ANNEX F

EXECUTIVE SUMMARIES OF THE ORAL STATEMENTS OF THE PARTIES - SECOND MEETING

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ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(25 June 2004)

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9. Whether or not every APRG and every pre-shipment loan will be an export subsidy is not determinative (although the European Communities has demonstrated many such cases). What is determinative is that the rules according to which the scheme operates may provide exporters with a benefit – indeed they are designed to do so. These schemes are only open to exporters and provide important advantages that are not available on the same terms on the market. They both provide exporters with important financing facilities for export contracts in the critical period before (properly so-called) export credits and export credit guarantees become available. Even if exporters do not always use these facilities (when alternative finance is more conveniently available), the availability of these programmes provides assurance that if market conditions were to change, finance from KEXIM would still be available at the pre-established conditions. In this respect, it is important to note that Article 3.2 of the *SCM Agreement* prohibits the *maintenance* of export subsidy programmes, even where they do not result in grants of export subsidies.

10. Turning now to the other "as such" claim – that against the legal framework of KEXIM – let me first say that the European Communities recognises the far-reaching nature of its claim but considers that it is justified in the circumstances. KEXIM is in reality a funding mechanism for directing state resources into the promotion of exports on better terms than commercial banks would offer. It is directed to do so on the basis of its interest rate guidelines rather than at market rates and at below cost rates when "inevitable for maintaining the international competitiveness to facilitate export".

B. BENEFIT

1. KEXIM as such

11. KEXIM as such is a benefit because exporters are provided with a bank that enjoys huge amounts of government money and unlimited state guarantee with a mandate to promote exports and the requirement to disregard market principles where necessary to support the export competitiveness of key Korean industries. The existence of such a body the work of which is not explicitly limited to either market principles or to OECD standards is a very significant advantage for exporters, in particular shipbuilding which is in Korea an export oriented industry.

2. APRG and PSL Programmes as such

12. The possibility of obtaining a preshipment loan involves a tremendous advantage for shipyards because they can then offer tail-heavy payment terms with the majority of the payment delayed until delivery. Contrary to what Korea and Drewry want to make the Panel believe, tail-end schemes have become common in recent years on the shipbuilding market. Tail-heavy payment implies that the payments to the shipyard are not sufficient to fund the cash flow during production and financing will therefore be required. Pre-shipment loans (in the form of credit-lines) enable Korean shipyards to accept tail-heavy payment terms. The provision of this "financial product" provided by KEXIM that is not offered by other commercial banks confers a very significant benefit. The existence of the APRG and pre-shipment loan programmes provide financial and thereby economic stability to shipyards.

3. Individual Grants

13. The European Communities noted that it had adequately rebutted Korea's argument in the second written submission, but wishes to draw the Panel's attention to a pattern that runs through them: Korea's non-cooperation in providing the necessary information to adjust the market benchmark in terms of duration and collateral. The European Communities asked about collaterals as early as the Annex V procedure. Korea did not respond. The Panel gave Korea a further opportunity to submit "internal documentation" concerning KEXIM's review/authorisation of a few transactions,

including worksheets and other documentation showing calculations of the interest rate and other terms, including consideration of collateral". Korea contented itself with providing the minutes of the Board of Director's meeting and noting that "it is not KEXIM's policy to keep and maintain worksheets and similar documents."

Another tactic of Korea to obstruct the European Communities' *prima facie* case on benefit regarding individual transactions is the frequent "clarification" of facts once it realised that it had mistakenly failed to withhold information that could be valuable to the European Communities' case. The European Communities considers that it has done more than making a *prima facie* case and fully rebutting Korea's defence on the issue of benefit by taking full account of any differences in duration and collateral. Korea has not rebutted the EC *prima faci*

20. The European Communities has provided evidence that the financial institutions involved in restructuring of the shipyards were unable to act independently, including the following:

- letters from the Korean Government to the IMF indicating that public funds would be withheld from banks that did not participate in corporate restructuring;
- acknowledgement by a Korean bank that the Government's influence would cause it to make loans that it otherwise would not;
- a signed commitment by banks to participate in restructurings;
- Government decrees requiring bank participation in financial stabilisation;
- an explicit Government policy of supporting failing companies through debt for equity swaps; and
- statutory limits on the discretion of banks to make decisions relevant to the restructuring.

21. The EC has demonstrated that the Korean Government leveraged its multiple roles as decision-maker, legislator, executive, regulator, shareholder, capital injector, guarantor, and lender to ensure that credit was provided and debt was forgiven for the failing shipyards.

B. BENEFIT

22. The European Communities has presented reasonable market benchmarks to measure the benefit of these financial contributions to the Korean shipyards. This benchmark is based on the conduct of investors outside the reach of the Korean Government's tremendous influence. It showed that the Korean shipyards received a benefit because they paid less to be relieved of their debts to domestic creditors than they would have under fair market terms.

23. With respect to Daewoo, the European Communities logically compared the value of the debt with the value of the equity, which was based on the opening price of the Daewoo

foreign banks because domestic banks were influenced by the Government. Moreover, the purchase and anticipated purchase of these loans from Daewoo's creditors, for example, cleansed the creditors' balance sheets in a manner that would not have been possible absent KAMCO's actions.

27. In addition, Korea has failed to rebut the EC's evidence that Daewoo benefited from a specifically targeted tax exemption valued at KRW 236 billion.

C. SERIOUS PREJUDICE

28. The European Communities has shown that the subsidies to the Korean shipyards have caused serious prejudice to the European Communities' interests by causing significant price suppression and price depression in the same markets. In response, Korea submitted a report by its consultant, Drewry Shipping Consultants ("Drewry report"), which attempts to prove that:

- Korean and EC yards do not compete;
- commercial ships are so different from each other that a meaningful economic comparison between products is not possible;
- price suppression and depression do not exist in the relevant product markets;
- past price developments are not related to Korean subsidisation; and
- Korean yards are more competitive than EC (and other) yards.

29. Careful scrutiny of the Drewry report, however, reveals that it:

- provides a large quantity of irrelevant information and data;
- represents the European Communities' positions in a subjective and biased manner;
- bases the like product analysis entirely on the end use of vessels, despite the fact that this end use frequently changes over the lifetime of a ship, and its like product analysis fails to appreciate the necessity for a supply side perspective;
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that, but for the massive subsidies, the tremendous overcapacity maintained by the Korean shipyards

report that Korean yards were almost solely responsible for increases in capacity and that investments in these yards were viable only as long as the companies did not face the true cost of borrowing (the banks did instead).

47. Korea also confirms through Drewry's report that shipyards with overcapacity tend to offer low prices, a factor that lies at the base of the European Communities' assessment of the problems in the world shipbuilding market.

(d) Assessment of shipbuilding prices and costs

48. The European Communities has presented accurate and comprehensive information regarding the various factors that influence shipbuilding prices and costs. Korea, by contrast, fails to take account of overhead costs, or the depreciation and interest charges. The European Communities' evidence of the rising costs of ship production for the three Korean yards is based on consideration of all relevant costs, and accounts for the cost-advantages enjoyed by those yards. The European Communities and FMI stand by the results of their cost modelling and market and price analyses; all efforts by Korea to disprove these results have failed.

49. With respect to prices, Drewry fails to refute directly the price indices offered by the European Communities for each of the three product markets. Instead, Drewry argues that it is impossible to derive meaningful price indices for these product markets, even though Drewry uses these very same indices in chapter 8 of its report and in its own non-commissioned works. The European Communities has shown that a convergence of the following three factors should have caused shipbuilding prices to rise (in the case of product/chemical tankers, container ships, and LNGs) or not to fall (in the case of LNGs): increasing volume, increasing producer costs and high customer earnings.

(e) Valuation of subsidies

50. Although the *SCM Agreement* does not require a complainant to calculate the precise value of subsidies for purposes of demonstrating serious prejudice, the European Communities nonetheless has done so. Korea disputes the calculation of the benefit from the restructuring subsidies to Daewoo, arguing that it improperly looks beyond the liabilities of the core business of shipbuilding. The European Communities' point, however, is that the restructuring would not have occurred if the creditors had acted pursuant to market considerations, and the company would have retained *all* of its liabilities, whether or not related to its "core" operations.

51. With respect to the calculation of benefit to Samho-HI/Halla-HI, Korea disputes the European Communities' stock valuations. In fact, this valuation must be considered correct unless Korea admits that Rothschild made an incorrect valuation of Samho. The European Communities has already explained why Korea's proposed valuation based on net asset value is inadequate and further notes that no consultant has ever used this methodology to value shipyards.

52.

54. With respect to Korea's attack of the European Communities' attempt to quantify the value of a KEXIM pre-shipment loans and APRGs, the European Communities has already explained that it made reasonable estimates based on the limited evidence provided by Korea. Even on the basis of the new information on disbursement dates the quantified value remains high.

ANNEX F-2

ORAL STATEMENT OF KOREA

(28 June 2004)

I. INTRODUCTION AND EVIDENTIARY MATTERS

1. Korea is presented at this Second Meeting with a difficult task brought on by the litigation tactics of the EC claiming that it was not required to demonstrate the necessary facts to establish a *prima facie* case. The EC claims that a *prima facie* case can be based on simple assertions of facts that do not need to be proven if undisputed by the respondent. Hence, all a complainant would have to do is to make allegations which would shift the burden to the respondent to rebut them. Only then would the complainant need to adduce any evidence to support its claims. The EC further argued at the First Meeting that it need not demonstrate elements of its case that it considered "obvious", but then refused to identify just which elements those were.

2. The EC's position could not be more contrary to the jurisprudence of the WTO. This is summarized by the Appellate Body statement in *US – Wool Shirts and Blouses* to the effect that "[W]e find it difficult, indeed, to see how any system of judicial settlement could work if it incorporated the proposition that the mere assertion of a claim might amount to proof."

3. Following from its legal proposition regarding the burden of proof, the EC provided a virtually fact-free First Submission and oral presentation at the First Meeting. This forced Korea, arguing in the alternative and in response to Panel questions, to provide a considerable amount of argumentation and facts. Only then, did the EC submit a large number of new arguments and supporting "facts" in its Second Submission. This left Korea with the task of presenting rebuttal data at the Second Meeting in response to EC material that should have been provided at earlier stages of the dispute to support establishment of the EC's *prima facie* case in accordance with WTO rules and jurisprudence. Korea has responded as thoroughly as possible with arguments in the alternative, while reserving all of its rights regarding the burden of proof, due process and the Panel's Working Procedures. Korea specifically recalls the Appellate Body findings in *Japan – Agricultural Products II* and *Chile – Price Bands* to the effect that the Panel is not to use its investigatory powers to make the complainant's case for it nor to answer affirmatively claims that have not been effectively advanced by the complainant. Particularly in light of the difficulty of benchmarking during the period of the financial crisis, Korea also recalled the reasoning of the panel in the *US – Section 301* dispute to the effect that, if faced with a situation where the arguments of two parties left it in uncertainty or equipoise then, logically, the proper allocation of the burden of proof would mean that the benefit of the doubt would go to the respondent.

4. It is useful to step back and look at what is really going on in the shipbuilding markets --

the whole country to its knees. In this financial crisis, the EC has seen an opportunity to extract a competitive advantage that it could not through competition in the marketplace.

5. Regarding the issue of "public bodies", Korea agrees with the EC that the question of

- The EC failed to adjust Samho Heavy Industries' pre-shipment loan rates for the 100

20. **Regarding DSME**, the EC has alleged that the Korean government "controlled" the process. However, even if the panel were to agree that mere government ownership of several Korean banks made them public bodies, these entities did not control enough of the outstanding credit to control the process under the prevailing arrangements. The EC also refers to the alleged "control" that the Government of Korea had over all of the banks during the financial crisis. However, despite the EC's repeated attempts to get the IMF to support the EC's point, the evidence is conclusive that the restructuring of the financial sector pursuant to the agreement with the IMF was done on market principles and banks restructured their bad loans to maximize value. Thus, any influence of the government had exactly the opposite effect that the EC alleges. The sole piece of "evidence" the EC proposed regarding alleged improper influence was revealed by Korea's provision of the full quotation by a single Korean bank to be a reference to the real estate sector and even that was specifically noted by the bank's lawyer not to refer to even the general point the EC was alleging.

21. Regarding the issue of benefit in the DSME restructuring, the EC offered a report by its consultant, Price Waterhouse Coopers (PwC) critiquing the workout report done by Anjin, the former Korean affiliate of Arthur Andersen. A response by the authors of the Anjin Report as well as an independent retired senior British banker, Mr. William Lawes, confirmed that the Anjin Report was objective and fair; it was commissioned for the purpose of determining the best commercial, value-maximizing solution to the insolvency of DHI resulting from the credit crunch brought on by the

to another there was no taxable event and no forgoing of any government revenue that was otherwise due. Therefore, Article 45-2 did not confer a benefit. Korea noted that the numbers the EC presented were taken exclusively from a newspaper report and that was not sufficient evidence. Moreover, the number the EC alleged was with respect to all of DHI and did not reflect any allocation between the divisions. Korea further demonstrated that the tax laws in question were not specific to the DSME transaction. If they had been, there would have been no reason to extend them for a further two years after the DHI spin-offs. As noted above, Article 46 of the Corporate Tax Act mandates specific tax treatment with respect to "gain" or "profit" realized to the spun-off company as a result of the "valuation" of assets conducted in the course of spin-off.

26. **Regarding the Samho restructuring**, Korea noted that the EC seemed to drop any reference at all to the role of the judges in the transaction. The reorganization proceeding cannot start unless the court determines that the going concern value of the subject company is greater than its liquidation value. If such is the case, the court has the power to order a receiver to submit a reorganization plan based on the continuation of business activities of the company concerned. If the plan submitted does not conform the provisions of the Corporate Reorganization Act or is unfair, unequal or not feasible, the court may decide not to refer the plan to the meeting of the interested parties for resolution. The court also has the authority to approve or reject the plan adopted by the interested parties. In sum, it is the court that decides whether to permit the subject company to continue its business operations. In order to establish that the court receivership, and any transaction done within the context of the court receivership, was not done at arm's length or conferred a benefit, the EC needs to show that the judge in this instance did not do his job, that he failed in his legal and fiduciary responsibility to maximize the return on the debt to the creditors. The EC has presented no such evidence. None exists.

27. The EC contradicted its approach to the DSME workout where the EC alleged that the new owners overpaid, by now arguing that the new owners of Samho underpaid. Of course, once again, the real answer is that facts do not support the EC's allegations regardless of which of their contradictory approaches they choose. In the case of Halla/Samho (as with Daedong/STX discussed later), the court determined that the going concern value was greater than the liquidation value and decided to proceed with the corporate reorganization. This court decision was based on the valuation by Rothschild, a financial advisor, and on Rothschild's corporate reorganization proposal which was drafted to maximize the debt repayment to the creditors. Moreover, among the many factual errors in

B. SERIOUS PREJUDICE

30. There is a basic disagreement between Korea and the EC on the issue of whether there is a need for the complainant to demonstrate serious prejudice. According to the EC the treaty contains a very mechanistic test. If any *one* of the elements of Articles 6.3 (a), (b) or (c) is shown, then the serious prejudice element of the case *automatically* is satisfied. The complainant need show nothing more. Essentially, the case is over. Of course, this approach requires reading out of the treaty some very important words. The chapeau of Article 6.3 provides that serious prejudice *may* exist when *one or several* of those elements are demonstrated. The EC reads the word "may" to mean "shall". Indeed, the EC really is replacing it with something more; it is really saying "shall be deemed to exist" because once again the EC is trying to create presumptions as substitutes for proof. It is worth lacb2.7ue the

as substitutes for proof. It is worth

exclusion of all sorts of products from cruise ships to Ro-ro ferries to pure chemical tankers. First, what is a like product must be determined primarily from the demand side based on technical characteristics and their value added for the use of the products as perceived by the user. Second, no single yard in the world claims that it can build all vessels. In reality, EC yards intentionally - well before the corporate restructuring in Korea - concentrated on the smaller like products as well as on high value added niche vessels including cruise ships, ferries or roll-on roll-off vessels. It is equally an arbitrary and broad brush conclusion by the EC to refer to "Korea" in general when the participation of the restructured and non-restructured yards in different like product vessel markets is widely different. This is true all the more in that those like product vessels where there still is some competition between EC and Korean vessels, most, if not all of these Korean vessels were built by non-

benefits (if any) were minimal and certainly by far insufficient to explain the price difference of 15 per cent which the EC alleges with the competing Lindenau offer. (Korea also notes that the EC *ad valorem* subsidization across its shipyards is much higher and would need to be considered in any proper causation analysis.) That is, the EC's own approach of lumping everything together based on generic cost/price modelling actually leads to the opposite conclusion of what the EC wishes. Any price effect is not that of the alleged subsidies.

38. One of the many problems here is that the EC is collapsing distinct steps. The treaty text in each of the subparagraphs of Article 6.3 is that the "effect of the subsidy" is to cause one of the possible elements that can be a constituent of serious prejudice. That is, the causation *within* 6.3(c) is not of serious prejudice, but of the possible supporting factors. The treaty clearly states that the EC must demonstrate that the effect of the alleged subsidies is to cause significant price depression or suppression. There is no dancing around these words. Those specific identified subsidies must be actually having an effect themselves of significant price depression or suppression. Other factors may be at play and they may also have price depressive or suppressive effects, but such effects cannot be attributed to the alleged subsidies. Korea must point this out once again because the EC does not even get to the point of separating out the effect of the subsidies and, instead, tries to rely on the effect of the *products*. Only then after that element is established as an effect of the alleged subsidy can the complainant move on to show that that one element listed in 6.3 alone or along with others of the *several* identified elements may be causing serious prejudice. It is axiomatic that other factors causing the prejudice cannot be attributed to the alleged subsidies. This is not only required by the jurisprudence relating to all injury-type inquiries, but it is also mandated by the full contextual analysis of Part III which provides in Article 7.8 that one available remedy is to remove the injury. If there has not been a reliable analysis tracing through from the alleged subsidy having the effect of significant price suppression which, in turn causes serious prejudice, then this analysis is rendered literally impossible.

39. In conclusion, it is clear that the EC has failed to carry its burden of proof, indeed, has misconstrued that burden as a matter of law. Moreover, arguing in the alternative and at the request of the Panel, Korea has adduced substantial evidence on each legal point demonstrating that there is no basis for the EC's claims. Accordingly, Korea requests that the Panel reject the EC's claims under Parts II and III of the SCM Agreement.