COLUMN:
FINDINGS OF APPELLATE BODY IN SOUTH KOREA PNEUMATIC VALVE CASE (DS504)

1. PURPOSE OF THIS COLUMN

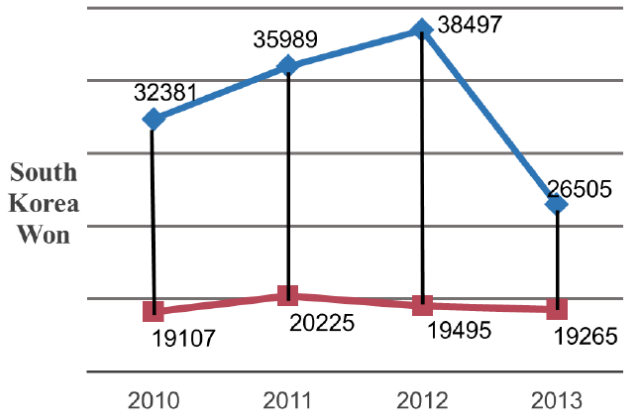
The background and overview of the Korea valve case have been described in the main report. The Appellate Body Report issued on September 10, 2019 was based on the contents of the Panel Report (which was issued in April 2018) and is somewhat complicated. Therefore, it will be useful to analyze the main issues of the Appellate Body Report and consider its implications on international anti-dumping discipline in this column.

2. VALVES FOR PNEUMATIC TRANSMISSION

Valves for pneumatic transmission (pneumatic valves) are the valves controlling the flow of compressed air and are powered mainly by electricity. They are important industrial machine components used in production and assembly processes for a wide range of industries including automobiles, home electrical appliances, semiconductors and medicines. For example, by building pneumatic valves into assembly or carrier equipment installed in a factory of semiconductors or automobiles, a driving part will be expanded, contracted or turned by air, which enables the control of the delicate movements of the equipment (pushing, seizing, etc.).

Pneumatic valves manufactured in Japan are superior in quality (operating life, energy saving, flow capacity, response speed, etc.) and used in the production process of semiconductors which requires accurate movements. Valves manufactured in Japan and those manufactured in Germany dominate the international market (as of 2018, valves manufactured in Japan and in Germany account for 60% of the world market share). Vales manufactured in Korea have inferior quality and lower prices compared to Japanese products and are used in the production process of general machinery or the painting process, and are therefore not in direct competition with valves manufactured in Japan.

* Reference: Korean domestic prices of Japanese valves (upper line) and Korean valves (lower line)



(Source: WTO report of the panel for Korean valve case)

3. ARTICLE 3 OF ANTI-DUMPING AGREEMENT AND CONCEPT OF PRICE COMPARABILITY

The major issue in regards to the anti-dumping measures taken by Korea in this case is whether or not

the dumping of exports of Japanese valves has an effect on the price of Korean valves (price effects; the 2nd paragraph of Article 3.2 of the Anti-Dumping Agreement). The Korean investigating authorities' determination of the price effects regarding the anti-dumping measures in this case lacked careful consideration and was made based on the superficial correlation of price movements and one-sided oral evidence. However, no analysis was made on how the decline in prices of Japanese products, which are still much more expensive than Korean products, influenced the price of domestic products.

(1) Price Comparability in General

With respect to the interpretation of Article 3.2 of the Anti-Dumping Agreement, the Appellate Body Report in *China – GOES* (DS414) is the classic precedent. That report found that "although there is no explicit requirement in [Article] 3.2 [*omitted*], we do not see how a failure to ensure price comparability could be consistent with the requirement under [Article] 3.1 [*omitted*] that a determination of injury be based on 'positive evidence' and involve an 'objective examination' of, *inter alia*, the effect of subject imports on the prices of domestic like products" (Paragraph 200). Although the Appellate Body did not clarify the meaning of the term "price comparability," in light of the matter in question in the China – GOES case, the term seems to refer to the competition between the imported and domestic products based on their similarity in terms of specifications, performance, use, price range or commercial distribution (meaning the relationship where one side's sales will decrease if the other side decreases its price, unless the first one also decreases or holds down its price). Since then, the prevailing interpretation has been that price comparability between subject imports and domestic like products should be taken into consideration when recognizing the price effects described in the latter paragraph of Article 3.2.

Recently, Japanese manufacturers have not performed as well as China, Korea and other Asian countries in terms of competition based on price only. However, they have maintained global competitiveness by differentiating their products based on quality and technology. For Japanese manufacturers, the concept of price comparability, which suggests the necessity of carefully analyzing the differences between products in terms of performance or use before issuing anti-dumping measures, was revolutionary. Subsequently, in the WTO disputes concerning Article 3 of the Anti-Dumping Agreement (*China – HP-SSST* (DS460), *China – Cellulose Pulp* (DS483), etc.), Japan always emphasized price comparability and expressed its opinion to promote further refined analysis thereof (many developed countries including the United States, Europe and Canada share the same opinions as Japan).

However, the concept of price comparability is not necessarily understood in the anti-dumping practices of developing countries and such countries tend to recognize price effects without careful consideration. Such anti-dumping measures taken without careful consideration are likely to cause unfair damage to Japanese companies. The case under consideration in this column brought this problem to the surface.

(2) Problems in This Case

The determination of the Korean investigating authorities regarding the anti-dumping measures in this case was unfair in that they failed to appropriately consider the difference in the price range between Japanese products and Korean products as shown in the figure above, and determined that there were price effects simply based on the superficial correlation of price movements and one-sided oral evidence. Such determination is inconsistent with Article 3.2 in that price comparability as described above was not taken into consideration.

In addition, according to precedents, if price effects are deemed to exist in a case where import prices are higher than domestic like products prices (overselling), investigating authorities need to make adequate explanations (*China – Autos (US)*, *China – Cellulose Pulp*), and in this regard, the

determination of the Korean investigation authorities was inconsistent with the Anti-Dumping Agreement. Nonetheless, the higher price of Japanese products is a sign of superiority of Japanese products in terms of technology as described above, and the factual basis behind these two issues is the same.

(3) Findings of the Panel and the Appellate Body of This Case

The reports of the panel and the Appellate Body of this case found that Korea had acted inconsistently with Article 3.2 (or Article 3.5, as the panel dealt with this issue as a part of the problem of a causal relationship), after demonstrating the issues of "price comparability" and "overselling" and recommended that Korea make a correction.

The findings of the panel and the Appellate Body concerning this issue are analyzed below.

(i) Panel Report (April 2018)

What is strange in the Panel Report of this case is that the entirety of Japan's claim under Article 3.2 (including price comparability) was found to be outside the panel's terms of reference (Paragraphs 7.123-131) and excluded from the subject of consideration. Instead, a claim that was substantially the same was treated by the panel as a causal relationship claim that fell under the scope of Article 3.5, and the panel made its judgment considering such claim as the issue under Article 3.5. The problem with the terms of reference is considered below ("4. Panel's terms of reference").

The panel discussed price comparability, referring to the case of *China – GOES* described above (Paragraph 7.266). However, considering the fact that the panel listed, as a concrete methodology for price comparison, the methodology for comparing the average import prices with the average domestic like product prices (Paragraph 7.269) and the methodology for comparing individual imports with the average domestic like product prices (Paragraph 7.270-), it seems that the panel did not show much interest in the difference between products in terms of performance and use implied in precedents and instead, literally questioned the appropriateness of the price comparison methodology. The panel found that Korea was inconsistent with the Anti-Dumping Agreement primarily because "the listed transactions took place on different dates and involved different quantities" and "different time periods and quantities may affect the prices in the individual transactions, which may cast doubt on the relevance and significance of the comparisons" (Paragraph 7.271).

On the other hand, with respect to the fact that the price of the Japanese products was higher than the price of the Korean products (overselling), the panel found that Korea was in violation of Article 3.5, stating that the Korean investigating authorities failed to make adequate explanations (in this regard, the panel stated that it was not sufficient to merely say that there were examples where some individual export prices were less than domestic like product prices) (Paragraphs 7.297-322).

(ii) Appellate Body Report (September 2019)

The Appellate Body criticized the panel for failing to make findings, and decided to deal with the above-mentioned issue as a problem of price effects under Article 3.2 (Paragraphs 5.239 and 5.255). Then, as with the panel, the Appellate Body found that the Korean measures were inconsistent with the Anti-Dumping Agreement in that Korea failed to confirm price comparability (Paragraph 5.327) and failed to make adequate explanations on overselling (Paragraph 5.334).

However, while the panel simply questioned the appropriateness of the price comparison methodology (i.e. the difference in terms of time periods and quantities of transactions for price comparison samples), in discussing price comparability, the Appellate Body stated that Korea had recognized price effects relying upon "individual cases of dumped import resale prices [*omitted*] that were lower than average domestic prices [*omitted*] (i.e. individual instances of 'underselling')" and this led to the problem of

price comparability (Paragraph 5.325). In the end, the Appellate Body found that Korea had acted inconsistently with the Anti-Dumping Agreement by following the same factual basis as the issue of overselling.

In other words, compared to the Panel Report, the Appellate Body was more aware of the implications of price comparability raised in case precedents (i.e. the difference between imports and domestic like products in performance and specifications), and it can be observed that the Appellate Body intended to show that it was not sufficient to select and refer to, in an arbitrary manner, individual instances in which import prices were close to domestic prices by chance ("underselling" instances) in order to determine that the imports of Japanese products, which are more expensive than Korean products, had an effect on domestic prices. Accordingly, the Appellate Body in this case can be considered to have supported the view that serious consideration of the original implications of price comparability (i.e. difference in performance and specifications) was necessary for a faithful investigation since the original price range between Japanese products and Korean products was different and this problem cannot be solved by changing the comparison methodology in a superficial way.

4. Panel's Terms of Reference

Japan made 13 claims in total including the issue of price effects under Article 3.2 described above. However, the Panel Report found that Japan's panel request was too abstract to present facts and therefore "outside the panel's terms of reference," and based on this erroneous finding, made an unusual judgment where the panel avoided making findings on 9 claims (including the claims where the panel avoided making findings in respect of only part of those claims). Such findings were unfair as they erroneously interpreted Article 6.2 of the DSU concerning the panel's terms of reference, and in fact, all of the findings were revoked by the Appellate Body Report (with respect to the issue of price effects under Article 3.2, while the panel avoided making findings under Article 3.2 by stating that it was "outside the panel's terms of reference" as an issue under Article 3.2, the panel made substantive findings regarding the same issue under Article 3.5, which was a different provision, and no persuasive reason as to why the findings were made under Article 3.5 instead of Article 3.2 was indicated.). However, the Appellate Body, which revoked the panel's findings, also did not make any substantive findings on the issue for which the panel avoided making findings. This is because the hearing of the Appellate Body is "limited to legal interpretations developed by the panel" (Article 17.6 of the DSU), and in principle, the Appellate Body is not authorized to consider new facts. Therefore, the Appellate Body Report determined that although the panel erred in avoiding making findings, the Appellate Body did not have a sufficient factual basis to complete the legal analysis. In the end, the dispute settlement procedures ended without any findings on whether or not there were violations in respect of most of the issues raised (with respect to the issue of price effects, the basis of the panel's findings was shown in the Panel Report "as an issue under Article 3.5" and therefore, the Appellate Body was able to make findings regarding this issue by referring to it "as an issue under Article 3.2."). The panel's findings, which was based on an overly narrow interpretation of its terms of reference, not only deserves criticism for such erroneous interpretation, but also for being inconsistent with the purpose of dispute settlement procedures of "achieving a satisfactory settlement of the matter" (Article 3.4 of the DSU) in that the panel caused a situation in which findings were not given concerning most of the issues. In fact, at the meeting of the Dispute Settlement Body in September 2019, at which the Appellate Body Report was adopted, the EU expressed approval for the Appellate Body's findings which revoked the panel's avoidance of making findings.

5. Significance of This Case and Conclusion

Although there are certain limitations including the problem of the terms of reference as described above, in the dispute settlement procedures to which Japan is a party, it is significant that price

comparability was confirmed to be important once again in determining price effects. In addition, it is also significant that such findings were made by taking into consideration the unique characteristics of Japanese products, namely that they are more expensive and sophisticated than domestic like products of a country imposing anti-dumping measures. The Appellate Body Report in this case is valuable as a precedent in order to improve anti-dumping practices of developing countries that often impose anti-dumping measures in an arbitrary manner. The Japanese government should continue to make an effort to strengthen international anti-dumping regulations.

With respect to the anti-dumping measures under this case, Korea had the obligation to implement the recommendations based on the Appellate Body Report, and it was agreed that Korea would do so by May 30, 2020. In light of the intent of the findings of the Appellate Body described above, Japan will continue to pursue correction of anti-dumping measures in good faith.

6. Please Refer to the Webpage of the WTO:

https://www.wto.org/english/tratop_e/dispu_e/dispu_agreements_index_e.htm?id=A6