JAPAN - COUNTERVAILING DUTIES ON DYNAMIC RANDOM ACCESS MEMORIES FROM KOREA - RECOURSE BY KOREA TO ARTICLE 21.5 OF THE DSU

(WT/DS336)

THIRD PARTY SUBMISSION OF THE UNITED STATES OF AMERICA

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Table of Reports Cited

Panel Report	Panel Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/R, adopted 17 December 2007, as modified by the Appellate Body Report, WT/DS336/AB/R
Appellate Body Report	Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, adopted 17 December 2007
US – Softwood Lumber CVD Final (AB)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004
Korea – Commercial Vessels	Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005

I. Introduction

1. The United States welcomes this opportunity to provide the Panel with its views in this dispute, in which Korea challenges Japan's implementation of the recommendations and rulings of the Dispute Settlement Body ("DSB") in *Japan - Countervailing Duties on Imports of Dynamic Random Access Memories ("DRAMs") from Korea* (WT/DS336). This submission addresses certain arguments advanced by Korea pertaining to the consistency with the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") of the Japanese investigating authority's (JIA) determination of the existence and amount of benefit from the 2002 restructuring of Hynix Semiconductor, Inc. ("Hynix").

II. Argument

A. Korea Mischaracterizes the Appellate Body's Findings Regarding Benefit

2. In its submission, Korea repeatedly asserts that the Appellate Body found that the market for distressed debt or debt restructuring is the "relevant market" in this case, and that Japan erred by not using this "relevant market" as the benchmark in determining the existence and amount of benefit for the 2002 restructuring of Hynix.[1] Korea also suggests that the JIA was obliged to use an "existing" (i.e., inside) creditor standard to determine benefit.[2] The Appellate Body, however, made no such findings, nor would such findings be consistent with the text of Article 14 of the SCM Agreement.

3. While the Appellate Body stated that an investigating authority must identify the "relevant market" when choosing a benchmark, it did *not* find, as Korea elsewhere asserts, that the market for debt restructurings or distressed debt *must* be used as the relevant market in this case.[3] Rather, the Appellate Body discussed the market for distressed debt "[b]y way of example" to illustrate its point about the need to identify the appropriate benchmark when conducting a subsidy analysis consistent with Articles 1.1(b) and 14 of the SCM Agreement.[4]

4. Responding to arguments regarding whether the JIA measured the benefit to Hynix from the various financial contributions using an inside investor or outside investor standard, and

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[1] *See, e.g.*, First Written Submission of the Republic of Korea (November 7, 2008) ("First Written Submission of Korea (21.5)"), heading B.3.a. ("Under the Appellate Body Decision, the Benefit from a Government-Directed Debt Restructuring Must Be Measured by Comparison to the Terms that Would be Available in the Market for Debt Restructurings"). See also *id.*, paras. 79, 82, 83-96, and 118.

[2] See First Written Submission of Korea (21.5), para. 90 ("[A] complex transaction involving debt-equity swaps by existing creditors should be compared, where possible, to the market terms for similar transactions."); See also paras. 93, 119 (asserting that JIA erred in not relying on evidence regarding creditors with "existing claims on an insolvent company" to determine benefit).

[3] First Written Submission of Korea (21.5), para. 90 ("The framework established by the Appellate Body therefore requires that the measurement of the benefit of a debt restructuring be based on findings concerning the market for distressed debt.").

[4] Appellate Body Report, para. 172.

which standard was appropriate under Article 14 of the SCM Agreement,[5] the Appellate Body stated simply that it did "not consider the distinction between inside and outside investors to be helpful in order to determine the appropriate benchmark for calculating the amount of benefit under Articles 1.1(b) and 14 of the SCM Agreement."[6] It further stated: "We also do not consider that there are different standards applicable to inside and outside investors. There is but one standard — the market standard — according to which rational investors act."[7] Thus, the Appellate Body simply clarified that an investigating authority should determine the benefit from the financial contributions at issue in this case — equity infusions and loans — by comparison to, respectively, the usual investment practice of private investors and the amount the company would pay on a comparable commercial loan which the firm could actually obtain on the market. According to the Appellate Body, the "private investors" at issue could be inside or outside investors, or both, and the comparable commercial loan from the market could come from a market consisting of either existing lenders or new lenders, or both.[8] Korea, therefore, is simply incorrect in arguing that, under the Appellate Body's findings, the JIA could not examine benefit by reference to the market for new loans to and new stock purchases in solvent companies by new investors that do not already hold the insolvent company's debts.[9]

5. In asserting that the only "relevant market" is the market for debt restructurings or distressed debt, Korea also ignores the Appellate Body's clarification that "Article 14 of the SCM Agreement ... provides guidance as to how the relevant market shall be identified. Specifically, with respect to 'government infusions of equity capital', Article 14(a) stipulates that such equity infusions 'shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice of private investors in the territory of that Member.'"[10] Likewise, the Appellate Body referred to Article 14(b) as providing the needed guidance for identifying the relevant market for loans. The Appellate Body thus did *not* consider – as Korea's argument implies – "debt restructurings" to be a type of financial contribution for which a benchmark in the relevant market must be identified.

6. As the Appellate Body notes elsewhere in its report, Article 14 does not specify a single methodology for purposes of calculating benefit. Rather, Article 14 provides guidelines that must be followed in establishing methods for determining the benefit from particular types of financial contributions. "More than one method consistent with Article 14 is available to investigating authorities for purposes of calculating the benefit to the recipient," and therefore, as

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[5] *See* Panel Report, paras. 7.304-7.315; Appellate Body Report, paras. 171-174.

[6] Appellate Body Report, para. 172.

[7] *Id.*

[8] *See* Appellate Body Report, para. 173.

[9] First Written Submission of Korea (21.5), para. 93.

[10] Appellate Body Report, para. 173.

the Appellate Body observed, "[t]he chapeau of Article 14 provides a WTO Member with some latitude as to the method it chooses to calculate the amount of benefit."[11] Korea's argument – that only one approach to calculating benefit from the 2002 restructuring is permissible under the SCM Agreement – is thus at odds with both Article 14 and the Appellate Body's position on what constitutes the "relevant market".

B. Several of Korea's Arguments Regarding Calculation of the Benefit from a Debt-Equity Swap Are Unsupported by the SCM Agreement and the Appellate Body's Findings

7. The United States also disagrees with Korea's position regarding the requirements of Article 14 for calculating the amount of benefit from a debt-equity swap. In the original proceedings, the Appellate Body found that "the JIA did not sufficiently explain, in its determination, how it reached the conclusion that the value of the shares was zero from the perspective of Hynix, the recipient."[12] In its Re-Determination, the JIA evaluated the value of the equity provided to Hynix by the entrusted or directed creditors, and found that the equity had no value based on several facts suggesting that Hynix incurred no financial burden from the debt-to-equity swap.[13] Korea's argument that the JIA's analysis is inconsistent with Article 14, like its arguments described in section A, *supra*, is unsupported by the SCM Agreement and based on a misreading of the Appellate Body Report.

8. With respect to the provision of equity, Article 14(a) of the SCM Agreement states that any method used to calculate the benefit to the recipient of the equity shall be consistent with the following guideline: "government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member." The Appellate Body in the original proceeding stated that, under Article 14(a), the benchmark used for calculating the benefit from an equity infusion is the "usual practice of private investors."[14]

9. Contrary to Korea's argument, Article 14 does not contain requirements with respect to how an investigating authority determines what constitutes the "usual investment practice ... of private investors." Korea argues that the valuation of equity shares "must" be measured in

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[11] Appellate Body Report, para. 191 (quoting *US – Softwood Lumber CVD Final (AB)*, para. 91); see also Appellate Body Report, paras. 172-174.

[12] Appellate Body Report, para. 178 (footnote omitted).

[13] First Written Submission of Korea (21.5), para. 100; First Written Submission of Japan (December 8, 2008), paras. 226, 259-277.

[14] Appellate Body Report, para. 173.

certain ways, or that certain factors are "not relevant" to the analysis.[15] However, Article 14 does not contain any such rules. Indeed, several of the factors that JIA appears to have considered in its Re-Determination would be relevant in measuring the benefit from an equity infusion.

10. For example, Korea claims that "Hynix's returns during calendar year 2002 are not relevant to the measurement of the value of the equity received in the December 2002 debt-equity swap, because they reflect the income generated by Hynix's operations before the restructuring was adopted."[16] Contrary to what Korea suggests, it is entirely reasonable for an investigating authority to consider past performance of a company relevant when assessing the benefit from an equity infusion. This is because private investors, when deciding whether to invest in a company, might look at past performance — such as past returns on equity — as an indicator of the company's current financial health and as an indicator of whether the company will be a good investment going forward.[17] The SCM Agreement does not preclude consideration of these factors, and, indeed, such considerations may be relevant to an investigating authority's analysis.

11. Similarly, Korea objects to the fact that the JIA considered whether Hynix sold any shares contemporaneously with the government-provided equity infusion during the debt restructuring. Korea claims that this shows that the JIA "failed to consider the 'appropriate benchmark' in the 'relevant market.'"[18] However, the issuance of other shares—in other words, the willingness of private investors to invest in the company—may be highly relevant to determining the benefit from an equity infusion. Again, as the Appellate Body suggested in its findings in the underlying proceeding, the relevant market benchmark in cases of equity infusions is the usual investment practice of private investors.[19] When private investors are not investing in a company, an investigating authority reasonably may consider that fact to be relevant when determining the amount of the benefit from the government-provided equity infusion.

12. Moreover, as the Appellate Body found, the fundamental problem with the JIA's original benefit calculation was that it did not sufficiently explain "how it reached the conclusion that the value of the shares was zero from the perspective of Hynix, the recipient."[20] The inability of a firm to raise any equity capital on the private market may be highly relevant to an investigating

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[15] *See, generally*, First Written Submission of Korea (21.5), paras 103-113.

[16] First Written Submission of Korea (21.5), para. 110.

[17] *See Korea – Commercial Vessels*, para. 7.491 ("Instead, the terms of the debt-for-equity swap should be assessed in light of the facts before creditors at the time they decided upon them."). A company's past returns on equity are facts before the creditors at the time of deciding upon the equity infusion. Future returns on equity are not.

[18] First Written Submission of Korea (21.5), para. 118.

[19] SCM Agreement Art. 14; *see also* Appellate Body Report, para. 173.

[20] Appellate Body Report, para. 178.

authority's measurement of the benefit to the recipient from a government equity infusion. In other words, if there is a government equity infusion that the private market would not provide, then, from the perspective of the recipient, it may have received something that it could not obtain on the market. There may be a benefit from the perspective of the recipient in the full amount of the equity infusion. In effect, as the JIA found, the value of the shares would be zero. Contrary to what Korea argues, an investigating authority reasonably may consider the nonissuance of other shares when determining the benefit from a government-provided equity infusion.

13. In many respects, the flaws in Korea's arguments concerning benefit from a debt-equity swap stem from its misunderstanding of the Appellate Body Report. As described above, Korea believes that in cases involving restructurings of troubled companies, the relevant market benchmark must be the market involving debt restructurings (or distressed debt). The Appellate Body merely confirmed, however, that for equity infusions, the market benchmark is the usual investment practice of private investors, whether they be inside or outside or both. An investigating authority is not obligated to use a particular methodology. When examining an equity infusion, an investigating authority may consider the firm's return on equity in the time period preceding the equity infusion and whether other investors purchased shares in the company at the time of the government purchase, because factors such as these may be part of the "usual investment practice ... of private investors in the territory of that Member."[21]

III. Conclusion

14. The United States thanks the Panel for providing an opportunity to comment on the issues in this proceeding, and hopes that its comments will prove to be useful.

[21] SCM Agreement, Art. 14.