does the EC correctly characterize your argument as being that no violation can be found based on a past action? Please explain your position on this issue, including any relevant past disputes. Does your position differ as between alleged prohibited and allegedly actionable subsidies?**

Korea believes that the EC has not properly reflected Korea's position in paras 17 to 20 of its Oral Statement. Korea does not argue that the subsidies must still be current on the day that the Panel issues its report or on the day that the DSB adopts its report. However, where a statutory framework or a programme is challenged as such, as a prohibited export subsidy, such statutory framework or programme at the time of the initiation of the dispute settlement proceeding must still reflect the deficiencies complained about. Simply put, the facts are completely contrary to the EC's argument regarding the programmes "as such".

Moreover, in the present dispute, it must be recalled that the period under review is not a single continuum. It is not the case as it would be if this Panel were examining the long history of EC subsidization of its shipyards where the underlying economic conditions were relatively stable. In this case, the early part of the period the EC identifies was one of huge generalized financial and economic turmoil in Korea and other Asian countries. Reviewing this time of financial turmoil becomes of questionable relevance in light of the actions taken over a reasonable period of time in the most recent past. As Korea noted, the period of extreme financial turmoil does indeed make it difficult to find market benchmarks not just in this matter but in any other aspect of Korea's economy during that period. Korea is firmly of the view that, if proper adjustments are made to reflect these conditions, it is clear that there was no subsidization at that time either. Thus, is it not a question of a legal bar on examining the earlier part of the period, it is a matter of probity and relevance of the data.

The EC itself refers to the fact that a credit risk assessment was introduced in Korea's APRG transactions in March 1998. It is neither reasonable nor in line with Article 3.2 of the *SCM Agreement* that a possible deficiency remedied some 5 years before the initiation of the dispute settlement should still be challenged. In that sense, a WTO Member cannot be said to "maintain" a prohibited subsidy.

Korea wishes also to bring to the attention of the Panel that the EC in support of its arguments has relied on APRGs and PSLs that were frequently afforded up to some 5 or 6 years ago while Korea had submitted much recent data. Thus:

- (i) for Daewoo: the EC shows APRGs issued from 1997 to 2001 (Figure 11 of the EC's First Written Submission) and PSLs issued from 1999 to 2001 (Figure 16 of the EC's First Written Submission);

- (ii) for Halla: the EC shows APRGs issued in 2000 (Figure 12 of the EC's First Written Submission) and PSLs issued primarily between 2001 and 2002 with two only in May 2003 (Figure 17 of the EC's First Written Submission);
- (iii) for Daedong: the EC shows APRGs issued in 1999 (Figure 13 of the EC's First Written Submission) and the PSLs issued in 2002 and three only in May 2003 (Figure 18 of the EC's First Written Submission);
- (iv) for Hanjin: the EC shows APRGs issued in 2002 (Figure 14 of the EC's First Written Submission) and PSL's issued between 1999 and 2001 (Figure 21 of the EC's First Written Submission);
- (v) for Samsung: the EC shows APRGs issued in 1997 (Figure 15 of the EC's First Written Submission);
- (vi) for Hyundai Mipo: the EC shows PSLs issued between 1999 and October 2002 (Figure 19 of the EC's First Written Submission);
- (vii) for Hyundai: the EC shows PSLs issued between 1999 and 2003.

The EC has made a selective approach of APRGs and PSLs and selected for a number of shipyards "old" APRGs or PSLs while additional data was provided by Korea on more recent APRGs and PSLs in Annex 1.2(31)-1 and 1.2(30) of the responses filed by Korea in the Annex V process, i.e.:

- (i) Daewoo: APRGs issued by KEXIM in 2002 and 2003 were shown as well as PSLs with commitment dates in 1996, 1997 and 1998;
- (ii) Halla: data on APRGs issued by KEXIM in 1997, 1998, 1999, 2002 and 2003 were shown as well as PSLs with commitment dates in 1996, 1997 and 2000.
- (iii) Daedong: data on APRGs issued by KEXIM in 1998, 2000, 2001, 2002 and 2003 were shown.
- (iv) Hanjin: data on APRGs issued by KEXIM in 1998, 2000, 2001 and 2003 were shown as well as PSLs with commitment dates in 2002 and 2003;
- (v) Samsung: data on APRGs issued by KEXIM in 1998, 1999, 2000, 2001, 2002 and 2003 (many) were shown as well as PSLs with commitment dates in 1998, 2000, 2001 and 2002;
- (vi) Hyundai Mipo: data on APRGs issued by KEXIM in 1998, 1999, 2000, 2001, 2002 and 2003 was shown as well as PSLs with commitment dates in 1996 and 1998;
- (vii) Hyundai: data on APRGs issued by KEXIM in 1997, 1998, 1999, 2000, 2001, 2002 and 2003 was shown.

The position taken by the EC in paragraph 38 of its Oral Statement is simply incorrect as a matter of law. Panels cannot make rulings based on an assumption of bad faith implementation by Members. In addition, if the EC's point were taken to its logical conclusion, one fails to see what would be the use of consultations. If a settlement is found during consultations, the principle is that this obviates the need for a dispute settlement even if it is theoretically conceivable that a defending party could change its legal system again. What is the difference with a defending party that has itself remedied a deficiency in its legal or regulatory framework before there was even any mention of a

possible dispute settlement? As mentioned by China in its third-party submission (paragraph 18), the word “maintain” in Article 3.2 of the *SCM Agreement* does not mean “prevent”.

The case of actionable subsidies covered by Articles 5 and 6 of the *SCM Agreement* is indeed different from that of prohibited subsidies. Simply put, the complainant must show adverse trade effects. It is not like demonstrating nullification or impairment elsewhere under the WTO Agreements where there is a presumption created if legal inconsistency is demonstrated. All but the most recent past practice will be of extremely limited legal and factual relevance especially when there is a qualitative distinction represented here by the financial crisis as a compared to the returning normality of the recent past.

Moreover, it is important to recall that under Article 7.8 the remedy is the withdrawal of the subsidy or its adverse trade effects. The negotiators, therefore, contemplated that adverse trade effects had to exist at the time of the dispute settlement. Korea has further submitted that the use of the present tense “is” in Article 6.3(c) contrasts with the wording of Article 15.2 of the *SCM Agreement* which refers to “whether there has been a significant price undercutting by the subsidized imports ... or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree”. The provision of Article 15.2 contemplates a review over a reference period sufficiently long in order to provide a trend showing injury to the domestic industry. In the case of Article 6.3(c), Korea submits that price depression or suppression must be shown in a relatively recent period preceding the initiation of the dispute settlement. In support, it has referred to the conclusion of the Panel in *US – Wheat Gluten* in paragraph 543 of its First Written Submission.

Korea has noted that the EC in support of its allegation of price depression as regards LNGs, has provided a graph with newbuilding price developments up to January 2003 (Figure 30). However, Korea submits that the EC should show LNG price developments up until June 2003 taking into account prices submitted by Korea in the Annex V process and other prices as has become publicly available since January 2003. Similarly, in support of price suppression, the price data supplied by the EC are the same graph showing prices only up to January 2003 and for container vessels and chemical and product tankers up to the end of 2002 only (refer to Figures 39 and 42 of the EC’s First Written Submission) whilst price data was obviously available to the EC in terms of the monthly reports prepared by its own expert, FMI, and particularly relevant as shown in Annex 5a of the EC responses to the Annex V process.

**84. Is it your position that the outcome of all restructurings is *ipso facto* a market outcome, making the existence of subsidization impossible? Please explain. What is meant by your statement that every corporate restructuring was "market oriented"? Do you mean that its going concern value was higher than its liquidation value, or do you mean something else or something in addition?**

Where an insolvency procedure can proceed only after it has been confirmed that the going concern value of the insolvent company is greater than the liquidation value and creditors can make a most market-oriented decision through mutual negotiations and a majority rule when adopting the restructuring plans, Korea considers that the insolvency procedure yields a market outcome. In particular, in the three cases at issue, each was market oriented in the sense that each creditor attempted to maximize the return on the debt it was holding. In these cases, it means that it was more profitable to continue operating the companies than winding them down and liquidating the assets. The existence of insolvency rules (corporate reorganization or workout) is the essence of a market economy; if the restructuring is made according to the insolvency rules on a market-oriented basis, then there is no subsidization.

**85. You argue that the concept of "like product" applies in respect of price suppression/price depression, yet the relevant portion of SCM Article 6.3(c) does not**

**refer to "like product". What in your view is the significance of the fact that "like product" is not referred to in respect of price suppression/price depression or lost sales? Is your argument that this was an inadvertent omission by the negotiators? If so, is there any evidence to support this? Please explain.**

Korea considers that the wording of Article 6.3(c) is consistent with a finding that the concept of "like product" applies with respect to price suppression/price depression. Article 6.3(c) states in this regard that serious prejudice may arise where:

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...

The fact that the word "like product" is not repeated in the second part of the sentence after the disjunctive "or" is neither an omission on the part of the drafters, nor, in Korea's view, should it be interpreted to imply that the concept of "like product" does not apply in the context of price suppression/price depression. Read in context, Korea believes that the term "like product" in the first part of the sentence refers also to "price suppression, price depression or lost sales" in the second part of the sentence. The reason why the words "like product" are not repeated in the second part of the sentence, while the words "same market" are repeated, is that repetition of the former is superfluous while the latter is not. In this regard, throughout the subparagraphs of Article 6.3, the treaty specifies and differentiates the geographic boundaries of the market that is being referred to, i.e. the "market of the subsidizing Member" in subparagraph (a), a "third country market" in subparagraph (b) or a "world market" in subparagraph (d) etc. In the context of the contrasting geographic markets being juxtaposed in subparagraphs (a)-(c), it is therefore logical that the drafters would take care to specify the geographic boundaries within which the serious prejudice criteria (price undercutting, price depression etc.) should be examined.

In contrast, the term "like product" is not differentiated or redefined in each of subparagraphs (a)-(c) and consequently there is no need to again define or refer to this term in the second part of the sentence.

Indeed, comparable formulations are found elsewhere in the *Anti-Dumping and SCM Agreements*. In this regard, Article 3.2 of the *Anti-Dumping Agreement* states with respect to the injury analysis that:

With regard to the effect of the dumped imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred... (Emphasis added).

Article 15.2 of the *SCM Agreement* similarly provides:

With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred... (Emphasis added)

In both the above formulations, the term "like product" is not repeated in the second part of the sentence after the disjunctive "or." Nonetheless, Korea considers that the drafters clearly intended

that depressed prices or lack of price increases in the context of the above-quoted Articles are to be analyzed by reference to the “like product” concerned and not by some novel undefined standard. There is no reason to interpret the use of the term “like product” in Article 6.3(c), and its applicability to the evaluation of price-suppression/depression, differently.

As Korea argued in its First Written Submission, Articles 6.3(a), (b) and (c) posit “like product” and “market” as different requirements (paragraph 506). Yet, the EC would have the Panel conclude that the words “in the same market” in the context of price suppression/depression suddenly comprises both a geographic and product dimension. This construction is illogical. It would require reading into the text of Article 6.3(c) a wholly undeclared and unexplained intent that the word “market” should comprise only a geographic dimension in some cases (e.g. subparagraph (a) and (b)) but in the context of subparagraph (c) the same word implies both a product and geographic dimension.

Moreover, to hold that “like product” does not apply in respect of price suppression/depression would mean that the absence of the word “like product” in the second part of the sentence under subparagraph (c) should be interpreted to mean – with no express words to that effect – that the *SCM Agreement* took the exceptional step introducing a new and undefined standard in the context of the subparagraph (c), despite that ‘like product’ is a cornerstone found throughout the *SCM Agreement* and indeed the *WTO Agreement*. Had the drafters intended such a result, Korea considers that they would have made this intent explicit and would moreover have defined or elaborated the alleged product dimension of the “same market” in the context of evaluating price suppression/depression. Korea notes in this regard that footnote 46 to the *SCM Agreement* provides that:

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.

Had the drafters intended to introduce a special product dimension to the term “same market” in Article 6.3(c) the drafters would presumably have similarly defined this concept.

For these reasons, in addition to Korea’s previously submitted arguments, Korea considers that under the ordinary meaning of the terms in Article 6.3(c), read in their context, the concept of “like product” applies to price suppression/depression under subparagraph (c).

Finally, the issue here is not simply a matter of what label one applies. The real problem is that it is impossible to have a sensible discussion of the market unless one first defines that market. As noted above, the whole structure of the *SCM Agreement* is premised on defining that market in terms of “like product” and there is no indication of an exception for this one single portion of Article 6.3(c). But, even if one were to choose a different term, one still needs to define the market. Is there significant price depression in the market? But, what *market*, one must ask. The parameters must be rigorously defined or one is left with the situation demonstrated by the EC’s arguments where they refer to some vague categories through which certain products sail at random such as the sudden exclusion of certain types of “pure” chemical tankers. At the next moment, the EC is endorsing the apparent Japanese view that there is a single product category and that every ship affects every other in a legally relevant manner. This vagueness renders it quite literally impossible for Korea to respond and the Panel to make a determination.

**86. Do you think that footnote 46 of the SCM Agreement establishes a narrower definition of “like product” than that applicable under Article III, paragraphs 2 and 4 of the**

**GATT 1994? Could similarity of end-use be a criterion for determining "like product" as defined in footnote 46? Why or why not?**

As explained more fully below, Korea is of the view that Article III provides a single analytical framework for determining "like product." However, Article III does not provide one single definition of "like product." The term "like product" under Article III can be broad in some instances and more narrow in others (the so-called accordion). Footnote 46, with its narrow definition focused on physical characteristics is similar to the narrow approach required by Article III:2 first sentence. As with Article III:2 first sentence, end-use can be a criterion incorporated into the like product analysis, but end-use cannot be used to broaden the scope of the like product away from the narrowness of the definition implied by the reference to physical characteristics.

The answer to this question and Question 87 have many overlaps. It is important to emphasize that Korea does not agree that the EC has adopted a "product segment" analysis like that suggested by the Panel in *Indonesia – Autos*. With its vague references and shifting product categories and the utter lack of any sort of proof of any sort, the EC has not followed any recognizable approach followed under any provision of the WTO Agreements.

In *Indonesia – Autos*, the Panel explicitly referred to the like product test as developed in the jurisprudence of Article III, explicitly citing the Appellate Body analysis in *Japan – Alcoholic Beverages*.<sup>4</sup> Indeed, the EC also endorsed this Article III-based analytical approach<sup>5</sup>, but then completely abandoned any attempt to follow-through on the analysis. Instead, the EC tried to claim the right to make mere assertions of points that it subjectively considered "obvious" and hopes to shift the burden onto Korea to prove the negative of its assertions.

In contrast to the EC's approach, the Panel in *Indonesia – Autos* then went through the list of issues it would be examining including, physical characteristics, consumer perceptions, end-uses, price differences and tariff classifications. The Panel stated that it considered that, in the specific case before it, it found physical characteristics to be particularly important, but did not limit itself to that element of the like product analysis.

The term 'characteristics closely resembling' [as per footnote 46] in its ordinary meaning includes but is not limited to physical characteristics, and we see nothing in the context or object and purpose of the SCM Agreement that would dictate a different conclusion.<sup>6</sup>

Thus, it is clear that the Panel in *Indonesia – Autos* was not attempting to construct a new analytical approach to like product based on something outside the treaty language called "product segmentation" as proposed by the EC. Rather, the Panel was bringing the like product analysis of footnote 46 within the analytical context of the like product analysis used elsewhere in the WTO Agreements, including Article III of the GATT 1994.

By referring to Article III, the Panel in *Indonesia – Autos* was endorsing the analytical rigor of the Article III approach and certainly would not have approved the fuzziness and vagueness of the EC approach. According to the EC at times, there is a single product category of all ships. This was how it was described in parts of the EC's First Written Submission and certainly was the basis of the EC's endorsement of the Japanese approach in the First Substantive Meeting where any commercial vessel has a legally recognized impact on any other vessel regardless of type.<sup>7</sup> This is in contrast with

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<sup>4</sup> *Indonesia – Autos* at para 14.174.

<sup>5</sup> EC First Written Submission at para. 39.

<sup>6</sup> *Indonesia – Autos* at para. 14.173

<sup>7</sup> In this regard, Korea would like to draw the Panel's attention to the discussion in the Panel Report in *Korea – Alcoholic Beverages* wherein the Panel noted that, in the context of a discussion of the broad category of whether products are directly competitive or substitutable, at some general level all products and services are

other suggestions by the EC that there are three product categories rather than one. But even with three categories, the EC has failed to provide any sort of rigorous analysis of the parameters of such categories. Indeed, the parameters are so fluid that they apparently can permit certain types of ships to sail in and sail out of the categories depending on the complainant's supply side factors in isolation from any other sort of analysis.<sup>8</sup>

The key point to understand from the jurisprudence under Article III is that it defines an *analytical approach* to define product categories. This analytical approach is essentially the same in Articles III:2 and III:4. There are three different *results* of the approach depending on whether a panel is making fact findings with respect to Article III:2, first sentence regarding "like product", Article III:2, second sentence, regarding "directly competitive products", or Article III:4, "like products". Thus, the *conclusion* will differ based on the breadth of the categories, but the *analytical approach* is basically the same.

Accordingly, the Appellate Body in *Japan – Alcoholic Beverages* found that the definition of "like product" was narrow and used an analogy to an accordion to denote how the term can be narrow or more expansive given the context.<sup>9</sup> Directly competitive products are a broader category, of which like products are essentially a subset. This was made very explicit in *Korea – Alcoholic Beverages* where the Panel applied essentially the same analytical tools to both analyses and found that the narrower like product categories had not been proved by the complainants.<sup>10</sup>

This approach was confirmed in *EC – Asbestos*, where the Appellate Body used the multi-element analytical approach and specifically criticized the Panel for looking at only one factor in making its like product analysis.<sup>11</sup> The Appellate Body then applied the tests but reached a conclusion based on a broader definition of like product than used for Article III:2, first sentence. In doing this, the Appellate Body expressly noted that it had not decided that the broader like product analysis of Article III:4 was coterminous with the directly competitive product analysis of Article III:2, second sentence, but it left open the possibility.<sup>12</sup> The conclusions of the Appellate Body in this regard necessarily mean that the analytical approach of the like product and directly competitive analyses of the different parts of Article III must be the same. The issue of narrowness of the product category becomes an issue of interpretation of the results of the analytical approaches, not any differences in the elements contained within such approaches.<sup>13</sup>

Footnote 46 of the SCM Agreement focuses on identical products or products with characteristics closely resembling each other. This is, on its face, a strong physical identity test. The Panel in *Indonesia – Autos* was applying this in a manner that found that physical characteristics could subsume some of the other issues such as end-uses, tariff classification and price relationships. That is, those other factors could also be taken into account within a like product analysis undertaken

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competitive with each other, but that the requirements of Article III meant that a more rigorous and specific analysis was required. Panel Report in *Korea – Taxes on Alcoholic Beverages* at paras. 10.39-10.43 (Panel Report approved without modification by the Appellate Body). If that was the case for the broad category, it certainly should be the case for the narrower category of like product.

<sup>8</sup> The EC stated at the First Substantive Meeting that a certain type of specialty chemical tanker was no longer relevant because the EC yards do not construct such vessels. However, the question of whether the EC makes a particular product is irrelevant in answering the question as to whether such specialty chemical tankers are similar or dissimilar to the other chemical tankers, i.e., whether there are similarities in physical characteristics, end-uses, and demand side price relationships. The causal relationships cannot be analyzed unless these parameters are properly established.

<sup>9</sup> Appellate Body Report in *Japan – Taxes on Alcoholic Beverages* at p. 21.

<sup>10</sup> Panel Report in *Korea – Taxes on Alcoholic Beverages* at paras. 10.103-10.104 (Panel Report approved without modification by the Appellate Body).

<sup>11</sup> Appellate Body Report in *EC – Asbestos* at paras. 119-120.

<sup>12</sup> *Ibid.* at para. 99.

<sup>13</sup> *Ibid.* at paras 101-102.

pursuant to footnote 46. The language of footnote 46 clearly means that the conclusions drawn from such analyses must be taken on the basis of the “closed accordion” of like product definitions.

Korea considers this *Indonesia – Autos* approach, properly understood, as clearly within the jurisprudence that has developed under Article III which looks to these various elements of the like product/ directly competitive product test. However, the treaty text is quite clear in footnote 46 that the test for purposes of the SCM Agreement accords with the narrow approach adopted by the Appellate Body in Article III:2, first sentence, not the broader analyses of Article III:4 and Article III:2, second sentence.

In the present dispute, the problem has arisen that the EC has attempted to avoid the issue completely and claim that the Panel in *Indonesia – Autos* developed a whole new test of “product segmentation” that is not based on the treaty text and apparently is more vague, completely fluid and quite broad. This is contrary to the approach used by panels and the Appellate Body pursuant to Article III, as endorsed by the *Indonesia – Autos* panel. There simply is no way to read that panel report to imply a broadening of the interpretation of like products or a weakening of the analytical rigor needed to define the parameters of the categories.

In the absence of such rigorously defined product categories, it is simply impossible for the respondent or the Panel to address the complaint in any meaningful manner and the claims necessarily must fail as a matter of law. As Korea – supported by the US – has argued, the abdication by the EC of establishing the like product categories (regardless of whether the EC now tries to apply a different label) should end the Panel’s inquiries because the EC has failed to carry its burden of proof. As the Appellate Body emphasized in *Japan – Agricultural Products II*,<sup>14</sup> the purpose of Panel questions asked pursuant to DSU Article 13 is to better understand the parties’ arguments, not to make the complainant’s case for it.

**87. If the concept of "like product" does apply in respect of price suppression/price depression analysis, what in your view would be the appropriate "like product" categories to be used in this dispute? Do you agree with the EC on the general idea that like products could be defined on the basis of a market segmentation approach similar to that used by the *Indonesia – Autos* panel (even though the panel notes your disagreement with the particular market segments proposed by the EC)?**

- (a) At the outset, Korea is forced to note that it is deeply troubled by this question and wishes to reiterate its position that the burden of proof to demonstrate the existence of serious prejudice rests on the EC. If the Panel agrees with Korea (as supported on this issue by the US) that this requires an analysis based on like products, then the inquiry ends. The EC, to use its term, “**rejects**” the relevance of like product.

Korea recognizes the broad authority of Panels to ask questions for purposes of clarifying the parties’ arguments and also recognizes that by merely asking a question, the Panel is not stating its position on a legal issue. Of course, therefore, Korea will do its best to answer this question in as full a manner as possible in the ten-day period allotted. However, Korea is concerned that when it answers this question, the EC will incorrectly try to shift the burden of carrying the argument to Korea. Therefore, Korea must note for the record its objection to being required to formulate *ab initio* a “like product” presentation in the face of the EC’s rejection of its legal relevance.

The requirement of pursuing a like product analysis was confirmed by the Panel in *Indonesia – Autos*, the very case invoked by the EC itself in relation to the “like product” definition. That Panel observed:

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<sup>14</sup> Appellate Body Report in *Japan – Agricultural Products II* at para. 129.

In assessing the arguments of the parties, we are cognizant that the complainants are required to demonstrate the existence of serious prejudice by positive evidence. Thus, we agree with Indonesia that the complainants bear the burden of presenting argument and evidence with respect to each element of their serious prejudice claims – including the existence of effects on a “like product”.<sup>15</sup> (Emphasis added)

The EC has failed to carry its burden of proof. In paragraph 393 of its First Written Submission, it has stated that the same product market in Article 6.3(c) requires showing that products are competing which can be done by using the factors used in the “like product” analysis developed in the case-law on Article III of GATT 1994. It proposes a “market segmentation” approach used by the Panel in *Indonesia – Autos* in relation to an assessment on the existence of price undercutting under Article 6.3(c). It has then proceeded to posit as three separate products, LNGs, container vessels and product and chemical tankers but without any argument or evidence as to why these products are separate like products from the point of view of the factors that were taken into account even by the Panel in *Indonesia – Autos*. The EC’s Oral Statement only makes general references to cross-price elasticity and substitutability from the point of view of the shipyards and the shipowners, without any presentation of supporting evidence at all. It indicates that container vessels can be used on a variety of routes and that for a shipbuilder it is immaterial which ship it builds as every ship is an assembly of steel products. So far, however, there is no clear indication on the specific criteria based on which the EC considers that it can identify LNGs, all container vessels and all product and chemical tankers as separate like products. Hence, Korea considers that the EC has not carried its burden of proof and that this deficiency cannot be remedied at this stage of the proceeding. Nevertheless, as discussed above, despite its deep reservations about the appropriateness of requiring Korea to provide this like product analysis, in the face of the EC’s rejection of its legal relevance, and in a spirit of co-operation, Korea *ab initio* submits herewith as Exhibit Korea – 66 its approaches regarding how it considers that “like product” should be established. In doing so, Korea reserves all of its rights.

- (b) In referring explicitly to the Panel’s analysis in *Indonesia – Autos* which, Korea repeats, relates to an assessment of price undercutting under Article 6.3(c), the EC has, in effect, admitted that the concept of “like product” applies or at least provides determining guidance for the purpose of the assessment on price depression or suppression under Article 6.3(c). When the EC then turns and “rejects” the legal relevance of the concept of “like product”, it is admitting it has not carried the necessary burden in this dispute. Indeed, the so-called market segmentation used by the Panel in *Indonesia – Autos*, is not some new test created out of whole cloth totally apart from the treaty. If it were, it would not be useful as a reference. Rather market segmentation occurs within the concept of “like product” as set forth in Article 6.3(c) and explained in Footnote 46 to the *SCM Agreement*. Establishing market segments is none other than determining the “contours” – using the EC’s own term – of the products that can be considered to be closely resembling in order to constitute a “like product”. The core issue is nevertheless which criteria to use to determine the contours of what is a market segment or a like product. In this regard, Korea refers to the following statement by the Panel in *Indonesia – Autos*:

Turning first to the argument of the European Communities that all passenger cars should be considered “like products” to the Timor, we consider that such a broad approach is not appropriate in this case. While it is true that all passenger cars “share the same basic physical characteristics and share an identical end-use”, we agree with Indonesia that passenger cars are highly differentiated products. Although the European Communities have not provided the Panel with information regarding the range of physical characteristics of passenger cars, all drivers know that passenger cars may differ greatly in terms of size, weight, engine power, technology, and

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<sup>15</sup> Panel Decision in *Indonesia – Autos*, para. 14.169.

features. The significance of these extensive physical differences, both in terms of the cost of producing the cars and in consumer perceptions regarding them, is manifested in huge differences in price between brands and models. It is evidence that the differences, both physical and non-physical, between a Rolls Royce and a Timor are enormous, and that the degree of substitutability between them is very low. Viewed from the perspective of the SCM Agreement, it is almost inconceivable that a subsidy for Timors could displace or impede imports of Rolls Royces, or that any meaningful analysis of price undercutting could be performed between these two models. In short, we do not consider that a Rolls Royce can reasonably be considered to have “characteristics closely resembling” those of the Timor.<sup>16</sup> (Emphasis added)

As discussed in response to the previous question, these are the common criteria used in “like product analyses under Article III, as well. Therefore, in the present dispute, Korea proposes to make use of the indicators referred to by the Panel in *Indonesia – Autos* coinciding with the indicators frequently used for the definition of “like product”, i.e., physical characteristics, customer perception and end-use.<sup>17</sup> This is no different from how the EC itself has assessed the shipbuilding market as is shown in several statements made by the EC and its expert FMI in various documents. These statements cannot simply be discarded by the EC as needed only “to follow developments in certain characteristic sub-types of most interest to EU yards for purely information purposes” (paragraph 106 of the EC’s Oral Statement). Reference is made to the document in Exhibit EC-1 to the EC’s First Written Submission entitled “Overview of the International Commercial Shipbuilding Industry, Background Report” (May 2003), i.e., an FMI report dated May 2003 in which the FMI states the following with regard to tankers, bulk carriers and container ships:

The above three ship types make up by far the largest portion of the fleet and a significant proportion of the output from the shipbuilding industry. These main volume products are normally further sub-divided into distinct sub-classes, as described in table 3.2. The main ship types and sub types listed in this table are according to common industry usage and the terminology used will be found in any documentation relating to the fleet. The main ship type is defined by the function of the ship and the sub types are defined by size classifications demanded by operators of the ship. The sub-classifications have been developed to suit the economic conditions of the main trades in each sector and can largely be regarded as standard products. There is little material difference in operational terms between different ships within any class of sub-type, whoever the supplier may be. It should be note that the economic classes of ship represented by the sub-types listed below are not readily substitutable for other ship types. For example, it may be technically possible to adapt a bulk carrier to carry containers but in operational terms this would be unfeasible. Similarly, substitution is rarely possible on a size basis because of the economics of trade. One seventy thousand dwt ship, for example, is not operationally or economically equivalent to two thirty-five thousand dwt ships.

To this should be added the following FMI statement on container ships in particular indicating that container vessels have different uses depending on their size:

There are a wide range of sizes of ships on a wide range of routes, typically following an established ‘hub and feeder’ pattern. Very large ships (the largest of which now rival the largest category of tankers in terms of physical dimensions) carry boxes on trans-oceanic routes servicing the main hub ports in the Far East, Europe, North America and Middle East. Smaller ‘feeder’ ships then distribute the boxes from the

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<sup>16</sup> Panel Decision, *Indonesia – Autos*, para. 14.175.

<sup>17</sup> In the *Indonesia – Autos* case, the Panel considered that all cars had the same end-use to transport passengers. This is not the case of the commercial vessels subject of the dispute as is mentioned in (a) above.

main hub ports to local ports. The contents of the boxes is made up of 'general cargo', and may include such diverse items as machinery, white goods, clothing, electronic equipment, and so on.

**88. To whose prices do the terms "price suppression" and "price depression" refer: the subsidizer's, the complainant's, or both?**

Because the issue is serious prejudice to the interests of the complaining party, the price suppression must be of the complaining party, otherwise there cannot logically be serious prejudice to the interests of that Member, as required by Article 5(c). However, Korea would note that the significant price suppression or depression has to be caused by the subsidies. The EC has ignored the causation analysis. Please refer to the response in Question 91 below.

**89. The panels in the GATT 1947 disputes on EC – Sugar brought by Australia and Brazil found that EC export refunds had contributed to depressed world prices for sugar, thus indirectly causing serious prejudice to Australia's and Brazil's interests. In other words, in those cases, the market in question was a world market, the prices in question were world market prices, and the finding of serious prejudice to Australia's and Brazil's interests was exclusively based on the depression of those (world market) prices.**

**You argue, by contrast, that the price suppression/depression provisions of the SCM Agreement neither contemplate nor permit an analysis based on a "world market". You also argue that price suppression/depression by itself does not constitute sufficient evidence of serious prejudice, but rather that a complaining party must (1) present evidence and analysis to establish that its own domestic industry is suffering significant overall impairment, i.e., something similar if not identical to "serious injury" such as for a safeguard investigation, and (2) must show as well that the survival of the industry in question is vital to the complaining party's overall interests.**

**(a) Is there anything in the text of the SCM Agreement to support your position that the domestic industry of the complaining party should suffer the equivalent of "serious injury", when SCM Article 5 clearly treats injury and serious prejudice as two separate concepts?**

(i) The word "may" as used in the chapeau of Article 6.3 does not stand for "permitted", at least as that was used by the EC during the First Substantive Meeting. If the negotiators had meant to indicate that serious prejudice would exist any time only one of the factors stipulated in Article 6.3(a) to (d) were achieved, they would have used the word "shall" as was done in many of the provisions of the WTO Agreements. The word "may" indicates that serious prejudice does not automatically exist when any one or more of the factors in Articles 6.3(a) to (d) is found to exist.

(ii) The use "one or several" in the chapeau of Article 6.3 further confirms that the existence of any single factor does not *ipso facto* lead to an affirmative finding on the existence of serious prejudice.

(iii) Price suppression or depression are two indicators only of the existence of material injury of which Article 15.2 provides that "no one or several of these factors can necessarily give decisive guidance." If it were allowed pursuant to Article 6.3 to find serious prejudice if there was either price depression or price suppression, the standard to find serious prejudice under Article 5(c) would be substantially below that to find material injury under Article 5(a) and footnote 11. However, the Appellate Body in US – Lamb has concluded that the "word 'serious' connotes a much higher

standard of injury than the word ‘material’<sup>18</sup>. The qualitative difference between “serious” and “material” does not change depending on whether it qualifies “injury” or “prejudice”. It is inherent to the meaning of the words viewed in isolation.

- (b) Is there anything in the text of the SCM Agreement to support your position that for serious prejudice to be present, the survival of the domestic industry of the complaining party must be vital to its overall interests?**

Korea stated that it considered the term “prejudice” to be within the series of terms used in the WTO such as “injury”, “damage” or resulting in “market disruption”. Korea was noting that the whole phrase of “serious prejudice to the interests of another Member” connotes a standard that is not only higher than material injury (based on the considerable jurisprudence in this regard), but also broader, as the interests of a Member necessarily encompass something more than just the industry at question. The domestic industry is part of the interests of the Member but cannot automatically be equated to the broader interests of a WTO Member. Far from addressing this issue of “serious prejudice to the interests of another Member”, the EC attempts to construct a case that would not even satisfy the requirements of *initiating* an investigation by a national investigating authority under Part V of the SCM Agreement. The “standards” proposed by the EC are so low and so vague that apparently they can be met by showing a “kink” on a graph.

- (c) How do you square your arguments with the quite different approach and results of the prior GATT panels cited above?**

The Sugar Panels cited examined the EC’s export refunds for sugar under Article XVI:1 and XVI:3 of the GATT. Article XVI:1 imposes a notification and a consultation requirement for “any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product, into its territory”. The operative section is Part B referring to “Export Subsidies” which are not relevant to the interpretation of Part III of the SCM Agreement. Specifically, Article XVI:3 provides that, for export subsidies, if a Member grants directly or indirectly any form of subsidy that operates to increase the export of any primary product from its territory “such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of would export trade in that product”. In that sense, to the extent that there is relevance under Part III of the *SCM Agreement* relating to export subsidies as actionable subsidies, the provisions are closer to (but still not the same as) Article 6.3(d) which considers the situation where the effect of subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity which is the only provision of Article 6.3 which explicitly provides that a “world market” may be taken into account.

The provisions of Article XVI:1 and XVI:3 indicate that the notification and consultation requirements must apply and that a subsidy cannot give a contracting party more than an equitable share of the world export trade as the word “shall” is used throughout these provisions. In this sense, the wording of the chapeau of Article 6.3 is different and, hence, it is not possible to derive any direct implications from the above Sugar Panels for the purpose of its interpretation.

- (d) In this regard, what in your view is the significance of footnote 13 to SCM Article 5(c), which provides that the term "serious prejudice" in the SCM Agreement has the same meaning as in GATT Article XVI:1? We note that Article VI:1 of GATT 1994 contains no reference to injury to the domestic industry of the complainant. Is the purpose of this footnote to incorporate into the SCM Agreement the interpretations of the prior GATT panels on serious prejudice? If not, what is the purpose of this footnote?**

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<sup>18</sup> Appellate Body Report, *US – Lamb*, para. 124.

Given the explicit provisions of the chapeau of Article 6.3, the purpose of footnote 13 is to clarify that a threat of serious prejudice, as is explicitly provided in Article XVI:1 is also covered under Article 5(c) of the *SCM Agreement*. In addition, the reference can be interpreted to mean that a finding of price depression or suppression is not enough but must be accompanied by an increase in exports by the subsidizing Member from its territory or decrease in imports into its territory which must be shown to be result of the alleged subsidy. In response to both this and the previous sub-question, Korea would like to recall that the Appellate Body explicitly approved the following statement by the Panel in *Brazil – Desiccated Coconut* regarding the relationship between the *SCM Agreement* and Article VI, which applies equally with respect to Article XVI, particularly in light of footnote 13:

Article VI of the GATT 1994 and the *SCM Agreement* represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. Thus, Article VI and the respective *SCM Agreements* impose obligations on a potential user of countervailing duties, in the form of conditions that have to be fulfilled in order to impose a duty, but they also confer the right to impose a countervailing duty when those conditions are satisfied. The *SCM Agreements* do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the *SCM Agreements* and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.<sup>19</sup>

There is nothing in Article XVI that detracts from the proposed interpretation of Articles 5 to 7 of the *SCM Agreement*. Indeed, when combined with an examination of Article VI and Part V of the *SCM Agreement*, it is quite evident that it is the EC's minimalist approach that is inconsistent with the overall scheme of the treaty language. The EC's approach is vague and standards-less with no like product analysis, no examination of the state of the complaining Member's industry, no examination of the broader scope of that Member's interests and only the most minimalist causation analysis that is not in harmony with the treaty. The EC's approach would render the standards of Part II of the *SCM Agreement* and Article XVI affecting markets in other Members at a much lower level than those required for examining imports into a Member's own market pursuant to Article VI and Part V of the *SCM Agreement*. This is both logically absurd and completely without support in the broader scheme of the treaty language.

**90. In your view is the causation standard for serious prejudice the same as that in a countervailing duty investigation? If so, then what accounts for the very different drafting of the respective provisions of the *SCM Agreement*, and for the clear distinction in *SCM Article 5* between injury and serious prejudice? If not, please explain the differences.**

The causation standard for serious prejudice and in a countervailing duty investigation are different. Pursuant to Article 6.3(c), it must be shown that it is the challenged subsidy specifically that is causing the alleged price depression or suppression. Article 6.3(c) explicitly states: “the effect of the subsidy is a significant ...” It is, therefore, not sufficient to show that the products that are being subsidized are causing price suppression or depression but it must be shown that the subsidy in isolation has caused significant price depression or suppression. As stated in Korea's First Written Submission (paragraph 532), where price depression or suppression significant enough to cause serious prejudice is not caused by the alleged subsidy but by other factors, the actionable subsidies cannot be prohibited. When price depression or suppression is caused by the alleged subsidy and by other factors, the actionable subsidies can only be prohibited when the alleged subsidy itself has caused significant price depression or suppression considered in isolation from other factors. This too requires a quantification of the alleged subsidy as explained in paragraph 536 of Korea's First Written

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<sup>19</sup> Panel Report in *Brazil – Desiccated Coconut* at para. 246, as approved in the Appellate Body Report in *Brazil – Desiccated Coconut*, at p. 17.

Submission. As Korea noted at the First Substantive Meeting, 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.

**91. In respect of causation, you argue that no matter what other factors may be present in the market, the subsidization independently of these other factors must itself cause serious prejudice.**

**(a) How could such an analysis be performed?**

As discussed above in regard to the issue of “like product”, Korea would like to note its concern about burden shifting. The EC has rejected any sort of conventional approach to causation, instead relying on a vague, mechanical approach that has a far lower standard than any trade remedy investigation or dispute under any of the WTO Agreements. Thus, if the Panel agrees that some sort of normal causation analysis should be pursued, the dispute should conclude at that point, for the complainant has rejected that approach and refused to provide any evidence or arguments of that sort.

As Korea has noted, the Appellate Body made it very clear in *Japan – Agricultural Products II* that the Panel has a broad mandate to gather information for purposes of clarifying the parties’ arguments, but not making the complainant’s case for it. Again, recognizing that questions are not statements of position, Korea provides the following discussion setting out its views. However, Korea must again reserve all of its rights so that its response cannot be interpreted as its agreement to assume a burden belonging to the complainant.

Subject to these reservations, Korea believes that, in order to establish the causation between the subsidy and the price depression or suppression, the analysis could be performed in accordance with the following order:

Step I: The alleged subsidy must be quantified with respect to each subsidized shipbuilder.

- If the quantity of the alleged subsidy is insignificant, the analysis must end there.
- If the quantity of the alleged subsidy is significant, the Panel should proceed to Step II.

Step II: The effect of the subsidy on the prices of the subsidized shipbuilder must be quantified.

- Logically, the chain of causation should begin with the effect of the subsidy on the prices of the subsidized shipbuilder. In a competitive market, it is generally assumed that prices are set at the level of the total production cost, even though actual prices may sometimes go below cost of production in the case of a highly capital-intensive, cyclical industry such as the shipbuilding industry. A subsidy would enable the subsidized shipbuilder to sell its products at prices below the competitive price level by either lowering the production cost or simply compensating the loss from sales below the production cost, depending on the nature of the subsidy in question. Therefore, the effect of the subsidy on the prices of the subsidized shipbuilder may be measured by (i) determining first the level of production cost not affected by the subsidy (e.g., the actual unit cost plus the prorated subsidy amount per unit of the subsidy that reduced the production cost (hereinafter the “non-subsidized production cost”) and then (ii) comparing this non-subsidized production cost with the prices of the subsidized shipbuilder.

- If the prices of the subsidized shipbuilder still exceed the non-subsidized production cost, the subsidy has not affected the actual prices of the subsidized shipbuilder. Therefore, the subsidy has not had price depression or suppression for its effect.
- On the other hand, if the prices of the subsidized shipbuilder are below the non-subsidized production cost, the subsidy has affected the prices of the subsidized shipbuilder downward by an amount which is equivalent to the smaller of (i) the difference between the subsidized shipbuilder's prices and its non-subsidized production cost or (ii) the prorated subsidy margin included in the above production cost (this difference can be called the "subsidy effect margin" for convenience in the explanation).
- If the 'subsidy effect margin' is insignificant, there is no causal link and the serious prejudice analysis must be ended.
- If the 'subsidy effect margin' is found to be significant, the analysis should move to Step III.

Step III: The price depression and suppression margin must be quantified.

- This is a complex process of determining the percentage margin by which the prices of the like product produced by the shipbuilders of the complaining Member (i.e., the EC) have been depressed or suppressed.
- For this purpose, 'like products' produced by the shipbuilders of the complaining Member must first be identified.
- Then, it should be analyzed whether the prices of the shipbuilders of the complaining Member would have been significantly depressed or suppressed as a result of the subsidy granted to the subsidized shipbuilders (i.e., the 'subsidy effect margin'). In this regard, the causation analysis is an integral part of the process of determining the existence of a 'significant price depression or suppression'.
- The detailed analytical methods suggested will be explained in subsection (d) below. Any elements of fair competition leading to a decrease in the price of the allegedly subsidized products (economies of scale, cost advantages, etc.) must be assessed.
- The effects of competing non-subsidized products from other sources on the price levels must be considered. An allegation of the maintenance of capacity due to the alleged subsidy is insufficient to establish that the subsidy caused significant price depression or suppression is insufficient when there are significant other sources of like products that are not subsidized.
- For price suppression, all factual and economic elements, including economic factors relevant to the industry of the complaining member, affecting price levels must be determined in order to assess whether prices would have increased in the absence of the alleged subsidies.

Taking at least all of these elements into account, the effects in isolation of the alleged subsidies on price levels must be determined to assess whether the subsidies specifically caused significant price depression or suppression. Korea would like to emphasize that this question is difficult to answer in isolation from the complainant's arguments. The EC has explicitly rejected price undercutting. In this regard, the burden is on the complainant to demonstrate the market mechanism

transmitting the effect of the subsidy to the alleged price depression or suppression. To do this, the EC has relied almost exclusively on issues of capacity. When challenged on this point, the EC denied that they were looking at just capacity and stated that it necessarily includes a multi-faceted approach including a certain amount of price undercutting. Korea would agree with the complexity and subtlety needed, but in the EC's case it must be *explicitly* to the exclusion of price undercutting. Thus, in providing the above response, Korea notes that this is not necessarily the exclusive way to demonstrate causation if one were to take a more rational, broad based approach. It also still might not be applicable in this case to the extent that there remain elements of a prohibited price undercutting argument.

- (b) You suggest that one part of the analysis would be to quantify the amount or degree of subsidization and to compare this to the degree of price suppression or depression that may exist. Please clarify this argument. In particular, would the degree of subsidization be compared with the alleged degree of suppression or depression of the subsidized product's price?**

As mentioned in subsection (a) above, Korea submits that the subsidy must be quantified and pro-rated so as to determine its possible effect on the price of the allegedly subsidized product (i.e., the 'subsidy effect margin' to be calculated in Step II mentioned above). Then, as explained in subsection (d) below, at Step III this 'subsidy effect margin' will be added to the actual prices of the subsidized product to calculate the 'hypothetical non-subsidized prices' of the vessels produced by the subsidized shipbuilder. This "hypothetical non-subsidized prices" of the subsidized shipbuilder are necessary to assess whether the prices of the shipbuilders of the EC as the complaining Member would have been depressed or suppressed as the effect of the subsidy.

In light of the above analytical process, it would be inaccurate to state that the degree of subsidization must necessarily be compared with the alleged degree of suppression or depression. Korea refers to Section (d) below.

Again, Korea would like to note its reservations concerning the potential for incorrectly shifting the burden of proof and also the limitations of this proposed methodology which is constructed in the absence of direct price comparisons.

- (c) Or would it be compared with the alleged degree of suppression or depression of the price of the complaining party's product? If the latter, what if anything is the logical connection between the specific amount by which a particular country may subsidize a given product and the degree to which the price of the same product produced by a producer in another country may be affected?**

Korea considers that price suppression or depression must be shown to the prices of the complaining party's products but that the establishment of a causal link requires it to also investigate the price depression/suppression at the level of the products of the subsidizing party. As mentioned in subsections (b) above and (d) below, however, the alleged 'subsidy effect margin' would not be directly compared with the alleged degree of suppression or depression, but will be considered as a crucial factor in determining the degree of such suppression or depression.

A mere allegation as mentioned by the EC of the continued existence of capacity due to the coverage of debt-servicing cost through the subsidy without investigation into causal link as indicated in (a) above is insufficient.

Korea would like to refer again to the EC Commission's Third Report on World Shipbuilding where it outlines the massive amounts of subsidies provided to the EC shipyards over the decades. These were as high as 28 per cent direct operating subsidies as recent as 1988, only being phased down to a "mere" six percent at the present time. As the Commission noted, this was only one form

of subsidization. There also was export subsidization, research and development subsidization; equity injection subsidization; regional subsidization, research and development subsidization (now as high as 25 per cent), tied aid subsidization, etc. This is one of the anomalies of the EC's narrow focus on maintenance of capacity. The Commission itself noted that the EC had maintained too much capacity and had not made sufficient competitive adjustment due to this sustained high level of subsidization. If one is looking at the question of maintained capacity, as per the EC's argument, then the causal link lies much more firmly with the EC's subsidies than any other Member.

**(d) How, in concrete terms, is the degree of price suppression or depression quantified and expressed?**

Korea submits that the price suppression or depression means, with respect to each like product identified, the percentage margin by which the price of the products of the complaining Member's products have been suppressed or the percentage margin by which the price has been depressed, as the effect of the subsidy. In order to determine the degree of price suppression or depression, the Panel should analyze whether the prices of the shipbuilders of the complaining Member have been significantly suppressed or depressed as a result of the subsidy granted to the subsidized shipbuilders.

In order to determine whether there is any significant price depression or suppression; Korea believes that the Panel should consider all the factors that will determine the prices. In this regard, Korea considers that the Panel could take the following steps:

Step 1: The prices of 'like products' sold by all the shipbuilders that are believed to affect the prices of the 'like products' of the EC shipbuilders must be identified

- The prices of the non-subsidized EC shipbuilders' like products must be determined as from the period immediately preceding the granting of the subsidy throughout the most recent period preceding the initiation of the dispute settlement procedure
- The hypothetical non-subsidized prices of the like products sold by the allegedly subsidized shipbuilder in Korea must be determined for the same period. These hypothetical prices can be determined by increasing the actual prices of the allegedly subsidized shipbuilder by the 'subsidy effect margin' since the granting of the alleged subsidy
- The prices of non-subsidized like products from other WTO Members must also be determined for the period immediately preceding the granting of the alleged subsidy throughout the most recent period preceding the initiation of the dispute settlement procedure.

Step 2: All the factors that are believed to affect the prices of the non-subsidized EC shipbuilders must be assessed in respect of their possible effect on such prices.

**(a) Demand and supply factors**

- As the prices are determined by the interaction of supply and demand, those factors that constitute the demand and supply, respectively, should be identified and assessed.
- On the demand side, a main indicator may be the trend in new orders. If the demand has increased in excess to the capability of the shipbuilders in the market to supply products, prices would have increased while if the demand has decreased over the production capability, the prices would have decreased.

- An important supply side factor is the trend of major cost items. The ship prices are sensitive to cost movements. As demonstrated by Korea, the price decline as alleged by the EC coincides with the decline of steel and other cost items as well as devaluation of Korean won. In such case, the causation analysis should stop there. If the decline of production cost is not sufficient to the entire price movements, then the actual impact of the cost decline must be accurately quantified and should be compared with other causation factors.
- (b) Effect of prices of other non-subsidized shipbuilders (whether Korean or third country shipbuilders)
  - If, with respect to each like product, there are a number of non-subsidized shipbuilders which collectively have sufficient market shares to be able to lead or substantially influence setting of the market prices, then the prices charged by these non-subsidized shipbuilders will constitute the ceiling of the prices that can be charged by the EC shipyards, regardless of the effect of the alleged subsidy in question. Thus, the causation of the effect of the alleged subsidy is cut.
- (c) Effect of the prices of the subsidized shipbuilders
  - In the absence of any other causes mentioned above that are reasonably considered to disrupt the causal link between the alleged subsidy and the alleged price suppression and depression, the Panel can proceed to analyze the effect of the alleged subsidy;
  - First, the Panel should look into whether the allegedly subsidized shipbuilder has the ability to lead or substantially influence the market prices of the like products, in terms of its market share or otherwise. If the market share is insufficient, or if the shipbuilder has not maintained a substantial market share consistently, it will be difficult to find a causal link as such.
  - Only if the subsidized shipbuilder has maintained a sufficient market share to lead or substantially influence the market prices, should the Panel proceed to examine the effect of the subsidy on the prices of the shipbuilders of the EC. The Panel can compare the hypothetical non-subsidized prices of the allegedly subsidized shipbuilders ("Price A") with the actual prices of the non-subsidized EC shipbuilders ("Price B").
  - If Price A is higher than Price B, it can be said that Price B, i.e., the prices of the non-subsidized EC shipbuilders were prevented from increasing up to the level of Price A. On the other hand, if Price B is equal to or below Price A, it can be assumed that, regardless of the effect of the alleged subsidy, the prices of the non-subsidized EC shipbuilders would have decreased (no price depression) or would not have increased (no price suppression) in any event.
  - In such case, if the price difference is insignificant, the Panel should find that there was no "significant" price suppression or depression. On the other hand, if the difference is significant and the 'subsidy effect margin' is also significant, the Panel may find that there was "significant" price suppression or depression as the effect of the subsidy.
  - In cases where the effect of the subsidy or the effect of other causes is not decisive or has equal force, then the quantity of the subsidy effect should be compared with the

aggregate quantities of all other factors, in order to determine whether “the effect of the subsidy” in isolation was the cause of significant price suppression or depression.

Korea would again like to note that it has answered this question the best that it can, but recalls that the EC has excluded price undercutting. In light of the EC’s exclusion of such a critical element – which probably is present in the approach noted above – it is inequitable that Korea has been asked to construct an analytical approach *ab initio* to fit the skewed EC argument. This burden should be on the EC; thus, Korea reserves all of its rights even though it is attempting to be as responsive as possible to the Panel’s questions in this regard.

**92. What is the basis for your argument that the complaining Member must prove the effect of the alleged benefit from each alleged subsidy individually, rather than the combined effect of the alleged subsidies? How does this square with, for example, the approach to calculating the 5 per cent subsidization under the now-expired SCM Article 6.1, in respect of which paragraph 6 of Annex IV provided that "In determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated", which seems to have implied that it was the overall impact of the subsidies in question that was relevant to the existence of serious prejudice? How in practice could a Panel conduct such a separate analysis of the effects of each subsidy individually?**

The chapeau of Article 5 refers to “any subsidy”. In addition, Article 7.8 provides that when a Panel or Appellate Body report is adopted in which it is determined that “any subsidy” has resulted in adverse effects to the interest of another Member, the subsidizing Member must either remove the adverse effects or withdraw the subsidy. The use of the term “any subsidy” confirmed by the multiple references to “the subsidy” in Article 6.3 confirms that the effects of a subsidy must be reviewed for each subsidy separately. In that regard, the wording of Article 6.1(a) and paragraph 6 of Annex IV is different from that in Article 6.3.

The analysis described in the response to question 91 above should be carried out for each subsidy individually.

As Korea noted during the First Substantive Meeting, this does not mean that after assessing each subsidy individually, a sum of the actionable subsidies cannot be aggregated for purposes of making the final causal assessment. But, unless they are broken down, the possibility of removing the adverse effects under Article 7.8 could not be done in any rational manner. Article 7.8 provides important context for understanding Articles 5 and 6 and is not a disembodied provision to only be looked at in isolation during implementation. To sever it in such a manner would be contrary to the provisions of Article 31 of the Vienna Convention. Rather, Article 7.8 serves as a useful illustration of the uniqueness of a trade effects dispute under the WTO. Because no other provision entails an adverse trade effects demonstration, no other provision allows for limiting the remedy to removing the adverse trade effects. Thus, in understanding what would need to be done to alleviate adverse trade effects later, a panel must build the case from the bottom up, one element at a time so that it is a comprehensible whole.

**93. Is it your argument that, in a case involving multiple actionable subsidies, there would be double-counting of effects if somehow it could be demonstrated that in the absence of one of the subsidies, the remaining ones could not have caused adverse effects? What is the basis in the text of the SCM Agreement to such an approach to adverse effects?**

No, there is not necessarily double-counting *per se*. In the question posed by the Panel, Korea is of the view that in the case of multiple actionable subsidies, the effect of the subsidies must be aggregated to determine whether in total they cause adverse effects. If one then removes one subsidy,

and the effect of the remaining subsidies is not adverse, then no remedy is required. The support for this conclusion comes from Article 7.8.

The double-counting issue only arises when there is a simultaneous claim regarding the same measure under Parts II and III of the SCM Agreement. The answer to the previous question shows why combining prohibited subsidies and actionable subsidies would result in double counting. To stack the prohibited subsidies on top of the actionable subsidies for purposes of the causation analysis would be including subsidies that as a *matter of law* under Article 4 will be removed. If they will be removed, then they should not be considered as part of the accumulated subsidies examined for purposes of causation in a trade effects case. For example, were they to be the subsidies that tipped the balance to an affirmative finding, then Article 7 becomes moot because the prohibited subsidies must be removed pursuant to Article 4. Thus, there would be no adverse trade effects to remedy and, therefore, no basis for the initial affirmative finding. The jurisprudence is quite clear that a treaty cannot be interpreted in a manner that renders part of *inutile*.

**94. Please provide examples of recent bids for container ships, product/chemical tankers, and/or LNGs, which were won by Korean shipyards not alleged by the EC to have received subsidies, and for which bids you consider that at least one EC shipyard was a competitor.**

As the Korean and EU shipyards focus on different product categories, the Korean yards, whether alleged by the EC to have been subsidized or not, did not compete with the EU shipyards with respect to many projects. One example of recent competition between Korean and EU yards would be the bids for a LNG Carrier order placed by Gaz de France (GDF). For this order, 5 shipyards (Mitsui, Chantiers de L'Atlantique, Daewoo-SME, Samsung and Hanjin) submitted bids, and Chantiers de L'Atlantique has won the order, thanks to the substantial amount of subsidies granted by the EC.

For details on this dubious transaction, please refer to the news articles, which are submitted herewith as Exhibit Korea – 67.

## II. QUESTIONS TO BOTH PARTIES

**95. Article 11-2 of the Guidelines for Interest and Fees (Amended) (Exhibit EC-13) provides that [BCI: Omitted from public version].**

(a) **To Korea: Does this suggest that KEXIM considers that foreign financial markets constitute an appropriate market benchmark? Please explain.**

As stated in Korea's response to the Panel's question No. 77, KEXIM operates mainly in the Korean financial market in terms of its customers and competing financial institutions. Therefore, Korea is of the view that the appropriate market benchmark for KEXIM's interest rates is the Korean market. The fact that KEXIM may adjust the Base Rates by a marginal amount, taking into account the trends of domestic or foreign financial markets pursuant to Article 11-2, does not in and of itself support that KEXIM's overall interest rates must be comparable to the interest rates charged by foreign financial institutions.

(b) **To EC: What impact, if any, does this provision have on the EC's argument that KEXIM is not required to act on commercial principles? Please explain.**

**96. Can footnote 5 of the *SCM Agreement* be used to justify an *a contrario* reading of item (j) and the first paragraph of item (k) of the Illustrative List of Export Subsidies? Please explain.**

Yes, in Korea's view so-called "safe harbors" do exist based on an reading of items (j) and (k) read in light of footnote 5 and the broader context of the SCM Agreement. While some have attempted to argue that the Appellate Body's statements in this regard in *Brazil – Aircraft (Article 21.5 – Canada)*<sup>20</sup> are mere dicta and do not mean anything, Korea is not of the view that the Appellate Body's views can be taken so lightly. Indeed, it is clear that any other reading risks rendering meaningless items (j) and (k), first paragraph.

In Korea's view a perfectly harmonious reading of the broader treaty text is achieved if there is an *a contrario* reading of these provisions. First, the language of items (j) and (k) both imply that the relevant issue is whether the programmes at issue cover the costs to the government of operating such programmes.<sup>21</sup> While some have expressed concerns that this reading in some way undermines the benefit to the recipient standard of Article 1.1(b), this is not the case at all. This is clear from the language of footnote 5 which provides that: "Measures referred to in Annex I as not constituting export subsidies shall not be *prohibited* under this or any other provision of this Agreement." (emphasis added). This language can be contrasted with the language of Article 8.1 which identified subsidies that "shall be considered as *non-actionable*" (emphasis added). Thus, it can be seen that all footnote 5 does is establish that measures that are not export subsidies under Annex I are not considered prohibited subsidies. It is a safe harbor with respect to Part II alone and is simply irrelevant to the analysis of benefit.

To put the issue another way, if benefit to the recipient is established pursuant to Article 1.1(b) and the other elements of the various tests are satisfied, then there is a subsidy. The question remains as to whether the subsidy is prohibited or actionable. All, footnote 5 – read in context with the language of items (j) and (k), first paragraph – does is provide that such subsidies are not prohibited. It is silent as to whether they may be actionable. If more were intended the drafters would have used the term "non-actionable" in footnote 5 as they did in Article 8.1. The harbors may be safe, but they are not all-encompassing.

Indeed, this point is illustrated in this very case. The EC has argued that the KEXIM measures are both prohibited and actionable. The safe harbors would render them immune from attack under Part II, but are not relevant to the analysis under Part III. Thus, even after the application of the safe harbors, the EC could still pursue its claims regarding alleged KEXIM subsidies under Part III. In this regard, it is worth recalling that Korea has not argued that the EC cannot claim that the KEXIM measures are actionable. Rather, Korea has only argued that they cannot be considered by the Panel as both prohibited and actionable simultaneously because that would result in double-counting in terms of considering serious prejudice.

**97. What is the meaning of the term "material advantage" in the first paragraph of item (k) of the Illustrative List of Export Subsidies?**

The term "material advantage" refers to whether the measure in question provides the exporter with some advantage relative to an appropriate "market benchmark".<sup>22</sup>

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<sup>20</sup> Appellate Body Report in *Brazil – Aircraft (Article 21.5 – Canada)* at paras. 80-81.

<sup>21</sup> *Canada – Dairy (Article 21.5 – New Zealand and US)* at para.93.

<sup>22</sup> In *Brazil – Aircraft*, the Appellate Body noted that one example of a material advantage would be if the net interest rate was higher than the relevant CIRR.<sup>22</sup> However, the fact that the CIRR provided only one example and not the exclusive reference point for determining market benchmarks was re-emphasized by the Appellate Body in the Article 21.5 proceeding in that dispute. The Appellate Body noted that the CIRR reflects certain market conditions in one currency at one particular time and does not, in fact reflect the rates available in the marketplace. Thus the CIRR does not constitute the sole market benchmark. *Brazil – Aircraft (Article 21.5 – Canada)* at para. 64.

The Appellate Body stressed in *Brazil – Aircraft* that one cannot ignore the term “material” in item (k) first paragraph.<sup>23</sup> It logically must mean something more than the term benefit in Article 1.1. Of course, it must be observed that the issue of “advantage” requires a question of advantage relative to something. If it is merely an advantage relative to what would otherwise be available to the recipient, then it is simply redundant, as the Appellate Body noted. It, therefore, necessarily implies that it cannot be at a rate that gives the recipient a meaningful competitive advantage over other sellers, but must provide a competitive advantage as seen from the perspective of the buyer.

**98. As a legal matter, does the definition of export credits used by the OECD in the context of the Export Credit Arrangement govern the meaning of this term in the first paragraph of item (k) of the Illustrative List of Export Subsidies? Why/why not?**

The terms are not identical. The second paragraph of item (k) provides a very specific exception to the rule provided in the first paragraph. This exception effectively applies with respect to a very limited number of Members that are also OECD members and in a very specific circumstances described in the second paragraph. In this regard, it should be noted that the full term in the first paragraph is “export credits”, while the full term in the second paragraph is “official export credits” which refers back to the very specific OECD agreements described further in the second paragraph. As is generally the case, exceptions should be construed narrowly and it follows that there is no reason for the term in the operative paragraph to be constrained by the definition of a specific narrow exception.

This conclusion also follows from the discussion in response to the previous question where it was demonstrated that the Appellate Body did not find that the language in the first paragraph was constrained by the OECD terms applied pursuant to the exception contained in the second. Thus, just as the CIRR does not provide the sole market benchmark relevant for determining material advantage in the first paragraph, so the reference to “official export credits” covered by the OECD arrangements in the second paragraph cannot be considered controlling on the definition of “export credits” in the first paragraph.

**99. Would you provide us with the rationale behind your definition of export credits and export credit guarantees? Does an export credit have always to be a credit extended by the exporter or a financial institution to the buyer, and does an export credit guarantee always have to be a guarantee of such a credit? PSLs are loans extended by KEXIM to the shipbuilder, not to the buyer. APRGs are guarantees extended by KEXIM to the buyer, not to guarantee a credit given by the exporter or by a private financial institution to the buyer, but to guarantee that an advance payment by the buyer to the exporter shall be refunded in case of a contractual default. Does this exclude APRGs and PSLs from the realm of export credits/export credit guarantees?**

Please refer to the Answers to questions 60, 97 and 98. With respect to item (j), it is clear that the definitions of the relevant terms should not be limited to guarantees provided to buyers only. The reference in the second sentence of item (j) to guarantees against increases in cost implies a reference to the seller, for that is the party that generally carries the risk of increases in cost, while the buyer generally carries the risk of increases in price. At the very least, the reference to costs implies that the guarantees at issue in item (j) can cover both ends of the transaction and are not limited to buyers only.

Regarding item (k), it would seem to follow that there is no reason to assume that the prohibition contained in the first paragraph of item (k) should be narrower than that contained in the first paragraph of item (j). As discussed in the previous two questions, the indirect reference to the OECD in the narrow and quite specific exception contained in the second paragraph of item (k)

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<sup>23</sup> *Brazil – Aircraft* at para. 177.

cannot logically be taken to mean that terms used in the broader positive rules have the same narrow meanings. The manner in which the Appellate Body referred to the use of the CIRR - as but one possible market benchmark rather than the exclusive benchmark - supports this conclusion.

Moreover, the economic effect of credits and guarantees can be the same whether the extension of the guarantees or credits are to the buyer or the seller. There is nothing in the language of items (j) and (k) that implies such an economically non-sensical limitation to the language.

**100. In the *Indonesia – Autos* dispute (the only circulated panel report to date addressing serious prejudice claims), the panel in analyzing the claims of displacement or impedance of imports into the Indonesian market applied a "but for" approach. In particular, the panel asked the question whether, "but for" the subsidies, the complaining parties' sales volumes and/or market shares in the Indonesian market either would not have declined, or would have increased by more than they in fact did.**

- (a) **Would an analogous approach be appropriate here? That is, in assessing the price suppression/depression claims, should the Panel seek to answer the question whether, but for the subsidies, the prices in question either would not have declined, or would have increased more than they in fact did?**

The Panel in *Indonesia – Autos* used a but/for test for a displacement or impedance case, with it being particularly relevant to impedance. In the present dispute, the Panel is examining what actually has happened in the market rather than what would have happened in the form of possible establishment or entry into the market. Thus, Korea is somewhat reluctant to endorse a test that has been applied in a different setting without knowing precisely what the Panel means in this setting. Korea believes that the approach that it has described in the response to Question 91 above is much more nuanced than a strict "but for" approach, but if that is what the Panel means by analogizing the test (as opposed to adopting it as applied), then perhaps the label could be used.

Obviously, no but/for test can be applied unless the subsidies in question have been precisely quantified and the EC has not only failed to do this, it has affirmatively refused to do it. The EC threw out some general numbers without any support and asserted that there was no burden on it to supply anything, even those assertions. Again, regardless of the label applied, Korea is of the view that the approach it suggests in the answer to Question 91 requires that the subsidy specifically must have caused significant price depression or suppression but also does not exclude an analysis of whether other factors may have caused significant price depression or suppression. Indeed, it is required that an assessment of such other factors be made.<sup>24</sup> The assessment in this regard will very much depend on a case-by-case assessment. Thus, for example, where non-subsidized like products have an important part of the like product market and prices for these non-subsidized products have decreased substantially over the period considered without it being possible to demonstrate that these prices followed the prices of the allegedly subsidized products, in Korea's opinion, it will not be possible to conclude that the price depression or suppression is the specific effect of the alleged subsidy.

- (b) **If so, what sorts of considerations should the Panel take into account in trying to determine what the price movements would have been in the absence of the alleged subsidies? If not, why not, and what other approach should be used?**

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<sup>24</sup> Korea notes that the EC claimed at the First Substantive Meeting that Korea agreed that there were no other such factors in this case. (See EC Oral Statement at para. 120) A review of the section of Korea's First Written Submission cited by the EC makes it clear that Korea was using the term "other factors" at that point to refer to the other elements listed in Article 6.3. The use of the term "factors" there in Korea's submission was not the best, although the broader context makes it clear that Korea in no manner agrees with the EC that other market factors than the alleged Korean subsidies are relevant to this dispute. Quite the contrary.

Korea refers to the approach which it has submitted in the response to Question 91 above.

**101. Does the word "may" in the chapeau of Article 6.3 mean that a complainant of a "serious prejudice" must prove something more than the existence of price suppression/depression?**

**(a) If so, what is it that the complainant has to prove beyond price suppression/depression, and what is the basis in the text for any such additional requirements?**

**(b) If not, what is the significance of the word "may"?**

The inclusion of the term "may" does not mean that something else *must* be shown. But, equally, it does not mean that demonstrating one element *automatically* leads to a finding of "serious prejudice," and by implication something more could be required to establish serious prejudice, is the use of word "may" in the chapeau of Article 6.3.

As discussed in Korea's response to question 89(a), the word "may" as used in the chapeau of Article 6.3 does not stand for "permitted" as was argued by the EC during the First Substantive Meeting. In Korea's view, this can be clearly established by a plain reading of the text of Article 6.3, according to the ordinary meaning of the terms used and in their context.

The word "may" is defined, inter alia, as "might...a possibility..."<sup>25</sup> In some case the word may indeed mean "permitted" as suggested by the EC. But the EC's interpretation does not apply in the context of Article 6.3. Article 6.3 chapeau states that:

Serious prejudice ... may arise in any case where one or several of the following apply...

If the word "may" is in this context interpreted as "permitted" rather than "might" or "possible," the sentence becomes nonsensical. One cannot logically say that serious prejudice is "permitted to arise." Rather, in the context of the chapeau, it seems that the drafters clearly intended the word "may" to read as "might" or "possibly" (e.g. "serious prejudice might arise...").

Further support for this interpretation is found by contrasting the word "may" in Article 6(3) with the word "shall" in the (expired) Article 6.1. Article 6.1 provides:

Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist...

Korea notes that in the context of Article 6.1, the word "shall" refers to the conclusion that serious prejudice shall be "deemed" or "determined" to exist in the circumstances described in subparagraphs (a)-(d). By contrast, the words "may arise" in Article 6.3 do not refer to a determination. Rather, they refer to the possibility that a situation might (or might not) arise if the circumstances described in subparagraphs (a)-(d) of that Article are established. Had the drafters intended the word "may" to mean "permitted" in this context, the provision should more properly have read that serious prejudice "may be deemed to exist" in the circumstances described in subparagraphs (a)-(d).

The conclusion therefore should be that while Article 6.1 referred to situations where serious prejudice is "deemed" automatically to exist, Article 6.3 chapeau makes clear that it refers to circumstances where serious prejudice "might" exist, or by implication, might not. The chapeau

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<sup>25</sup> The New Shorter Oxford English Dictionary.

therefore makes it clear that a finding of serious prejudice is not automatic even if the existence of price suppression/depression is shown to exist. It should also be noted that as the word “may” is found in the chapeau of 6.3, this interpretation applies to all subparagraphs in Article 6.1.

The use “one or several” in the chapeau of Article 6.3 further confirms that the existence of any single factor does not *ipso facto* lead to an affirmative finding on the existence of serious prejudice.

Against this background, with respect to what else might need to be proved beyond price suppression/depression in order to establish serious prejudice, Korea would first recall that Article 5(c) refers to serious prejudice to the “interests” of a “Member.” As Korea has noted, Presumably there was a reason the term “interests” was chosen rather than injury and it clearly implies something more than just the alleged damage to specific industry(ies) for a Member’s “interests” are necessarily broader than just that. Against this background, the finding that alleged subsidies have resulted in price suppression or depression with respect to a particular like product may not, on its own, rise to the level of harm resulting in serious prejudice to the more broader “interests” of the Member concerned. Under this reading, the EC needs to demonstrate, and the Panel would need to find, not only the existence of price depression, but that the subsidies complained of have risen to the requisite degree of harm to the interests of the EC.

The EC has failed however to provide any basis for such a finding. The EC does not address the question of what EC interests have supposedly been seriously prejudiced and how that might have occurred. There is no evidence supplied about the state of the EC industry or “industries.” Moreover, the EC did not provide any evidence on the level of the alleged subsidization. Without such evidence, it is impossible in Korea’s view to make a determination that any subsidies, even if found to exist, would rise to the requisite level of harm to the interests of the EC. Korea would also recall that the EC has failed to establish a causal link between the alleged subsidies and the serious prejudice claimed. Korea considers that these are some of the additional factors that would be encompassed in proving serious prejudice. Korea believes that other factors could be taken into account and that this list may not be exhaustive. Korea would finally recall that price suppression or depression are only two indicators of the existence of material injury of which Article 15.2, which provides that “no one or several of these factors can necessarily give decisive guidance.” It would seem to follow that the existence of price depression or suppression, if not dispositive on their own in the context of the lower standard of “material injury,” should equally not be determinative in the context of the much higher threshold of “serious prejudice” in Article 6.3(c).

**(b) Korea refers to its reply under part (a) above with respect to the significance of the word “may” in Article 6(3) chapeau.**

**102. In its arguments concerning price suppression/depression, the EC has focused on demand side factors. Korea, on the other hand, has focused on the supply side. Is it not more correct that the two aspects should be taken together. Please explain the impact of such an approach on your argument concerning price suppression/depression.**

Korea disagrees with the premise of this question. In fact, the reverse appears to be the case. The EC has looked at the supply side almost exclusively to support its argument that there is no like product because virtually any yard can build any ship (which is, of course, inaccurate). Korea discussed the issue of capacity to a great extent because that necessarily is all that is left of the EC’s causation analysis once they so dramatically narrowed their claims. Korea was emphasizing how extremely difficult it is to demonstrate causation on such a narrow basis, particularly when a great deal of the world capacity consists of inefficient and uneconomic EC yards that have been maintained for decades on the back of huge subsidies, as acknowledged by the Commission in its Third Report on World Shipbuilding. Indeed, the alleged difficulties of the EC industry bear an interesting correlation with the enforced decline of those subsidies from the early 1990’s when the EC started reducing the

direct operating subsidies from the astronomical level of 28 per cent. This correlation is much stronger than any alleged relationship to the events arising out of the systemic financial crisis of the late 1990's. Korea's focus on the supply side was only to illustrate the lack of evidentiary and logical bases of the EC's approach.

In Korea's view, as far as the definition of "like product" used in the *SCM Agreement* is concerned, the EC's "competition market" approach based on supply side's substitutability is not acceptable. However, Korea agrees that, in conducting the causation analysis, all elements contributing to the setting of the vessel prices must be taken into account both from the supply and demand side. This is the purpose of its response to Question 91-(a) hereinabove as well as of paras 522 to 527 of its First Written Submission. In assessing the causal link between any alleged subsidy and significant price depression or suppression, all supply and demand factors should be taken into account including the increase in orders, freight rate or production costs as submitted by the EC. These alone are not, however, sufficient and factors such as overcapacity, building expertise, payment terms, slot availability, delivery time and changes in demand patterns must also be taken into account. The assessment of the causal link is fact-driven and must be done in a comprehensive manner and carried out on a case-by-case basis.

## ANNEX D-4

### RESPONSES OF KOREA TO QUESTIONS FROM THE EUROPEAN COMMUNITIES

(22 March 2004)

#### I. QUESTIONS TO KOREA

**1. In paras 4-8 of its oral statement, Korea repeatedly invoked the “financial contagion”. In which way did the “contagion” hit the three shipyards who went bankrupt differently than the ones who survived.**

The impact of the “financial contagion” on the Korean shipyards varied according to the financial or business conditions of each shipyard. For instance, Daewoo was more heavily hit by the contagion than other major Korean shipyards as Daewoo held a substantial portion of non-operating assets as a result of investments in other Daewoo Group affiliates, such as Daewoo Motor. The difficulties Daewoo Motor ran into with various investments such as its Polish car plant are well known.

However, the real reason for Korea’s reference to this financial contagion is set forth in paragraphs 8 and 9 of its Oral Statement. That is, Korea wished to highlight the following facts:

- the financial contagion first hit the banks, resulting in a serious credit crunch where money was not available for rolling over loans;
- the Government of Korea used the IMF funds to provide liquidity to the banks;
- there were conditions attached to this provision of funds, which required the banks to enhance financial soundness, reduce outstanding bad debts and meet BIS ratios; as a result, they needed to ensure that all corporate restructurings were done pursuant to market-oriented principles, including maximization of returns from their debts.

These facts as such negate the EC’s allegation that the Korean banks somehow misbehaved in the restructuring process to subsidize the insolvent firms.

**2. Korea points out that EC yards have recently produced smaller vessels than Korean yards (graph in para. 10 and the comments of Korea on the different sizes and types of EC and Korean ships in para. 13). Is this in line with the Korean presentation made during the last OECD meeting, where they explain that yards can easily switch from one ship to another?**

At the last OECD meeting in early March 2004, competition law experts and government officials discussed whether a single shipbuilder can acquire a dominant position (or monopoly power) in the world shipbuilding market from the ‘competition law’ perspective. At that meeting, Korean experts explained that, in order to determine the possibility of a ‘market dominance’, one must first define the relevant ‘product market’ as well as the ‘geographical market’. However, the context of those discussions was quite different and had nothing to do with WTO “like product” definitions.

As demonstrated in paragraphs 10 – 13 of Korea’s First Written Submission, it is supported by empirical evidence that the Korean and EU shipbuilders operate in largely different product and

size segmentations. As a result, the area of competition between the Korean and EU shipbuilders is at best marginal. This divergence between the Korean and EU shipbuilders is not transient, but rather structural, as it has been due to the changes in patterns of demand and the differences in dock sizes and technical and cost advantages between the Korean and EU shipyards.

**3. In its oral statement today, the EC hypothesized a scheme whereby the Minister for export promotion of a WTO Member would be empowered to award any sum he considered necessary to ensure that an exporter wins a contract against foreign competition where he considers this to be in the national interest. Would Korea consider such a scheme to be entirely compatible with Article 3 of the *SCM Agreement*?**

Korea considers that a scheme allowing but not mandating the Minister to award an amount ensuring that an exporter obtains a specific contract would not necessarily be incompatible with Article 3 of the *SCM Agreement*. It would still be necessary to determine whether, in the individual circumstances of the recipient, it was granted in a form and under conditions that would constitute a financial contribution under Article 1.1(a)(1) of the *SCM Agreement* conferring a benefit under Article 1.1(b) thereof.

**4. Does Korea believe that a body can not be considered a “public body”, or a government agency can not be considered a “government” if it provides goods or services on competitive terms?**

Korea submits that the mere shareholding or controlling interest by the government in a body and the pursuit of a public policy objective is not sufficient to qualify such body as a public body when it participates in the market together with private bodies on a market-oriented basis.

**5. Does Korea believe that the same institution can be a “public body” for some of its activities, and a “private body” for other activities? If so, how is this view supported by Article 1.1 of the *SCM Agreement*?**

Yes, Korea submits that this can be the case. Article 1.1(a) is aimed at covering all financial contributions whether conferred by a public body under Article 1.1(a)(1)(i) to (iii) or by private bodies acting under direction and entrustment of the government under Article 1.1(a)(1)(iv). Case-law has indicated that the provisions aim to be exhaustive and that the only difference lies with the actor of the financial contribution rather than with the functions. Hence, for those functions for which a body cannot qualify as “public body”, it would still qualify as “private body” if it acted under direction or entrustment of the government.

**6. In your opinion is KEXIM a “special institution controlled by” the Korean government within the meaning of items (j) and (k) of Annex I or a “special institution acting under the authority of” the Korean government within the meaning of item (k).**

KEXIM is neither a “public body” nor a private body “entrusted or directed” by the Government of Korea as those terms are used in Article 1.1 of the *SCM Agreement*. Korea notes that the EC has made no claims that Korea has acted inconsistently with the terms of items (j) or (k) of Annex I. The issue of the applicability of these items only arises as a possible safe harbor under the *a contrario* reading implied by footnote 5 and the plain meaning of the language of items (j) and (k), first paragraph. As such, these constitute affirmative defenses that the Panel need only address if it has already reached conclusions contrary to Korea’s arguments under Article 1.1. Article 1.1(a)(1) provides that for purposes “of this Agreement” both the government and public bodies shall be referred to as “government”. Thus the reference to “government” in items (j) and (k) would cover KEXIM, if the Panel makes an affirmative finding with respect to KEXIM as a public body.

Thus, the questions of the applicability of these safe harbours only arises as *arguments in the alternative* made by Korea, a concept that should be quite familiar to the EC.

**7. Korea states in para. 156 of its submission that Article 26 of the KEXIM Act requires KEXIM to operate with the goal of achieving a profit. Please refer to Article 26 (Exhibit EC - 10) and explain where there is any reference to profit?**

Please refer to Korea's responses to Panel's question No. 55 addressed to Korea.

**8. In para. 170 of its submission, Korea attempts to explain away Article 24 of the KEXIM Act (which states that it must not compete with commercial banks) by claiming that it must be read together with Article 25, para. 2 of the KEXIM Act. Please explain how you arrive at this construction since there is no cross-reference between these articles in the text of the Act?**

Please refer to Korea's responses to Panel's question No. 53 addressed to Korea.

**9. Korea provides, in para. 172 of its submission, an explanation of the function of the market adjustment rate provided in the KEXIM Interest Rate Guidelines. Please provide the source of this interpretation?**

Please refer to Korea's responses to Panel's question No. 57 addressed to Korea.

**10. Is the statement in para. 184 of Korea's submission that "foreign institutions were less equipped to monitor the collateral offered by the shipbuilders and, accordingly, insisted on APRGs without adequate collateral, but with higher premium rates" based on conjecture or on evidence? If the latter, what evidence?**

The assessment by Korea 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. However, Korea notes that the EC is in a better position to make inquiries of the foreign lenders than Korea. While the EC has developed a habit of attempting to shift the burden of proof to Korea, the EC is not relieved of the burden of establishing its case. The plain facts are that the foreign credit providers did not require the same level of collateral. Beyond this, the rationale of such lenders seems to be of no evidentiary value.

**11. What is the value of "Yangdo Dambo" collateral<sup>1</sup> at the beginning of a project, when an APRG or pre-shipment loan is first granted?**

[BCI: Omitted from public version.]

**12. Korea states in para. 199 of its submission that the term of pre-shipment loans normally does not exceed period that it designates as [BCI: Omitted from public version]. How does this comport with Korea's argument in para. 170 of the submission that "KEXIM financing may be extended only 'when the term ... is six (6) months or more", and with the fact that the KEXIM pre-shipment loans listed in paras. 175-179 of the EC's first written submission are for terms greater than 6 months (and some have terms up to 24 months)?**

Article 9 of the KEXIM Interest Rate Guideline prescribes that the loan period applied for calculating the loan interests shall commence from the date of initial disbursement and end on the final repayment date. In other words, the loan period does not start until the loan disbursement is actually made.

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<sup>1</sup> Defined by Korea in its reply to follow-up question 7 of the EC on 10 October 2003.

In the case of PSLs, the period between the “commitment date” and the “expiry date” ranges between [BCI: Omitted from public version.] Korea believes that such weighted average of actual disbursement periods must be used as the loan period of PSLs for the purpose of finding comparable benchmarks, because the KEXIM’s Interest Rate Guideline calculates interests starting from the actual “disbursement” date, rather than the “commitment” date.

However, for the purpose of Article 25.2 of the KEXIM Act, the maturity of ‘6 months’ referred to in that Article may be interpreted to mean the period from the “commitment date”. In such case, the maturity of PSLs in general is not less than 6 months.

**13. Please provide the (1) sales contract (2) the loan amount for the following pre-shipment loans granted to DSME:**

- **Project Nr: 000110 P Commitment date 12 October 2000**
- **Project Nr: 000142 P Commitment date 21 December 2000**
- **Project Nr: 010008 P Commitment date 8 March 2001**

This is a request for new evidence that the EC has no legal basis to make. After the First Substantive Meeting, submission of new evidence is prohibited except for purposes of rebuttal, but not be asking questions. As for the loan amount, please refer to Korea’s response to EC question No. 16 below.

**14. Korea argues in para. 207 of its submission, without any citations or evidentiary support, that the collateral required by KEXIM was “stronger” than collateral required by foreign financial institutions. Please provide specific information regarding the valuation of the collateral involved in the transactions by Korean and foreign banks listed in paras. 170-173 of the EC’s first submission to justify this statement.**

It is the obligation of the EC to establish the comparability of the benchmarks it proposed. Moreover, Korea has no access to the information regarding the valuation of the collateral by foreign banks and other domestic banks as it is proprietary information in nature and is not publicly available. The EC is in a better position to obtain that information and has the responsibility to build its own case. Therefore, Korea provides only the information regarding whether any collateral was provided for the projects the EC enlisted and, if so, what type of collateral it was, as set forth below.

[BCI: Omitted from public version.]

**15. In order to enable the panel to place values on the benefit of the KEXIM APRGs listed in paras. 170-173, please provide the actual values of the guarantees, or, alternatively, the monetary value of the APRG premiums.**

The EC is assuming a legal conclusion in its question; there is no “benefit”. Again, this is new evidence that the EC is attempting to derive to support its initial *prima facie* case. According to the *DSU* and the Panel’s Working Procedures, the time is long past for the EC to attempt this. It was the legal obligation of the EC to calculate what it considered the “benefit”. The Panel is not a domestic investigating authority. The Appellate Body opinion in *Japan – Agricultural Products II* makes it very clear that panels are prohibited from making the complainant’s case for it. This question serves as an admission by the EC that it has not fulfilled its obligation to establish a *prima facie* case in this regard.

**16. In order to enable the panel to place actual values on the benefit of the KEXIM pre-shipment loan transactions listed in paras. 175-179 of the EC’s first submission, please provide the actual value of the loans for the transactions listed therein.**

Please refer to Korea's responses to EC question No. 15 above.

**17. Korea includes several charts in paragraphs 231, 233, and 236 of its submission purportedly showing the interest rates of corporate bonds issued by DSME, Samho, and STX. In order to allow the Panel to determine whether this is a relevant market benchmark, please provide all detailed information available related to the issuance of these bonds, including, but not limited to, (a) whether the bonds were issued below, above, or at par value, (b) the difference between the interest rates on the bonds and the yields, (c) the terms of the bonds, (d) guarantees by other entities (including KAMCO, Seoul Guarantee Insurance, etc.) of the bonds, (e) who underwrote the bond issue, and (f) the relationship between the yield/interest rate on the bonds and the corporate restructuring of the shipyards. Was there any guarantee between the underwriting bank and the yards to buy a certain percentage of the bonds if all bonds were not underwritten?**

[BCI: Omitted from public version.]

**18. Korea states in para. 348 of its First Written Submission that according to the Arthur Andersen Report the expected collection rate i.e. the total recoverable value compared to the creditors outstanding claims was:**

[BCI: Omitted from public version] under the Liquidation value scenario.

[BCI: Omitted from public version] under the “going concern value” scenario.

**Please explain why KAMCO bought NPLs at rates of [BCI: Omitted from public version] from foreign creditors and [BCI: Omitted from public version] from domestic creditors although the expected return under the going concern scenario was only [BCI: Omitted from public version].**

The purchase prices for NPLs held by domestic and foreign creditors were determined through negotiations between the parties in [BCI: Omitted from public version]. By the time that these negotiations took place, the business conditions of DHI and the external shipbuilding market environment had improved far more substantially than that assumed by Arthur Andersen when it assessed the value of DHI as of August 1999.

In contrast, as indicated in its workout report, Arthur Andersen made very conservative assumptions of various factors (such as growth rates) for its valuation, which resulted in the total recoverable value of [BCI: Omitted from public version] under the “going concern value” scenario. In other words, the price differential can be explained by the difference in timing and the difference between the assumed growth and the actual growth, as well as the fact that the KAMCO purchase prices were ‘negotiated prices’.

**19. Are the Pre-shipment loans provided as lump-sum payment, i.e., 100 per cent of the loan amount provided at the commitment date, as opposed to a credit line?**

**Has this been a consistent practice since 1997? If not please detail all changes in policies.**

[BCI: Omitted from public version.]

**20. Korea states in para. 308 of its submission that “Articles 31 and 23 of the KAMCO Act provide that KAMCO realizes profits”. Please point to the text in these provisions that Korea believes justifies that statement (see Exhibit EC - 45).**

Korea refers to the provisions of Articles 31 and 32 of the KAMCO Act and apologizes for the error in the reference in para. 308 of its written submission. Still, the KAMCO Act does provide for the realization of profits through the fees and sales margin in performing its services and the income arising from operation (Article 31) and provides for the settlement of dividends after reserves are made (Article 32).

**21. Please provide the basis for Korea's statement in its submission (para. 323) that "circumstantial evidence" cannot be used to demonstrate entrustment or direction of a private body pursuant to Article 1.1(a)(1)(iv) of the SCM Agreement.**

The Panel in *US – Export Restraints* stated the following:

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 believe that either entrustment or direction could be said to have occurred until all of these three elements are present.<sup>2</sup>

Korea agrees with the above analysis by the Panel and has, accordingly, stated in para. 323 that challenges cannot be made on the basis of vague circumstantial evidence that does not amount to an explicit and affirmative action. Thus, as Korea noted in response to the Panel in the First Substantive Meeting, while paragraph 323 may be too categorical, what is certainly the case is that very firm and persuasive evidence must be presented by the complainant to carry the substantial burden of proving the three elements necessary to demonstrate entrustment and direction. While circumstantial evidence may be legally recognized, a great deal of firm and persuasive circumstantial evidence must be presented in the face of a total lack of direct evidence. In paragraph 323, Korea was reacting to the utter lack of proof in the EC's submission – either direct or circumstantial – which has carried over into the First Substantive Meeting. Instead of offering real proof, whether circumstantial or direct, the EC has offered vague assertions based in large part on grotesque and discredited stereotyping.

**22. If there is no subsidy where a creditor bank becomes owner of a company (as argued in para. 319) what is the purpose of the term "equity infusion" in Article 1.1(a)(1)(a) of the SCM Agreement?**

This question does not make any sense as there is a logical disconnect in the middle of it. Equity infusions are legally distinct from debt-for-equity swaps. There are also differences in their practical effect. So called "equity infusions" often are covers for direct subsidies to cover operating losses. For example, over a long period of time the French government has made so called equity infusions into their aircraft engine company, SNECMA. The purported capital calls generally were mere shams reflected by the unwillingness of private minority shareholders to respond. Thus, the "purpose" of the term equity infusion is to cover such sham direct contributions of funds to cover operating losses.

The issue in a debt for equity swap 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.

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<sup>2</sup> Panel Report, *US – Export Restraints*, para. 8.29.

The creditor financial institutions were holding debt and the issue was what they could do with the debt in order to maximize their return. More specifically, the creditors were holding debt in distressed companies in a country facing a financial crisis. The EC's odd diversion at the First Substantive Meeting into an elementary description of the different characteristics of the two forms of financial instruments (debt and equity) was completely beside the point. There is no logical relationship of debt-equity swaps to the term equity infusion.

**23. In light of the same para. 319, is it Korea's position that a government can never subsidize a state-owned company?**

No. As noted above, a government holding cash that makes an equity infusion into a state-owned company is making a financial contribution to the company. Whether the financial contribution is a subsidy depends on whether a benefit is conferred to the recipient.

**24. In Annex V question Nr. 3.1(12), the EC asked Korea to provide a complete list of creditors in: (i) DHI as of August 1999; (DSME), DHIM, and DHI as of mid-October 2000 (i.e., before the debt-for-equity swap); and (iii) DSME, DHIM, and DHI as of December 2000 (i.e., following the debt for equity swap). In response, Korea refers to attachment 3.1(12). However, that attachment does not contain all the information. Thus, Korea did not provide the data on sub-questions (ii)-(iii). In response to a follow-up question Korea maintained that it had provided all the requested information. However, the EC has never received it. Please provide the missing information.**

Korea's Annex V Attachment 3.1.2(12) contains all the information requested by the EC. In any event, Korea will provide again the data on sub-questions (ii) and (iii) requested by the EC. (*See* Korea's Annex V Attachment 3.1(12) attached hereto as Exhibit Korea - 69).

**25. Please provide a breakdown for each DHI creditor between secured and unsecured claims. (Not just for DSME creditors so that the Panel can assess the interest of each creditor in restructuring or liquidation.)**

Korea has already provided the data on DSME creditors. Beyond that, the "interest of each creditor in restructuring or liquidation" can be confirmed by the Arthur Andersen's workout report and the decisions of the CCFI to adopt the proposed workout plan.

**26. Please provide the dates on which KAMCO purchased non-performing loans from each creditor. In your answer, please distinguish between the foreign and the domestic creditors.**

[BCI: Omitted from public version.]

**27. Please identify those creditors that refused to participate in the workout.**

The question is not clear which "creditors" and which "workout" it refers to. If the EC meant the financial institutions which did not sign the Corporate Restructuring Agreement (CRA), a workout framework agreement, they were 231 mutual savings banks, 1,592 credit unions, and 47 branches of foreign banks.

**28. What was the market value of the warrants issued to foreign creditors of Daewoo-HI, as described in para. 358 of Korea's submission?**

No information is available to the Government of Korea. The EC is in a better position than the Government of Korea to develop that information from the foreign creditors. Korea notes again that the information the EC would develop in this regard would be new evidence and would be inadmissible absent good cause. Korea reserves its rights in this regard.

**29. Korea states in para. 356 that foreign lenders were able to obstruct the workout procedure, even though they held a minority stake among creditors? Why did not {sic} domestic creditors also have this ability?**

The domestic creditors did have the ability to obstruct the workout process within the creditor committee. And, indeed, the first Daewoo reorganization plan was rejected by a blocking minority of creditors during the early meetings of the creditor committee. Nevertheless, domestic creditors were also conscious that, if they pursued an obstructive path, the workout company's financial conditions would rapidly deteriorate and would always be thrown into the insolvency procedures. During the financial crisis, this would have inevitably led to the collapse of the whole national economy and there would be no financial institution that could survive. Therefore, they decided not to pursue legal means on their own or to seek individual repayment (i.e. outside of the process) by agreeing to the CRA workout process. From a commercial point of view, this was the best option for them to take to avoid their own demise.

**30. Please provide citations or other evidentiary support, other than Korea's own Annex V answers, for the statement in para. 385 of Korea's first submission that the purchasing conditions for debts of foreign and local creditors were "slightly different."**

For more detailed information on this question, please refer to Korea's response to the Panel's Question No. 80.

**31. Korea argues that foreign banks do not understand the Korean system sufficiently to participate in a work-out proceeding and can therefore not be considered as benchmark.<sup>3</sup> Why does then the Corporate Restructuring Promotion Law of August 2001 which "replaced" the Corporate Restructuring Agreement by creating a statutory legal framework for workouts<sup>4</sup> – also include obligatorily foreign creditors in any future workouts. Have foreign creditors suddenly been considered more understanding?**

Korea regrets that the EC continues to feel it necessary to inject such sarcasm into its questions. As stated in Article 1 (Purpose) of the Corporate Restructuring Promotion Act of August 2001 (the "CRPA"), the main purpose of this Act was to "*facilitate a continuous and market-oriented corporate restructuring by prescribing the matters necessary or required for implementing corporate restructuring in swift and orderly manner*". (See Korea's Annex V Attachment 2.2(16)). To achieve this purpose, the CRPA created a statutory legal framework for workouts which had been regulated by the CRA.

In line with the stated purpose of facilitating the corporate restructuring (workout) in a more orderly manner, the CRPA has included in the Council of Creditor Financial Institutions ("CCFI") all "financial institutions" which operate in Korea under Korean law, including domestic branches of foreign financial institutions and mutual savings banks which had not participated in the former CRA. However, the CRPA also allows financial institutions to withdraw from participation in the CCFI or individual workout procedures if they so wish: First, the CCFI can exclude from the CCFI membership small creditors which hold less than a certain percentage of the total loans, not exceeding 5 per cent of the total outstanding loans extended by all the CCFI members (CRPA, Article 25). Second, any creditor financial institutions that object to the proposed initiation of a particular workout procedure or to the proposed debt restructuring in the workout procedure, are entitled to exercise an appraisal right whereby such objecting creditors can request the CCFI (which approved the proposals)

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<sup>3</sup> First Written Submission of Korea, para. 378.

<sup>4</sup> See response to question 16, page 39 of Korea's Annex V Response and Attachment 2.2(16) of Korea's Annex V Response.

to purchase the debt held by the objecting creditors at a certain negotiated or appraised value (CRPA, Article 29).

In sum, although the CRPA expanded the general scope of financial institutions participating in the workout framework, any foreign or domestic financial institutions which hold a small portion of debts or which are only interested in immediate collection of their loans at a reduced value, rather than long term recovery through workout, can still refuse to participate in the CCFI or in the particular workout plan. In this regard, it can be said that there is no substantial difference between the former CRA and the present CRPA.

**32. Please clarify where the shipbuilding industry is accounted for in the table provided in para. 392 of Korea's first submission.**

The shipbuilding industry is included in Machinery/Plants.

**33. With respect to the Rothschild Report referred to in para. 413 of Korea's first submission, please provide the Rothschild valuation report, in its entirety. (So far Korea has provided the valuation for the shipbuilding division).**

We understand that the "Rothschild Report" in the above question refers to both the 'Proposal of Restructuring of Halla Group' dated June 1998 (Korea's Annex V Attachment 3.2(47)-1; Exhibit EC - 81) and the 'Final Proposal for Restructuring of Halla Group' dated 8 September 1998 (Korea's Annex V Attachment 3.2(47)-2; Exhibit EC - 75). As these titles indicate, such Rothschild Report was in fact a compilation of the discrete reports relating to 4 independent Halla Group companies: Mando Machineries, Co., Halla Cement, Co., Halla Construction, Co., and Halla Heavy Industries ("Halla-HI").

Korea has provided all available reports of Rothschild to the extent that they relate to 'Halla-HI' which was the only Halla Group companies at issue in this dispute. **[BCI: Omitted from public version.]**

**34. Please state whether other companies were given the opportunity to manage and take an option over Halla in the same way as Hyundai?**

The Government of Korea has no information in this regard.

**35. Please specify the price for the call option paid by Hyundai?**

**[BCI: Omitted from public version.]**

**36. According to para. 460 of Korea's submission, five companies submitted final offers to invest in Daedong. Were any of these companies foreign companies?**

The KPMG carried out an international bidding for sale of Daedong. Therefore, foreign investors may have possibly been included in the five final bidders. However, it is impossible to confirm any further information. There was confidentiality agreement between KPMG and the bidders.

**37. Korea states in paragraph 475 of its submission that it was fully responsive to the EC's questions regarding Daedong's unsecured creditors. The EC disagrees. Please provide specific information regarding the creditors that held 58.94 per cent of the unsecured debt Annex V attachment 3.3(54) (also Exhibit EC - 93) does not provide any information about these creditors, but simply lists them as "general commercial claims". Were any of these commercial**

**claims held by foreign creditors? If so, how did these foreign creditors vote with respect to the reorganization?**

Korea has provided full information on Daedong's creditors, whether or not the EC agrees.  
[BCI: Omitted from public version.]

**38. According to para. 458 of Korea's submission, one of the shareholders of Daedong, Mr. Do-Sang Lee, agreed to a complete reduction in his shareholding ownership. What were the terms of this agreement? Why did Mr. Do-Sang Lee agree to treatment less favourable than the other shareholders? How can Korea argue that he acted in his own self-interest, as it does in para. 476, when he agreed to take a total loss of his investment?**

[BCI: Omitted from public version.] Article 221(4) provides that at least 2/3 of the shares held by the shareholder who influenced the directors in the mismanagement of the bankrupt company shall be written-off. [BCI: Omitted from public version.]

[BCI: Omitted from public version.] At least in Korea, registering an objection to the stock write-off may be viewed as a shameful behaviour for a controlling shareholder and CEO of the bankrupt company. In any event, Korea is not in a position to comment on Mr. Lee's personal motivation.

**39. Can Korea confirm that the Korean Shipbuilders' Association uses a breakdown by ship types for categorizing the Korean shipbuilding production, which identifies four distinct ship types in the production of which Korean yards are particularly active, namely LNG carriers, tankers, containerships, bulk carriers?<sup>5</sup>**

The Korean Shipbuilders' Association (KSA) uses different breakdowns of ships according to the diverse purposes of such breakdown. There is no reason for KSA to apply a WTO 'like product' definition when it generally describes the ship types in which the Korean yards are active. Moreover, as the Appellate Body found in *Japan – Alcoholic Beverages*, the definition of "like product" can differ according to the provision at issue. This was confirmed in *EC – Asbestos*.

**40. Is it true that after the take-over of Halla/Samho by Hyundai the management tried to renegotiate contract prices as Halla's prices were seen as too low compared to Hyundai's?**

[BCI: Omitted from public version.]

**41. In para. 579 of its first submission, Korea lists the factors that it believes provide significant cost advantages for Korean shipyards, when compared with European shipyards. Notably missing from this analysis is the cost of debt servicing, and the cost of maintaining and constructing facilities. Why does Korea exclude these important factors from its analysis? Do prices charged by Korean shipyards not take account of these costs?**

As mentioned in the Annex V process, debt servicing costs and the cost of maintaining and constructing facilities are taken into account when Korean shipbuilders determine their sales prices. The analysis provided by Korea in para. 579 aimed at listing those elements of costs in which Korea has a significant advantage over the EC; debt servicing and the cost of maintenance and construction of facilities is a cost that all shipyards overall need to incur in order to maintain efficient production.

**42. Can Korea indicate to which extent the production value of Korean yards is hedged against currency exchange rate risks?**

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<sup>5</sup> <http://www.koshipa.or.kr/upload/english/industry.pdf>

Again, this is new evidence that the EC is attempting to derive to support its initial *prima facie* case. According to the DSU and the Panel's Working Procedures, the time is long past for the EC to attempt this. Nonetheless, Korea notes that some Korean yards do not hedge the currency exchange risk at all, while some others do hedge. For those who hedge against foreign exchange risks, the production values covered by the hedging vary from company to company and project to project.

**43. Can Korea indicate the typical time period that elapses between first contacts with an owner or broker and the actual signing of a shipbuilding contract?**

There is no typical time period. It ranges from several months to more than one year after receipt of inquiry, depending on the projects.

**44. Can Korea confirm the exact price for the Nigerian LNG carriers from Hyundai mentioned in para 561 of the Korean submission (only a price range is indicated)?**

**Why does Korea claim that Hyundai is non-subsidized? It has taken over Halla and benefits from the subsidies granted through these transactions?**

The Government of Korea does not know the exact price for the Nigerian LNG carriers from Hyundai. Moreover, Korea notes the EC has expressly rejected price undercutting arguments. The price on an individual sale is, therefore, not legally relevant to the EC's claims.

The EC again fails to apply the correct consequences of the WTO case-law indicating that "any analysis of whether a benefit exists should be on 'legal or natural persons' instead of productive operations."<sup>6</sup> As part of the Halla reorganization process, the stockholders lost their shares in Samho (first change in ownership); subsequently, the creditors who owned Samho sold all of their shares to Hyundai (second change of ownership). Therefore, Hyundai obtained no benefit.

This is the first time that the EC alleges Hyundai to have been "subsidized". Moreover, the EC has never alleged that the purchase of Samho by Hyundai was anything but an arm's-length transaction.

**45. Is the market share analysis given in para. 595 based on number of ships, rather than tonnage or cargo carrying capacity? If so, why was this particular indicator chosen?**

The market share analysis provided is based on CGT.

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<sup>6</sup> Appellate Body Report, *US – Countervailing Measures on Certain Products from the EC*, para. 110.

## ANNEX D-5

### COMMENTS OF KOREA ON RESPONSES BY THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL

(22 March 2004)

#### I. QUESTIONS TO THE EC

##### A. GENERAL

#### 1. What makes an entity a public body? Is the power to regulate and tax a necessary and sufficient condition to qualify an entity as a public body?

Korea would like to refer to the position which the EC itself took in *US – Export Restraints* in which it stated that:

“Public bodies” are types of emanations of the government, without necessarily equalling the “government” proper. Their specific characteristic is the (at least occasional) exercise of public authority (*imperium*).<sup>1</sup>

#### 2. Para. 83 of the EC's first written submission describes the purpose of permitting prospective challenges against mandatory legislation. What would be the purpose of prospective challenges against non-mandatory legal instruments? What would Members protect themselves against by bringing a prospective challenge against another Member's law that allows, but does not require, the grant of prohibited export subsidies?

Korea submits that in the case of discretionary legislation, the benefits accruing to WTO Members under the WTO Agreements are not impaired in the terms of Article 3.3 of the *DSU*. Challenging a discretionary legislation would be tantamount to be presuming bad faith on the part of a WTO Member. In practice, in cases of doubt on the implementation of the said discretionary legislation, Article 25.8 of the *SCM Agreement* provides a WTO Member with an instrument to seek information on the manner in which the legislation concerned is implemented and to discuss the matter in order to make certain that the implementation of the said legislation is WTO-compliant.

#### 4. What is the basis for interpreting Article 3.2 in a manner that prohibits legislation containing a discretion to provide prohibited export subsidies?

Korea refers to and supports the position taken by the USA in para. 12 of the third-party submission which the USA entered on 9 February 2004 and which stated the following:

With respect to Article 3.2 of the *SCM Agreement*, the EC emphasizes the phrase “neither grant nor maintain,” asserting that the word “maintain” would have no meaning if legislation providing for the discretionary grant of subsidies was not

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<sup>1</sup> Panel Report, *US – Export Restraints*, Annex B-3, para. 12.

prohibited.<sup>2</sup> Accepting for purposes of argument (1) the EC's definition of the word "maintain" as "cause to continue," and (2) the notion that "maintain" refers to subsidy legislation rather than a "subsidy" itself, the application of the mandatory/discretionary distinction to Article 3.2 does not render the word "maintain" meaningless. The word "grant" can be construed as applying to actual, discrete bestowals of subsidies under subsidy legislation – "as applied" situations – while the word "maintain" can be construed as applying to the enactment of legislation that mandates the "grant" of prohibited subsidies, thereby causing such subsidies to continue – "as such" situations. Under this approach, legislation that conferred discretion to bestow subsidies would not run afoul of either term insofar as an "as such" challenge is concerned.

## B. KEXIM LEGAL REGIME

### **6. Is the EC of the view that finance / guarantee measures provided under the KEXIM legal regime would necessarily be inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement? Please explain.**

Korea will await the position of the EC in this regard but, at this stage, wishes to point out that even if it were considered that the KEXIM legislation mandates giving export assistance (which Korea disputes), this still is not incompatible with Articles 3.1(a) and 3.2 as no benefit is afforded. Further, specific grants of financing and guarantee measures are not inconsistent necessarily with Articles 3.1(a) and 3.2. In fact, the EC did not and could not argue that all of the APRG/PSL grants were subsidies although Korea provided data on these grants.

### **7. The KEXIM 2002 Annual report (Exhibit EC-14) contains a chapter entitled Bank Operations. That chapter refers to a decline in KEXIM's export credit business. It states that "[m]ajor Korean exporters were reluctant to use bank loans, instead they preferred raising funds from direct markets which was possible due to their successful corporate restructuring". Does this suggest that KEXIM's export credit terms are less attractive to Korean exporters than the terms for competing financing from other sources? Please explain.**

Yes, KEXIM export credits are now less attractive. This is demonstrated by the fact that Korean shipbuilders are now using KEXIM preshipment loans for a small portion (approximately 20 per cent) of their shipbuilding projects. Moreover, some Korean shipbuilders are never using the KEXIM preshipment loans at all.

### **8. Para. 122 of the EC's first written submission states that the KEXIM legal regime, as "confirmed by KEXIM practice", provides for the grant of subsidies. Is the EC challenging "KEXIM practice" as well as the KEXIM legal regime as such, or does the EC rely on evidence regarding "KEXIM practice" in support of its claim against the KEXIM legal regime as such? If the latter, please explain how evidence regarding "KEXIM practice" is relevant to the Panel's assessment of whether the KEXIM legal regime as such is, or is not, in conformity with the SCM Agreement.**

In the opinion of Korea, para. 131 of the EC's first written submission confirms that the EC's assertions are based both on the legal regime and the alleged practice and that the EC considers that it cannot rely on the legal regime alone. Indeed, the EC states that "[t]hese factors, when considered together with the record of KEXIM financing detailed below, establish that the KEXIM Act, Decree and Interest Rate Guidelines provide for WTO-inconsistent actions."

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<sup>2</sup> EC's First Written Submission, paras. 79-80.

At a different level but based on the same argument, Korea reiterates that the EC has never defined the so-called KEXIM APRG and pre-shipment loans other than by the individual instances in which APRGs and PSLs were issued to shipbuilders.

C. APRG PROGRAMME

**9. How does the EC's claim against the "APRG programme" as such differ from its claim against the KEXIM legal regime as such? Isn't the "APRG programme" based on the KEXIM legal regime? Is it conceivable to assess one of them differently from the other?**

As mentioned above, Korea considers that the EC has never defined what the APRG programme really is in terms of statutory framework. Beyond that, however, the conditions at which APRGs can be afforded are set forth in the KEXIM Interest Rate Guidelines which, in accordance with the EC's own arguments, are part of the KEXIM legal regime that is challenged as such.

D. PSL PROGRAMME

**11. How does the EC's claim against the "PSL programme" as such differ from its claim against the KEXIM legal regime as such? Isn't the "PSL programme" based on the KEXIM legal regime?**

Korea refers to its comments in relation to Question 9 above which equally applies as regards the PSLs.

F. ACTIONABLE SUBSIDIES

**16. In its third party submission in the *US – Export Restraints* case, the EC argued that there is no government entrustment or direction in a case where freedom of action is "limited", but not "curtailed", i.e., where "the producer can still make choices". Does the EC consider that the freedom of action of private financial institutions participating in the restructuring process was (i) "limited" or (ii) "curtailed"? Were those companies able to make choices regarding their participation in the restructuring process? Please explain.**

In the same vein, Korea would like to mention the EC's response to a question raised by the Panel in *US – Export Restraints*:

- (b) Why would the "pre-determined conditions" have to exist in order for a private body to be carrying out a function normally vested in a government?

As already explained by the EC in its Written Submission, the actions contemplated by Article 1.1(a)(1)(iv) of the *SCM Agreement* are not "expansive", but limited to those enshrined, for governments or public bodies, in subparagraphs (i) to (iii) of the same Article.

Therefore, the determining factor for a private body carrying out the functions normally vested in the government and the practice differing, in no real sense, from practices normally followed by governments (which is the full text of the relevant part of Article 1.1(a)(1)(iv) of the *SCM Agreement*) is that the private body must, through government direction, perform materially the same function as would otherwise be carried out by the government itself – and caught by Article 1.1(a)(1)(i)(iii) of the *SCM Agreement*.

Now, when a government decides to provide a subsidy to a certain industry or part of an industry, the government will decide in advance the kind of action it wishes to take, the class of beneficiaries it wishes to reach and the extent of the "benefit" it wishes to confer. The same standard must apply in the case of an 'indirect subsidy' with the government predetermining,

through regulatory means, essentially the same conduct for the private body, and the same result for the beneficiary industry, than the government would otherwise “directly” have implemented itself.

Only if such pre-determination exists, will the private body become a quasi-emanation of the government. Only then will it carry out a subsidizing function “normally vested in the government”, and only then will the practice “in no real sense differ from practices normally followed by governments”. In the EC’s view, therefore, the existence of (government) “pre-determined conditions” is a *sine qua non* for the existence of an indirect financial contribution in the sense of Article 1.1(a)(1)(iv).

Korea submits that the Government of Korea has not predetermined the kind of action that private banks had to take when participating in corporate restructuring, which specific companies had to go in corporate restructuring or the extent of the benefit (if there were one, which Korea denies) to confer. The private creditors of DHI, Halla and Daedong freely determined whether to apply for workout or corporate reorganization and which measures to take in the corporate restructuring. The many creditor meetings and the opposition of private creditors to initial restructuring plans demonstrate that there were no pre-determined conditions of such a nature that there was direction or entrustment on the part of the Korean Government vis-à-vis the private creditors participating in the corporate restructuring.

**17. Are you arguing in paragraph 73 of your oral statement that the banks that participated in the Corporate Restructuring Agreement thereby legally committed themselves up front to follow the direction of the government? Did such undertaking(s) by the banks affect all of the restructurings referred to in your complaint? Please elaborate and provide specific evidence.**

The fact that creditors opted for a corporate reorganization in the case of Halla and Daedong rather than for a workout demonstrates that the banks that participate in the CRA did not commit “to the workout as the solution for bankruptcy” as is stated by the EC in para. 73 of its oral statement.

The CRA aims to achieve the promotion of workouts as an accelerated means for restructuring in accordance with Korea’s negotiations with the IMF. Nevertheless, nothing in Articles 1, 2 and 20 referred to by the EC entails any waiver by the domestic banks from their rights to act independently. In particular, the penalty provided in Article 20 does not relate to a breach of the CRA itself but would apply if a creditor institution which freely entered into a workout plan failed to implement the workout plan. It is a penalty for a contractual default but not a penalty in case the financial institutions failed to participate in a workout.

**20. The EC asserts (first written submission, para. 281) that KAMCO purchased non-secured loans held by foreign creditors of DHI on terms more favourable than those offered to domestic creditors. How is this relevant to the Panel's examination of the issues of whether or not there was a financial contribution and benefit to the restructured company?**

Korea also refers to the response it provides to Question 80 of the questions addressed to it by the Panel.

**24. Where a government entity is a creditor of an insolvent company being restructured, will the restructuring always result in a subsidy? Why or why not?**

As long as the government – creditor behaved according to commercial standards, the restructuring does not constitute a subsidy.

G. SERIOUS PREJUDICE

**27. Korea argues that there is considerable variation or diversity of products within each of the product segments proposed by you, meaning that these product segments are too broad and should be broken down, for example, at least into different size ranges. Please comment on the diversity of products within each of the product segments that you propose, and in this context please respond specifically to Korea's arguments on this point.**

With regard to Questions 25, 26 and 27, Korea refers to the responses which it provided to questions 86 and 87 that were raised to it by the Panel.

**29. You argue that there are three market "segments" relevant to your price suppression/depression claim: LNGs, chemical/product tankers, and container ships.**

- (a) Is the implication of this that in your view, price suppression/depression should be found in respect of each of these segments separately?**
- (b) If so, what is the relevance of figures 33-36 of your submission? That is, please explain what conclusions about price and cost trends in respect of the particular kinds of ships referred to in your claim can be drawn from these graphs, which appear to represent averages for all ships of all types.**

Where there are different like products as stated by the EC or for like products as submitted by Korea, price depression or suppression must be established for each of those separately. Where no significant price depression or suppression is found for one or more of them, then no adverse effects can be found for that like product and no remedy should be adopted as regards that like product. Therefore, the burden of proof lies on the EC not only to determine, as is argued by Korea, the like product but also to prove the existence of price depression or price suppression for each like product separately. The graphs submitted by the EC reflect ship types as diverse as cruise ships, RoRos, bulk carriers, container vessels, LNGs, pure chemical tankers and product and chemical tankers, etc. without evidentiary nature for the price depression or suppression of each of the three ship types concerned.

- (c) Do you agree with Japan's argument that a low price for any individual transaction will put downward pressure on all types of ships, whether substitutable or not? If so, why? Does a decline in the price of a ship of a certain type, for instance a container ship, cause a decline in the price of a ship of another type, e.g., a tanker or passenger ship? Is it not more defensible to argue that a decline in the price of one ship causes a decline in the price of another ship with the same end-use?**

We do not agree with this statement from Japan for several reasons.

First, shipping markets, e.g., product tankers for carrying oil and containers vessels are discrete segments, which operate with no possibility of vessel substitution. It is also the case that each market will follow its own freight cycle, due to underlying movements in vessel supply and demand. Furthermore, it is rare for individual markets to be at the same stage in the development of the freight cycle (increasing or decreasing). The freight cycle is important, in that it influences the level of earnings for the ship owner and in turn this will have a bearing on new ordering levels. Normally, in a strong freight market new ordering will rise.

From the shipbuilders perspective it is not uncommon to witness a situation where new ordering for one type of ship is strong, but for another weak. As such, it does not follow that if new

ordering in one sector is weak and a builder accepts a “low” price, that price in other sectors (where ordering levels maybe stronger) would be under downward pressure.

In fact, there are examples of where ship prices by sector move in opposite directions, due in the main to differences in demand for individual ship types. For example, between 1998 and 1999 newbuilding prices for oil tankers of all types fell, while prices for bulk carriers of all types rose. Even in individual market sectors, e.g., oil tankers, there will be differences in price changes between one vessel type and another due to the existence of different specifications even within the same type of vessels as stipulated by Korea.

Second, most shipbuilders and owners are aware that a price for a ship will be determined by many factors, not least of which are the vessel’s physical specifications, yard material, labour and production costs and exchange rates. One transaction in isolation does therefore not set a trend for the industry as a whole. Although it is true that the “last quoted price” will have a bearing on the next subsequent order for that particular ship type, provided the ship is of a similar specification. However, the influence of “last business” will not necessarily extend to all other ship types within a sector and certainly not across all fleet sectors.

Third, in a typical year between 1,500 and 2,000 new orders (for all commercial ship types) will be placed with the world’s shipbuilders. There is no established mechanism for making the prices of these contracts known publicly; indeed many are concluded on private and confidential basis. In short, shipbuilders will not be aware of every price transaction, so it is illogical to argue that a single transaction can set a price trend for the whole industry.

**(d) Is it not more defensible to argue that a decline in the price of one ship causes a decline in the price of another ship with the same end-use?**

Within fleet sectors there is some crossover between individual segments. For example, a suezmax tanker at the low end of the suezmax size spectrum may at times compete with larger aframax for cargoes. However, a VLCC does not compete with a handy tanker.

Overall, if the newbuilding price for a VLCC is either falling or rising it will have a bearing on price trends in other adjacent oil tanker segments. Movements in newbuilding prices between ship types in a sector are not always uniform. Once again, the reason being that there will be differences in demand for individual ship types within a sector.

**34. As a general matter, please describe the precise nature of the analysis that you believe is required to establish serious prejudice through price suppression/price depression, including the following issues:**

- (a) Must there be (at least *inter alia*) a demonstration that the prices for the complaining party's products have been suppressed or depressed, or is the focus of the analysis instead the prices for the allegedly subsidizing party's product? Or are both sets of prices relevant?**
- (b) How if at all should these two sets of prices be juxtaposed against or related to one another?**
- (c) How similar must the complaining party's and allegedly subsidizing party's products be?**

Korea refers to the response it is submitting to Question 91 of the questions raised to it by the Panel.

**38. In arguing, on the basis of US – Norwegian Salmon CVD and Article 15 of the SCM Agreement that an "a cause" standard is sufficient for a finding of serious prejudice, are you implying that the causation standard for serious prejudice is the same as that for a countervailing measure? If so, what is the textual basis for such an argument? If not, what is the relevance to this dispute of either SCM Article 15 or the standard applied by the Salmon CVD panel? In this context, please respond to the US comment pointing to the difference in drafting between SCM Article 6.3(c) and SCM Article 15 ("the effect of the *subsidy* [...]" versus "the effects of the *subsidized imports* [...]"), respectively).**

Korea refers to the response which it is submitting to Question 90 of the questions raised to it by the Panel.

**41. Please respond to Korea's argument that the effect of any alleged subsidy must be "current", and thus that past subsidies should not be taken into account unless they can be shown to have such a current effect.**

Korea refers to its response to Question 83 of the questions raised to it by the Panel.

**45. Please comment on China's argument, in paragraph 46 of its written submission, that if the total amount of a subsidy is ten dollars only, it cannot be successfully demonstrated that the effect of such a subsidy is to *significantly* suppress or depress the price of a one-billion-dollar vessel.**

With respect to questions 44 and 45, Korea refers to its response to Question 91 of the questions raised to it by the Panel.