

## ANNEX E

### EXECUTIVE SUMMARIES OF THE SECOND WRITTEN SUBMISSIONS OF THE PARTIES

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## ANNEX E-1

### SECOND WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

(13 April 2004)

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## I. INTRODUCTION

1. The Second Written Submission by the European Communities rebuts legal and factual assertions that have been made by Korea in its First Written Submission and at the First Substantive Meeting.

## II. FACTUAL BACKGROUND

2. The European Communities discusses a number of inaccurate factual statements that Korea made in its First Written Submission, and shows that Korea attempted to mislead the Panel with respect to the nature of the commercial shipbuilding industry, the Korean economy, and the views of the International Monetary Fund (IMF).

## III. BURDEN OF PROOF AND ADVERSE INFERENCES

3. Rather than respond to the EC's evidence, Korea hides behind unsubstantiated assertions that the European Communities has not established a *prima facie* claim. Korea has even argued that the European Communities does not understand the difference between the role of complainant and respondent, and is asking the Panel to make "the complainant's case for it." As discussed in the EC's Oral Statement, Korea misunderstands what is necessary to make a *prima facie* case. If complainants were obliged to set out a case in the excruciating detail demanded by Korea, any dispute settlement proceeding would become unworkable.

4. A *prima facie* case can be based on simple assertions of facts that do not need to be further proven if undisputed by the respondent. The complainant would then be obliged to provide further proof only if the defending party disputes such assertions in a substantiated way. Moreover, a *prima facie* case may be supported by certain presumptions from the WTO Agreements, or by adverse inferences.

5. In this way, during the course of dispute settlement proceedings, the burden of persuasion shifts between the complainant and the respondent. Once the complainant makes a *prima facie* case, the burden shifts to the respondent to rebut those claims. Once rebutted, the burden then shifts back to the complainant, and so on. In this way, WTO dispute settlement is an iterative process in which both the complainant and the respondent have a responsibility to assert and substantiate claims to support their respective positions.

6. In cases involving subsidies and in particular serious prejudice arising from subsidies, panels are asked to be particularly active in seeking information (*e.g.*, Article 6.8 of the *SCM Agreement*). This Panel has already used its power under Article 13 of the *DSU* and Article 6.8 of the *SCM Agreement* to request specific evidence from Korea. As Korea has not produced this evidence in its entirety, the Panel must draw adverse inferences. The European Communities recalls the authority vested in the Panel to request further information from the parties, where necessary.

## IV. KOREA'S INTERPRETATIONS OF "PUBLIC BODY" AND ENTRUSTED AND DIRECTED "PRIVATE BODY" ARE CONTRARY TO THE TEXT, AND OBJECT AND PURPOSE OF THE *SCM AGREEMENT*

7. The European Communities demonstrates that Korea's narrow definition of "public body" and "private body" entrusted or directed by the government is not compatible with Article 1.1(a)(1) of the *SCM Agreement*. Article 1.1(a)(1) refers to financial contributions by a "government," a "public body," or a "private body" entrusted or directed by the government. Without the reference to "public body" and "private body," Members could entirely circumvent the disciplines of the *SCM Agreement* by using non-governmental entities to dispense subsidies.

8. To determine whether an entity is a public body or a private body entrusted or directed by the government, a Panel must consider all evidence, including circumstantial evidence. Korea wrongly interprets the terms “public body” and “government” as being synonymous and provides irrelevant context for the interpretation of “public body” from the *Agreement on Agriculture* and the *GATS Annex on Financial Services*.

9. There is no requirement in the *SCM Agreement* that the direction be “explicit and affirmative.” Instead, the *SCM Agreement* refers only to instances in which a government “entrusts or directs a private body” without any such limiting qualifiers. Korea cannot rely on *US – Export Restraints* because the entrustment and direction in that case related to a general legislative measure, while in the present case it relates to *specific measures* taken to influence the policies and practices of private banks.

10. Just as Korea wrongly interpreted “government practice” in Article 1.1(a)(1)(i) of the *SCM Agreement*, Korea also wrongly interprets “functions . . . which would normally be vested in the government” or “practices normally followed by governments” in Article 1.1(a)(1)(iv). Korea erroneously argues these references are limited to functions and practices such as taxation and expenditure of revenue. This error arises again because Korea ignores the fact that “government” has been defined to include both “government” and “public body.” The practices performed by public bodies are not limited in the same way as those of actual governments – i.e. regulatory function is not a necessary characteristic of “functions . . . which would normally be vested in the government” or “practices normally followed by governments.”

11. The European Communities therefore repeats and amplifies its arguments that:

- KEXIM, KAMCO, KDB, IBK, KDIC, and BOK are public bodies, or, in the alternative, private bodies entrusted or directed by the Government of Korea; and
- The private creditors involved in the corporate restructuring of the Korean shipyards are private bodies entrusted or directed by the Government of Korea.

## V. THE *SCM AGREEMENT* APPLIES TO PAST AS WELL AS PRESENT SUBSIDIES

12. Articles 3 and 5 of the *SCM Agreement* clearly prohibit certain behaviour – i.e. subsidisation contingent on export (or the use of domestic over imported goods), and subsidisation that causes adverse effects to the interests of other Members. As discussed in the EC’s Oral Statement, there is no WTO rule that allows a violation to be forgiven once it is in the past. When Korea argues that subsidies granted in the past cannot be challenged under the *SCM Agreement*, it confuses the issue of whether a subsidy has been granted with countervailing duty principles, which only allow current benefits to be offset. It also confuses the issues before this Panel—whether a violation has occurred—with the appropriate remedy for violations. In this case, the Panel has not been asked to specify how Korea may bring itself into conformity with its WTO obligations.

13. The European Communities is entitled to a panel finding for all subsidies granted or maintained after the entry into force of the Uruguay Round. The Panel in *Indonesia – Autos* confirmed that past subsidies are subject to review. The Panel found that to exclude past (and future) subsidies from the scope of review would make it difficult for any complainant to demonstrate serious prejudice.

14. The same reasoning applies, *a fortiori*, to prohibited subsidies claims. It would be illogical for the scope of review of prohibited subsidies, which are illegal *per se*, to be narrower than the scope of review for subsidies that may be illegal depending on their trade effects.

15. While not required to demonstrate the current effects of subsidies, the European Communities has nevertheless done so in its Responses to the Panel's Questions with respect to the actionable subsidies granted to the shipyards through the corporate reorganisation and restructuring proceedings.

## **VI. PROHIBITED SUBSIDIES**

16. The European Communities responds to numerous arguments raised by Korea claiming that (i) the KEXIM Act, KEXIM Decree, and KEXIM Interest Rate Guidelines as such, (ii) the KEXIM APRG and pre-shipment loan programmes as such, and (iii) specific grants of APRGs and pre-shipment loans do not constitute prohibited export subsidies under Article 3 of the *SCM Agreement*.

17. First, the European Communities demonstrates that the mandatory/discretionary doctrine can not be used to shield the KEXIM Act, KEXIM Decree, KEXIM Interest Rate Guidelines, or APRG/pre-shipment loan programmes from the obligations of the *SCM Agreement*. In particular, the Appellate Body has confirmed that analysis of WTO consistency of a measure does not end with a finding that it is discretionary. Moreover, it is clear from the *SCM Agreement* that subsidy regimes like those of KEXIM are subject to prospective challenge.

18. The European Communities further explains that Korea has not rebutted the EC's evidence that the KEXIM Act, KEXIM Decree, and KEXIM Interest Rate Guidelines specifically envisage the provision of prohibited export subsidies. The European Communities reiterates its understanding that various provisions of the KEXIM Act, Decree, and Interest Rate Guidelines, including Articles 18, 19, 24, 36(2), and 37 of the KEXIM Act, and Articles 17(2) and 25(6) of the Interest Rate Guidelines, specifically envisage the grant of subsidies that violate Article 3 of the *SCM Agreement*. Korea's responses, including a request that the Panel virtually ignore Article 24 of the KEXIM Act based on an explanation that it should have been repealed, lack merit.

19. The European Communities next addresses Korea's counter-arguments regarding the specific grants of APRGs and pre-shipment loans, and confirms that these specific grants provide benefits to Korean shipyards. In particular, the European Communities demonstrates that transactions by foreign creditors provide a relevant market benchmark, and makes use of additional information provided by Korea to again demonstrate the benefit provided by KEXIM APRGs and pre-shipment loans. Additionally, the European Communities demonstrates that the alternative benchmarks proposed by Korea are not relevant benchmarks.

20. Finally, the European Communities reiterates that Korean APRGs and pre-shipment loans cannot be considered to fall within "safe havens" under the *SCM Agreement*. APRGs are neither export credit guarantees nor guarantee programmes against increases in costs under item (j) of the Illustrative List. Moreover, pre-shipment loans are not "export credits" within the meaning of item (k) of the Illustrative List.

## **VII. ACTIONABLE SUBSIDIES**

### **A. RESTRUCTURING SUBSIDIES**

21. Korea implies throughout its First Written Submission and Oral Statement that the European Communities believes that *all* bankruptcies and reorganisation proceedings constitute actionable subsidies within the meaning of the *SCM Agreement*. Moreover, Korea characterises the EC's arguments as indicating that a restructuring scheme requiring banks to act on market principles and to maximise returns results in the granting of an actionable subsidy. This is plainly an incorrect reading of the EC's submission. Indeed, as detailed previously, the European Communities fully accepts that bankruptcy law is a necessary part of a market economy, and that a bankruptcy proceeding does not generally give rise to a subsidy within the meaning of the *SCM Agreement*.

22. However, where the outcome of a bankruptcy proceeding or a corporate restructuring is determined by the Government, public bodies, or private bodies acting under the direction of the Government, 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.

23. While the European Communities has already presented evidence demonstrating a *prima facie* case that the financial contributions granted pursuant to the restructuring/reorganisation of the three Korean shipyards have resulted in a benefit, and that these grants were specific, the European Communities responds to Korea's various arguments by explaining that:

- Daewoo-HI/Daewoo-SME, Samho-HI/Halla-HI, and Daedong/STX received financial contributions from public bodies and private bodies entrusted or directed by the Government of Korea that provided benefit to these shipyards, and are specific within the meaning of the *SCM Agreement*, and
- Korea failed to respond adequately to the claim relating to the tax concession, in particular 45-2 of the Corporate Tax Act, which was enacted on 21 October 2000 and extended tax incentives provided under Article 46 to spin-offs carried out under a workout program approved on or before 31 December 2000. This specifically tailored tax exemption provided a benefit to Daewoo-HI/Daewoo-SME of KRW 236 billion.

24. The European Communities details the manner in which private bodies were entrusted and directed by the Government of Korea and public bodies to participate in the corporate restructuring process. For example, the Government of Korea explained, in its Letter of Intent to the IMF, that public funds would be made available when a "bank is making adequate progress on implementation of sound corporate debt restructuring", at a time when Korean financial institutions depended on public funds for their own survival. The European Communities also details the instrumental role of KAMCO, a public body, in influencing the restructurings.

25. With respect to each of the three shipyards, the European Communities reiterates the appropriate market benchmark for analysing the corporate restructuring, and demonstrates the benefit accorded to the restructured shipyards. With specific respect to Daewoo-HI/Daewoo-SME, the European Communities demonstrates that the Arthur Andersen report does not rebut a *prima facie* case of benefit.

26. The European Communities details again the manner in which the restructuring subsidies are specific within the meaning of Article 2 of the *SCM Agreement*. They were all provided within the context of a specific restructuring of a single enterprise. Daewoo-HI/Daewoo-SME, in particular, was restructured under the specifically created framework of the Corporate Restructuring Agreement; Daewoo affiliates accounted for over half of the workout procedures under this framework in 1999, and two-thirds in 2000. The European Communities has also provided evidence that certain financial institutions were re-capitalised specifically for the purpose of ensuring payment of Daewoo bondholders.

27. With respect to Samho-HI/Halla-HI, and Daedong/STX, the European Communities reiterates its evidence that public bodies, including KEXIM and KDB, and entrusted/directed private creditors specifically selected these shipyards as recipients of restructuring on better-than-market terms. Korea can not prevail by arguing that any restructuring that takes place pursuant to an existing legal framework precludes a finding of specificity, as this would exempt all corporate reorganisations from the scope of the *SCM Agreement*.

B. KOREA'S SUBSIDIES HAVE CAUSED SERIOUS PREJUDICE TO THE INTERESTS OF THE EUROPEAN COMMUNITIES, WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(C) OF THE SCM AGREEMENT

28. The European Communities responds to Korea's various arguments, and reiterates that Korea's subsidies to its shipyards have caused serious prejudice to the interests of the European Communities within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*, as they resulted in significant price suppression and depression in the same market. Specifically, the European Communities demonstrates in the Second Written Submission that:

- Serious prejudice is not a separate legal element, and the European Communities has met its burden under Articles 5(c) and 6.3(c) by demonstrating that price depression or suppression in the same market was caused by the Korean subsidies;
- Korean and EC shipyards compete in the same geographic market (*i.e.*, the world market) and the same product markets (*i.e.*, liquid natural gas tankers (LNGs), container ships, and product/chemical tankers);
- Korean subsidies have caused significant price suppression and depression in these markets; and
- Korea fails to rebut the *prima facie* case of causation presented by the European Communities.

**1. Significant Price Suppression or Depression**

29. The European Communities responds to Korea's various arguments regarding price suppression and depression and demonstrates that:

- The assessment by the European Communities of prices of commercial vessels, and the dynamics affecting these prices, is well-supported by factual evidence;
- The European Communities has properly identified the general relationship between subsidies and prices of commercial vessels;
- KEXIM APRGs and pre-shipment loans have contributed to the price depression and suppression; and
- The Korean subsidies have caused price depression and suppression of LNGs, and price suppression of container ships and product/chemical tankers.

**2. Causation**

30. The European Communities replies to Korea's erroneous legal and factual assertions regarding causation of price depression and suppression by explaining as follows:

- Korea's proposed approach, including the vastly overcomplicated multi-step procedure to assess the effects of subsidies, has no basis in the text of the *SCM Agreement* and in WTO jurisprudence, which requires a 'but for' test;
- The evidence provided by the European Communities shows a clear coincidence in time between the subsidies and the price effects;

- The European Communities has presented *prima facie* evidence of causation, through use of relevant statistics and examples, including numerous facts and calculations showing the level of the subsidisation and the level of price depression and suppression;
- Korean subsidies allowed for maintenance of over-capacity, that significantly affected prices;
- The ability of subsidised Korean shipyards to affect the prices of LNGs, container ships, and product/chemical tankers is further supported by accurate market share data and information regarding individual transactions; and
- Korea's reference to additional factors does not cast doubt on the *prima facie* case of causation set forth by the European Communities.

## VIII. CONCLUSION

31. The European Communities has shown that Korea has failed to rebut the *prima facie* case put forth by the European Communities demonstrating that the Government of Korea, public bodies, and private bodies entrusted or directed by the Government of Korea have provided enormous subsidies to Korean shipyards from 1 January 1997 to the present.



## ANNEX E-2

### SECOND WRITTEN SUBMISSION OF KOREA

(13 April 2004)

#### I. INTRODUCTION

1. In Korea's Second Written Submission, Korea rebuts the factual and legal allegations made by the EC in its Oral Statement of 9 March 2004 and in the responses submitted by the EC to the questions raised by the Panel and Korea on 22 March 2004. Korea addresses the core issues raised by the EC in terms of the subsidy allegations and sets forth the factual and legal grounds on which Korea relies to conclude that no prohibited or actionable subsidies were granted by Korea.

2. Korea notes from the outset that the EC's continued references to a centralized role of the Korean Government in the Korean economy are outdated and inappropriate. Ironically, to the extent that there was guidance from the Korean Government during the relevant period, it was to ensure that market principles and commercial considerations were paramount in the course of restructurings and more generally throughout the financial sector – a fact repeatedly confirmed by the IMF despite the EC's pressure on the IMF to say otherwise.

#### II. EVIDENTIARY ISSUES

3. The EC has utterly failed to carry its burden of establishing a *prima facie* case for each of its claims based on proven facts. The EC as complainant has the burden to establish every point necessary to demonstrate each claim. Failure on one point means failure on the claim as a whole. The EC has failed or refused to even argue critical issues underlying its claims.

4. Regarding prohibited subsidies, the EC does not have sufficient evidence and has been forced to demand that adverse inferences on APRGs be made against Korea based on law exclusively related to serious prejudice cases (i.e. Annex V), resulting in an abuse of the Annex V process.

5. With respect to pre-shipment loans, the EC relies on a totally unrelated benchmark (corporate bonds) that differs in terms, collateral and very nature from the measure at issue. Korea also showed that the corporate bond rates were inaccurate. Moreover, the EC did not make any adjustments for any of the differences in the critical factors such as terms of credit, collateral, etc. The EC's response that it was now up to Korea to prove the negative of the EC example must be rejected. The EC has failed to carry its burden of proof on this critical point. The EC cannot dodge its burden of establishing its own *prima facie* case. It cannot shift its burden to Korea nor to the Panel. The Appellate Body in *Japan – Apples* makes clear that the burden of establishing a *prima facie* case rests entirely with the complainant.

6. The EC demands from Korea further information at this late stage in the panel proceeding purportedly for the Panel to figure out how to use such information in calculating benefit. As Korea has pointed out a number of times, the Appellate Body in *Japan – Agricultural Products II* made it quite clear that panels are not to make the complainant's case for it. The EC's approach betrays that it has not presented sufficient evidence to satisfy its burden of proof.

7. The EC's arguments that the KEXIM Act, the APRG and pre-shipment loan programmes are inconsistent "as such" must be rejected. The EC is asking the Panel to reject an enormous amount of

GATT and WTO jurisprudence regarding the mandatory/discretionary distinction in evaluating legislation.

8. Regarding the EC's claim of serious prejudice, not a single element of the *prima facie* case has been proven. The EC did not establish that the banks identified were "public bodies". The EC cites to the fact that there is governmental ownership and public policies stated in the charter but these certainly do not suffice to be a 'public body'. A public policy or sectoral focus is also found in many privately owned companies. Further, Korea has identified the key issue in identifying a 'public body' as looking to the governmental function. With respect to "private bodies directed or entrusted by government" the EC has utterly failed to provide any explicit evidence at all.

9. The EC has for the first time actually identified the alleged beneficiaries. But its answers are mutually contradictory. On the one hand, the EC argues that the beneficiary of the Daewoo restructuring is Daewoo. Does the EC mean the old bankrupt Daewoo? If so, the EC has admitted that the new entity is not subsidized for the owners of the new entity want market returns on their assets and that motivation is completely detached from any earlier events under prior ownership. It may be that the EC actually means to refer to the new entity, DSME. But this would be similar to the losing arguments of the United States in the privatization cases. Moreover the EC argues that the subsidy occurs because the DHI creditors paid too much for the DSME stock they received in the restructuring. The contradictory nature of the EC's arguments is revealed when it turns to Hyundai and argues that the basis for the subsidy is that Hyundai paid too *little* for Samho.

10. Remarkably, the EC argues that "debt and equity do not have the same value".<sup>1</sup> This is not true. Debt and equity are different forms that may or may not have the same value at any given moment depending on the facts. The EC further claims that debt and equity swaps *per se* confer a benefit<sup>2</sup> and thereby proposes a sweeping rule that would render large swathes of Member countries' bankruptcy and insolvency codes as *per se* subsidies. Debt-for-equity exchanges are the base line manner of resolving insolvency. The EC is arguing that anything other than termination and winding up of insolvent companies is a *per se* subsidy. There is simply no basis for such a sweeping rule. Indeed, it would be inimical to the operation of any market economy including those of the EC .

11. Furthermore, in response to Question 20, the EC now wants to argue that the purchase of debt by KAMCO constituted a grant or equity infusion ignoring the inconsistency of this claim with its earlier statement that debt and equity cannot as a matter of law have the same value. This amounts to a new claim which was neither in the consultation request, request for Panel establishment, nor in any argument made so far and must be rejected at this stage.

12. Also, regarding the alleged restructuring subsidies, the EC has failed to carry its burden with respect to specificity, relying instead on repetitions of the benefit claims.

13. In response to Question 22, the EC again argues for a *per se* rule as a substitute for presenting the necessary evidence. The EC is reduced to arguing that unless every company in every country that ever went bankrupt has precisely the same circumstances or obtains different results from their debt workouts or restructurings, there is a *per se* subsidy.<sup>3</sup> Obviously, there cannot be any such *per se* rule regarding insolvency procedures.

14. With respect to serious prejudice the EC has not shown how the alleged subsidies affect the broader interests of the EC, much less seriously prejudice them.

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<sup>1</sup> Refer to para. 62 of the EC's response to the Panel's Question 17, at page 16 of the EC's responses.

<sup>2</sup> Refer to para. 75 of the EC's response to the Panel's Question 18, at page 19 of the EC's responses.

<sup>3</sup> Refer to paras 91 and 93 of the EC's response to the Panel's Question 22, at pages 24-25 of the EC's responses.

15. Like product has been left undefined. There is no information regarding how the products are physically similar or distinct in meaningful ways. More than that, the EC explicitly rejects that the notion is relevant and instead relies on some extra-treaty term of “market segmentation” but even then products seem to sail in and out of each pliable category depending on which passage of the EC’s submissions one refers to. The EC continues to refuse to provide this essential evidence.<sup>4</sup> It is too late to do so now.

16. In question 30, the Panel asked for the EC to provide the capabilities and experience of each shipyard that produces vessels within the scope of the dispute. The EC refused to do so because the number of relevant shipyards is “too many”. This is outrageous. The EC submitted about 600 questions to Korea in the short Annex V process and demanded that Korea translate thousands of resulting pages for the convenience of the EC. The EC then simultaneously shrank the size of its case, meaning much of that effort was wasted and then tried to claim adverse inferences liberally. Yet, when asked by the Panel for a relevant piece of information the EC refuses to answer the question because it allegedly is too hard. Korea requests that the Panel make adverse inferences against the EC in this regard.

17. With respect to causation, the EC rejects any need to quantify the alleged subsidy and rejects any need to link that subsidy to the alleged price suppression or depression. The EC has abandoned any attempt at identifying, much less explaining, the market mechanism that transmits the effects of the alleged subsidies, having abandoned every other element of proof contained in Article 6.3, including price undercutting.

18. The EC has failed to carry its burden of proof and indeed explicitly rejected it on element after element. Korea has been as forthcoming as it can be in supplying information; however, this cannot serve as a substitute for the EC’s burden of establishing its own *prima facie* case on each claim.

### III. ABSENCE OF PROHIBITED SUBSIDIES

19. KEXIM is not a public body. Korea has articulated a standard based on the one used in *Canada - Dairy* specifically that an entity is a public body only when it acts in an official capacity.<sup>5</sup> Conversely, if an entity is acting in a commercial manner consistent with market considerations and not in an official capacity, it is not a public body. The EC, by contrast has not even articulated a consistent theory on what constitutes a public body. KEXIM is required to operate on a commercial basis and does not have the authority to regulate and is thus not a public body under the definition espoused by Korea or under the definition used by the EC in its TBR report or in initial statements in its First Written Submission. Moreover, as explained in response to question 49 of the Panel’s questions, KEXIM has minimal government borrowing and borrows nearly all its funds on the open market and must maintain a sound credit rating. Any capital injections made by the Korean Government were not for the purpose of covering losses but were for improving KEXIM’s credit rating. Finally, KEXIM has been consistently profitable.

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<sup>4</sup> Indeed, in response to a question to provide further evidence, the EC responds by repeatedly citing its own Oral Statement. See paras 115-116 of the EC’s response to the Panel’s Question 27, at page 32 of the EC’s responses that can hardly be considered convincing evidence. The EC also attempts to cite Korea’s request for consultations. Refer to paras 118-121 of the EC’s response to the Panel’s Question 28, at page 33 of the EC’s responses. Obviously, Korea does not present rigorous evidence in its request for consultations and it is odd that the EC would consider that to be the case since the EC has not done so in this dispute through the point of its “Answers” to Questions, much less the request for consultations. Korea would also make the observation that much of the contours of that case will depend on the Panel’s interpretations in this case, not the other way around.

<sup>5</sup> Korea’s First Written Submission at paras 146 and 147.

20. Not only do the individual APRG and PSL instances not confer a benefit but, in addition, the KEXIM legal regime, the APRG and PSL schemes cannot be challenged as such. The individual APRG and PSL transactions confer no benefit and the EC has failed to establish the appropriate market benchmark. Moreover, individual instances of APRGs and PSLs that have long since expired are not prohibited subsidies that are being ‘granted’ or ‘maintained’.<sup>6</sup> Measures which provide a mere discretion to provide alleged subsidies are simply not challengeable as such under the SCM Agreement. The KEXIM Act, KEXIM Decree and Interest Rate Guidelines do not mandate the provision of any alleged export or other subsidies and therefore cannot, as such, be found in violation of the SCM Agreement. The EC argues that the traditional mandatory/discretionary distinction cannot be applied in the context of Article 3 subsidies under the SCM Agreement, but offers no support for this radical conclusion. In fact the Panels in *Brazil – Aircraft Article (21.5 II)* and *Canada – Aircraft* left no doubt that the distinction applies in Article 3 SCM cases. Moreover, the EC expressly admits that it is possible that measures taken by KEXIM would not be inconsistent with Article 3 SCM thereby confirming that the KEXIM regime cannot be said to mandate the provision of prohibited export subsidies.

21. The KEXIM APRG and PSL schemes and the individual instances in which APRGs and PSLs were conferred to shipbuilders benefit from the safe haven in items (j) and (k) of Annex I to the SCM Agreement. Footnote 5 of the SCM Agreement, read in the context of the language of items (j) and (k), first paragraph, of Annex I, as well as other provisions of the Agreement, clearly provides for so-called “safe harbours”. Footnote 5 provides that excepted measures under Annex I are not “prohibited subsidies”; it does not use the broader term “non-actionable subsidies” as is found in Article 8.1. Therefore, such subsidies could still be considered under Part III or Part V.

22. Both items (j) and (k), first paragraph, have affirmative provisions that must be met in order for them to identify prohibited export subsidies. Logically, if those provisions are not met, then there would not be an export subsidy. Otherwise, the provisions would have no meaning.

#### **IV. ABSENCE OF ACTIONABLE SUBSIDIES**

23. The EC has alleged that Daewoo Heavy Industries (DHI), Halla and Daedong were provided subsidies by virtue of undergoing corporate restructuring (DHI) and court supervised corporate reorganization (Halla and Daedong). However, the EC has failed to prove that a financial contribution was provided, articulated who the recipient of the financial contribution was, prove that a benefit was provided or that the corporate restructuring and corporate reorganization were specific to these companies or the shipbuilding industry. Therefore, the Panel should find that no subsidy was provided or in the alternative, if a subsidy was provided, it was not specific to these companies.

24. The EC failed to prove that either KDB, IBK, KAMCO, or KEXIM is a public body, under its definition or otherwise, and its analysis of what constitutes a public body is flawed. KDB and all of the creditors acted on commercial terms while participating in the corporate restructurings or reorganizations. KDB has no regulatory or taxation powers at all. The EC failed to show how government control goes beyond ownership. The KDB and all its creditors are not public bodies under either Korea’s or even the EC’s own criteria.

25. With regard to IBK, IBK acted only as a commercial creditor in the corporate restructurings and reorganizations and therefore did not meet Korea’s definition of a public body.

26. With regard to KAMCO, KAMCO purchases and disposes of non-performing assets based on commercial considerations and does not have the authority to regulate any sector of the economy and its decisions are not enforceable in a court of law. It does not, for example, have the regulatory

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<sup>6</sup> Korea’s First Written Submission at paras 201 to 204, as challenged in para. 33 of the EC’s Oral Statement.

authority of BOK. KAMCO just buys distressed loans on a commercial basis; it does not try to determine culpability. Therefore, KAMCO is not a public body.

27. With regard to KEXIM, Korea refers to its arguments above explaining why KEXIM is not a public body. The EC offered only vague or irrelevant evidence to support its claim. Korea referenced the test advocated by the Panel in *US - Export Restraints* that direction and entrustment requires three elements (i) an explicit and affirmative action be it delegation or command; (ii) addressed to a particular party; (iii) the object of which action is a particular task or duty. Something more than vague circumstantial evidence is required and the actions have to be specific to the subsidy alleged. Nothing suggests that the financial institutions were directed or entrusted to take specific actions in the corporate restructuring of DHI or the corporate reorganization of Halla or Daedong. Therefore, the EC's claims must fail.

28. With respect to the alleged corporate restructuring subsidies, the EC has clearly stated in its Oral Statement that if creditors behaved in a profit maximizing manner no benefit was conferred.<sup>7</sup> Korea believes in this regard that the information before the creditors at the time of the restructuring can be used to determine whether they acted based on market considerations. The Appellate Body has made clear that "the value of the 'benefit' under the SCM Agreement is to be assessed using the marketplace as the basis for comparison".<sup>8</sup> Korea demonstrates that in each of the restructuring cases at issue, a market valuation was conducted and the companies were maintained as going concerns based on the market valuation and each was subsequently sold pursuant to arm's length transactions at fair market value.

29. The EC has failed to specify the correct benefit benchmark. In the present case, the appropriate benchmark is whether the creditors of an insolvent company in the same situation as that of the three Korean shipyards would have acted in the same way. Applying this benchmark, the evidence on the record supports the finding that the three proceedings were done on an arm's length basis and no benefit was provided.

30. The EC claims at paragraph 77 of its response to the Panel's questions that the creditors of Daewoo overpaid for the equity in the debt for equity swap on 14 December 2000 when compared to the price of the stock when it was first publicly traded on 2 February 2001. Amazingly, the EC proposes that the benefit amount be determined by comparing prices from December 2000 to prices weeks later, while in blatant contradiction, the EC claimed in its Oral Statement that Korea cannot invoke the fact that the share value of the restructured yards increased over time, because there is no room for an *ex post* analysis. The EC cannot have it both ways, relying on *ex post* analysis where convenient and rejecting it elsewhere. The EC's subsidy calculation for the debt to equity swap is meaningless because the calculation has to be done at the time of the transaction, based on information available to the creditor at the time, and there is no room for *ex post* analysis. Furthermore, the Appellate Body has clearly stated that if a sale of a company occurred in the context of an arm's length transaction, there was an irrebuttable presumption that the purchaser paid for what he got and thus did not get any advantage.<sup>9</sup> In each of the cases at issue, the creditors or the court decided that the companies were worth more as a going concern than in liquidation, based on the

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<sup>7</sup> EC Oral Statement at paragraph 77, page 19.

<sup>8</sup> Appellate Body Report, *US - Countervailing Measures*, para. 102.

<sup>9</sup> Appellate Body Report, *US - Countervailing Measures*, para. 127. Moreover, the Panel and Appellate Body indicated that their concern, under the facts of that case, was whether there had been a less than arm's length purchase price, whereas here the EC is arguing that the DHI creditors did not get enough for their debt, i.e., that they overpaid. *Ibid.* at paras 103-104. It is difficult to see how an overpayment for the new equity could result in above market returns leading to the possibility of a pass-through of the subsidy. In Korea's view, the facts are clear in the present case that there was neither an overpayment nor an underpayment; the DHI creditors got fair market value for their debt.

market-based analysis the creditors exchanged debt for equity. In each of the cases, the stock was then sold on the open market for fair market value.

31. Remarkably, the EC claimed that the creditors paid too much for the stock in DSME but then complained that Hyundai-HI paid too little for Samho. These contradictions leave it unclear in which scenario the EC is arguing a benefit is conferred. Nonetheless, Hyundai-HI is an independent party that freely decided to purchase the stock in an arm's length transaction. Therefore, no benefit should be found to exist. The EC has also erred in calculating the benefit in a piecemeal fashion by wrongly considering the various portions of the debt restructuring in isolation.

32. For example, as explained at paragraph 411 of Korea's First Written Submission, Halla Heavy Industries filed for a corporate reorganization proceeding with the Court on 6 December 1997. The Court then determined that the going concern value was greater and appointed a receiver. The receiver submitted the first reorganization plan on 22 October 1998. The corporate reorganization was not concluded until 6 September 2000. Therefore, any payments made during the course of the corporate reorganization process have to be taken into consideration in the calculation of the debt. If the alleged subsidy is the corporate reorganization, then the entire process has to be taken into consideration in determining whether a benefit was provided. Therefore, this would not be an *ex post* analysis. Similarly for Daedong, if the EC is claiming that a subsidy was provided during the course of the corporate reorganization proceeding it must consider the entire proceeding. Consideration of the entire bankruptcy process would not be an *ex post* analysis.

33. The EC failed to use the correct benchmark in determining the alleged benefit and failed to rebut the evidence that the creditors acted in a commercial fashion.

34. The Arthur Andersen Report clearly shows that the creditors – based on reasonable assumptions and information available at the time – acted to maximize their return. The EC itself concedes that a primary criterion for keeping an insolvent company operating is “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.”<sup>10</sup> Korea provided the valuation reports used by the creditors and the courts in each of the three restructuring cases as part of the Annex V process showing the EC's own criteria are met. Faced with the weakness of its case, the EC instead resorts to inventing an insurmountable and incorrect standard under which only companies whose going concern value “significantly exceeds” the liquidation value and those whose business plans do not have uncertainties would continue.

35. As confirmed by Anjin Deloitte LLC, the going concern value of DHI exceeded the liquidation value as reported in the original report.

36. The EC's specificity analysis is flawed and lacking in evidence. Korea believes that evidence of non-specificity and general availability is shown in two elements: 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 but is generally applicable to all companies irrespective of their industrial sectors. Second, the restructuring legislation or scheme established “objective criteria or conditions” governing eligibility for the alleged subsidy, establishing non-specificity by virtue of Article 2.1(b). The CRA and the Corporate Reorganization Act, 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.

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<sup>10</sup> Refer to para. 98 of the EC Response to Panel's Question 23, page 27.

37. The EC is incorrectly advocating benefit from the perspective of the physical assets of the company and not the legal entity. As discussed by Korea in response to Question 46 of the Panel's questions, the Appellate Body in *US - Countervailing Measures*, explained that "the focus of any analysis of whether a "benefit" exists should be on the "legal or natural persons" instead of on the productive operations,"<sup>11</sup> and that "once a fair market price is paid for the equipment, its market value is redeemed, regardless of the utility the firm may derive from the equipment. Accordingly, it is the market value of the equipment that is the focal point of the analysis, and not the equipment's utility value to the privatized firm."<sup>12</sup> This reasoning applies in the case of financial restructuring and in the case of Daedong, Halla and DHI, the transaction occurred at arm's length or market values.

38. Korea demonstrates in its submission why the purchase price paid by KAMCO for non-performing loans is irrelevant to the benefit analysis.

39. With respect to the EC's allegation of KEXIM measures as actionable subsidies, the EC failed to even allege specificity in relationship to the PSLs and APRGs' and without this element alone the EC's claim must fail.

40. The EC has failed to understand the value of debt and equity. The creditors in the case of DSME were not faced with the choice of debt or equity. They were faced first with the choice of liquidating the company or having it continue. Once the choice was made that it was more profitable to continue DHI as an operating concern, the creditors then considered the debt restructuring required that would allow them again to maximize their return. This included transferring a certain amount of debt into equity. Moreover, even assuming, *arguendo*, that the face value of the equity was worth less than the credit paid for it, no benefit would have been provided to DSME because 1) the company had been transferred to the creditors, 2) the creditors maximized their return which in turn means 3) the restructuring package received by DSME was market determined.

41. The EC has failed to show that the alleged subsidies have caused serious prejudice. The EC's arguments are characterized by a number of serious flaws. Among others, the assessment under Article 6.3(c) of the SCM Agreement cannot be made on the basis of the "world market," contrary to the EC's claims that the term "same market" in Article 6.3(c) of the SCM Agreement has no geographic qualification and that national boundaries have hardly any effect on the shipbuilding business.<sup>13</sup> In this regard, the EC itself in several documents has confirmed that, among others, the Japanese market is closed and the US cabotage provisions affect one third of the US' orders. It cannot be said that geographic or national boundaries are irrelevant. Also, contrary to the EC's assertion, the GATT Panel in *EC - Sugar* does not apply in the present circumstances because that case was concerned with export rather than actionable subsidies.

42. With respect to the like product issue, it is in law and in practice impossible to make an accurate assessment on the existence of price depression or suppression pursuant to Article 6.3(c) of the SCM Agreement without determining the "like product" first in accordance with the provisions of footnote 46 of the SCM Agreement. The EC instead relies on a vague and shifting extra-treaty concept of "market segmentation" which in any event is too broad to meet the requirement of footnote 46. Footnote 46 of the SCM Agreement focuses on identical products or products with characteristics closely resembling each other. Thus, footnote 46 rests on a strong physical identity test. The Panel in *Indonesia - Automobiles* 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. It is clear – and the EC also admits – that vessels are highly differentiated. It is ludicrous to then assert that all ships are like products. The like product definition must be sufficiently narrow in order to allow an accurate assessment of the price effects. The EC has failed to

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<sup>11</sup> Appellate Body Report, *US - Countervailing Measures*, para. 110.

<sup>12</sup> *Id.* at paragraph 102.

<sup>13</sup> EC's Oral Statement, paras 93-95, pages 23-24.

provide any coherent product analysis to allow such an assessment and thus the EC cannot meet its burden of establishing serious prejudice.

43. Price suppression and depression must be demonstrated for each like product separately with separate supporting evidence. But the EC's so-called evidence in support of price depression (i.e., the decrease in newbuilding price index, the increase in order book volume, the alleged increase in freight rates and increase in cost of production) is based on data for the whole range of commercial vessels including vessels that are totally unrelated to the present dispute including cruise ships, bulk carriers, RoRos or LPGs. No finding of serious prejudice can be made on the basis of such wholly defective evidence.

44. The EC's claim that price suppression or depression does not require head-to-head competition but mere capability on the part of the EC shipyards to compete is legally unfounded and must be rejected. Article 6.3(c) of the SCM Agreement requires head-to-head competition as a pre-requirement to find price suppression or price depression.

45. The EC's mechanism to establish price suppression or depression is fatally flawed. The EC alleges that it is not required to show that the complainant's prices are actually depressed or suppressed. This is incorrect. Price depression or suppression must be established with regard to the prices of the EC vessels and the prices of the complaining party's products must therefore be shown to have declined or to have been suppressed.

46. In addition, the causal link between the price effects and the alleged subsidies must be demonstrated and the causal link requires a quantification of the alleged subsidies and their effect on the prices of the Korean vessels. The EC claims, among others, that alleged overcapacity suppresses or depresses prices, but the EC has nowhere established how this allegedly occurs. The EC has failed to carry its burden of proof.

47. The use of the term "any subsidy" in the *chapeau* of Article 5 of the SCM Agreement and in Article 7.8 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. The existence of price depression or suppression caused by the effects of the subsidies as outlined above must be carried out for each subsidy individually.

48. A finding of price depression or suppression caused by the alleged subsidies does not mean that a serious prejudice finding is automatic. Rather, a finding of serious prejudice must be made separately. This is clear, *inter alia*, from the use of the word "may" and the use of the words "one or several" in the *chapeau* of Article 6.3. Any other interpretation would mean that the standard to find serious prejudice under Article 5(c) is substantially lower than to find material injury under Article 5(a) and footnote 11, whereas the Appellate Body in *US – Lamb* has concluded that the word 'serious' connotes a much higher standard of injury. Thus, something more must be proven to establish serious prejudice. Article 5(c) of the SCM Agreement refers to serious prejudice to the "interests" of a "Member". There must have been a reason that the term "interests" (in plural) 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.

49. Nonetheless, the alleged subsidies have not caused significant price depression or suppression and the EC's claims fall far short of demonstrating serious prejudice. The EC provides in Attachment 2 to its responses to the Panel's questions a response to the Panel's question with regard to the existence of significant price depression or suppression caused by the alleged subsidies. But there is, among others, no indication of the like product vessel and hence the data is fatally flawed from the outset and cannot establish price depression or suppression for the like product vessels. Nor is there any serious attempt to establish a causal link. Among many other flaws, the price allegations



are also inaccurate. In sum, the EC has failed to establish any semblance of a *prima facie* case that would allow a finding of serious prejudice in this case, even assuming, *arguendo*, that alleged subsidization could be shown.