

ANNEX A

EXECUTIVE SUMMARIES OF THE FIRST WRITTEN SUBMISSIONS OF THE PARTIES

Contents		Page
Annex A-1	First Written Submission of the European Communities	A-2
Annex A-2	First Written Submission of Korea	A-11

ANNEX A-1

FIRST WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

(22 December 2003)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	A-3
II. FACTUAL BACKGROUND	A-3
III. HISTORY OF DISPUTE.....	A-3
IV. LEGAL CLAIMS.....	A-3
A. INTRODUCTION.....	A-3
B. BURDEN OF PROOF, BEST INFORMATION AVAILABLE AND ADVERSE INFERENCES.....	A-4
C. PROHIBITED SUBSIDIES	A-5
1. The KEXIM Act, Decree, and Interest Rate Guidelines, As Such, Violate Article 3 of the SCM Agreement.....	A-5
2. The KEXIM Advance Payment Refund Guarantee and Pre -shipment Loan Programmes constitute measures in the form of a “practice” of KEXIM pursuant to the KEXIM Act	A-6
3. Specific Grants of Prohibited Subsidies	A-7
D. ACTIONABLE SUBSIDIES.....	A-7
V. CONCLUSION.....	A-9

I. INTRODUCTION

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

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

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

II. FACTUAL BACKGROUND

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

III. HISTORY OF DISPUTE

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

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

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

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

IV. LEGAL CLAIMS

A. INTRODUCTION

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

- first addresses general issues relating to the burden of proof, best information available, and adverse inferences (Section B)
- then proceeds to consider the issue of prohibited subsidies (Section C); and
- finally addresses actionable subsidies (Section D).

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

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

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

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

- The information provided under the Annex V procedure constitutes “the record” on the basis of which the Panel is to decide the case.³
- Where there is a lack of cooperation by the subsidising Member or any third-country Member, the complaining Member is entitled to make its case based on evidence available to it.⁴
- The Panel may then “complete the record as necessary relying on best information otherwise available”⁵ and may seek additional information to complete the record that it “deems essential to a proper resolution to the dispute, and which was not adequately sought or developed during that process”.⁶ However in doing so, the Panel “should not request additional information to complete the record where the information would support a particular party's position and the absence of that information in the record is the result of unreasonable non-cooperation by that party in the information-gathering process.”⁷
- The Panel is expressly instructed to draw adverse inferences from instances of non-cooperation.⁸

¹ Appellate Body Report, *US – Wool Shirts and Blouses*, at 14.

² Appellate Body Report, *Japan – Apples*, para 157.

³ *SCM Agreement*, Annex V, at paras. 6 and 9.

⁴ *Ibid.* at para. 6.

⁵ *Ibid.*

⁶ *Ibid.* at para. 9.

⁷ *Ibid.* at para. 9.

⁸ *Ibid.* at para. 7.

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

13. The European Communities has exercised self-restraint in requesting the Panel to base its findings on best information otherwise available or to draw adverse inferences in accordance with paragraphs 6 to 8 of Annex V of the *SCM Agreement*. Whether it will be necessary for the Panel to draw further adverse inferences, to use best information otherwise available, or to seek further information through use of its powers under Article 13 of the DSU to seek technical advice and information from relevant individuals or bodies such as the OECD, will depend on the position taken by Korea on the case made by the European Communities.

C. PROHIBITED SUBSIDIES

14. The European Communities makes three distinct claims that Korean measures constitute prohibited subsidies under Part II of the *SCM Agreement*. These are:

- (a) The regime established by the Export-Import Bank of Korea Act (“KEXIM Act”), the Enforcement Decree of the Export-Import Bank of Korea (“KEXIM Decree”), and the Guidelines for Interest and Fees (“KEXIM Interest Rate Guidelines”).
- (b) The KEXIM practice, undertaken pursuant to the KEXIM Act, Decree, and Interest Rate Guidelines of providing export subsidies through its advance payment refund guarantee (“APRG”) and pre-shipment loan financing programmes.
- (c) Specific grants of APRGs and pre-shipment loans to Korean shipbuilding companies by KEXIM.

15. The European Communities shows that all of the above constitute prohibited subsidies within the meaning of Article 3.1(a) of the *SCM Agreement*. The definition of subsidy in Article 1.1(a)(1) of the *SCM Agreement* encompasses financial contributions provided by “any public body”. The European Communities demonstrates that KEXIM is a “public body” within the meaning of Article 1.1(a)(1) of the *SCM Agreement*.

1. **The KEXIM Act, Decree, and Interest Rate Guidelines, As Such, Violate Article 3 of the *SCM Agreement***

16. The European Communities first explains that the fact that the regime established by the KEXIM Act and Decree does not expressly *require* the granting of WTO-inconsistent export subsidies does not alter the fact that the regime, as such, is contrary to the requirements of the *SCM Agreement* and Article 3.1(a) thereof.

17. The Appellate Body has recently laid to rest the notion that non-mandatory measures cannot be the subject of dispute settlement in *US – Sunset Review (Japan)*. In that case the Appellate Body reviewed the alleged basis for this doctrine and reversed the reliance of the panel in that case on it, stating:

Hence we see no reason for concluding that, in principle, non-mandatory measures cannot be challenged "as such".¹⁰

⁹ Appellate Body Report, *Canada – Aircraft*, para 202 (footnote omitted).

¹⁰ Appellate Body Report, *US – Sunset Review (Japan)*, para. 88.

18. While the mandatory or discretionary nature of a measure may be relevant in assessing the compatibility with certain WTO obligations, the Appellate Body held in *US – Section 211* that an assessment of the compatibility of a measure cannot end with the conclusion that it is discretionary.¹¹ The scope of WTO obligations, and the possibilities for invoking them against measures maintained by the Members, must be determined on the basis of the ordinary meaning of the text of the relevant WTO provisions, read in light of their object and purpose.

19. Nothing in the language of Article 3.1 of the *SCM Agreement* suggests that a Member can have discretion to provide export subsidies. Indeed, Article 3.2 of the *SCM Agreement* makes this clear since it provides that Members “shall neither grant nor *maintain* subsidies referred to in” Article 3.1 (i.e. prohibited subsidies).

20. The KEXIM Act, Decree, and Interest Rate Guidelines provide for the granting of prohibited export subsidies. They (a) establish as a main operational objective of KEXIM the promotion of Korean exports through the grant of loans and guarantees; (b) prohibit KEXIM from competing with other financial institutions; and (c) enable KEXIM to grant loans and guarantees without regard to financial risk, and in unlimited amounts. Consequently, this legal regime is inconsistent, as such, with Article 3 of the *SCM Agreement*.

21. KEXIM’s legal framework, including the KEXIM Act, by providing for the grant of loans and loan guarantees in amounts not limited by consideration of the financial status of the borrower, and on more advantageous terms than the market would provide, confers a “benefit” on exporters. KEXIM’s legal framework, including the KEXIM Act, provides for the grant of subsidies that are *de jure* contingent on export performance. Under Article 18 of the Act, the loans and guarantees are, by its own terms, “[f]or the purpose of facilitating exports of products.” Thus, under the plain language of the statute, the subsidies, in the form of loans and guarantees, are *de jure* export contingent within the meaning of Article 3.1(b) of the *SCM Agreement*. As a prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the subsidies granted by KEXIM pursuant to KEXIM’s legal framework are “deemed to be specific” pursuant to Article 2.3 of the *SCM Agreement*.

22. The European Communities also points out that the KEXIM Interest Rate Guidelines do, in fact, specifically require the grant of a subsidy at below-market markets under certain circumstances.

2. The KEXIM Advance Payment Refund Guarantee and Pre-shipment Loan Programmes constitute measures in the form of a “practice” of KEXIM pursuant to the KEXIM Act

23. KEXIM operates the **Advance Payment Refund Guarantee programme** pursuant to the KEXIM Act. Under this programme, KEXIM guarantees that a foreign buyer will be refunded 100 per cent of any advance payments made to a Korean exporter, including any accrued interest on the advance payments, if the exporter fails to perform its obligations under the relevant contract. The amount of the APRG, also known as an Advance Payment Bond, is determined by the total amount of advance payments actually paid to the Korean exporter, plus accrued interest on the advance payments that would be due in case of default.

24. KEXIM guarantees confer a “benefit” to Korean exporters by providing financial support on more advantageous terms than they would otherwise be able to obtain in the Korean financial market. Although KEXIM charges each exporter a certain fee (i.e. premium) when granting APRGs, the premium fails to reflect the degree of creditworthiness of the Korean exporters. KEXIM issues guarantees without proper consideration of the risk involved in the transaction – in many cases, granting guarantees to financially troubled companies that would not have been able to obtain a guarantee from a commercial bank.

¹¹ Appellate Body Report, *US – Section 211 Appropriations Act*, para. 260.

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

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

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

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

3. Specific Grants of Prohibited Subsidies

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

D. ACTIONABLE SUBSIDIES

30. The European Communities demonstrates in the submission that subsidies granted by Korea to its shipbuilding industry cause serious prejudice to the EC’s shipbuilding industry. These subsidies were granted pursuant to the restructuring process of the Korean shipbuilding industry since 1997. They take the form of debt forgiveness, debt-for-equity conversions on non-market terms, tax concessions, and KEXIM APRGs and pre-shipment loans.

31. The European Communities first presents evidence that the Government of Korea has provided “financial contributions” in the form of debt forgiveness, debt-for-equity conversions on non-market terms, and tax concessions that confer a “benefit”, and that are “specific” to certain enterprises within the meaning of Articles 1 and 2 of the *SCM Agreement*. The European Communities then shows that the subsidies, together with the KEXIM subsidies described in Section IV.C granted directly or indirectly by the Government of Korea constitute actionable subsidies that violate Articles 5(c) and 6.3(c) of the *SCM Agreement* by causing serious prejudice to the interests of the European Communities.

32. The Government of Korea has a long history of intervention in the country’s financial and corporate sectors, directing the lending practices of financial institutions to promote the export-

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

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

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

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

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

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

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

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

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

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

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

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

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

V. CONCLUSION

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

- Korea through the KEXIM Act, KEXIM Decree and Interest Rate Guidelines provides prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the *SCM Agreement*;
- Korea through the establishment and maintenance of the APRG and pre-shipment loan programmes provides prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the *SCM Agreement*;
- Korea through individual grants of APRGs and pre-shipment loans provided prohibited subsidies, inconsistent with Article 3.1 and 3.2 of the *SCM Agreement*;
- Korea, by providing subsidies to Daewoo-SME/Daewoo-HI, Samho-HI/Halla-HI, and STX/Daedong through (i) workout plans and restructuring plans; (ii) tax concessions provided to Daewoo-HI/Daewoo-SME; and (iii) the grant of KEXIM APRGs and pre-shipment loans, has caused serious prejudice to the interests of the European Communities in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

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

ANNEX A-2

FIRST WRITTEN SUBMISSION OF KOREA

(9 February 2004)

I. OVERVIEW AND INITIAL MATTERS

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

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

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

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

5. The EC's failure to identify the "like product" is a fatal flaw in any attempt by a complainant to establish a *prima facie* case of serious prejudice under Part III. Having suggested using the tests for determining "like products" derived in the jurisprudence of Article III of the GATT 1994, the EC then failed to identify the like product based on arguments or evidence in accordance with such tests. The identification of the "like product" is a basic element of any trade effects-type determination with

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

6. The EC fails to identify, and *a fortiori* to prove, the existence the “serious prejudice” that it has experienced either with respect to the industry(ies) producing the unidentified like product(s) or to its broader interests. To the extent that it even identifies a standard, it attempts to use the lower standard of *material* injury rather than *serious* prejudice.

7. The EC has failed to establish any causal link at all between the alleged subsidies themselves and the asserted serious prejudice as is required by Article 6.3(c) of the SCM Agreement. It has improperly attempted to rely on a link between the products and the alleged serious prejudice. Even then, the EC does not differentiate products made by Korean shipyards that did not undergo restructuring.

8. Contrary to the requirement under Article 6.3(c) of the SCM Agreement which provides that causation has to be by reason of the effects of the subsidy itself, the EC fails to present any evidence to establish that any alleged serious prejudice was not caused by factors other than the alleged subsidies such as competition from shipyards in Japan or other countries or the effect of the closed nature of the Japanese market which it acknowledges. Moreover, the EC Commission’s Third Report on World Shipbuilding identifies the decades of the EC’s heavy subsidization of its shipyards as a factor in the lack of competitiveness of the EC yards. The EC also does not address other matters such as the sharp appreciation of the Euro, and so forth.

9. The EC does not attempt to calculate the level of the alleged subsidization and rests with throwing out some unsupported and unexplained numbers with respect to the alleged restructuring subsidies. It further claims the right to present some econometric or other studies should either the Panel or Korea challenge its assertions. The EC misunderstands that this and other elements of proving its case do not entail further rights for the EC, but, instead, are obligations that it has failed to fulfil.

10. Article 13 of the Dispute Settlement Understanding (“DSU”) provides the Panel with certain investigative powers but the Appellate Body has made it clear that there are limits on how these are to be used. In *Japan – Agricultural Products II*, the Appellate Body stated that: “A panel is entitled to seek information and advice from experts and from any other relevant source it chooses, pursuant to Article 13 of the DSU. . . to help it understand and evaluate the evidence submitted and arguments made by the parties, **but not to make the case for a complaining party.**”¹

11. Preliminary Ruling Requests -- Korea has asked for certain clarifications of issues left from the Panel’s preliminary rulings.² Specifically, Korea has asked for clarification that the dispute is actually limited to commercial vessels and that the only claim pursuant to Article 6.3 is with respect to paragraph (c) of Article 6.3. Korea has also requested the Panel to rule that the dispute is limited to Article 5(c) as there are no arguments or even mention of Article 5(a) in the EC’s first submission. Korea has also requested that the Panel rule that price undercutting under Article 6.3(c) and 6.5 is no longer included in the dispute as it is not addressed in the EC’s first submission.

12. Korea re-iterated its request that the Panel consider the question of the EC basing claims under both Part II and Part III of the SCM Agreement on the same alleged export subsidies. Unlike every other provision of the WTO agreement, Part III SCM disputes require a showing of adverse effects. Thus, basing two separate claims under both Parts on the same subsidies can result in double-

¹ Appellate Body report in *Japan – Agricultural Products II* at para. 129. (emphasis added)

² Korea incorporated by reference its Preliminary Ruling Request as there were a number of issues in the request that the Panel decided to defer until later.

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

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

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

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

II. ALLEGATIONS OF PROHIBITED SUBSIDIES

16. The EC has alleged that the KEXIM Act and the Advanced Payment Refund Guarantee ("APRG") and pre-shipment loan programmes "as such" violate the provisions of Part II of the SCM Agreement. In order to prove the claim, the EC must establish that the Act and the programmes on their face are violations of the SCM Agreement. It is insufficient to argue that they *may* be interpreted and applied in such a manner. To find that a mere possibility of applying a law in a manner inconsistent with WTO obligations renders the law *per se* illegal would require all WTO Members to undergo a massive vetting and amending of all of their laws and regulations which would seriously undermine the sovereign rights of WTO Members. Aside from the practical impossibility of such a course of action, it would be a major change in the jurisprudence of the GATT and WTO and not in accord with the terms of the treaty.

17. The EC has failed even to properly identify what measure is involved in its claims that the APRG and pre-shipments programmes are inconsistent with Part II of the SCM Agreement. These are not measures with identifiable parameters that one can point to and state that there is compelled action that could be inconsistent with the SCM Agreement. Rather, the two programmes are applications of the KEXIM Act and KEXIM's policies which further require KEXIM to extend financing facilities on a market-oriented basis. The remainder of the dispute with respect to the EC's claims under Part II of the SCM Agreement illustrates that there can be no violation "as such", for it is a fact-intensive inquiry as to whether, for instance, a benefit has been provided by a government or public body through government practice. Moreover, even if there was a *prima facie* violation of Article 3 of the SCM Agreement, the availability of safe harbours under items (j) and (k) of Annex I, the "Illustrative List", would nonetheless apply in the present situation. Thus, there can be no violation with respect to the KEXIM Act or the APRG and pre-shipment loan programmes as such.

18. KEXIM is not a part of the Government of Korea nor is it a "public body" for purposes of Article 1 of the SCM Agreement. Mere government ownership is insufficient to prove that it is a "public body". To establish the point, the EC must demonstrate that KEXIM is acting in a regulatory

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

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

20. The way in which the KEXIM premia and interest rates were built up from a base rate identified in the market plus spreads (also taking into account the creditworthiness of the borrower or grantee) demonstrate that KEXIM was operating on market principles in the APRG and pre-shipment loan programmes. This is confirmed when comparing these premium and interest rates against the closest comparable benchmarks in the market as was held by the Panel and Appellate Body in *Canada – Aircraft*. Korea also notes that the EC has failed to demonstrate any current financial contribution or benefit as is required by Article 1.1 of the SCM Agreement. The “evidence” offered by the EC relates primarily to the period of the financial crisis during which period market benchmarks for identical financing facilities were difficult to identify. In the more recent period, as financial markets have stabilized, the re-emergence of identifiable market benchmarks for identical facilities demonstrates the market-based nature of KEXIM's lending and guarantee programmes.

21. According to the Appellate Body, Item (k) of the Illustrative list in Annex I to the SCM provides by *a contrario* reasoning that export credits supplied by governments that cover the government's cost of borrowing are provided a safe harbour from the provisions of Part II of the SCM Agreement. Pre-shipment loans are made at rates higher than the government's cost of borrowing and, thus, are such measures as would fit within this safe harbour provision. By the same *a contrario* reasoning, guarantees and programmes covered by item (j) would also be within a safe harbour if the premiums charged were sufficient to cover the long-term operating costs and losses of the programmes. APRGs are such measures that would fit within the safe harbour because KEXIM has always earned a profit on the programme.

II. Allegations of Actionable Subsidies

22. Restructuring --The Government of Korea took actions pursuant to an agreement with the IMF to support its financial sector during the Asian financial crisis that began in 1997. According to the IMF agreement, Korea would require banks in difficulty to re-order their lending according to market principles. Korea was required to break down the interlocking system of financing that had left it vulnerable when the financial contagion spread from other countries in the region. It was also recognized that many commercial firms were insolvent and would need to go through some sort of insolvency procedure involving changes to their operational as well as their debt structures for the purpose of rehabilitation.

23. The IMF required that these procedures be undertaken based on market principles and that only firms that could demonstrate that there was a greater going concern value than a total liquidation value would be restructured.

24. The EC has wrongly adopted the position that the only market-based solution is termination of an enterprise and distribution of the assets. Despite efforts by the EC Commission to get the IMF to agree with their position, the IMF has maintained the position that Korea based the restructuring processes on market principles and successfully carried out their Agreement in this regard.

Commentators, including some writing articles for the World Bank, agree that Korea has pursued economically efficient and transparent restructuring procedures.

25. The EC has not been able to demonstrate that the restructuring process resulted in subsidies being provided to the three shipyards it has identified. First of all, the EC has failed to establish that there was any government involvement in the restructuring process either through the government or banks as public bodies. The EC has made numerous factual errors regarding the extent of the role of government-owned banks. Moreover, the EC has failed to establish that these banks were acting in a governmental role. On the contrary, the evidence is that they were acting on normal market principles and in their best self-interest to maximize the recovery of their debts throughout the restructuring process and, thus, acting in a manner fully consistent with any privately-owned bank.

26. Mere government ownership and broad policy parameters for lending activities do not render a bank a public body. It is common for liquidity to be provided to financial systems in developing countries through government-owned banks. It is not unfamiliar even in developed countries for different types of lending institutions to have different charters by law that restrict their operations to certain sectors. This is even more important in developing countries where expertise and capital may be scarce. The EC must show more than mere government ownership and general policy parameters for operations. The EC does not and, instead, offers only assertions and allegations unsupported by facts.

27. Further, the EC has failed to show that the Government of Korea directed or entrusted any private banks to provide “financial contributions” within the meaning of Article 1.1(a)(1), to the three Korean shipbuilders. The actions by the Government of Korea during the Asian financial crisis to stabilize its overall financial market do not constitute evidence of direction or entrustment with respect to the three restructurings in question. These general actions aimed at averting a national financial calamity cannot be considered as constituting the type and level of “explicit and affirmative action of delegation or command” as found by the panel in *US – Export Restraints*. All of the private financial institutions acted in their own commercial best interests to maximize the recovery of their outstanding debts from the insolvent companies.

28. The EC has failed to demonstrate that the measures upon which it bases its claims involved “financial contributions” at all. In all of the instances of loans restructurings and debt-for-equity swaps, there was only one party involved, namely the group of creditors, for the creditors became shareholders of the new companies. It is inherent in the notion of a financial contribution that something must be transferred from one entity to another. An entity cannot “contribute” something to itself.

29. The Appellate Body has made it clear that it is also inherent in the notion of a financial contribution providing a benefit that there be a recipient. In this case, the EC has not even identified any such alleged recipients or addressed this issue. The Appellate Body has ruled twice³ (at the EC’s request) that recipients must be currently benefiting from the alleged financial contributions. The EC has completely failed to identify any current beneficiaries of the alleged financial contributions.

30. Even if there were considered to be financial contributions and recipients, the EC has failed to demonstrate how such persons benefited from such measures. As noted above, the EC’s primary argument is that the market allegedly required that the firms in question be wound up and exit the market. Such an extremist position is neither supported by the treaty text nor by logic.

31. In each of the three corporate restructuring instances identified by the EC, outside consultants or the insolvency court -- working objectively and without any government influence -- determined

³ *US – Lead and Bismuth II* and *US – Countervailing Measures on Certain EC Products*.

that the three firms in question had positive going concern values, i.e., greater than their liquidation and wind-up values.

32. With respect to Daewoo, a private workout was undertaken based on the so-called “London Approach” developed in the United Kingdom during financial difficulties experienced there. The London Approach was suggested in order to provide market-based parameters for workouts that could be undertaken on a faster time frame than court-based procedures. Workouts were voluntary and required the approval of a super-majority of creditors. With respect to Hall and Daedong, court-based procedures were followed in which creditors still had a role in evaluating and voting on restructuring packages with the Courts providing oversight and final approval. In all three cases, the shareholdings of the original shareholders were largely or totally extinguished. The creditors took control of the companies with ownership based on the seniority and quantity of the loans in question.

33. In one restructuring case, the EC offers a contrary benchmark of a few foreign banks that had minor debts in the restructured company, and attempts to claim that the restructuring was not done according to market principles. These foreign banks were operating in a totally different set of circumstances than the Korean banks and it is to be expected that banks with different perspectives will negotiate somewhat differently. Furthermore, when the totality of the circumstances is looked at, the results are essentially similar. In two court-supervised reorganization cases, the EC goes on to offer an “outside investor/lender” standard; however, this cannot provide an appropriate benchmark for commercial behaviour of the then current creditors who had to collect their non-performing loans from the insolvent companies for the sake of their own credit ratings and compliance with BIS requirements. All of the restructurings took place pursuant to market-oriented terms where all financial institutions which were then creditors of the insolvent companies worked to maximize their financial returns on their outstanding loans.

34. Alleged tax subsidies – The EC alleged that certain tax provisions that applied in the case of the reorganization of Daewoo Heavy Industries (“DHI”) constituted subsidies. However, the evidence shows that DHI did not take advantage of some of the alleged provisions. With respect to others, the EC has failed to show specificity. These are generally available corporate tax provisions that are found in most modern tax systems. Spin-offs involving no changes in ownership typically are not taxable events. The EC has provided no evidence that the tax provisions in question are of the type described in Article 1.1(a)(1)(ii) of the SCM Agreement.

35. Serious Prejudice -- The EC has failed to provide any evidence or argumentation with respect to serious prejudice. The EC has attempted to use the injury standards from countervailing duty investigations even though it is clear from the words and structure of Article 5 of the SCM Agreement that there is a distinction. The EC has ignored the Appellate Body’s findings to the effect the term “serious” connotes a much higher degree of injury than “material”.⁴ The EC draws conclusions from Part V of the SCM Agreement as to what is required in a serious prejudice case. However, the EC fails to understand that Part V merely provides guidance as to what must be included in the assessment but that this is not sufficient to find serious prejudice. The EC must go beyond the elements required in a countervailing duty investigation to establish that there is serious prejudice caused by the alleged subsidies.

36. Geographic Market and “Like Product” Definitions -- The EC has not properly defined the geographic markets. The EC claims that there is a world market, but that is not consistent with the requirements of Article 6.3(c) that Member state markets be identified. When the drafters wished to consider world markets as appropriate, they made it explicit as in Article 6.3(d). Moreover, the EC leaves unexplained the implications of its assertions elsewhere that the Japanese market is closed for foreign-built vessels or market segmentation possibly caused by such factors as the US Jones Act.

⁴ See, Appellate Body Report in *US – Lamb*, paras. 124, *et seq.*

37. As noted above, the EC has not even identified the “like products” that it considers the subject of the dispute. It refers in some places to a single product “market” implying a single like product for all commercial vessels. In other places, the EC offers three general categories of products. However, even though the EC has itself suggested that the jurisprudence of Article III of the GATT 1994 can provide guidance, the EC does not offer any of the elements of proof examined in such cases. There is no discussion of comparative physical characteristics. There are no discussions or market studies offered regarding cross-elasticities of demand or other measures to demonstrate competitiveness of products. There is no evidence of consumer preferences or end uses in the EC’s submission. The EC offers no evidence as to whether it is appropriate to group small feeder container ships with large post-Panamax container vessels. Nor does the EC offer evidence as to whether there is a competitive relationship or lack thereof between LNG tankers and chemical tankers. The vague and empty nature of the EC’s presentation in this regard is illustrated by the way it groups product tankers with container ships in one place and then hops them into the same category as chemical tankers in another. There is total silence as to whether there are common end uses, common physical characteristics or any cross-elasticities of demand. The discussion of the case simply cannot proceed without evidence and argumentation on this critical point from the complainant.

38. Without proof of like product categories, a national investigating authority would not be permitted even to initiate a countervailing duty investigation pursuant to the provisions of Part V of the SM Agreement. It is even more important in a case such as the present dispute, where there is no investigating authority, for the complaining party to carry its burden of proving a *prima facie* case. A complainant must establish the basic elements of its case by the first stage of the process or the whole proceeding itself threatens to become a mockery of due process. It is impossible for the respondent to respond or the Panel to evaluate a case when basic elements of the complainant’s case are missing.

39. Condition of the Industry(ies) -- The EC has offered only the most cursory allegations regarding the condition of its industry(ies). There are some general allegations made, but no hard evidence that its industry(ies) are suffering serious prejudice at all, much less serious prejudice caused by alleged Korean subsidies. The EC’s shipbuilding industry(ies) may be in perfect financial and overall economic health. There is no evidence provided to the contrary. Indeed, to the extent there is any evidence, it comes from Korea which has noted that the EC Commission has admitted in its Third Report on World Shipbuilding that the decades of heavy subsidization provided by the EC Member states to their shipbuilding industry(ies) have been counter-productive and have resulted in a lack of normal adjustment to technological and market developments.

40. Causation -- The EC does not establish causation of serious prejudice by the alleged subsidies themselves. The EC has attempted to rest its whole causation case on price depression in LNGs and price suppression in other products. The EC has abandoned its assertions of price undercutting and lost sales.

41. The EC has failed to establish that any price suppression or depression that exists in any product market(s) is “significant” as required by the treaty text. Price suppression allegations are based on assertions regarding increases in freight rates, cost of production or demand. Not only does the EC ignore other important factors that are present in the market such as efficiencies, changing demand and technological changes but, in addition, it bases its claims on general factual data without distinction by vessel type though market developments differed per type of vessel concerned. The EC notes the effects of currency fluctuations and makes allegations based on the relative increase of the Korean won. However, the EC ignores the even more dramatic rise in the Euro both with respect to the dollar and to the won.

42. The EC’s own shipbuilding expert has concluded that EC and Korean vessels compete only within two limited product segments, feeder container vessels and small chemical tankers and has

affirmed clearly that in these segments, there is a significant presence of shipyards from other shipbuilding nations which influence prices. Hence, it is impossible to attribute price depression and suppression to all Korean ships indiscriminately or even to the Korean feeder container vessels or small chemical tankers. The EC has ignored the reality of the shipbuilding market, namely that vessels have increasingly become commodity-products with a corresponding decrease in prices starting from the early 1990s well before any of the alleged corporate restructuring subsidies were being granted.

43. In asserting its causation allegations, the EC does not differentiate between ships produced by the three entities that emerged from restructuring and the ships produced by the other Korean shipbuilders who did not undergo such processes. This is even more bizarre when the EC bases so much reliance on cost calculations. The EC seems to be making some sort of back door antidumping argument that Korean shipbuilders are selling below cost and therefore must be subsidized. The EC's evidence on the cost issue is deeply flawed and highly artificial. It would be unpersuasive in an antidumping case, but its role in a serious prejudice case is inexplicable. Moreover, this lack of differentiation between the restructured yards and others demonstrates the lack of value of such an approach. If Korean yards are operating on the same cost basis, as implied by the EC, then it serves as proof of lack of an effect of the alleged subsidies themselves if the unstructured yards and restructured yards are selling on the same basis. Indeed, the instance of a lost sale alleged by the EC was with respect to a yard that was not subject to restructuring.

44. Furthermore, the EC does not provide any calculations for the levels of subsidization. It provides mere assertions at the end of its submission regarding the alleged restructuring subsidies but does not offer any support for the alleged levels of subsidization that it asserts. Indeed, the underlying calculations are not even provided so that neither Korea nor the Panel is able to see what elements went into these asserted numbers. The EC completely fails to provide any calculation of the alleged tax subsidies or the export subsidies. Without these calculations and full evidentiary support, the EC's case necessarily fails.

45. The EC claims a right to provide some sort of economic arguments at a later stage if any one challenges its bald assertions. However, there is no right to be maintained in this regard; rather, it was the EC's **obligation** to prove its case with established facts and sufficient arguments in its first submission. Korea recalls that the Appellate Body has specifically instructed panels that they are not to make the complainant's case for it.