ANNEX A

EXECUTIVE SUMMARIES OF THE FIRST WRITTEN SUBMISSIONS OF THE PARTIES

ANNEX A-1

FIRST WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

(22 December 2003)

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I. INTRODUCTION

1. The European Communities seeks a ruling from this Panel recommending that Korea withdraw the massive subsidies it provides to Korean shipyards, remove the adverse effects of these subsidies, and revoke or amend measures that constitute *de jure* violations of the *SCM Agreement.* The granting of these subsidies to the Korean shipyards from 1 January 1997 through present, and the enactment and maintenance of such measures, violate multiple provisions of the *SCM Agreement.*

2. At issue in this dispute are subsidies that the Government of Korea has provided to Korea's commercial shipbuilding industry since 1 January 1997. In its first written submission, the European Communities:

> Firstly, summarises the relevant factual background (Part II);
>
> Secondly, briefly describes the procedure leading to this Panel proceeding (Part III); and then
>
> Demonstrates, that the Government of Korea has granted, and continues to grant, both prohibited and actionable subsidies, contrary to its obligations under the *SCM Agreement* (Part IV).

II. FACTUAL BACKGROUND

3. The submission provides background information on the "commercial shipbuilding industry", including on the nature of the shipbuilding market, the types of ships involved in the dispute and on the main players in Korea and the EU. It also describes the history of Korean government intervention in the economy.

III. HISTORY OF DISPUTE

4. The European Communities requested consultations with Korea on 21 October 2002 to discuss subsidies provided to Korean shipbuilders that violate Korea's obligations under the *SCM Agreement.*

5. The European Communities and Korea held three consultations on 22 November 2002, 13 December 2002 and 7 May 2003. On 11 June 2003, the European Communities requested the immediate establishment of a panel.

6. On 21 July 2003, the Dispute Settlement Body (DSB) established the Panel with the standard terms of reference. On 10 July 2003, the European Communities requested that the DSB initiate the Procedures for Developing Information Concerning Serious Prejudice as provided in Annex V of the *SCM Agreement.* The Annex V procedure was terminated on 10 November.

7. Special procedures apply for the protection of "business confidential information" ("BCI") in this proceeding. The European Communities does not accept all Korea's claims of BCI but has endeavoured to respect them in the submission by marking such information "**[BCI]"**. All BCI has been omitted from this executive summary.

IV. LEGAL CLAIMS

A. INTRODUCTION

8. The European Communities demonstrates in its submission that Korea provides prohibited and actionable subsidies to its commercial shipbuilding industry. It:

first addresses general issues relating to the burden of proof, best information available, and adverse inferences (Section B)

then proceeds to consider the issue of prohibited subsidies (Section C); and

finally addresses actionable subsidies (Section D).

B. BURDEN OF PROOF, BEST INFORMATION AVAILABLE AND ADVERSE INFERENCES

9. The general principle applicable in WTO dispute settlement is, as the Appellate Body stated in *EC – Hormones*, that the initial burden of proving a violation is on the complaining party, which must establish a *prima facie* case. It is also a well-established rule in WTO dispute settlement that "the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof."[1]

10. However, as the Appellate Body recalled in *Japan – Apples*, the principle that the complainant must establish a *prima facie* case of inconsistency with a provision of a covered agreement does not require the complainant to offer proof of every fact that it asserts.[2] Where a defending party contests the adequacy or the pertinence of the facts presented by the complaining party, the burden may be on the defending party to establish those facts.

11. In particular, Annex V of the *SCM Agreement* sets out certain special rules to take account of the particular problems of fact-finding in such cases. They provide in particular that:

The information provided under the Annex V procedure constitutes "the record" on the basis of which the Panel is to decide the case.[3]

Where there is a lack of cooperation by the subsidising Member or any third-country Member, the complaining Member is entitled to make its case based on evidence available to it.[4]

The Panel may then "complete the record as necessary relying on best information otherwise available"[5] and may seek additional information to complete the record that it "deems essential to a proper resolution to the dispute, and which was not adequately sought or developed during that process".[6] However in doing so, the Panel "should not request additional information to complete the record where the information would support a particular party's position and the absence of that information in the record is the result of unreasonable non-cooperation by that party in the information-gathering process."[7]

The Panel is expressly instructed to draw adverse inferences from instances of non-co-operation.[8]

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[1] Appellate Body Report, *US – Wool Shirts and Blouses*, at 14.
[2] Appellate Body Report, *Japan – Apples*, para 157.
[3] *SCM Agreement*, Annex V, at paras. 6 and 9.
[4] *Ibid.* at para. 6.
[5] *Ibid.*
[6] *Ibid.* at para. 9.
[7] *Ibid.* 6

12. The Appellate Body confirmed in *Canada – Aircraft* the drawing of adverse inferences from instances of non-co-operation is in fact a general principle of the *SCM Agreement* that is also applicable in the case of prohibited subsidies.[9]

13. The European Communities has exercised self-restraint in requesting the Panel to base its findings on best information otherwise available or to draw adverse inferences in accordance with paragraphs 6 to 8 of Annex V of the *SCM Agreement.* Whether it will be necessary for the Panel to

25. The evidence demonstrates that very few commercial banks granted APRGs to the Korean shipyards during the time of the financial crisis in 1997, and few have entered the market of granting APRGs since that time. The APRG programme, established by KEXIM pursuant to the KEXIM Act, provides prohibited export subsidies, as defined by Part II of the *SCM Agreement*. KEXIM guarantees (i) meet the definition of a "subsidy" under Article 1.1, (ii) are expressly contingent upon export performance in violation of Article 3.1(a) of the *SCM Agreement*, and (iii) are specific subsidies pursuant to Article 2.3 of the *SCM Agreement*.

26. The KEXIM **pre-shipment loan programme** provides loans to Korean companies in connection with export contracts, for the purpose of helping the Korean exporters to finance production.

27. KEXIM pre-shipment loans confer a "benefit" on the Korean exporters within the meaning of Article 1.1(b) of the *SCM Agreement* because the preferential interest rates provided by KEXIM place the Korean exporters in a more advantageous position than if they were to obtain such financing on market terms.

28. The pre-shipment loan programme, established by KEXIM pursuant to the KEXIM Act, provides prohibited export subsidies, as defined by Part II of the *SCM Agreement*. These KEXIM guarantees (i) meet the definition of a "subsidy" under Article 1.1, (ii) are expressly contingent upon export performance in violation of Article 3.1(a) of the *SCM Agreement*, and (iii) are specific subsidies pursuant to Article 2.3 of the *SCM Agreement*.

3. Specific Grants of Prohibited Subsidies

29. As detailed in the submission, KEXIM has charged premia that fall far below the rates that would have been charged by commercial banks. These individual transactions are not just evidence of KEXIM's APRG and pre-shipment loan "practices," but they are also themselves subject to challenge. The European Communities, therefore, also challenges as inconsistent with the *SCM Agreement* numerous individual transactions in which KEXIM has provided APRGs and pre-shipment loans to Korean shipbuilding companies at preferential rates that are well below the rates that would have been commercially available.

D. ACTIONABLE SUBSIDIES

30. The European Communities demonstrates in the submission that subsidies granted by Korea to its shipbuilding industry cause serious prejudice to the EC's shipbuilding industry. These subsidies were granted pursuant to the restructuring process of the Korean shipbuilding industry since 1997. They take the form of debt forgiveness, debt-for-equity cong746 Tc 3.312186 Tw (343n- TEof0.05038 T

oriented activities of selected *chaebols*. As described in Section II (Factual Background), each time these *chaebols* faced financial distress, the Government intervened to rescue them through favourable financial packages provided by government-controlled banks or private banks acting under the Government's instruction. This pattern of government intervention was repeated once again during the financial crisis that began in 1997. The Government of Korea played a central role of in the workout process; acted through a number of public bodies carrying out the Government policies; and entrusted and directed commercial financial institutions to support the Korean shipbuilding industry during a time of severe financial turmoil.

33. Indeed, the Government of Korea directed the workout process through, *inter alia*, (a) the participation, as creditors, of public bodies acting pursuant to Government policy; (b) the direct or indirect shareholding participation by the Korea Depository Insurance Company in the capital of many financial creditors of the ailing *chaebols*; (c) the purchase by the Korea Asset Management Corporation of non-performing loans from financial creditors; and (d) pressure exerted by the Government on other creditors—many themselves facing collapse—to abide by the Government's directives.

34. Public bodies acting pursuant to Government policy played a leading role in the council of creditors of the shipbuilding companies. At the same time, they pressured other "private" creditors that did not have an institutional nexus with the Government of Korea or did not pursue public policy objectives.

35. The submission demonstrates that six financial institutions (Korea Asset Management Corporation, Korea Depository Insurance Corporation, Bank of Korea, Korea Development Bank, Industrial Bank of Korea and KEXIM) which were involved as creditors of the shipyards in the work-out process are public bodies within the meaning of Article 1.1(a)(1) of the *SCM Agreement*. Advantages granted by them in the context of the workout process to Korean shipyards are, therefore, necessarily to be imputed to the Government of Korea.

36. Should the Panel adopt a different and more narrow interpretation of that term, the European Communities submits that these institutions are, in any case, private bodies "entrusted" or "directed" by the Korean Government within the meaning of Article 1.1(a)(1)(iv) of the *SCM Agreement*.

37. In addition to the above, commercial financial institutions that were creditors of the *chaebols* also provided financial assistance to the *chaebols* pursuant to the direction or entrustment of the Government of Korea. In the submission the European Communities sets out the general pattern of involvement of the Korean Government in the decision-making of the commercial financial institutions that were creditors of the three shipyards in the restructuring process.

38. The Korean Government and its public bodies took advantage of its multiple roles as decision-maker/strategist, legislator, executive, regulator, shareholder/owner, capital injector, guarantor, and lender to ensure that commercial financial institutions acted to support the Korean shipbuilding industry.

39. The European Communities demonstrates that the Government of Korea has granted **Daewoo HI/Daewoo SME** actionable subsidies that consist of: the workout plan, comprising several individual measures as implemented between August 1999 – December 2000; tax concessions provided to Daewoo-HI/Daewoo-SME under Korea's Special Tax Treatment Control Law; and grants of APRGs and pre-shipment loans by KEXIM. The European Communities also demonstrates that the Government of Korea has granted to **Samho-HI/Halla-HI** actionable subsidies that consist of the company's corporate reorganisation plan comprising of a number of individual components and the grant of APRGs and pre-shipment loans by KEXIM. Finally, the European Communities

demonstrates that the Government of Korea granted to **STX/Daedong** actionable subsidies that consist of the corporate reorganisation plan comprising several individual components and the grant of APRGs and pre-shipment loans by KEXIM.

40. Having established the existence of the subsidies, the European Communities demonstrates that they are actionable within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*. Through its use of subsidies to the shipbuilding industry, Korea has caused serious prejudice in the form of significant suppression or depression of prices for EC ships worldwide, in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

41. The European Communities' claims involve a number of distinct legal elements, each of which is established in the submission. First, the European Communities demonstrates that three types of ships produced in the European Communities and in Korea—container ships, product and chemical tankers, and LNGs—compete in the same product and geographic markets.

42. Second, the European Communities explains that Korean subsidies to Daewoo-SME/Daewoo-HI, Samho-HI/Halla-HI, and STX/Daedong cause depressed and suppressed prices for the European shipbuilding industry. To establish the causal link between the subsidies and this price depression and price suppression, the European Communities demonstrates that (a) the subsidies artificially maintained shipbuilding facilities that would not have been maintained under market conditions and materially enhanced the financial strength and freed up financial resources for use by Daewoo-SME/Daewoo-HI, Samho-HI/Halla-HI and STX/Daedong; (b) the need to utilise this capacity and the low costs resulted in lower bid prices for ships produced by the shipyards; and (c) given Korean price leadership, these lower prices caused price depression and price suppression in affected products.

43. Third, the European Communities shows that the price suppression or depression in the ship market worldwide, and in particular country or regional markets, has been "significant." Fourth, the European Communities demonstrates that the significant price suppression and price depression were of such a nature and quantity as to constitute "serious prejudice," and thus have created "adverse effects" to the interests of the European Communities.

V. CONCLUSION

44. For the above reasons, the European Communities asks the Panel to find that Korea has granted subsidies inconsistent with its obligations under the *SCM Agreement*, because:

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

ANNEX A-2

FIRST WRITTEN SUBMISSION OF KOREA

(9 February 2004)

I. OVERVIEW AND INITIAL MATTERS

1. Overview of the evidentiary deficiencies and legal omissions of the EC's First Submission -- The European Communities ("EC") has failed to establish a *prima facie* case with respect to its claims that Korea has provided export subsidies prohibited under Part II of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), and actionable subsidies inconsistent with Part III of that Agreement. The EC has fundamentally misunderstood the requirements for meeting its burden of proving its case with established and proven facts and has, instead relied on mere assertions without proving the facts establishing such assertions.

2. Having refused to carry the burden of proving the facts it asserts, the EC then claims that Korea, as respondent, has the burden of disproving the EC's assertions, but must, however, prove all facts it asserts in that process. This reflects a profound mis-reading of the *Japan – Apples* decision which only drew a distinction between proving facts and establishing claims. The Appellate Body made clear the nature of the two step process of demonstrating a *prima facie* case and in no way relieved complainants of the burden of proving the case with demonstrated and established facts as required by the WTO treaty and general principles of international law.

3. Beyond mere assertions, the only "evidence" the EC provides in support of its claim regarding prohibited subsidies comes from an improper use of the SCM Agreement's Annex V process which is explicitly limited to developing information regarding serious prejudice cases under Part III thereof. The EC then goes on to attempt to improperly request that adverse inferences be drawn against Korea for allegedly not providing certain evidence under Annex V pertaining to export subsidies.

4. The EC's first submission does not present evidence or even address critical elements of establishing that adverse effects, within the meaning of Part III of the SCM Agreement, were caused by alleged Korean subsidization. The EC fails to establish that there was even a financial contribution in the context of the restructuring process that took place with respect to three Korean shipyards, i.e., Daewoo, Halla and Daedong. Financial contributions imply two participants in any alleged transfer, but the transactions identified by the EC do not meet these criteria. Moreover, the EC has not identified any current recipients of any benefits that allegedly arose with respect to such transfers. Finally, the EC's allegations regarding restructuring are based on a reading of the SCM Agreement that would require that insolvent companies be terminated and exit the market. There is no basis in the treaty for such a reading and its adoption and the associated undermining of every Member's insolvency laws would wreak havoc on the world's market economies.

5. The EC's failure to identify the "like product" is a fatal flaw in any attempt by a complainant to establish a *prima facie* case of serious prejudice under Part III. Having suggested using the tests for

which, as a matter of law, no countervailing duty investigation could be initiated under Part V of the SCM Agreement.

6.

counting. This could result in attributing prejudice to non-injurious actionable subsidies based on the combined effect of such subsidies and export subsidies that have already been remedied elsewhere.

13. Korea asked the Panel to address the EC's misleading statements made to the Panel regarding Korea's preliminary ruling request as well as address the further evidence of abuse of the Annex V process. Korea noted that the EC asked the facilitator on 8 August 2003 to gather evidence on all products made by companies receiving KEXIM support as this purportedly was part of the EC's serious prejudice claims. On 5 September 2003 the EC told the Panel that it had "never" made any serious prejudice claim beyond commercial vessels. This mis-statement was made in order to avoid dismissal of the dispute for failure to identify the like products subject to the adverse effects claim.

14. Furthermore, the evidence submitted in the EC's first submission demonstrates that the EC used the Annex V process improperly to gather evidence to support an export subsidies claim that it did not have any support for. This is confirmed by the EC's request for adverse inferences on Part II claims under Annex V even though Annex V is explicitly limited to serious prejudice issues. Korea had raised concerns about the undue breadth of the Annex V requests for information in a number of respects, including concerns that the EC was using it with respect to its export subsidies claims. The EC denied that it was using the process for anything other than the adverse effects aspects of its claims with respect to the alleged export subsidies. This has been revealed as incorrect by the EC's first submission.

15. In order to protect its rights as well as the integrity of the dispute settlement process, Korea has asked the Panel to take appropriate steps in response to these abuses.

II. ALLEGATIONS OF PROHIBITED SUBSIDIES

16. The EC has alleged that the KEXIM Act and the Advanced Payment Refund Guarantee

or tax role, or a function that is analogous. The KEXIM Act provides a direction and general policy parameters within which KEXIM functions, but nothing more. The Government of Korea does not intervene in KEXIM's day-to-day operations. The facts are that KEXIM is required to act and has acted in a commercial and market-based manner. It is required to generate and has generated profits from its lending operations because credit is extended on a commercial basis.

19. The EC also has not demonstrated that there was a benefit provided to any of the shipbuilders identified by the EC. The EC has proposed inappropriate benchmarks as market rates ignoring substantial differences in the terms of the KEXIM loans and guarantees and the proposed benchmarks as regards factors such as collaterals, loan or guarantee periods or the past performance of the borrower or grantee.

20. The way in which the KEXIM premia and interest rates were built up from a base rate identified in the market plus spreads (also taking into account the creditworthiness of the borrower or