ANNEX D

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

ANNEX D-1

RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS FROM THE PANEL

(22 March 2004)

TABLE OF CONTENTS

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 subsides 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 subsides 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 subsides 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".[1]

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 subsides 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 Investors Services but presumes that these credit ratings are similar to those provided by Korea in

[1] Shorter Oxford English Dictionary (4th edition, 1993), p. 2371.

attachment 1.1(24)-1 of its Annex V replies.[2] 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-

[redacted]

Ex jExhibiesEC5 0 T90 Tc 0. Tc24674783

Rec054he ques ExhibiesECa5 TD 48D 0 Tc 0.1c0 Tw (13.) Tj iti60 TD D 0 Tc 0. Tc 62.T.9388

13.

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.

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 i 0 Twaht al avughr owailawevl896 Tc 42 supp

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".[5] 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".[6] 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

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[7] 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.[8]

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

[7] Exhibit EC-40.

[8] 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

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.[9]

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.[10]

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….[11]

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.[12]

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.

---

[9] MOFE press release – published on MOFE website on 6 October 2000 (Exhibit EC – 101).
[10] Attachment 5 of First written Submission by Korea.
[11] Korea Letter of Intent to IMF of 24/09/1998 (Exhibit EC-102).
[12] 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

egifhe isxwe isl seved Tj 1390 TD 0 Tc 0.1875 Tw ( ) Tj -93 -12 TD /

- restructuring (as opposed to liquidation) through debt-for equity swap and other measures listed in the Agreement.[13]

- certain procedures, i.e., leader bank will chair meetings thereby influencing the process, majority voting.[14]

- shorter time for decision-taking.[15]

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.[16]

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[17] (originally also foreseen for Daewoo) reflects the Korean Government's policy of resolving the corporate crisis **through debt/equity swaps**.

57. Through the *-interest iCC5 5 hve5 TD /F09 0.1860.512.75 TD ( ) Tj 0 -12.75.2sures li TDwhich d 11.2*

--

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.

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

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.[28]

85. KAMCO's purchase of more than **[BCI: Omitted from public version]** of DHI non-performing loans[29] 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;[30]
- 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.

26

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.[31] 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.

[31] First written submission of Korea, para. 302.

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

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

Response

106. Korea contents itself with generally questioning the three market segments identified by the European Communities (LNGs, container chips and product tankers)[34] 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.[35]

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.[36]

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.[37] 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.

---

[34] First written submission of the European Communities, paras. 417, 418. See also Oral Statement, paras. 101-110.

[35] First written submission of Korea, paras. 514.

[36] 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).

[37] 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.[38] 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 from the perspective of the shipbuilders.[39]

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.

[38] Oral Statement by the European Communities at the First Substantive Meeting with the Panel, paras. 105-107.

[39] 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.[40]

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.

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[41]

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 Euw (41) Tj 7.5.25l-12.75 s7dGDer.75 ships w one cane pj 70

2

h o

7

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.[43] 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.[44] 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:

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

[44] AWES – Annual Report 2002-2003 (Exhibit EC – 106).

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

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

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

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.

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

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))[50] and that this list is only *illustrative.*

[50] 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".[51] 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 subsides 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*

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.[53] Korea has done neither. 203.

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*". tst is t3Article 6.3 of the

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.[55]

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.[56]

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.

[55] 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".

[56] *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

LIST OF EXHIBITS

EC – 105

EC – 105 ctoAudMOFdpbu per sse of TDj 210.75 0 TD 0 Tc 0.1875 Tw 1

dpbu per sse of TDj 210.75 0 TD 0 Tc 0.1875 Tw 1

Question 15

In terms of benefit analysis, should the analysis in

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

ANNEX D-3

RESPONSES OF KOREA TO QUESTIONS FROM THE PANEL

(22 March 2004)

I. QUESTIONS TO KOREA

A.

of productive operations."[1] 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 0o3 Tw (.231c 1.134 Tf 0.375 Tc 0 5 Tc375 Tct rate

Next, 173 -12er Next, 28shodder s to answer the qus0.1224uv/F0 1s0.1224fcTD -0.1972 Tc01.13 -0.0627 Tl246 Tcy0.4D 28 Tw Whil (si

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

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

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

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 noting 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 j 102 imigT26 TD -0.31239 Tc 0.1upoeye6 TD

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 issued 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.]**

- 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

-

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 de1kaCeds Tj 3.975 0 TD -0.10659 Tc 1.46463 Tw ( )wthethe

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., "*Allw (-) Tj 3.ch a anciples tTc 0 Tvoluntary-had TD Redy -1s0*

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

(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) Huyndai 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

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 rea i.75 ly.

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 so

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.[8]

The key point to understand from the jurisprudence under Article III is that it defines an *analytical approach* to defineroduct 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.[9] 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.[10]

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.[11] 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.[12] 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.[13]

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 identicallity 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

---

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

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

> 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".[15] (Emphasis added)

The EC has failed to carry its burden of proof. In paragraph 393 of its First Written Submission

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*

standard of injury than the word 'material'".[18] 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?

[18] Appellate Body Report, *US – Lamb*, para. 124.

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

Th2 x1ie., the (i.e.,must boc 1.5892w (subsidi96 TD 0 T09

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

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)*[20] 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 Appellate Body stressed in *Brazil – Aircraft*

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

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?

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 and not be considered a government if it is controlled by the government, where the [illegible] iv). Case.5 -143D /F2 11.25w (c8737 Tw grant-0 TD -0.1139 Tc 415909 Tw 5 Tj 24.law3.5 -12436D -0.

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 preshipment 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 forenq

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 C7.5 0 TD -0.obc,5..0038 Tc 0 Tw (') Tj - TD -0.2794 Tc .11627 Tw (nal shipbing improloaiour

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.[2]

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 (preset41aces cann14 T Ar0atem8waps17

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

[a5]

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.

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:

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-

viden Tw390rice onfion valuev40.5 -12

44.

Tw (the exanonthrle e sd Sdai as epur sks)TO Sam agbyv-

44.

prohibited.[2] 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.

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--

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 <u>all</u> ships of <u>all</u> 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 <u>all</u> 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?

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.