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KOREA – MEASURES AFFECTING TRADE IN COMMERCIAL VESSELS (JAPAN)

REQUEST FOR CONSULTATIONS BY JAPAN

The following communication, dated 6 November 2018, from the delegation of Japan to the delegation of the Republic of Korea, is circulated to the Dispute Settlement Body in accordance with Article 4.4 of the DSU.

My authorities have instructed me to request consultations with the Government of the Republic of Korea (Korean Government), pursuant to Articles 1 and 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Articles XVI:1 and XXII:1 of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"), and Articles 4, 7, and 30 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), with respect to certain measures affecting trade in commercial vessels.

The Republic of Korea ("Korea") has developed and implemented a range of measures designed to provide financial support to its shipbuilders. These measures include providing both "producer support," such as direct financing provided to Korean shipbuilders that, *inter alia*, enables their continued market presence and prolonged periods of otherwise unsustainable low pricing, and "sales support" to Korean shipbuilders and their customers, which is designed to stimulate sales for Korean shipbuilders, including during periods of relatively low demand.

Japan considers that certain measures taken by Korea provide subsidies that are inconsistent with its obligations under the *SCM Agreement* and the *GATT 1994*. The measures in question relate to the development, production, marketing, and/or sale or purchase of commercial vessels, including vessels designed to carry crude oil, liquefied natural gas (LNG), and shipping containers. These measures include, but are not necessarily limited to, those described below.

1. Corporate Restructuring Measures to Support Korean Shipbuilders

Japan is concerned about the provision by Korea, directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, of corporate restructuring measures on non-commercial terms to support Korean shipbuilders. This includes (i) measures provided by the Korea Development Bank ("KDB"), including those provided pursuant to Chapter 3, Articles 18.(1).5 and 18.(1).6 of the Act on the Korea Development Bank, which states that, in order to achieve the purpose of the Act, KDB should provide funds for Korean businesses and industries to support their entry into foreign markets, for industrial development, and for corporate restructuring; (ii) measures provided by the Export-Import Bank of Korea ("KEXIM"), including those provided pursuant to Chapter 3, Articles 18.(1).1, 18.(2).9 and 18.(5) of the Act on the Export-Import Bank of Korea ("KEXIM Act"), which states that, in order to achieve the purpose of the Act, KEXIM should provide funds to businesses the KEXIM board deems to be important for the promotion of the nation's economic exchange; (iii) measures provided by the Korea Trade Insurance Corporation ("K-Sure") pursuant to the Trade Insurance Act; (iv) comprehensive measures adopted by Korea, including those establishing the Marine Finance Center to "strengthen marine and shipping finance"; and (v) measures provided by the Korea Ocean Business Corporation ("KOBC") pursuant to the Korea Ocean Business Corporation Act.

These measures take the form, *inter alia*, of loans with interest at below-market rates, share subscriptions and cancellations, purchase of perpetual bonds, and debt-equity swaps, as further described below. They include, but are not limited to, the following:

- a) All Korean measures related to the restructuring of Daewoo Shipbuilding & Marine Engineering ("DSME") from 2015 onward, including, but not limited to, the following:
 - i. All aspects of support provided to DSME pursuant to its 2015 restructuring, including, but not limited to, the following:
 - a. KDB's provision of 2.1 trillion KRW as short- and long-term loans by December 2016;
 - b. KDB's acquisition in 2015 of 76 million newly-issued DSME shares for 380 billion KRW; and
 - c. KEXIM's commitment in 2015 of 1.6 trillion KRW in the form of additional short- and long-term loans to promote capital expansion, as well as KEXIM's subsequent provision of such loans.
 - ii. All aspects of support provided to DSME pursuant to its 2016 restructuring, including, but not limited to, the following:
 - a. KDB's agreement to the cancellation in 2016 of 60 million shares in DSME and the reduction in value by 10:1 of 75 million additional shares in DSME, which KDB held prior to the restructuring plan, without compensation;
 - b. KDB's debt-to-equity swap in 2016 of 1.8 trillion KRW; and
 - c. KEXIM's purchase in 2016 of 1.0 trillion KRW in perpetual bonds issued by DSME.
 - iii. All aspects of support provided to DSME pursuant to its 2017 restructuring, including, but not limited to, the following:
 - a. KDB's debt-to-equity swaps in June and August 2017 of 320 billion KRW for all unsecured claims concerning DSME;
 - b. KEXIM's purchase in 2017 of 1.3 trillion KRW in perpetual bonds issued by DSME;
 - c. KDB's purchase in 2017 of 150 thousand shares in Daehan Shipbuilding Co., Ltd. ("Daehan") from DSME for 1.5 billion KRW;
 - d. KDB's commitment in 2017 to provide 1.5 trillion KRW of additional loans; and
 - e. KEXIM's commitment in 2017 to provide 1.5 trillion KRW of additional loans.
 - iv. Any other aspects of support provided to DSME pursuant to company restructuring from 2015 onward.
- b) All Korean measures related to the restructuring of Korean shipbuilders other than DSME since 2007, including restructurings of Sungdong Shipbuilding & Marine Engineering Co., Ltd. ("Sungdong"), STX Offshore & Shipbuilding Co., Ltd. ("STX"), and Daehan.

2. Guarantees and Other Insurance for Financing Related to Commercial Vessel Orders Placed with Korean Shipbuilders

Japan is concerned about the provision by Korea, directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, of guarantees or other types of insurance on sales-specific payments or financing on non-commercial terms. Public and private institutions owned, controlled, entrusted and/or directed by the Korean Government provide guarantees or other insurance at a preferential rate for payments and/or financing related to a commercial vessel order placed with a Korean shipbuilder in case the Korean shipbuilder or the customer fails to perform its obligations pursuant to the relevant agreement(s) relating to the purchase of commercial vessels. This support includes Refund Guarantees ("RGs") provided by KEXIM pursuant to Article 18 of the KEXIM Act. It also includes RGs and guarantees/insurance

covering export financing for shipbuilders provided by a number of Korean public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, including KEXIM, KDB, and K-Sure, as well as the Korea Credit Guarantee Fund, which provides a guarantee to the financial institutions that issue RGs. These measures include, but are not limited to, the following:

- a) All Korean measures providing Export Bond Insurance from K-Sure covering export orders from Korean shipbuilders or Export Base Insurance from K-Sure covering against losses of financial institutions providing funds to shipping companies to help them purchase ships from Korean shipbuilders;
- b) All Korean measures providing Medium- and Long-Term Export Credit Insurance or RGs from K-Sure for prepayments to Korean shipbuilders;
- c) All Korean measures providing RGs from KDB or KEXIM to small- and medium-sized shipbuilders for prepayments from customers to these shipbuilders, and guaranteeing those RGs by the Korea Credit Guarantee Fund, including, but not limited to, the following:
 - i. KDB issued a RG for the order of four crude oil tankers accepted by STX in June 2017.
- d) All Korean measures providing RGs from KEXIM for prepayments from customers to Korean shipbuilders, including, but not limited to, the following:
 - i. KEXIM issued a RG for the order of five crude oil tankers by a Greek shipping company accepted by Sungdong in July 2017.
- e) All Korean measures providing RGs to DSME, including, but not limited to, the following:
 - i. KDB's, KEXIM's, and K-Sure's agreement, pursuant to DSME's 2015 restructuring, to provide prepayment RGs for orders placed with DSME; and
 - ii. KDB's July 21, 2015 approval of a RG relating to the prepayment of a container ship to be produced by DSME on an order by Maersk;
- f) All Korean measures providing guarantees for loans provided to any shipping company placing an export order with Korean shipbuilders, including, but not limited to, the following:
 - i. K-Sure's provision of a guarantee for the loans provided to the shipping company placing an export order with Hanjin Heavy Industries.
- g) Any other Korean measures providing RGs and other guarantees/insurance on payments and/or financing in connection with commercial vessel orders placed with Korean shipbuilders.

3. Pre-Shipment Loans, Measures through the New Shipbuilding Program, and Other Financing for Commercial Vessel Orders Placed with Korean Shipbuilders

Japan is concerned about the provision by Korea, directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, of pre-shipment loans and other sales-specific financing on non-commercial terms provided to Korean shipbuilders or their customers. This financing includes: (1) provision of loans to finance production, or customers' purchases, of commercial vessels produced by Korean shipbuilders; (2) purchase of bonds to fund customers' purchases of commercial vessels produced by Korean shipbuilders; and (3) capital injections to finance customers' purchases of commercial vessels produced by Korean shipbuilders. This financing is offered by a range of Korean public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, including KEXIM.

As detailed in policy documents such as the Development Strategy for the Shipbuilding Industry and the Five-Year Marine Transportation Industry Rebuilding Plan (2018-2022), Korea is developing and executing a plan to support shipbuilders and shipping companies by providing financial support for purchases of commercial vessels from Korean shipbuilders. Further, Korean public and private institutions owned, controlled, entrusted and/or directed by the Korean Government will support the launching of vessels and ensure liquidity for shipping companies, through means that include the provision of financing.

These measures include, but are not limited to, the following:

- a) All Korean measures providing Export Implementation Fund Loans from KEXIM to Korean shipbuilders to produce commercial vessels for export orders;
- b) All Korean measures providing pre-shipment loans to Korean shipbuilders;
- c) All Korean measures providing support for purchases of commercial vessels for more than adequate remuneration and/or loans and leasing of commercial vessels at below-market rates pursuant to the New Shipbuilding Program, including, but not limited to, the following:
 - i. Korea Ocean Business Corporation, Korea Asset Management Corporation ("KAMCO"), K-Sure, KDB, and KEXIM's provision of loans and other financing totalling approximately 2.95 trillion KRW in connection with an order placed by Hyundai Merchant Marine in 2017 for seven container carriers from DSME, five container carriers from Samsung Heavy Industries, and eight container carriers from Hyundai Heavy Industries.
 - ii. KDB, KEXIM, KAMCO, KDB Capital, and K-Sure's provision of loans and other financing totalling approximately 250 billion KRW in connection with an order placed by Polaris Shipping for three very large ore carriers ("VLOCs") from Hyundai Heavy Industries in 2016 through the New Shipbuilding Program.
 - iii. The provision of financing to Hyundai Merchant Marine, a shipping company, in relation to its purchase of five very large crude carriers ("VLCCs") from DSME.
- d) All Korean measures providing Export Base Fund Loans from KEXIM, solely or jointly with K-Sure, to finance the purchase of commercial vessels from Korean shipbuilders, including, but not limited to, the following:
 - i. KEXIM's and K-Sure's provision of financing of 170 million USD each for a 680 million USD order by Oceanbulk Container Management SA;
 - ii. KEXIM's and K-Sure's provision of financing of 400 million USD (205 million USD in loans and 195 million USD in overseas loan guarantees) and 100 million USD, respectively, for a 1.36 billion USD order by Dorian LPG; and
 - iii. KEXIM's provision of financing of 77 million USD, along with a guarantee for an additional 10 million USD in loans from commercial banks, for a 174 million USD order by Container Carriers.
- e) All Korean measures where Korean public and private institutions owned, controlled, entrusted and/or directed by the Korean Government provided support to shipping companies and/or ship owners that have placed or would place an order with a Korean shipbuilder, including but not limited to:
 - i. Sale-and-lease-back arrangements, capital injections, the purchase of perpetual bonds, and other means of providing financing;
- f) Any other Korean measures providing financial assistance to shipbuilders or shipping companies through the provision of preferential loans, purchase of bonds, capital injections, the purchase of commercial vessels at above-market rates and the lease back of commercial vessels at below-market rates, or any other type of preferential financing.

4. Eco-Ship Replacement Subsidies

Japan is concerned about the provision by Korea, directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, of financial assistance on non-commercial terms to purchasers of commercial vessels produced by Korean shipbuilders, including providing price support (*i.e.*, cover a portion of the cost) for the purchases of commercial vessels that comply with certain environmental standards from Korean shipbuilders.

In 2017, the Korean Ministry of Oceans and Fisheries, a division of the Korean Government, announced that it planned to implement a system to provide price support for the purchase of newly built vessels when replacing an aged ship with an "eco-ship" or highly energy-efficient ship. Pursuant to the Development Strategy for the Shipbuilding Industry and the Five-Year Marine Transportation

Industry Rebuilding Plan (2018-2022), Korea is expanding these efforts to encourage and support the replacement of existing commercial vessels with eco-ships. Pursuant to the Eco-Ship Replacement Subsidies measures, the Korean Government provides cash payments to cover 10-20% of the price of an order for a new ship that meets certain environmental requirements if the purchaser is replacing an aged ship. In addition, Korea directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, will provide interest rate support to financial institutions that provide financing for projects pursuant to the eco-shipment measures.

These measures include, but are not limited to, the following:

- a) All Korean measures supporting the construction of 50 commercial vessels by 2022 envisioned by the Five-Year Marine Transportation Industry Rebuilding Plan, including, but not limited to:
 - i. Korea's provision of funding for Sinokor Merchant Marine's purchase of a new 1,800TEU container carrier (Bangkok Max) from Hyundai Mipo Dockyard.
- b) Any other Korean measures providing financing to purchasers of vessels that comply with set environmental standards and that are produced by Korean shipbuilders.

5. Other Korea's Support for Commercial Vessel Purchases

Japan is concerned about the provision by Korea, directly and/or through public and private institutions owned, controlled, entrusted and/or directed by the Korean Government, of financial assistance on non-commercial terms to Korean shipbuilders and/or purchasers, lessors, lessees, and/or operators of commercial vessels produced by Korean shipbuilders. As detailed in policy documents, such as the Development Strategy for the Shipbuilding Industry and the Five-Year Marine Transportation Industry Rebuilding Plan (2018-2022), Korea is developing and executing a plan to support shipbuilders and shipping companies, including by directly purchasing, or facilitating the purchase of, commercial vessels from Korean shipbuilders. Specifically, these measures include, but are not limited to, the following:

- a) All Korean measures designed to "increase contracting and public orders . . . in accordance with the marine transportation industry rebuilding plan" as described in the Development Strategy for the Shipbuilding Industry;
- b) All Korean measures related to the KOBC's investment in new commercial vessels and financing of new commercial vessels produced by Korean shipbuilders, including, but not limited to, the following:
 - i. The planned equity investments of 30 percent of the construction costs for up to 40 vessels.
- c) Any other Korean measures providing for the purchase of commercial vessels from Korean shipbuilders by the Korean Government for purposes of supporting the shipbuilding and shipping industries.

6. Amendments; Other Measures

This request for consultations extends to any amendments, revisions, implementation, or related measures to the measures described above, as well as the laws and practices on which the measures listed above are based or that they reflect or constitute.

In addition, this consultation request extends to any other measures that involve a financial contribution by Korea that, directly or indirectly, confers a benefit to Korean shipbuilders and/or lessors, lessees, owners and/or operators of commercial vessels produced by Korean shipbuilders.

7. Legal Basis

Japan is concerned that the measures described in Sections 1 through 6 above are inconsistent with Korea's obligations under various provisions of the *SCM Agreement*. In particular, these measures appear to be subsidies causing adverse effects to Japan's interests as provided in:

- a) Article 1.1 of the *SCM Agreement* because, in each instance, a subsidy exists in that there is a financial contribution and a benefit is thereby conferred.
- b) Article 2 of the *SCM Agreement* because, in each instance, the subsidies are specific.
- c) Articles 5 (a) and (c) and 6.3 (a), (b), and (c) of the *SCM Agreement* because the measures are specific subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement* that are causing or threatening to cause adverse effects to the interests of Japan in the form of injury to Japan's domestic shipbuilding industry and serious prejudice to the interests of Japan, including through displacement and impedance of imports and exports of the Japanese like product into Korea and third country markets, and significant price undercutting, price suppression, price depression, and lost sales in the same market or markets.

Japan is also concerned that the measures described in Sections 1 through 6 above appear to be export subsidies inconsistent with Articles 3.1 (a) and 3.2 of the *SCM Agreement*.

Japan is further concerned that measures described in Sections 3 through 6 above appear to be contingent upon the use of domestic over imported goods inconsistent with Articles 3.1 (b) and 3.2 of the *SCM Agreement*, and also appear to fail to accord products imported into Korea treatment no less favourable than that accorded to like products of Korean origin in a manner consistent with Article III:4 of the *GATT 1994*.

In accordance with Articles 4.2 and 7.2 of the *SCM Agreement*, Japan attaches a statement of available evidence with regard to the existence and nature of the subsidies in question, as well as the injury caused to the domestic industry, and/or serious prejudice caused to the interest of Japan. The available evidence is listed in **Annex** to this request.

Japan reserves the right to request that Korea produce further information and documents regarding the measures in question, to offer further evidence of each of the measures and potential violations listed above, and to raise further facts and claims under other provisions of the covered agreements and address additional measures during the course of consultations.

Japan looks forward to receiving a reply from Korea to this request for consultations and to find a mutually convenient date for consultations.

ANNEX

Statement of Available Evidence

Japan's request for consultations dated 6 November 2018 identifies the subsidies that are the subject of this request for consultations.

The evidence set out below is evidence available to Japan at this time regarding the existence and nature of those subsidies, as well as the injury caused to the domestic industry, and/or serious prejudice caused to the interest of Japan. Japan reserves the right to supplement or alter this list in the future, as required. Certain evidence may be indicative of the existence and nature of more than one type of subsidy or measure. However, for simplicity, all sources of evidence are only listed once.

The evidence presently available to Japan includes the following:

General

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- For All the Relevant Ministries and Government Agencies, Ministry of Strategy and Finance, *Plans to Enhance the Competitiveness of the Shipbuilding Industry* (Oct. 31, 2016), http://www.moef.go.kr/com/synap/synapView.do?atchFileId=ATCH_000000000003180&fileSn=1.
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Corporate Restructuring Measures to Support Korean Shipbuilders

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- DSME, *Correction Notification (Report)* (Oct. 19, 2017), <http://dart.fss.or.kr/dsaf001/main.do?rcpNo=20171019000325>.
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