

## Entrusted or Directed Subsidies in WTO Disputes

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*Entrusted or directed subsidies occur where a government or public body grants a subsidy by acting through private parties. Article 1.1(a) (1)(iv) of the Subsidies and Countervailing Measures Agreement allows for such subsidies to be caught by the regulation of World Trade Organization. The interpretation of entrusted or directed subsidies has been the subject of a string of Panel and Appellate Body rulings. The interpretation was restrictive at the first step, but there has been a loosening of the notion of entrustment or direction and the corresponding evidentiary standard. In this regard, this study attempts to analyze comparatively and comprehensively the legal criteria for defining "entrusted or directed" subsidies rendered in disputes involving Hynix, a South Korean manufacturer of semiconductors and memory chips. This study also explains a series of restructuring programs for Hynix and how they were addressed in different disputes.*

**Keywords:** *Entrusted or directed subsidies, Hynix DRAMs case, WTO, Countervailing Duties, standard of review*

### 1. INTRODUCTION

Government subsidies have been used as a major economic policy instrument for economic development and particularly during times of economic crisis.<sup>1</sup> The global financial crisis since 2008 was no exception. Massive government subsidies to bail out financial institutions in distress and to support faltering large manufacturing companies such as car-makers were poured into markets where beneficiaries tend to distort international as well as domestic competition. This situation has raised concerns about the consistency between WTO rules and prevalent government subsidy programs allegedly undertaken to counter economic crisis.

This controversial situation is in fact *déjà vu* for the WTO system. For example, Argentina claimed that its statistical tax was introduced as an effort to overcome financial crisis that demanded IMF conditionality programs. Similarly, Korea's shipbuilding industries have undergone massive restructuring in recent years to counter the shipbuilding downturn and slowdown in global demand, but Japan has initiated a WTO dispute complaint against this program. When Korea brought complaints against countervailing duties (CVDs) imposed by the United States, the European Union and Japan to the WTO dispute settlement body, the underlying argument was that subsidy activities countered by countervailing duties were in fact innocuous since they were implemented as essential parts of IMF conditionality programs to recover from near bankruptcy situations. In other words, Korea argued that

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<sup>1</sup> The typically stated objectives for subsidies include industrial development, promotion of innovation and national champion industries, redistribution of incomes, protection of environment and national security. WTO (2006).

government subsidy programs at dispute were the inevitable elements of government policies to facilitate industry restructuring rather than specific subsidies to distort market competition.

The controversy over the WTO consistency of government programs undertaken in relation to one of the major semiconductor producers in Korea, Hynix, led to three WTO disputes, among which two disputes went to the Appellate Body. These three disputes on basically the same matter offered rare opportunity to scrutinize the legality of subsidy programs undertaken in the context of financial crisis. In particular, subsidies “entrusted or directed” by governments were investigated so as to rule the permissibility of CVD against them. However, the rulings by panels and the Appellate Body did not clarify the legality of subsidies at dispute because of anomaly in legal procedure and structure of the disputes. The first dispute concerning CVD by the United States resulted in practically no decision on the WTO consistency of the subsidy when the Appellate Body annulled the panel decision based on evidentiary standards. The second dispute concerning EU’s CVD did not reach the Appellate Body although the panel decision shared many decisions with the US CVD dispute. The last dispute against Japan covered subsidies during the different period, leaving the main focal points of the other two disputes untouched.

In this regard, this study attempts to comparatively and comprehensively analyze the legal criteria for defining “entrusted or directed” subsidies rendered in Hynix disputes and recent disputes. This study also explains a series of restructuring programs for Hynix and how they were addressed in different disputes. The legal ruling drawn from the three disputes would shed an important light on potential legal issues for current bail out programs prevalent in major developed countries as well as for the disciplines on state-owned enterprises (SOEs) given increasing disputes on how to regulate them under the WTO and new trade agreements.<sup>2</sup>

## 2. HYNIX AND SEMICONDUCTOR INDUSTRY IN KOREA

Overcoming its sluggish start in the mid 1980’s, Korean semiconductor industry has remarkably grown to become one of the major suppliers in the world since the 1990s. Especially, in the field of DRAMs, Korea became the country which has the biggest market share in the world. The locomotives of this growth were Samsung Electronics, Hyundai Electronics Industries, and LG Semiconductor that were ranked among the top 10 largest DRAM manufacturers.

In the course of coping with the 1997 Asian financial crisis, however, numerous Korean enterprises including large conglomerates and financial institutions were bankrupt or restructured as the government implemented dramatic structural adjustment programs, many of which were imposed as preconditions for emergency rescue fund by major economic partners or conditionality programs mandated by the IMF. As a part of such restructuring programs, LG semiconductor was taken over by Hyundai Electronics in 1999, creating Hynix, one of the world’s largest memory chip companies. This was in fact a part of the large-scale exchanges of businesses among the industrial groups, so-called “Big-deals” undertaken in seven industries, which was based on a hope that the deal would create more efficient manufacturers by building on economies of scale.

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<sup>2</sup> There are increasing disputes whether a Chinese SOE constitutes a public body such that countervailing duties can be imposed under the SCM agreements.

**Table 1.** Major Restructuring Programs for Hynix

Programs		Content
December 2000 Syndicated Loan		10 creditor banks offered KRW 800 billion of the Syndicated loan.
January 2001 KEIC guarantee		The KEIC extended a guarantee to Hynix and the creditor banks extended D/A financing.
January 2001 KDB Debenture Program (KDB Fast Track Program)	debt roll-over	Maturing debt was rolled-over. Hynix had to pay 20 per cent of the due debt, while 80 percent was purchased by the KDB.
	debt re-packaged	70 per cent thereof was repackaged for sale to investors and 10 per cent was retained by the KDB.
May 2001 Restructuring Program	global depository receipts	The creditor banks injected fresh capital into Hynix through the offering of KRW 1.3 trillion of global depository receipts.
	debt roll-over	The creditor banks extended the maturities of short and long-term debt
	purchase by the creditor banks of CBs	The creditor banks purchased CBs worth KRW 1 trillion.
October 2001 Restructuring Program	new loan	The creditor banks provided a new loan of KRW 1 trillion to Hynix with an interest rate of 7 per cent.
	Debt-for-equity swap	The creditor banks allowed 3 trillion of debt-for -equity swap.
	extending the maturities of existing loans	The creditor banks extended the maturities of existing loans until 31 December 2004.
December 2002 Restructuring Program	Debt-for-equity swap	The creditor banks allowed 1.8 trillion of debt-for -equity swap.
	extending the maturities of existing loans	The creditor banks extended the maturities of existing loans amounted KRW 1.9 billion until 31 December 2004.

Restructuring programs for Hynix involved many massive scale financial adjustment measures and took a long time.<sup>3</sup> The multi-stage restructuring programs can be summarized as below.

On December 2000, the Syndicated Loan was offered by Hynix creditors as a part of a financial plan to resolve Hynix's "short term liquidity problems." In total, 10 banks participated in the loan which amounted to KRW 800 billion.<sup>4</sup> On January 2001, the official

<sup>3</sup> As a method of restructurings, the Korean government adopted private-led restructuring which is a "work-out" program instead of court-led restructuring. Under the work-out program adopted by the Korean government, creditors and enterprises voluntarily work together to restore faltering enterprises which have potential of revival.

<sup>4</sup> The ten banks were the Korea Development Bank (KDB), Hanvit Bank, Chohung Bank, the Korea Exchange Bank (KEB), the Korea First Bank (KFB), Kookmin Bank, Citibank, Shinhan Bank, Hana

export credit agency of Korea, the Korea Export Insurance Corporation (KEIC), extended a guarantee to Hynix, and fourteen Hynix creditor banks increased the ceiling of the export credit facility for D/A's (documents against acceptance) which was guaranteed by the KEIC. The ceiling was increased from USD 800 million to USD 1.4 billion, an increase of USD 600 million. In the same month, the KDB Debenture Programme was admitted by the government to resolve the financial instability caused by the simultaneous expiration date on a large amount of bonds issued by a few companies (including Hynix). Under this Programme, maturing debt was rolled-over and re-packaged for investors. 20 per cent of the due debt had to be paid by Hynix, while 80 percent was purchased by the KDB. And 70 per cent thereof was repackaged for sale to investors and 10 per cent was retained by the KDB. On May 2001, there was a financial restructuring by Hynix creditor banks. The eighteen banks injected fresh capital into Hynix through the offering of KRW 1.3 trillion of global depository receipts ("GDRs"), extended the maturities of short and long-term debt (a debt roll-over); and purchased CBs worth KRW 1 trillion.

In spite of restructurings, the situation of Hynix was not significantly improved as the semiconductor price did not show any sign of bouncing back. On October 2001, the Hynix creditor banks took a second restructuring package for Hynix. The Hynix creditor banks provided a new loan of KRW 1 trillion to Hynix with an interest rate of 7 per cent, debt-for-equity swap by provision of bonds convertible into shares, extended the maturities of existing loans until 31 December 2004, converting the maturing corporate bonds into corporate bonds with a three year maturity and an interest rate of 6.5 per cent and adjusting the interest rate of the remaining loans in Korean currency to 6 per cent (WTO 2005c).

The semiconductor price, which showed a temporary increase in early 2002, began to decrease again in the second quarter due to the recession of IT business and the continuous downturn of world economy. Making matters worse, the deal with Micron to sell the Hynix's non-memory division was vitiated in the first half of 2002 (Prusa 2008).<sup>5</sup> Hynix and its Creditors' Council consequently began to discuss the further restructuring. The measures taken by these participants were namely debt-for-equity swaps and extension of loan maturity. The creditor banks decided to allow 1.8 trillion of debt-for -equity swap and extended the maturities of existing loans which amounted KRW 1.9 billion until 31 December 2004.

These multi-stage restructuring programs led to CVD actions initiated by the United States and soon followed by the European Union and even Japan. These CVD actions were indeed the first case for Korean companies and government since the establishment of the WTO. Moreover, Korea took these cases very seriously not only because there were many other industries subject to similar programs but also because the allegation of governmental intervention in financial sectors would critically undermine the government's efforts to establish another financial hub for East Asia in Korea.

While CVD actions against Hynix brought about WTO disputes, Hynix decided to diversify its production basis by moving to China. Hynix China was established in 2006

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Bank, and the KorAm Bank.

<sup>5</sup> Hynix remained the subject of numerous rumors of mergers with other DRAM manufacturers throughout 2001. There was excess DRAM capacity in the market and that Hynix was an ideal target for consolidation and rationalization. In early 2002, US-based Micron Technology Inc. offered \$3.4 billion for Hynix's memory-chip business (the core of Hynix's business). The offer was rejected by Hynix's board in May 2002. When its takeover offer was spurned, Micron formally requested the countervailing-duty investigation.

with the major manufacturing basis at Wuxi, Jiangsu Province. The portion of the Hynix production in China was constantly rising and the share of DRAMs produced in the Wuxi plant was rapidly increased reaching to 50% of Hynix's total DRAM production in 2012.

### 3. TRILOGY OF COUNTERVAILING ACTIONS AND WTO DISPUTES

#### 3.1 Countervailing Duties (CVDs)

The CVD investigation by the United States was initiated in November 2002 in response to a petition by Micron. The U.S investigating authority, USDOC concluded that Hynix had received financial contributions from the Korean government to maintain the financial viability of Hynix. The ITC also concluded that the United States DRAMS industry had been materially injured by reason of imports of subsidized DRAMS from Korea. On the basis of these subsidy and injury determinations by the USDOC and the ITC, respectively, the USDOC imposed countervailing duties in the amount of 44.29 % on imports of DRAMS from Hynix on 11 August 2003. The United States determined that four programmes were countervailable; the December 2000 Syndicated Loan, the January 2001 KDB Fast Track Debenture Programme, the May 2001 Restructuring Programme, and the October 2001 Restructuring Programme, and the EC claimed one more, the January 2001 KEIC Guarantee. Japan concentrated on the October 2001 Restructuring Programme, and the December 2002 Restructuring Programme.

Around the time of the U.S investigation, the countervail investigation by the EC was also initiated on 25 July 2002, following a complaint filed by Infineon. The EC confirmed that the domestic industry suffered material injury caused by subsidized imports of DRAMs from Korea (WTO, 2005c). Based on these determinations by the EC, the rate of the definitive countervailing duty for Hynix was 34.8% on 22 August 2003 (EC, 2003). In this final determination, the EC determined that five programmes were countervailable: the Syndicated Loan, the Korea Export Insurance Corporation (KEIC) Guarantee, the Korea Development Bank (KDB) Debenture Programme, the May 2001 Restructuring Programme, and the October 2001 Restructuring Programme (EC, 2003). Compared to the case of the U.S, the January 2001 KEIC guarantee was added to the programmes countervailed by the U.S.

**Table 2.** CVDs by US, EU and Japan

	CVD Actions		
	US	EU	Japan
December 2000 syndicated Loan	CVD	CVD	
January 2001 KEIC guarantee		CVD	
January 2001 KDB Debenture Programme (KDB Fast Track Programme)	CVD	CVD	
May 2001 Restructuring Programme	CVD	CVD	
October 2001 Restructuring Programme	CVD	CVD	CVD
December 2002 Restructuring Programme			

Two years after the investigation by the U.S and the EC, Japan's investigating authorities (the "JIA") initiated a countervailing investigation on 4 August 2004 after a petition by Elpida Memory, Inc. and Micron Japan, Ltd. The JIA also concluded that certain restructuring programmes entered into Hynix were countervailable subsidies. The JIA calculated a countervailing duty rate of 27.2% on imports of DRAMS from Hynix in its final determination dated 20 January 2006. The JIA determined that two restructuring programmes were countervailable; the October 2001 Restructuring Programme and December 2002 Restructuring Programme. The December 2002 Restructuring Programme was firstly countervailed in the Japan case.

### 3.2 WTO disputes

On 19 November 2003, Korea sued the U.S and the EC, respectively, to the WTO requesting the establishment of the panel. The key issue was whether the creditors were 'entrusted or directed' by Korean government to make financial contributions to Hynix. In the US-DRAMS case, the panel ruled in favor of Korea on the majority of its claims finding that the USDOC's determination that there was entrustment or direction of Hynix's creditors was inconsistent with SCM Agreement. The panel concluded that the countervailing duties on all the four restructuring programmes were inconsistent with provisions of the SCM Agreement. The U.S appealed the panel's finding, asserting that the panel had failed to comply with Article 11 of the DSU. The Appellate Body largely reversed the panel's ruling, pointing out the critical errors in the Panel's standard of review.

Four months from the U.S-DRAMS panel's ruling, the EC-DRAMS panel's ruling was awarded on June 2005. Contrary to the U.S-DRAMS case, the panel ruled in favor of the EC on the certain claims. Out of five restructuring programmes, two restructuring programmes were ruled as countervailable subsidies, concluding that certain private creditors were "entrusted or directed" by Korean government to participate in those programmes.<sup>6</sup> However, the panel rejected the EC's claim on the other three restructuring programs.<sup>7</sup> There was no appeal to the Appellate Body in this case.

On May 2006, Korea sued Japan to the WTO regarding the imposition of countervailing duties by Japan on imports of certain DRAMS from Korea. In the panel report dated July 2007, panel found that Japan was erred in finding the existence of government "entrustment or direction" on certain private creditors to participate in the December 2002 restructuring of Hynix. By contrast, similar claim by Korea related to Hynix's 2001 Restructuring was rejected by the panel. The panel found that the October 2001 restructuring comes under the countervailable subsidies by constituting the financial contribution, specificity, and benefit. However, the panel concluded that because there was no benefit at the time of imposition in 2006 as the effect of subsidies was gone in 2005, Japan levied countervailing duties in violation of SCM Agreement. Japan appealed to the Appellate Body on August 2007. Regarding "entrustment or direction" for the 2002 Restructuring, the Appellate Body reversed Panel's finding concluding that Panel did not conduct "an objective assessment" under DSU Article 11. For non-recurring subsidies resulting from the October 2001 restructuring, Appellate Body upheld the panel's finding.

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<sup>6</sup> These two programmes were Syndicated Loan and May 2001 Restructuring Programmes.

<sup>7</sup> These three programmes were January 2001 KEIC Guarantee, January 2001 KDB Debenture Programme, and October 2001 Restructuring Programme.

**Table 3.** Implementation by U.S, EC, and Japan

		US	EC		Japan	
2003	July	44.29%	August	34.8%	January	27.2%
2005	February	Panel Report	June	Panel Report		
	June	AB Report				
2006	April	58.11% (1 <sup>st</sup> Annual Review)	April	32.90%		
2007	February	31.86% (2 <sup>nd</sup> Annual Review)			July	Panel Report
					November	AB Report
2008	March	23.78% (3 <sup>rd</sup> Annual Review)	April	0% (Sunset Review)	September	9.1%
	October	0% (Sunset Review)				
2009	February	4.91% (4 <sup>th</sup> Annual Review)			April	0%
	November	0% (5 <sup>th</sup> Annual Review)				
2011	January	1.93% (6 <sup>th</sup> Annual Review)				

Note: The date for the Panel Report and AB Report is based on the date circulated.

### 3.3 Implementation

After the adoption of the Appellate Body report, the United States did not modify any of the conclusions on price effects of the imported Hynix DRAMs or impact of the Hynix DRAMs on the domestic industry that the Commission made in the original opinion. USITC adjusted the rate of countervailing duty even higher to 58.11% on the first annual review. However, it was adjusted to lower rates to 31.86%, 23.78%, 4.91%, 0%, and 1.93% in its second, third, fourth, fifth and sixth annual reviews, respectively, from 2007 to 2011. However, on October 2008, the countervailing duty imposed on Hynix DRAM imports was lifted retroactively to August 2008 by the sunset review. Consequently, Hynix DRAMs imported into U.S has been no longer subject to countervailing duty from August 2008, while the annual review was in process for the refund of countervailing duty that was overpaid.

Implementing the DSB ruling and recommendations, the EC slightly modified the CVD rates from 34.8% to 32.9%. After the reassessment on the five specific aspects of the existing measures that were found to be inconsistent with the SCM Agreement, the EC fine-tuned its methodology for calculating the benefit conferred to Hynix and the determinations of the financial contribution in the May 2001 restructuring programme.<sup>8</sup> On April 2009, the EC

<sup>8</sup> Five recommendations were on the determinations of (a) the financial contribution in the May

decided to lift the countervailing duty imposed on Hynix's DRAM products retroactively, effective from December 31, 2007.

Compared to the U.S and the EC, Japanese government largely reduced the countervailing duty rate to 9.1% on September 2008 after the adoption of the Appellate Body report. The Japanese government also commenced a Changed Circumstance Review to see whether to abolish the countervailing duty by the request of Hynix, and the Japanese government decided not to impose the CVD rate on the Hynix DRAM imports since April 2009.

#### 4. LEGISLATIVE HISTORY OF THE 'ENTRUSTED AND DIRECTED' SUBSIDY PROVISION

The issue of government's entrusted or directed subsidies was first discussed at the early stage of the GATT. The panel noted that private subsidies could be also illegal if it is entrusted by government.<sup>9</sup> After the completion of the Tokyo Round, Committee on Subsidies and Countervailing Measures and the Group of Experts on the Calculation of the Amount of a Subsidy brought the spotlight back onto the subsidies by a non-government.<sup>10</sup> It was suggested that there may be some situations in which a government directs a private body to carry out certain government functions such as collecting revenues and expending them as illustrated in the panel report. And in 1991, the 'entrusted or directed' subsidy was codified in the Dunkel Text, a long time after this issue was discussed.

Although it was first codified only later in the Dunkel Text in 1991, the 'entrusted or directed' subsidy issue was already addressed by the panel at the early stage of GATT in 1960. In the meetings to elaborate the extent of subsidies that should be notified, the panel noted that private subsidies should be also notified if it was entrusted or directed by government.

The 'entrusted or directed' subsidy issue has been also discussed during the Tokyo Round. At the meetings to discuss when certain practices may constitute countervailable subsidies and how the amount of a subsidy should be measured in such cases, it was agreed that there may be some situations in which a government directs a private body to carry out certain

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2001 restructuring programme, (b) the existence of a benefit in the case of the syndicated loan, (c) calculation methods of the amount of benefit, (d) a relevant factor affecting the state of the domestic industry, and (e) the causal link between the subsidies and the injury. See EC (2006).

<sup>9</sup> The second Report of the Group on Anti-Dumping and Countervailing Duties, adopted by the Contracting Parties on 27 May 1960, (BISD 9S/194) contains observations which are of importance to the question of the definition of the practices in respect of which countervailing duties may be imposed: "With respect to the meaning of the word "subsidies," a large majority of the experts considered that it covered only subsidies granted by governments or by semi-governmental bodies. Three experts considered that the word should be interpreted in a wider sense and felt that it covered all subsidies, whatever their character and whatever their origin, including also subsidies granted by private bodies. It was agreed that the word "subsidies" covered not only actual payments, but also measures having an equivalent effect."

<sup>10</sup> It is agreed that the criteria of financial contribution "would seem to be useful to the extent it underlines that there is a necessary link between a subsidy and the taxation function of government, exercised either directly or delegated to other, private bodies as suggested by a panel report based on a review of Article XVI, set out in BISD 9<sup>th</sup> Supplement. Paragraph 12 of the report examines the issue of subsidies by a non-governmental levy."



government functions such as collecting revenues and expending them, and those can be countervailable.<sup>11</sup>

The ‘entrusted or directed’ subsidy issue did not reach an agreement even after the launch of the Uruguay Round, however, due to the disagreement on the calculation measurement of the subsidy amount. The contracting parties showed divergent views on whether the amount of ‘financial contribution’ should be limited to a ‘cost to government (a charge on the public account)’ or to more broadly ‘benefit to recipient (encompassing government transfers through non-governmental agents)’. Based on the ‘cost to government’ method, an entrusted or directed subsidy cannot be considered a ‘countervailable’ subsidy because the entrusted or directed subsidy is not taken out of public account but out of private body. On the other hand, under the ‘benefit to recipient’ method, the so-called ‘private subsidies’, wherein benefits are conferred on recipients from private sources but entrusted or directed by government, would be countervailable. Therefore, the ‘entrusted or directed’ subsidy is countervailable only when the ‘benefit to recipient’ method is taken for the calculation measurement of the subsidy amount.

Historically, the EC (and other GATT parties) favoured a subsidy definition whereby greater emphasis was put on the contribution by the government. The EC as well as Canada, Japan, the Nordic countries, Switzerland, and India, suggested that a ‘cost to the government’ should be a required condition for determining the actionable subsidy. They believed that stringent international regulation of domestic subsidies would lead to intolerable interference in their internal policy matters. They contended that the ‘benefit to recipients’ method would bring almost every conceivable action by public authorities within this concept, “because it is indeed a function of governments to undertake actions which are of benefit to the citizens.” They also alerted that the concept “the benefit to the beneficent” would be very ambiguous so that such a measurement would be very counterproductive to achieving improved subsidy discipline. They emphasized that the cost to the treasury of a subsidy is not only easy to calculate from the books of the treasury but also easily available in data (GATT, 1989a).

In contrast, the US authorities employed an effects-based doctrine whereby virtually any type of government program could confer a domestic subsidy if it provided some opportunity or advantage that would not otherwise be available in the marketplace. Unlike other GATT parties, the US used a definition of “subsidy” which included only a “benefit” criterion, which allowed the DOC to unilaterally countervail myriad schemes without clearly demonstrated government participation. It was primarily interested in strengthening the rules governing subsidies, given the increasing use of government subsidies to agriculture and manufacturing industries in the EC and developing countries. These countries emphasized that the value of a subsidy is necessarily measured by reference to the benefit to the recipient. Unsubsidized firms cannot be expected to compete with firms which are permitted to obtain funds at their government’s cost of funds, for example. The benefit to recipient approach to valuation is the only means of assigning a value which is commensurate with the distortions caused by the subsidies (GATT, 1989b).

Finally, the ‘benefit to recipient’ method suggested by the United States was taken in the Dunkel Text, which constitute the first attempt by GATT to define subsidy and which became the basis of Uruguay Round text (GATT, 1991). Along with the inclusion of the concept of

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<sup>11</sup> The Group of Experts on the Calculation of the Amount of a Subsidy, established by the Committee in 1981, has been discussing criteria to determine when certain practices may constitute countervailable subsidies and how the amount of a subsidy should be measured in such cases.

‘benefit’ into the definition of subsidy, the ‘entrusted or directed’ subsidy was finally codified in the Dunkel Text.

## 5. LEGAL ISSUES OF “ENTRUSTED AND DIRECTED” SUBSIDIZATION

### 5.1 Interpretation of a public body and a private body

Entrusted or directed subsidies occur where a government or public body grants a subsidy by acting through private parties. Article 1.1(a)(1)(iv) of the SCM Agreement allows for such subsidies to be caught by the WTO regulation. SCM Agreement Article 1.1(a)(iv) provides,

For the purpose of this Agreement, a subsidy shall be deemed to exist if: (a)(1) there is a financial contribution by *a government or any public body* within the territory of a Member (referred to in this Agreement as “government”), i.e. where:

(...)

(iv) *a government erritory of a Member a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;*

Given that the term “private body” is used as a counterpoint to the terms “government” or “any public body,” the scope of Article 1.1(a)(1)(iv) depends on the definition of ‘a government’ or ‘a public body’ as panel stated in the US-Export Restraints report (WTO, 2001).

There are generally two approaches when determining ‘public body’. The first one is the governmental ownership *per se* approach. In this approach, the government’s ownership *per se* is the criterion that determines whether an entity is a public body. The second one is the governmental authority approach. This approach recognizes those entities with governmental functions as public bodies, and holds that governmental control in some circumstances can evidence establishing a public body. Appellate Body’s jurisprudence on this issue is not clear, and the debate regarding the proper criterion continues.

Prior panels in Korea – Commercial Vessels and EC – Large Civil Aircraft have taken an ownership criterion for determining whether a given entity is a “public body” for the purposes of the SCM Agreement. In the Korea-Vessel case, the panel accepted the EC’s contention that the Export-Import Bank of Korea (KEXIM) was a public body on the grounds that it was 100 per cent owned by the GOK.<sup>12</sup> It stated that majority government ownership can demonstrate control, in that government ownership gives the government the ability to appoint managers and directors to overseas operations.

However, the Appellate Body of *US-Anti-Dumping CVD (China)* modified this ‘ownership’ criterion stating that a finding of government *ownership* of an entity by a government, in itself, is not sufficient to prove that the entity is a public body (WTO, 2014b). The Appellate Body concluded that government ownership and control does not make an entity a “public body,” but that the entity must possess, exercise, or be vested with “governmental authority” and be performing a “governmental function.” To reach this

<sup>12</sup> The notion of a “public body” was given a broad interpretation in the US-DRAMs and Korea-Vessel report.

conclusion, the report relies in part on context, in particular a subparagraph in the definition of a subsidy that establishes that financial contributions can also be provided through private bodies when they are entrusted or directed to do so by a government or a public body. The report then asserts that every public body must therefore be able to entrust or direct private bodies to provide financial contributions, and concludes that public bodies must necessarily possess governmental authority in order to do so (WTO, 2014b). The Appellate Body further explained that this determination may be straightforward when a statute or other legal instrument has an express statutory ‘delegation of authority.’ Therefore, according to Appellate Body’s interpretation, those SOEs may not be ‘public body’ if there is no evidence showing they exercise or are vested with ‘government authority’.

### 5.2 Interpretation of entrustment or direction

A private body falls under the scope of subparagraph (iv) only when an affirmative link between the government and the private body is demonstrated by government ‘entrustment or direction.’ The interpretation of entrusted or directed subsidies has been the subject of a string of Panel and AB rulings. The interpretation was restrictive at the first step, but there has been a loosening of the notion of entrustment or direction and the corresponding evidentiary standard.

Until the *US-DRAM case*, the WTO has interpreted ‘entrustment’ and ‘direction’ as ‘delegation’ and ‘command’. This definition was first introduced by the panel in the *US-Export Restraint* case. The panel said that the action of government entrustment or direction must contain a notion of “delegation” or “command,” and must contain three elements: (i) “an explicit and affirmative action,” (ii) “addressed to a particular party,” and (iii) “the object of which action is a particular task or duty” (WTO, 2001).<sup>13</sup>

The Appellate Body of *US-DRAMS* largely modified this interpretation of ‘entrustment’ and ‘direction’. Entrustment was interpreted more broadly to “giving responsibility to someone” for a task or an object and ‘direction’ were interpreted to “exercises its authority over” a private body (WTO, 2005d). The Appellate Body pointed out that the previous interpretation of the term ‘entrustment’ and ‘direction’ as limited to the act of ‘delegation’ and ‘command’ are too narrow. This was endorsed by the Appellate Body of recent *US-Anti-Dumping CVD (China)*. According to this broader interpretation, some form of “threat” or “inducement” could serve as evidence of entrustment or direction, and even “guidance” by a government can constitute direction.

### 5.3 Standard of Review

The *US-DRAMS* case is the first case that the Appellate Body overturned the panel’s decision mainly based on the standard of review. The standard of review, in the context of WTO dispute settlement, refers to the manner in which Panels are required to review member state measures in order to determine if such measures are in conformity with obligations under the various WTO Agreements. The issue of standard of review defines the appropriate

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<sup>13</sup> It is meaningful that the panel firstly indicated that the existence of a financial contribution by government entrustment or direction should be proven by reference to the ‘action by the government’, rather than the ‘reactions or consequences of those acts’ as these reactions and consequences may simply be the result of happenstance.

level of panel intrusiveness or deference in reviewing a member's measure in general (Oesch, 2003). One extreme standard is *de novo* and the other extreme one is total deference.<sup>14</sup> The former refers to a full merits review of a matter, and the latter refers to a minimal review task that might involve ensuring that procedural fairness has been observed (Becroft, 2006). In the SCM context, Panels must thoroughly examine the adequacy of an agency's reasoning but refrain from engaging in a "*de novo*" review of the evidence.

The Appellate Body found that the US-DRAMS panel did not fulfill its duty of objective assessment in three respects: (i) the Panel had incorrectly examined individual pieces of evidence selectively and required that entrustment or direction be established from particular pieces of evidence. Thus, the panel failed to assess the evidence "in its totality" by considering inferences that might reasonably have been drawn from the whole of the body of evidence. The Panel thus failed to assess the agency's determination. Instead, the Panel's examination reflected its own view of whether entrustment or direction existed in this case; the Panel thereby engaged, improperly, in a *de novo* review of the evidence before the agency.' (ii) the panel wrongfully refused to admit certain evidence submitted by the US that was contained in the DOC record but which was not cited in the original DOC decision. The panel considered that the reliance on such evidence in WTO proceedings constituted an "ex post rationalization" by the US. The AB rejected this finding and concluded that an agency does not need to discuss every piece of supporting record evidence for each fact in the final determination. (iii) the AB disagreed with the panel's conclusion that the USDOC should have been aware of a fact that was not reasonably based on evidence in the agency record. The AB concluded that taken together, these errors led the Panel to conduct a *de novo* review of the facts, overstepping the bounds of its review.

This suggests that panels must not only analyze discrete factual issues in detail, but must also consider the evidence in its totality and draw necessary conclusions in order to determine compliance with WTO obligations. Appellate Body would appear to require the panel to make a higher level of intrusion in assessing the domestic agency's measures than was the case in earlier decisions.

Therefore, in the Hynix DRAMs cases, Appellate Body confirmed that the factual findings on subsidies by government entrustment or direction are to be made on the basis of an examination of the totality of the evidence, particularly in the analysis of circumstantial evidence. By this confirmation, evidentiary burden for investigating authority was lowered.

## CONCLUSION

According to the rulings so far, investigating authorities now cannot claim that an entity

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<sup>14</sup> According to *EC-Hormones* AB report, 'In the view of the European Communities, the principal alternative approaches to the problem of formulating the "proper standard of review" so far as panels are concerned are two-fold. The first is designated as "*de novo* review." This standard of review would allow a panel complete freedom to come to a different view than the competent authority of the Member whose act or determination is being reviewed. A panel would have to "verify whether the determination by the national authority was 'correct' both factually and procedurally."75 The second is described as "deference." Under a "deference" standard, a panel, in the submission of the European Communities, should not seek to redo the investigation conducted by the national authority but instead examine whether the "procedure" required by the relevant WTO rules had been followed.

is a public body based solely on the fact that it holds a 100 per cent ownership. Since public bodies are interpreted more narrowly than before, an entity is less likely to be a “public body” for the purposes of the SCM Agreement. As a result, the onus would then be on the investigator to demonstrate entrustment or direction of a private body under 1.1(1)(a)(iv), since a private body’s financial contribution can be countervailable only when an affirmative link between the government and the private body is demonstrated by ‘entrustment or direction’ of government or public body.<sup>15</sup>

On the other hand, the evidentiary level to demonstrate the existence of entrustment or direction is lowered now. The problem of this position is that it enlarges a room for the abusive interpretation of the evidence compared to the piecemeal approach by establishing it in totality. Greater caution is required in determining ‘entrusted subsidy’ than ‘directed subsidy’. Following ‘direction’ means the addressee does the content of direction instead of director, as a proxy. There is no room for its own discretion, so that the addressee follows the guidance or course of action commanded or instructed by director. In contrast, under an entrustment, the addressee can have its own discretion, so that the addressee can conduct various actions by its own judgement under a given scope. By this difference, the outcome of subsidy determination can be largely different. A subsidy determination on ‘directed subsidy’ is limited to a certain financial contribution that is directed by government. In contrast, a subsidy determination on ‘entrusted subsidy’ is spread to various financial contributions that are done by its own discretion of the private body. Therefore, the outcome of subsidy determination on ‘entrusted subsidy’ can be bigger than the outcome of subsidy determination on ‘directed subsidy.’ A stricter regulation and criteria may be required to the determination on ‘entrustment’ than the determination on ‘direction’.

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<sup>15</sup> As for the “private body,” panel noted that “although the plain meaning of entrustment or direction requires that something must be delegated to someone, or that someone must be commanded to do something, the plain meaning of those terms does not require that such someone or something must necessarily be specified in detail”(WTO, 2005a). According to the panel of *Korea-Vessel*, entitles participating in a financial contribution “must assume responsibility for that participation,” otherwise “the disciplines of the SCM Agreement could be easily circumvented by groups of public bodies deciding collectively” (WTO, 2005b). Therefore, based on the rulings so far, a government entrustment or direction can be de established although a private body as an addressee does not be specified. This was actually how the U.S. interpreted in the Uruguay Round Agreements Act. The Administration’s view was that “the term ‘private body’ is not necessarily limited to a single entity, but can include a group of entities or persons (US Congress, 1994). This was intended by the Administration to interpret the ‘entrusts or directs’ standard more broadly. Under this broad definition, a threat, inducement, guidance of government to whole financial institutions can constitute government entrustment or direction under Article 1.1(a)(1)(iv) (WTO, 2005a).

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