

**EUROPEAN COMMUNITIES – MEASURES AFFECTING
TRADE IN COMMERCIAL VESSELS**

Report of the Panel

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<i>EC – Asbestos</i>	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
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<i>EC – Bananas III</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
<i>EC – Bananas III (Guatemala and Honduras)</i>	Panel Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by Guatemala and Honduras</i> , WT/DS27/R/GTM, WT/DS27/R/HND, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 695
<i>EC – Bananas III (Mexico)</i>	Panel Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by Mexico</i> , WT/DS27/R/MEX, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 803
<i>EC – Bananas III (US)</i>	Panel Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by the United States</i> , WT/DS27/R/USA, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 943

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<i>EC – Sardines</i>	Panel Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/R and Corr.1, adopted 23 October 2002, as modified by the Appellate Body Report, WT/DS231/AB/R
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<i>US – Cotton Yarn</i>	Appellate Body Report, <i>United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan</i> , WT/DS192/AB/R, adopted 5 November 2001, DSR 2001:XII, 6027

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<i>US – FSC</i> (Article 21.5 – EC)	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/AB/RW, adopted 29 January 2002
<i>US – FSC</i> (Article 22.6 – US)	Decision by the Arbitrator, <i>United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement</i> , WT/DS108/ARB, 30 August 2002
<i>US – Line Pipe</i>	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea</i> , WT/DS202/AB/R, adopted 8 March 2002
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<i>US – Offset Act</i> (Byrd Amendment)	Panel Report, <i>United States – Continued Dumping and Subsidy Offset Act of 2000</i> , WT/DS217/R, WT/DS234/R, adopted 27 January 2003, as modified by the Appellate Body Report, WT/DS217/AB/R, WT/DS234/AB/R
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I. INTRODUCTION

A. COMPLAINT OF KOREA

1.1 On 3 September 2003, Korea requested consultations with the European Communities ("EC") and certain EC member States pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXIII:1(a) of the General Agreement on Tariffs and Trade 1994 ("the GATT 1994"), Article XXIII:1(b) of the GATT 1994 and Article 5(b) of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), and Articles 4, 7 and 30 of the SCM Agreement, with regard to measures affecting trade in commercial vessels.¹ Korea and the European Communities held consultations on 9 October and 14 November 2003, but failed to settle the dispute.

1.2 On 12 September 2003, China requested, pursuant to Article 4.11 of the DSU, to be joined in the consultations.²

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.3 On 5 February 2004, Korea requested the establishment of a panel pursuant to Articles 6 of the DSU and Article XXIII:2 of the GATT 1994.³ At its meeting of 19 March 2004, the Dispute Settlement Body (the "DSB") established a Panel in accordance with Article 6 of the DSU to examine the matter referred to the DSB by Korea in document WT/DS301/3.⁴ At that meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The terms of reference are, therefore, the following:

"To examine, in the light of the relevant provisions of the covered agreements cited by Korea in document WT/DS301/3, the matter referred to the DSB by Korea in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.4 On 7 May 2004, Korea requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU. This paragraph provides:

"If there is no agreement on the panelists within 20 days after the date of the establishment of a Panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request".

¹ WT/DS301/1.

² WT/DS301/2.

³ WT/DS301/3, attached as Annex.

⁴ WT/DS301/4.

1.5 On 13 May 2004, the Director-General accordingly composed the Panel as follows:

Chairman: Professor William J. Davey

Members: Professor Donald M. McRae
Mr. Daniel Jacobus Jordaan

1.6 China, Japan and the United States reserved their rights to participate in the Panel proceedings as third parties.

C. PANEL PROCEEDINGS

1.7 The Panel met with the parties on 3-4 August 2004, and on 5 October 2004. It met with third-parties on 3 August 2004.

1.8 The Panel submitted its interim report to the parties on 23 December 2004. The Panel submitted its final report to the parties on 10 February 2005.

II. FACTUAL ASPECTS

2.1 This dispute concerns the European Communities' Temporary Defensive Mechanism for Shipbuilding (the "TDM Regulation") set forth in Council Regulation (EC) No 1177/2002, and modified in product coverage and duration by Notice 2003/C 148/10 published on 25 June 2003 and Council Regulation (EC) No 502/2004 of March 2004, respectively.

2.2 The dispute also concerns certain measures of EC member States, and corresponding European Commission decisions:

- Germany: Case N 744/2002, Commission Decision (2003)788 fin of 19 March 2003.
- Denmark: Case N 141/2003, Commission Decision (2003)1765 fin of 24 June 2003.
- The Netherlands: Case N 780/2002, Commission Decision (2002)2019 fin of 9 July 2003 and Case N 339/03, Commission Decision (2003)3378 of 18 September 2003.
- France: Case N 232/03, Commission Decision (2003)3234 fin of 17 September 2003.
- Spain: Case N 812/02, Commission Decision (2003)4079 fin of 11 November 2003.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

A. KOREA

3.1 Korea requests the Panel to find that:

- (a) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article 23.1, 23.2(a), 23.2(b) and 23.2(c) of the DSU;
- (b) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent

with the European Communities' and its member States' obligations under Article 32.1 of the SCM Agreement;

- (c) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under paragraphs 1-4 and 10 of Article 4 and paragraphs 1-4 and 9 of Article 7 of the SCM Agreement;
- (d) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article III:4 of the GATT 1994; and
- (e) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article I:1 of the GATT 1994.

3.2 Korea considers that the above violations have nullified and impaired benefits accruing to it under the WTO Agreement. In consequence, Korea requests the Panel to recommend that the European Communities bring its inconsistent measures into conformity with its WTO obligations.⁵

B. EUROPEAN COMMUNITIES

3.3 The European Communities requests the Panel to find that:

- (a) the TDM Regulation is not in violation of Article 23.1, 23.2(a)-(c) of the DSU, Articles 4, 7 and 32.1 of the SCM Agreement and Articles I and III:4 of the GATT 1994; and
- (b) the national TDM measures (to the extent that they still exist) are not in violation of Article 23.1, 23.2(a)-(c) of the DSU, Articles 4, 7 and 32.1 of the SCM Agreement and Articles I:1 and III:4 of the GATT 1994.

[Parties' and Third Parties' Arguments in Sections IV and V deleted from this version.]

⁵ As discussed below in Section VII.A.4(a), Korea has also requested that the Panel make a specific recommendation concerning a particular aspect of the measures at issue in this case.

VI. INTERIM REVIEW

6.1 The Panel issued its Interim Report pursuant to Article 15.2 of the DSU on 23 December 2004. On 13 January 2005, both parties submitted written requests to the Panel to review precise aspects of the Interim Report but neither party requested an interim review meeting. On 20 January 2005, both parties commented in writing on the other party's requests for review of the Interim Report. Pursuant to Article 15.3 of the DSU, this section contains the Panel's response to the comments of the parties on the Interim Report and forms part of the Panel's findings.

6.2 In addition to the changes discussed below, the Panel has corrected a certain number of typographical errors in the Interim Report.

A. CONDITIONAL PRELIMINARY OBJECTION OF THE EUROPEAN COMMUNITIES

6.3 Both parties request the Panel to modify and/or clarify certain paragraphs in Section VII.A.4(a) of the Interim Report which discusses a conditional preliminary objection raised by the European Communities with respect to the reference in Korea's first submission to "individual instances of application" of the TDM Regulation and the national TDM schemes.

6.4 The European Communities requests the deletion of the first sentence of paragraph 7.10 and the last sentence of paragraph 7.25 of the Interim Report (which correspond to, respectively, paragraphs 7.10 and 7.23 of the Final Report) on the ground that those sentences incorrectly suggest that the European Communities has stated before the Panel that a DSB recommendation would have direct effect under the internal law of the European Communities. The European Communities also request us to change paragraph 7.10 of the Interim Report to include certain arguments. Korea objects to most of these changes proposed by the European Communities.

6.5 Korea requests the Panel to further clarify the reasoning behind the distinction made in paragraph 7.23 of the Interim Report (paragraph 7.21 of the Final Report) between "individual instances of application" and "disbursements of funds". Secondly, regarding paragraph 7.24 of the Interim Report, Korea disagrees with the implicit criticism to the effect that "Korea has presented no evidence or specific arguments relating to any individual instances of application or disbursements of funds". Thirdly, with respect to the statement in paragraph 7.25 of the Interim Report (paragraph 7.23 of the Final Report) that it is not possible to state *ex ante* when an inconsistency with a panel ruling would arise from payments made pursuant to an impugned measure after the DSB rulings and recommendations, Korea does not see how there can be any instance when such payments would be consistent. Given the ambiguity of the European Communities with regard to the issue of whether disbursements of funds would be affected by a DSB recommendation, Korea requests the Panel to further clarify the final sentence of paragraph 7.25 of the Interim Report (paragraph 7.23 of the Final Report) to make it extra clear that disbursements of funds would be covered by the DSB's recommendation. Closely related to this, Korea requests the Panel to modify paragraph 8.4 of the Interim Report (paragraph 8.4 of the Final Report), which discusses the scope of the Panel's recommendation, to make a less conditional statement or at least to make clarifying suggestions pursuant to Article 19.1 of the DSU. The European Communities objects to the changes requested by Korea.

6.6 In light of the relatively extensive comments of the parties on this part of the Interim Report, we have made significant revisions with a view to better explaining our reasoning. The changes are reflected in paragraphs 7.10, 7.15-7.25 and 8.4 of the Final Report.

B. VESSELS AS IMPORTED PRODUCTS

6.7 The **European Communities** request that we change paragraph 7.64 of the Interim Report (paragraph 7.63 of the Final Report) which discusses the issue of whether the vessels covered by the TDM Regulation are "imported products" within the meaning of Article III of the GATT 1994. The European Communities submits that it has not argued as part of its legal defence in this case that ships are not imported products and that it was the Panel that had raised questions on this issue to the parties after Korea had stated in its first submission that ships are not often imported. It is in that connection that the European Communities has explained that due to transit rules ships have not been subject to importation requirements in the European Communities, as evidenced by the fact that import statistics on ships provided by Korea and relied upon by the Panel are explicitly based on changes of ownership not on data on importation. Since the notion of importation with respect to ships is complex and the Panel has correctly dismissed the claim of Korea under Article III:4 of the GATT 1994, the European Communities requests the Panel to leave this issue open or at least to delete the reference in the fourth sentence of paragraph 7.64 to "the volume and value of imports of seagoing tankers during the period 1998-2003".

6.8 **Korea** objects to the changes proposed by the European Communities. Korea points out that the European Communities in response to Panel question 51 clearly stated that the notion of importation within the meaning of Article I.1 of the GATT 1994 does not apply to this case as the vessels covered by the TDM Regulation are generally not imported, and that these vessels are means of transport in transit. While the European Communities clearly constructed an argument on the basis of an allegation that there are no imports of these ships, it has not been able to show that importation of these vessels is legally impossible. Finally, the argument of the European Communities regarding the status of ships as means of transport in transit is irrelevant to the issue of whether these ships can be imported.

6.9 The Panel notes that in response to Panel question 51 and in its statement at the second meeting the European Communities has taken the position that ships, at least the vessels subject to the TDM Regulation, *are not* imported within the meaning of Article I:1. It is true that strictly speaking the European Communities has not submitted this view specifically as part of its legal defence against Korea's claim under Article III:4, nor has the EC argued that these ships *cannot* be imported. This said, it is difficult to see how Article III can apply to products that cannot be imported. Therefore, even though this issue was not expressly discussed in the context of the claim under Article III:4, it presented the Panel with an important threshold question regarding the applicability of that provision. We therefore consider that it was logical to address this issue in our findings on the claim under Article III:4 even though we realize that in light of our substantive conclusion on the merits of that claim under Article III:4, it might not have been strictly necessary. However, we have adjusted paragraph 7.63 of the Final Report in light of the comments of the European Communities on the basis for the collection of statistics on imports of the vessels in question.

C. REFERENCES TO PRESS RELEASES

6.10 The **European Communities** objects to the fact that the Panel has attached certain evidentiary value to certain press releases submitted by Korea. In this regard, the European Communities recalls that in its first written submission and in its statement at the second substantive meeting it has explained in detail why it rejects the use of press releases of the European Commission, and more precisely of individual Commissioners, for the interpretation of the measure at issue, which is a Regulation of the Council of the European Union. The European Communities states that the Panel has correctly rejected the evidentiary value of the press releases in paragraph 7.172 of its Interim Report but that it has inappropriately relied on those press releases in paragraphs 7.25, 7.64, 7.137, 7.212, 7.213 and 7.218 and in footnotes 197, 198, 273, 397, 398 and 399 of the Interim Report. The European Communities considers that the explanation proffered by the Panel in footnotes 274 and 396 of the Interim Report that these statements are relevant because of "the role of the

Commission in initiating the legislation" is based on a misunderstanding of the legislative process in the European Communities. The European Communities submits in this regard that individual members of the European Commission are not the organ that initiates legislation but that it is the entire Commission that adopts a legislative proposal, and that in any event, once legislation has been adopted, it is exclusively the motivation and intent of the final act that describes the institutionally legitimated motivations of the act. A purely politically motivated press release of individual members of the Commission or even the Commission itself cannot modify or otherwise affect such Council act. In this case, the press releases were those of the individual Commissioners. The European Communities considers that the use by the Panel of these press releases amounts to a serious misrepresentation of its internal legislative procedures, division of competences and legal effects of acts. The European Communities argues that, contrary to what is suggested in footnote 396 of the Interim Report, the Panel Report in *US – Certain EC Products* is not relevant precedent.

6.11 **Korea** argues that it has submitted a mass of evidence on the nature of the TDM Regulation including official EC explanatory memoranda, interviews with Commissioners statements to Parliamentary Committees and press releases. Those press releases differed in regard to their degree of formality, and it is factually incorrect to assert that they were politically motivated statements of individual members of the European Commission. Korea submits that a WTO Member does not have the exclusive right to characterize its laws with respect to WTO obligations. Korea also refers to the fact that the EU's website describes the Commission as the driving force within the EU's institutional system in that it proposes legislation, policies and programmes of action and is responsible for implementing the decisions of Parliament and the Council. The same source describes the Commission as the European Union's executive body and as an important mouthpiece for the European Union on the international stage. In the case at hand, the Commission proposed the TDM regulation, shepherded the regulation through the Council and Parliamentary processes and retained for itself the authority to decide when to activate the TDM Regulation by initiating the WTO dispute settlement process upon which the TDM authority depended. The role of the Commission as executive body means that statements by the Commissioners are highly probative with regard to the implementation of a measure. Korea also submits that not all paragraphs cited by the European Communities contain references to press releases and, that where reference is made to press releases these are of the European Commission and not of individual Commissioners. Referring to the Panel Report in *Chile – Alcoholic Beverages* and Article 4 of the ILC's draft Articles on State Responsibility, Korea also submits that the European Communities cannot disavow the stated positions of its representatives. Finally, Korea argues that all of the statements, memoranda, press releases, etc. submitted by Korea lead to the same conclusion regarding the nature structure and intent of the TDM Regulation, and that the statements of the Commission referred to by the Panel therefore are not isolated statements that might not reflect the understanding and intent of the Commission.

6.12 The Panel notes that a number of paragraphs and footnotes mentioned by the European Communities do not make reference to press releases. Specifically, we see no such reference in paragraphs 7.25, 7.64 and 7.213 of the Interim Report (paragraphs 7.23, 7.63 and 7.212 of the Final Report), nor in footnotes 197 and 198 of the Interim Report (the text of which has been deleted from the Final Report) and footnote 398 of the Interim Report (footnote 402 of the Final Report). The issue therefore arises only in respect of paragraphs 7.137, 7.212 and 7.218 of the Interim Report (paragraphs 7.136, 7.211 and 7.217 of the Final Report) and footnotes 273, 397 and 399 of the Interim Report (footnotes 277, 401 and 403 of the Final Report). In these paragraphs and footnotes reference is made to two press releases, IP/01/656 and IP/01/1078, which are quoted in part in footnote 273 of the Interim Report (footnote 277 in the Final Report) and in paragraph 7.218 of the Interim Report (paragraph 7.217 of the Final Report). After carefully reviewing the arguments of the European Communities, we see no reason to change the text of the Report as requested by the European Communities.

6.13 First, we note that, as explained in the first and last sentences of paragraph 7.137 of the Interim Report (paragraph 7.136 in the Final Report) and in footnotes 274 and 396 of the Interim

Report (footnotes 278 and 400 of the Final Report), we have relied on these two press releases for the limited purpose of confirming a conclusion drawn from an analysis of the text of the TDM Regulation. We do not believe that our use of these press releases can be interpreted to mean that we view the statements in those press releases as autonomous sources of interpretation that can be relied upon independently of an analysis of the preamble and operative provisions of the TDM Regulation. Secondly, while the summary section of each of these press releases includes in one sentence a comment made by an individual Commissioner, which has been omitted from the quotations in the Panel Report, as a whole these press releases clearly describe and explain decisions and actions taken by the Commission as such, not its individual members. Thus press release IP/01/656 of 8 May 2001 is entitled "Commission sets out strategy on Korean shipbuilding case following investigation into unfair trade practices" and its summary states *inter alia* that "...the Commission today approved the strategy it will propose to the Council of Ministers...", that "the Commission will recommend that the matter be taken before the WTO...", and that "the Commission will propose accompanying measures in the form of a temporary support mechanism to European shipyards...". Similarly, press release IP/01/1078 of 25 July 2001 is entitled "Commission proposes temporary defensive mechanism for shipbuilding against unfair Korean practices" and the summary section of that press release begins by stating that "[t]he Commission today adopted a proposal for a Council Regulation..." We therefore can see no factual support for the argument of the European Communities that "[i]n this case the press releases were those of individual Commissioners". With respect to the argument of the European Communities that the reference in footnotes 274 and 396 of the Interim Report (footnotes 278 and 400 of the Final Report) to "the role of the Commission in initiating the legislation" reflects an incorrect understanding of the internal legislative process, we consider that it is clear that the expression "the role of the Commission in initiating this legislation", when read in context, simply means the role of the European Commission as an institution in proposing the draft TDM Regulation to the Council. Since the relevant paragraphs of the Panel Report clearly refer to statements of the Commission, not its individual members, there is nothing in these paragraphs to suggest that the Panel considers individual members of the European Commission as "legislators". As to the argument of the European Communities that "once legislation is adopted it is exclusively the motivation/intent of the final act that describes the institutionally legitimised motivations of the act" and that "politically motivated press releases of individual Commissioners or even of the EC Commission cannot modify or otherwise affect such Council act", we reiterate that the Report relies on these two press releases only to confirm a conclusion derived from the analysis of the text of the TDM Regulation. Finally, regarding the argument of the European Communities that the reference in footnote 396 of the Interim Report (footnote 400 in the Final Report) to the Panel Report in *US - Certain EC Products* is not a relevant precedent, we note that the primary reason why we consider it appropriate to lend some weight to the press releases is explained in the first sentence of the footnote and that the reference in the second sentence to *US - Certain EC Products* is of subsidiary importance.

VII. FINDINGS

A. INTRODUCTION

1. Findings requested by the parties

7.1 Korea requests the Panel to find that:

- (a) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Articles 23.1, 23.2(a), 23.2(b) and 23.2(c) of the DSU;
- (b) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving

member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article 32.1 of the SCM Agreement;

- (c) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article 4.1-4 and Article 7.1-4 and 9 of the SCM Agreement;
- (d) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article III:4 of the GATT 1994; and
- (e) the TDM Regulation, its member State implementing provisions as well as any instances of application of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the European Communities' and its member States' obligations under Article I:1 of the GATT 1994.

7.2 The **European Communities** requests the Panel to find that:

- (a) the TDM Regulation is not in violation of Articles 23.1, 23.2(a)-(c) of the DSU, Articles 4, 7 and 32.1 of the SCM Agreement and Articles I and III:4 of the GATT 1994; and
- (b) the national TDM measures (to the extent that they still exist) are not in violation of Articles 23.1, 23.2(a)-(c) of the DSU, Articles 4, 7 and 32.1 of the SCM Agreement and Articles I:1 and III:4 of the GATT 1994.

2. Order of Analysis

7.3 The order in which we analyze the claims of Korea takes into account their substantive interrelationship. Given that a key question of interpretation in this case is whether Article 23 of the DSU can prohibit a measure that does not entail a suspension of concessions or other obligations under the WTO Agreement, we examine first whether the measures at issue are inconsistent with the provisions of the GATT 1994 and the SCM Agreement cited by Korea. We also note the interrelationship between the claims of Korea under Articles I and III of the GATT 1994, given that Korea challenges the TDM Regulation under Article I of the GATT 1994 as an internal measure covered by Article III:4 of the GATT 1994. Finally, we note the close relationship between the issues raised by Korea under Articles 4 and 7 of the SCM Agreement and under Article 23 of the DSU. In light of these considerations, we decide that the most efficient manner to proceed is to analyse first the claims of Korea under Articles III and I of the GATT 1994, followed by Korea's claims under Article 32.1 of the SCM Agreement, Article 23 of the DSU and Articles 4 and 7 of the SCM Agreement.

3. Burden of proof

7.4 We recall that the general principles applicable to burden of proof in WTO dispute settlement require that a party claiming a violation of a provision of the WTO Agreement by another Member

must assert and prove its claim.¹⁴¹ In these Panel proceedings, Korea, which has challenged the consistency of the European Communities' measures, thus bears the burden of demonstrating that the measures are not consistent with the relevant provisions of the Agreement. Korea also bears the burden of establishing that its claims are properly before us. We also note that it is generally for each party asserting a fact to provide proof thereof.¹⁴² In this respect, therefore, it is also for the European Communities to provide evidence for the facts which it asserts. We also recall that a *prima facie* case is one which, in the absence of effective refutation by the other party, requires a panel, as a matter of law, to rule in favour of the party presenting the *prima facie* case.

4. Preliminary issues

(a) Conditional preliminary request of the European Communities

(i) *Main arguments of the parties*

7.5 In its first submission, the **European Communities** made a conditional request for a preliminary ruling by the Panel that Korea had violated Article 6.2 of the DSU on the grounds that Korea's first submission expanded the claims of Korea to include "individual instances of application" of the TDM Regulation by the European Commission and the respective EC member States, "the application of the TDM scheme in specific cases", and "TDM contributions provided pursuant to the TDM framework".¹⁴³

7.6 In support of this request, the European Communities argued that the request of Korea for the establishment of a panel¹⁴⁴ explicitly did not identify as impugned measures any individual grants. Since Korea's request explicitly distinguished between the national TDM schemes of the EC member States as such and "particular instances" of grants in its description of the consultations that had taken place in this dispute, Korea could not claim that the reference to "implementing measures" comprised individual grants. The European Communities requested the Panel to invite Korea to clarify that individual instances of application of the national TDM measures were not within the scope of the proceeding and, if Korea were to insist on the inclusion of individual instances of application, to rule that the claim, insofar as it related to the individual instances of application was contrary to Article 6.2 of the DSU and should, therefore, be dismissed.¹⁴⁵

7.7 **Korea** requested the Panel to deny the request of the European Communities on the following grounds.¹⁴⁶ First, the paragraph of Korea's request for the establishment of a panel that described the content of the consultations did not make a legal distinction between the TDM Regulation and implementing measures, on the one hand, and the actual instances of grants of funds, on the other, but only contained a non-exhaustive list of the issues that were the subject of the consultations. Moreover, Korea's request for the establishment of a panel referred to disbursements in that it identified the measures as "...the TDM Regulation and member States implementing measures involving the bestowal of German, Danish, Dutch, French and Spanish grants to shipyards on a vessel-specific and product-related basis...". Second, if a Member challenged a measure as WTO-inconsistent, the Member did not need to include the actual instances of nullification and impairment for them to be included within the dispute. Third, while Korea considered that individual grants were not separate measures but were mere applications of the TDM Regulation and the EC member States' implementing laws, if the Panel considered that individual grants were separate measures, they would

¹⁴¹ Appellate Body Report, *US – Wool Shirts and Blouses*, p. 16.

¹⁴² *Ibid.*

¹⁴³ The European Communities referred to, respectively, paras. 12-13; p. 14; and paras. 131, 140, 169, and 192 of the first submission of Korea.

¹⁴⁴ WT/DS301/3, attached as Annex.

¹⁴⁵ First submission of the European Communities, paras. 107-113.

¹⁴⁶ Attachment 2 to the oral statement of Korea at the first substantive meeting of the Panel with the parties.

still be covered by the terms of reference as directly related to the measures at issue. Fourth, the European Communities had not shown how its due process rights were adversely affected by a lack of clarity of the request for the establishment of a panel. Finally, if specific applications of a measure found to be WTO-inconsistent were to be excluded from the scope of a panel ruling unless individually listed in the request for establishment, the result would be that such applications could continue, at least to the extent they had been committed but not yet paid prior to the DSB rulings and recommendations.

7.8 At the first substantive meeting of the Panel¹⁴⁷, Korea indicated that it did not seek a ruling of the Panel on each disbursement. However, it rejected the argument of the European Communities that disbursements were not covered by the dispute. Korea expressed concern regarding the systemic implications of a preliminary ruling that disbursements of funds were not covered because this would mean that where a measure was found to be WTO-inconsistent, a Member could continue to apply that measure in individual cases if those individual instances had not been specifically identified.

7.9 The **European Communities** inferred from this statement of Korea that Korea did not ask this Panel to find that individual disbursements of funds under the TDM were WTO-inconsistent. Regarding the concern expressed by Korea with respect to a Panel ruling that would not cover individual instances, the European Communities argued that Korea was challenging these individual instances in another dispute settlement proceeding¹⁴⁸ in which context the specific remedies provided for in the SCM Agreement would possibly apply. In the present case, however, the only remedy possible was a remedy of a prospective nature in the form of a recommendation to bring the general measure into conformity with WTO obligations.

7.10 In response to questions from the Panel, the European Communities indicated that if the Panel were to find the TDM Regulation and the national measures of the five EC member States (to the extent still in force) to be inconsistent with the WTO Agreement, the European Communities would bring those measures into conformity. The European Communities also stated that if the basic law is incompatible with the WTO Agreement, there would be no basis for further granting any aid. The European Communities also indicated that the TDM Regulation and the national measures as a legal basis for providing aid will expire on 31 March 2005, i.e., possibly even before a final report in this proceeding is adopted. The European Communities also pointed out that it often happens that a law or subsidy scheme is attacked without equally attacking individual applications, for example, the recent Byrd case. The issue of the payment of state aid pursuant to aid granted before the effective date of such a recommendation was a matter for implementation. The European Communities, in response to another question of the Panel, also clarified that Korea's statement that it was not asking for any findings or recommendations on specific measures had allayed the concerns that had led to the conditional request for a preliminary ruling.

7.11 Referring specifically to the comment of the European Communities on payments made pursuant to subsidies granted before a DSB recommendation would become effective, **Korea** requested the Panel to clarify that the case-by-case implementation of an illegal measure would be covered by a ruling against such measure. The position of the European Communities on individual instances of application as separate measures that needed to be identified in order to be covered by the dispute made it necessary for the Panel to clarify that such instances would be covered by any ruling or recommendation against the TDM Regulation and the national measures.

¹⁴⁷ The remarks of Korea and the European Communities as reflected in paragraphs 7.8-7.11 were made during the course of an oral discussion on this point during the first substantive meeting, and are not fully reflected in the written versions of the parties' oral statements. The description of these remarks thus is based on a transcription of the relevant part of that meeting.

¹⁴⁸ WTDS307.

7.12 After hearing the parties' views on this matter at the first substantive meeting, and taking into account the European Communities' declaration (para. 7.10 above) that Korea's statement had allayed the concerns that had led to its conditional request for a preliminary ruling, the Panel stated that:

"[...] the Panel's view at this point is that the EC has withdrawn its request for a preliminary ruling and so we will not be making a preliminary ruling.

As to the implementation issues generally, the Panel noted:

"We are aware that both sides have specific concerns on the issue that we were talking about; we are aware of those concerns and we are not making any decision, one way or the other, on any of the issues that were being discussed yesterday. We assume that you may well have more to say on those issues and, if necessary, we may have additional questions on those issues in due course."

The European Communities raised no objection to the Panel's characterization of the status of the European Communities' conditional request for a preliminary ruling.

7.13 In its second written submission, **Korea** reverted to this matter and requested the Panel to clarify whether or not it considered the disbursements of funds to be separate measures. If the Panel considered them to be distinct measures, the Panel should find that they were covered in the request for the establishment of a panel because they were directly related to the cited measures and, in addition, were identified in that request, and the Panel should find the disbursements to be inconsistent with the obligations of the European Communities under the WTO provisions referenced in the request for the establishment of a panel. On the other hand, if the Panel agreed with Korea that the disbursements of funds were not separate measures but simply the implementation of measures found to be illegal, Korea requested the Panel to make an affirmative recommendation pursuant to Article 19.1 of the DSU that the European Communities immediately cease any further disbursements of illegal funding.¹⁴⁹

7.14 The **European Communities** recalled its position that while the request of Korea for the establishment of a panel did not cover individual disbursements, its concerns regarding the implications of the inclusion of such disbursements within the scope of the present proceedings had been alleviated by Korea's clarification at the first meeting that Korea did not base its case on individual grants. For this reason, the European Communities considered that the request of Korea that the Panel clarify the theoretical relationship between general subsidy schemes and individual disbursements was an inappropriate request for an advisory opinion.¹⁵⁰

(ii) *Evaluation by the Panel*

7.15 From a procedural viewpoint, the Panel finds itself confronted with a somewhat unusual situation: while initially it was the European Communities which presented a conditional request for a preliminary ruling concerning "individual instances of application", subsequently, after the Communities indicated that it no longer considered it necessary to pursue this matter, Korea requested the Panel to decide whether "disbursements of funds" pursuant to the TDM Regulation and national measures are part of the subject matter of this dispute.

¹⁴⁹ Second submission of Korea, paras. 25-34; see also oral statement of Korea at the second substantive meeting of the Panel with the parties, para. 67.

¹⁵⁰ Further comments on preliminary issues and Korea's DSU Article 19.3 request by the European Communities (delivered as part of the oral statement of the European Communities at the second substantive meeting of the Panel).

7.16 The Panel notes that Korea has confirmed that it is not seeking specific findings on individual disbursements of funds but that Korea nevertheless requests the Panel to clarify that such disbursements would be covered by any ruling or recommendation against the TDM Regulation and the measures of the member States. Korea's position is that separate findings on individual disbursements are not necessary to bring them within the scope of any Panel ruling or recommendation, i.e., that they are inherently part of the subject of this dispute. By contrast, the European Communities has withdrawn its conditional request for a preliminary ruling on the basis of a statement of Korea that it was not seeking findings on individual disbursements, but it would appear that the European Communities' withdrawal of the request for a preliminary ruling does not signify that the Communities shares Korea's position that individual disbursements are inherently part of the subject matter of this dispute. The issue on which Korea asks us to rule thus is whether individual disbursements are covered by our terms of reference.

7.17 Under its terms of reference, a panel's authority to examine and make findings is restricted to the matter referred to in the request for establishment of a panel. Whether an issue is properly within a panel's terms of reference depends upon whether that issue forms part of the matter described in the request for establishment, defined in terms of claims and measures.

7.18 Korea's request for establishment of a panel¹⁵¹ indicates that consultations took place in this dispute with regard to, on the one hand, the provisions of the TDM Regulation and the EC member States implementing provisions as such, and, on the other, the provision of subsidies by the European Communities and its member States "in particular instances"; and that these consultations have failed to resolve the dispute between parties concerning "the TDM Regulation...and the EC member States' implementing provisions". The request next states that: "[t]he measures that are the subject of this request are the EC and its member States' legal provisions and decisions providing for the supply of grants to shipbuilders" Korea considers in particular "that the following measures are inconsistent with the European Communities' obligations under the SCM Agreement": the TDM Regulation, "the EC member State implementing provisions of the TDM regulation", and "the European Commission Decisions approving these implementing provisions". The request then lists these "implementing measures" and Decisions.¹⁵² The "implementing measures" listed provide a general framework for providing aid, and do not relate to the actual provision of aid in individual instances. Finally, the request states that "the EC and its member State measures referred to above" are inconsistent with Articles I:1 and III:4 of the GATT 1994, Articles 23.1 and 23.2 of the DSU and Articles 4 and 7 of the SCM Agreement, and Articles 32.1 and 4 and 7 of the SCM Agreement.

7.19 The request for establishment therefore does not explicitly identify either "individual instances of application", the expression used in the first submission of Korea, or "disbursements of funds", the expression subsequently used by Korea. The Panel considers this omission from the request for establishment especially significant as the request for consultations explicitly covered the provision of subsidies by EC member States in "particular instances" as a subject distinct from the provisions of the TDM Regulation and the EC member States' implementing provisions "as such". The Panel further notes, in this connection, that in February 2004 Korea submitted another request for consultations¹⁵³ indicating that while Korea had "requested the establishment of a panel with respect to the TDM Regulation and its inconsistency with certain provisions of the GATT 1994, the SCM Agreement and the DSU", Korea now "wishes to proceed with consultations with the EC regarding other aspects of the TDM Regulation and other measures which were the subject of its September 3rd request along with additional measures recently adopted by the EC". That request clearly identifies as the measures at issue relevant legal provisions at the EC and member State level as well as the granting of aid in particular instances.

¹⁵¹ WT/DS301/3, attached as Annex.

¹⁵² Id.

¹⁵³ WT/DS307/1.

7.20 In order to decide on Korea's request, we would have to determine whether "individual instances of application" or "disbursements of funds" were somehow implicitly identified in the request for establishment, and if not, whether the request otherwise covers such disbursements either because they are "applications" of the cited measures or because they are "directly related" to those measures.¹⁵⁴ The Panel is not persuaded, however, that it is necessary or appropriate for it to pronounce on these questions.

7.21 In this regard, the Panel recalls first that the conditional request of the European Communities for a preliminary ruling pertained to "individual instances of application", and that Korea's first submission contained similar notions. By contrast, the request as made by Korea in its second submission refers to the "disbursement of funds". In the Panel's view, while the expression "individual instances of application" refers generally to the provision of aid in particular cases, the expression "disbursement of funds" is a more specific reference to the act of "payment" of aid. Concerning individual instances of application in this sense, the European Communities has not contested in this proceeding that, in the event of a DSB ruling that the TDM Regulation and the national TDM schemes are inconsistent with WTO provisions, the obligation of the European Communities to implement the concomitant recommendation under Article 19.1 of the DSU would cover future decisions by EC member States to grant state aid in response to new applications for such aid. Thus, the question of the implications of such a recommendation for the provision of TDM aid in particular cases (i.e., individual instances of application) has not given rise to controversy between the parties.

7.22 Korea's request to the Panel for a decision regarding the status of "disbursements of funds" thus exclusively relates to the act of payment of aid, and specifically to the application of a DSB recommendation to future such payments¹⁵⁵. Korea's concern in this regard pertains to whether, in the event of a DSB recommendation to bring the TDM Regulation and national aid schemes into conformity with WTO obligations, EC member States could continue to make payments after the effective date of such a recommendation pursuant to aid authorized before that date.¹⁵⁶

7.23 We acknowledge that the continued payment of money, following a DSB recommendation that the European Communities bring the TDM Regulation and the national TDM schemes into conformity with WTO obligations, pursuant to state aid authorized previously under national TDM schemes, might well constitute a breach of WTO obligations¹⁵⁷. However, to determine precisely when an inconsistency with WTO obligations would arise from such payments would require analysis of factual and legal issues which would be neither feasible nor appropriate to attempt *ex ante* in the

¹⁵⁴ See cases discussed in *WTO Analytical Index*, at 1305—1308.

¹⁵⁵ Korea indicated in interim review that "[t]he issue is the *future disbursements* of monies made pursuant to the impugned measure"(emphasis in original).

¹⁵⁶ Our understanding of Korea's request is confirmed by its position in interim review. At the second meeting of the Panel with the parties, the European Communities stated that if the Panel were to find the TDM Regulation and the national measures of the five EC member States (to the extent still in force) to be inconsistent with the WTO Agreement, the EC would bring those measures into conformity. The European Communities also stated that if the basic law is incompatible with the WTO Agreement, there would be no basis for further granting any aid. We understand these statements to mean that, in the event of a finding of WTO-inconsistency, the European Communities would bring the TDM and the national measures into conformity with its WTO obligations, and that such action would remove the legal basis for granting any further aid. In response to this statement by the European Communities, Korea, in its interim review comments, has indicated its concern that "the EC is referring to the lapse of the authority of the EC member states to grant new aid *rather than with respect to continued disbursement of already granted aid*. (emphasis added)."

¹⁵⁷ Thus, for example, the Panel notes the reference made by Korea to the statement of the Appellate Body in paragraph 45 of its report in *Brazil – Aircraft (Article 21.5 - Canada)* that "to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies" in which connection Korea argues that the language in Article 4.7 of the SCM Agreement is simply the particular application of Article 19.1 of the DSU. Oral statement of Korea at the first substantive meeting of the Panel with the parties, Attachment 1, para. 16.

context of the present proceeding. The Panel considers that this issue rather should be addressed at an implementation stage, on the basis of the specific facts presented to the Panel at that time. To attempt to do so now would require us to speculate with respect to facts not placed before us and with respect to developments that have not yet occurred.

7.24 The Panel also notes Korea's request that, if the Panel agrees with Korea that individual disbursements of funds are not separate measures but are simply the application or implementation of the measures found to be illegal, the Panel make a recommendation under Article 19.1 of the DSU that the European Communities immediately cease any further disbursements of illegal funding. We do not see how the text of Article 19.1 permits us to make a recommendation other than that the EC "bring its measures into conformity with that agreement". Therefore, even if we agreed that disbursements of funds are applications of the measures identified in Korea's request for the establishment of a panel, Article 19.1 of the DSU would preclude us from making the kind of specific recommendation requested by Korea.

7.25 To conclude, the Panel **takes note** that the European Communities has indicated that it is not necessary for the Panel to make the preliminary ruling initially requested by the European Communities; and **decides** that it is neither necessary nor appropriate to clarify the status of disbursements of funds in the manner requested by Korea.

(b) New Measures of EC member States

7.26 In response to a question of the Panel, **Korea** indicates *inter alia* that "it has specifically requested in its request for Panel Establishment the inclusion of all EC member State provisions implementing the TDM Regulation including the implementing provisions by the new member States that acceded to the European Communities on 1 May 2004. The TDM Regulation constitutes a regulatory framework that gives the authority but the EC member State provisions are the implementation of the unilateral and discriminatory retaliation in the TDM Regulation".¹⁵⁸

7.27 The **European Communities** objects to this reference by Korea to implementing provisions including those in new member States and those that entered into force since the request for the establishment of a panel. The European Communities argues that Korea cannot ask the Panel to make findings on measures that were not included in the request for establishment of a panel and could indeed not even have existed at that time. Since the request only includes the TDM Regulation and the five schemes existing at the time of the request, Korea cannot expand the scope of this proceeding to any future measures of all future possible new EC member States. In this context, the European Communities also rejects Korea's characterization of the national TDM measures as "implementing" measures.¹⁵⁹

7.28 In response, **Korea** argues that new measures of EC member States would certainly be covered and refers in this respect to its discussion of the notion of "directly related" measures in its opening statement at the first meeting.¹⁶⁰

7.29 As noted above (paras. 7.18-7.19), Korea's request for the establishment of a panel¹⁶¹ refers to: (i) the TDM Regulation as extended in product scope and proposed to be extended in duration; and (ii) the EC member State implementing provisions of the TDM Regulation and the European Commission Decisions approving these implementing provisions, including the measures adopted by Germany, Denmark, the Netherlands, France, and Spain. The Panel finds nothing in this request

¹⁵⁸ Response of Korea to Panel Question 4.

¹⁵⁹ Second submission of the European Communities, paras. 32-33.

¹⁶⁰ Oral statement of Korea at the second substantive meeting of the Panel with the parties, para. 64.

¹⁶¹ WT/DS301/3, attached as Annex.

suggesting that, as Korea now argues before the Panel, Korea "specifically requested... the inclusion of all EC member State provisions implementing the TDM Regulation, including the implementing provisions by the new member States that acceded to the European Communities on 1 May 2004".

7.30 We note that neither party has identified any further implementing provisions by any member State, whether new or existing as of the date of its request for establishment of a panel, beyond the five implementing measures specifically identified by Korea. Nor has either party identified any further proposed implementing provisions by other member States. In fact, there is not a scintilla of evidence before the Panel, nor in fact any basis to speculate, that any further implementing provisions are envisioned. To the contrary, we note that of the five implementing provisions specifically identified, three have been allowed to expire. We do not consider that an abstract ruling on hypothetical future measures is necessary nor helpful to the resolution of this dispute.¹⁶²

7.31 Therefore, the Panel does not further address this matter.

(c) Whether the present dispute is a dispute between Korea and the European Communities or a dispute between Korea and the European Communities and its member States

7.32 The parties have raised certain issues relating to the identification of the Member to whom our rulings and recommendations should be addressed, with respect to measures taken by the EC member States. More specifically, the European Communities considers that it is the "proper respondent" for the measures at issue and states that it "takes full responsibility under international law"¹⁶³ for measures taken by EC member States pursuant to the TDM Regulation, and that for the purposes of WTO law, such measures are taken by the European Communities as a Member of the WTO. Korea, for its part, while taking note of the European Communities' statement that it takes full responsibility for the measures, considers that "the present dispute is between Korea and the EC and its member States. Hence Korea requests the Panel to make findings in relation to the European Communities and EC member State measures and to recommend that both the EC TDM Regulation and the EC member State provisions should be brought in conformity with the WTO obligations".¹⁶⁴

7.33 We note that there is no dispute that both the TDM Regulation and the EC member State measures are within our terms of reference and that, in the event they are found inconsistent with the WTO Agreement, they would be subject to our recommendation to the extent that they are still operational. As to the WTO Member to whom any recommendations should be addressed in relation to these measures, we first note that Korea in its first submission requested that we recommend that *the European Communities* bring all these measures into conformity. Korea's articulation of its requests for rulings and recommendations subsequently varied somewhat in the course of the proceedings, but the Panel understands Korea's principal concern to be that any ruling or recommendation should cover the EC member State measures as well as the TDM Regulation. We also recall the European Communities' declaration that it assumes full responsibility for all these measures, including the EC member State measures. We understand this to mean that the European Communities accepts responsibility for any actions that may be required to bring into conformity the measures at issue. We also note that the measures at issue were taken by the EC member States pursuant to the TDM Regulation itself. In light of these elements, we would find it

¹⁶² The European Communities in its first submission also raised as issues the status of expired measures and the lack of clarity of Korea's description of the measures at issue. The Panel notes however that the European Communities, while characterizing these issues as "preliminary issues relating to the measures at issue", does not specifically request the Panel to rule on this basis that particular measures are outside its terms of reference, and we therefore will not do so. We note, however, that the national measures which expired on 31 March 2004 were specifically identified Korea's request for the establishment of a panel and were in force on the date of the establishment of the Panel's terms of reference (19 March 2004).

¹⁶³ First submission of the European Communities, para. 93.

¹⁶⁴ Response of Korea to Panel Question 4.

sufficient, in the circumstances of this case, to address our recommendation to bring the measures at issue into conformity to the European Communities.

(d) Other "preliminary issues" raised by the European Communities in its first submission

7.34 In addition to the conditional request for a preliminary ruling on whether the individual instances of application of the TDM Regulation and the national measures are covered by this dispute, other preliminary issues raised by the **European Communities** in its first submission pertained to: (i) the alleged mischaracterization by Korea of the legal nature of the TDM Regulation and its relationship with the national TDM programmes; and (ii) Korea's reliance on press releases.¹⁶⁵

7.35 In the Panel's view, the observations offered by the European Communities in this part of its first submission concern certain legal and factual aspects of the measures involved that the European Communities considers to be particularly important to a correct understanding of these measures. The Panel addresses these issues when discussing the factual and legal aspects of the claims raised by Korea.¹⁶⁶

5. Measures at issue

(a) Council Regulation (EC) No 1177/2002, as amended

7.36 The principal measure at issue in this proceeding is Council Regulation (EC) No 1177/2002 of 27 June 2002 concerning a temporary defensive mechanism to shipbuilding (hereinafter: TDM Regulation)¹⁶⁷, which was extended in product coverage in June 2003 and the duration of which was extended by Council Regulation (EC) No 502/2004 of 11 March 2004. The TDM Regulation was adopted by the Council of the European Union on the basis of, in particular, Articles 87(3)(e), 89 and 133 of the Treaty establishing the European Community, which deal with respectively state aids and the common commercial policy.

7.37 In June 1998, the Council had adopted new rules on state aids to the shipbuilding sector providing *inter alia* for the phase out of contract-related operating aid by 31 December 2000.¹⁶⁸ However, the TDM Regulation provides that, as a temporary and exceptional measure, contract-related operating aid for the building of container ships, product and chemical tankers and LNG carriers¹⁶⁹ shall be considered compatible with the common market.¹⁷⁰

¹⁶⁵ First submission of the European Communities, paras. 92-106. Korea's specific responses to the observations of the European Communities appear in paras. 11-25 of the oral statement of Korea at the first substantive meeting of the Panel and in Korea's responses to Panel Questions 7-8 and 10.

¹⁶⁶ See *infra*, paras. 7.52-7.54 and footnotes 278 and 400.

¹⁶⁷ OJ L 172, 2.7.2002, p. 1, reproduced in Exhibit Korea -4 (a).

¹⁶⁸ Council Regulation (EC) No 1540/98 of 29 June 1998 establishing new rules on aid to shipbuilding, OJ L 202, 18.7.1998, p.1, reproduced in Exhibit EC-18. Article 3(1) of this Regulation provided:

"Until 31 December 2000, production aid in support of contracts for shipbuilding and ship conversion, but not ship repair, may be considered compatible with the common market provided that the total amount of all forms of aid granted in support of any individual contract (including the grant equivalent of any aid granted to the ship-owner or third parties) does not exceed, in grant equivalent, a common maximum aid ceiling expressed as a percentage of the contract value before aid. For shipbuilding contracts with a contract value before aid of more than ECU 10 million, the ceiling shall be 9 per cent in all other cases the ceiling shall be 4.5 per cent."

¹⁶⁹ As explained below, LNG carriers were not covered by the TDM Regulation from the outset but were included in its scope in June 2003.

¹⁷⁰ Article 1 of the TDM Regulation defines the terms "container ships", "chemical tankers", "product tankers", and "LNG carriers":

7.38 The introductory Recitals of the TDM Regulation explain the considerations motivating its adoption and design as follows.

7.39 First, it is stated that, while in June 2000 the European Commission and the Government of Korea signed Agreed Minutes relating to world shipbuilding with the aim of restoring fair and transparent conditions¹⁷¹, Korea has not effectively implemented the commitments under the Agreed Minutes, notably the commitment of ensuring an effective price mechanism. Second, it is stated that although operating aid has not been effective in preventing the European shipbuilding industry from being injured by competition not respecting normal competitive conditions and that accordingly contract-related operating aid may not be granted in respect of contracts agreed as from 1 January 2001, a temporary defensive mechanism should nevertheless be authorized for limited market segments and for a short and limited period only as an exceptional and temporary measure and in order to assist Community shipyards in those segments that have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition.

7.40 Third, regarding the product coverage of the TDM Regulation, the fourth Recital notes that, while there are segments of the Community shipbuilding industry in which Community shipyards are in a strong position on the international market, "in other segments, there is evidence that Community shipyards have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition", and contract-related aid may therefore be authorized in those sectors in certain circumstances, namely container ships and product and chemical tankers. Regarding LNG carriers, the fifth Recital points to the exceptional development in this sector and states that contract-related temporary support may be authorised in this sector "if the Commission confirms, on the basis of investigations covering the period of 2002, that the Community industry has suffered material injury and serious prejudice in this sector caused by unfair Korean practices to the same extent as has been found for container ships and product and chemical tankers".

7.41 Fourth, regarding the level of aid, the sixth Recital states that operating aid of 6 per cent of contract value before aid may be authorized "in order to effectively enable Community shipyards to overcome unfair Korean competition".

7.42 Finally, in respect of the temporal application of the aid scheme, Recital 7 of the TDM Regulation states that the temporary defensive mechanism should only be authorized after the initiation of WTO dispute settlement proceedings by the European Communities against Korea and may no longer be authorized "if these dispute settlement proceedings are resolved, or suspended on

(a) 'container ships' shall mean ships designed with a single deck hull with an arrangement of holds to carry containers (standard or non-standard; refrigerated or non-refrigerated), whose holds are fitted with cell guides to facilitate the positioning of the containers, as may be some of the deck storage space. Other ships combining cargo carrying capacity for containers and other cargo are considered as container ships if the larger part of the cargo carrying capacity is dedicated to containers;

(b) 'chemical tankers' shall mean ships designed with a single deck hull with an arrangement of integral and/or independent tanks suited to carry chemical products in liquid form. Chemical tankers are characterized by the ability to carry and handle several substances at the same time and the particular equipment of the tanks with coatings, reflecting the nature and hazard of the cargo carried;

(c) 'product tankers' shall mean ships designed with a single deck hull with an arrangement of integral and/or independent tanks suited to carry refined petroleum products in liquid form;

(d) 'LNG carriers' (Liquefied Natural Gas carriers) shall mean ships designed with a single deck hull with fixed integral and/or independent tanks suited to carry natural gas in liquid form.

¹⁷¹ Agreed Minutes between the European Community and the Government of the Republic of Korea relating to the world shipbuilding market, OJ L 155, 28.6.2000, p. 49, reproduced in Exhibit EC-6.

the grounds that the Community considers that the agreed minutes have been effectively implemented".

7.43 The key operative provisions are in Articles 2(1)-(4) of the TDM Regulation:

"1. Subject to paragraphs 2 to 6, direct aid in support of contracts for the building of container ships, product and chemical tankers as well as LNG carriers shall be considered compatible with the common market when there has been competition for the contract from a Korean shipyard offering a lower price.

2. Direct aid in support of contracts for the building of LNG carriers may only be authorised under this Article for final contracts signed after the Commission gives notice in the *Official Journal of the European Communities* that it confirms, on the basis of investigations covering the period of 2002, that Community industry has suffered material injury and serious prejudice in this market segment caused by unfair Korean practices.

3. Aid under this Article may be authorised for shipbuilding contracts up to a maximum intensity of 6 % of contract value before aid.

4. This Regulation shall not apply in respect of any ship delivered more than three years from the date of signing of the final contract. The Commission may, however, grant an extension of the three-year delivery limit when this is found justified by the technical complexity of the individual shipbuilding project concerned or by delays resulting from unexpected disruptions of a substantial and defensible nature in the working programme of a yard due to exceptional circumstances, unforeseeable and external to the company."

In June 2003, the European Commission published a notice under paragraph 2 of this Article confirming, on the basis of investigations covering the period of 2002, that the Community industry had suffered material injury and serious prejudice in the market segment of LNG carriers caused by unfair Korean practices.¹⁷²

7.44 Article 3 of the TDM Regulation stipulates that the operating aid covered by the Regulation shall be subject to Article 88 of the EC Treaty, which Article provides for the supervision of state aid by the European Commission, notably through a mechanism of *ex ante* control on the basis of notifications by member States.

7.45 Article 4 of the TDM Regulation provides that the application of the Regulation is limited to contracts signed in the period from the date of the initiation by the European Communities of WTO dispute settlement proceedings against Korea until the date one month after the resolution or suspension of those proceedings:

"The Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry, with the exception of final contracts signed before the Community gives notice in the *Official Journal of the European Communities* that it has initiated dispute settlement proceedings against Korea by requesting consultations in accordance with the World Trade Organization's Understanding on the Rules and Procedures for the Settlement of Disputes and final contracts signed one month or more after the Commission gives notice in the *Official Journal of the European Communities* that these dispute settlement proceedings are resolved, or

¹⁷²Notice under Article 2 of Council Regulation (EC) No 1177/2002 of 27 June 2002, OJ C 148, 25.6.2003, p.14, reproduced in Exhibit Korea- 4 (b).

suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented."

The European Commission published a notice under this Article of the initiation of WTO dispute settlement proceedings on 24 October 2002.¹⁷³

7.46 The TDM Regulation entered into force on 3 July 2002 with an original expiry date of 31 March 2004. Council Regulation (EC) No 502/2004 of 11 March 2004 amended the TDM Regulation to extend its duration until 31 March 2005.¹⁷⁴

(b) Authorization by the European Commission, on the basis of the TDM Regulation, of state aid granted by EC member States

7.47 The European Commission has adopted decisions¹⁷⁵ authorizing aid schemes notified by Germany¹⁷⁶, the Netherlands¹⁷⁷, Denmark¹⁷⁸, France¹⁷⁹ and Spain¹⁸⁰ after it had satisfied itself that the proposed scheme was in conformity with the provisions of the TDM Regulation.

7.48 The legal instruments embodying the specific measures adopted by these five member States are the following:¹⁸¹

Germany	Richtlinien des Bundesministeriums für Wirtschaft und Arbeit zu befristeten Schutzmassnahmen für des Schiffbau vom 24. Oktober 2002 (Directives of the Federal Ministry for Economy and Work on temporary defensive measures for Shipbuilding of 24 October 2002)
Netherlands	Regeling van de Staatssecretaris van Economische Zaken van 17 juli 2003, nr. WJZ 3040972, houdende regels inzake het verstrekken van subsidies aan de scheepbouwsector bij wijze van tijdelijke defensieve maatregel "Tijdelijke Regeling Ordersteun Scheepsnieuwbouw van 17 Juni 2003" "Kaderwet EZ subsidies" ("Framework law for Grants from the Ministry of Economy), Art. 3
Denmark	"Lov om midlertidig kontraktbetinget driftsstotte til bygning af visse skibstyper" (law) "Bekendtgørelse om administration af lov om midlertidig kontraktbetinget driftsstotte til bygning af visse skibstyper" (administrative decision).
France	No legal act, but budgetary line for this purpose in the Finance law for the year in question. Ad hoc decision of a special inter-ministerial committee created for this

¹⁷³ Notice under Article 4 of Council Regulation No 1177/2002 of 27 June 2002, OJ C 257, 24.10.2002, p. 11, reproduced in Exhibit Korea-16.

¹⁷⁴ Council Regulation (EC) No 502/2004 of 11 March 2004 amending Regulation (EC) No 1177/2002 concerning a temporary defensive mechanism to shipbuilding, OJ L 81, 19.3.2004, p. 6, reproduced in Exhibit Korea-4(c).

¹⁷⁵ Exhibits Korea 11-15.

¹⁷⁶ OJ C 108, 7.5.2003, p. 5.

¹⁷⁷ OJ C 221, 17.9.2003, p. 10 and OJ C 269, 8.11.2003, p. 23.

¹⁷⁸ OJ C 227, 23.9.2003, p. 7.

¹⁷⁹ OJ C 257, 25.10.2003, p. 2.

¹⁸⁰ OJ C 6, 10.1.2004, p.22.

¹⁸¹ Attachment EC-1.

purpose

Spain

Real decreto 1274/2003 de 10 de octubre, por el que se modifica el real decreto 442/1994, de 11 de marzo, sobre primas y financiación a la construcción naval" (Royal Decree 442/1994 on 11 March on premiums and financing for shipbuilding, as amended by Royal decree 1274/2003 of 10 October), Art. 9.

7.49 There is a difference in product coverage between these measures in that the French measure is limited to LNG carriers while all other schemes cover container ships, product tankers, chemical tankers and LNG carriers.¹⁸²

7.50 In the proceedings before the Panel, the European Communities indicated that the aid schemes adopted by France and the Netherlands have been extended until 31 March 2005 but that the other three schemes have expired on 31 March 2004.¹⁸³ The European Communities also explained that no application for operating aid could be made after 31 March 2004 in the case of the expired measures and after 31 March 2005 in the case of the two extended national schemes.¹⁸⁴

7.51 Authorization by the European Commission applies to the aid scheme as such, not to the grant of aid in individual cases pursuant to the aid scheme. There is no information before the Panel regarding individual cases of application of the national aid schemes authorized by the Commission.

6. The nature of the TDM Regulation and its relationship with national measures adopted by EC member States

7.52 The parties disagree on the correct characterization of the nature of the TDM Regulation and its relationship with national aid schemes adopted by EC member States. The principal issues that have arisen in this respect are: (i) whether the TDM Regulation is an "authorization" of state aid or a "limitation" on state aid; (ii) whether the measures adopted by EC member States are properly viewed as measures "implementing" the TDM Regulation; and (iii) whether the TDM Regulation constitutes a state aid measure.

7.53 The Panel notes that the TDM Regulation was adopted pursuant to, *inter alia*, Article 87(3)(e) of the EC Treaty. This clause, one of the exemptions from the general prohibition in Article 87(1) of the EC Treaty of state aid that distorts competition and affects trade, provides that the Council may specify categories of aid considered compatible with the common market. The Panel further notes that the kind of aid provided for by the TDM Regulation had been prohibited under Council Regulation 1540/98 as of 1 January 2001. While the TDM Regulation arguably can be regarded as a "limited derogation" from the self-imposed general prohibition on the use of state aid contained in Article 87(1) of the EC Treaty, its legal effect under Community law is to provide the necessary legal basis without which the introduction of new national aid schemes providing for this kind of aid would not have been possible. However, strictly speaking, the term "authorization" may not be accurate insofar as it suggests that the Regulation itself is a sufficient basis to permit member States to introduce such aid schemes. It is clear that the member States cannot without Commission approval adopt these schemes directly on the basis of the TDM Regulation. Similarly, the term "implementation", if used in relation to the aid granted by the member States within the framework of the TDM Regulation, is somewhat lacking in precision in that individual member States are obviously not under any obligation to introduce schemes providing for the kind of operating aid referred to in the TDM Regulation. Finally, as regards the issue of whether the TDM Regulation is a state aid measure, the Panel notes that the TDM Regulation was adopted on the basis of *inter alia* the

¹⁸² Attachment EC-1.

¹⁸³ Response of the European Communities to Panel Question 2.

¹⁸⁴ Response of the European Communities to Panel Question 2.

provisions of the EC Treaty on state aid and that these provisions are the same that formed the legal basis of Council Regulation 1540/98. However, the Panel does not consider that whether or not the TDM Regulation constitutes a state aid measure within the meaning of EC law is of particular relevance to the Panel's analysis of the conformity of this Regulation with WTO provisions.

7.54 Closely related to its argument that Korea misrepresents the nature of the TDM Regulation, the European Communities characterizes the Regulation as not "legally relevant" because it neither provides for nor authorizes the granting of subsidies.¹⁸⁵ In this regard, we note however, that the European Communities does not explain why this would make the TDM Regulation legally irrelevant in the context of WTO dispute settlement. After all, it is the legal authority under which EC member States provide subsidies in certain instances, and the European Communities has indicated that it accepts responsibility for such member State actions. Moreover, it is not in dispute that the TDM Regulation is a measure of the European Communities that is clearly within the Panel's terms of reference. In the Panel's view, although the Regulation may not by itself direct or authorize the EC member States to take certain action, this does not imply that the Regulation cannot be in violation of the WTO Agreement. Whether or not this is the case is an issue that we will address in our findings in light of our analysis of the substance of the claims of Korea.

B. CLAIM UNDER ARTICLE III:4 OF THE GATT 1994

1. Arguments of the parties¹⁸⁶

7.55 **Korea** argues first, that the TDM Regulation is a "law" or "regulation" within the meaning of Article III:4 of the GATT 1994 which affects the internal sale, offering for sale, purchase etc. of imported products because it clearly affects and adversely modifies the conditions of competition between domestic and imported Korean products. Second, the domestic and Korean-origin vessels covered by the TDM Regulation are "like products" for purposes of Article III:4 of the GATT 1994.¹⁸⁷ Third, the TDM contributions clearly reduce opportunities for Korean vessels to compete with EC vessels under equal conditions. Since the contributions are only available in case of vessels built at EC yards they create an incentive for shipowners to place orders with EC shipyards. It is this "artificial incentive to purchase EC origin vessels at the expense of competing Korean like products" that constitutes less favourable treatment of Korean like products.¹⁸⁸ Korea also points to the fact that the TDM Regulation is a narrow trade weapon aimed exclusively at Korea and not a generalized subsidy programme for the benefit of the development of the EC shipbuilding industry.

7.56 In response to the argument of the European Communities that the TDM Regulation is covered by Article III:8(b) of the GATT 1994, Korea submits that it challenges the TDM Regulation as a regulatory framework rather than as a subsidy measure *per se*.¹⁸⁹ As a discriminatory regulatory framework, the TDM Regulation is not covered by Article III:8(b) because it does not actually provide for the payment of subsidies and because it is not a measure that serves the general economic development purposes contemplated by the drafters of Article III:8(b).¹⁹⁰ Korea also rejects the argument of the European Communities that Article III:8(b) is an "exemption" that clarifies that subsidies to producers are not measures affecting the "internal sale, offering for sale, purchase, transportation, distribution or use" of products.¹⁹¹

7.57 The **European Communities** argues that the notion of regulations "affecting the internal sale, offering for sale, purchase, transportation, distribution or use" of imported products does not cover

¹⁸⁵ First submission of the European Communities, p. 31.

¹⁸⁶ For a more detailed account of the arguments of the parties, see Section IV.C.1.

¹⁸⁷ First submission of Korea, paras. 157-162.

¹⁸⁸ First submission of Korea, paras. 163-165.

¹⁸⁹ Oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 60-62.

¹⁹⁰ Second submission of Korea, paras. 200-215.

¹⁹¹ Second submission of Korea, paras. 209-210 and 218.

budgetary aids to producers within the meaning of Article III:8(b) of the GATT 1994 and that the TDM Regulation and national TDM measures are legally excluded from the scope of Article III:4 of the GATT 1994.¹⁹² First, Article III:8(b) clarifies that the national treatment rule in Article III does not require WTO Members to pay domestic subsidies to foreign producers. A subsidy can be inconsistent with Article III:4 only if it discriminates between domestic and foreign producers through differential application of tax measures, internal postal rates, etc.¹⁹³ Second, the TDM Regulation and the national TDM schemes are outside the scope of Article III:4 of the GATT 1994 because they involve the payment of subsidies exclusively to domestic producers. The fact that the aid provided for is not general but temporary and limited to certain sectors does not remove it from the scope of Article III:8(b).¹⁹⁴

7.58 The European Communities argues that Article III:8(b) is an "exemption" rather than an "exception" because it clarifies that subsidies to domestic producers are not "laws, regulations, or requirements affecting the internal sale...of an imported product." The European Communities rejects the argument of Korea that the TDM Regulation is covered by Article III:4 as a discriminatory regulatory framework rather than as a subsidy. In the view of the European Communities, Korea has not established how the Regulation, when viewed as a regulatory framework, affects the internal sale ...of imported products.¹⁹⁵

7.59 **Korea** notes that the fact that vessels are not often "imported" into the European Communities does not prevent the application of Articles III (and I) of the GATT 1994 because these provisions apply regardless of whether the measure in question produces trade effects.¹⁹⁶ In response to a Panel question, Korea argues that the burden is on the European Communities to show that importation of ships is impossible. Nevertheless, Korea submits that it is possible for ships to be imported and that "the general paucity of importation is not the result of a legal bar but, instead, reflects the tendency of ship owners to move to flags of convenience as an economic matter". That ships generally do not enter another Member's customs territory as part of their day-to-day operations of transporting people and goods is quite distinct from the issue of whether they can be imported at the time of initial delivery. Nothing in Articles I and III of the GATT indicates that the drafters intended to exclude ships from these provisions.¹⁹⁷ Korea points out that the European Communities' Combined Nomenclature contains headings for "sea going tankers" and for "sea going other vessels for the transport of goods and other vessels for the transport of both goods and persons", and provides data on the import volume and value recorded by the statistical office of the European Communities for the vessels concerned during the period 1998-2003.¹⁹⁸

7.60 In response to a Panel question, the **European Communities** states that the notion of importation within the meaning of GATT Article I:1 does not apply to the present case because the four types of vessel involved are generally not imported. As confirmed by Article V of the GATT, the customs status of these ships is that of means of transport in transit.¹⁹⁹ The European Communities submits that the existence of headings for ships in the Combined Nomenclature does not automatically mean that ships are cleared through customs because these headings are also applied for the purpose of collecting statistics, and that statistics on imports of ships into the European Communities are not based on customs data but on changes in ownership of ships.

¹⁹² First submission of the European Communities, para. 222.

¹⁹³ First submission of the European Communities, paras.224-228.

¹⁹⁴ First submission of the European Communities, paras. 292-232.

¹⁹⁵ See also second submission of the European Communities, paras. 40-42.

¹⁹⁶ First submission of Korea, para. 149.

¹⁹⁷ Response of Korea to Panel Question 51.

¹⁹⁸ Second submission of Korea, paras. 206-207 and Exhibit Korea 46.

¹⁹⁹ Response of the European Communities to Panel Question 51.

2. Arguments of third parties

7.61 Japan argues that the TDM measures involve "the payment of subsidies exclusively to domestic producers" within the meaning of Article III:8(b) of the GATT 1994 and are therefore not covered by Article III.²⁰⁰

3. Evaluation by the Panel

7.62 Article III:4 of the GATT 1994 provides in relevant part:

"The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

7.63 Article III:4 applies to "the products of the territory of any Member imported into the territory of any other Member..." The Panel notes that in response to a question of the Panel the European Communities has expressed the view that the notion of importation within the meaning of Article I of the GATT 1994 does not apply to the vessels covered by the TDM Regulation because they are treated as means of transport in transit.²⁰¹ The European Communities find support for this position in the provisions on freedom of transit in Article V of the GATT 1994. Although the view of the European Communities specifically refers to the notion of importation under Article I of the GATT 1994, the Panel considers that it is also relevant to Article III which applies to "products...imported into the territory of any other Member". In the view of the Panel, in order to find in a particular case that Article III:4 does not apply because the products in question are not "imported products", it would be necessary to establish that importation of those products is inherently impossible. While the Panel realizes that most ships entering the European Communities carrying goods are in transit and are not formally imported, that does not preclude the possibility of a ship being imported. In this regard, the Panel agrees with Korea that a distinction can be made between entry as part of normal commercial operations and entry at the time of the initial delivery of a vessel. The fact that Article V of the GATT 1994 obligates Members to accord vessels freedom of transit across their territories does not establish that such vessels cannot be imported into the territory of a Member. The Panel notes that in any event the European Communities does not rely on this view regarding the customs status of ships as part of its legal defence against Korea's claims under Article III:4 of the GATT 1994.²⁰²

7.64 In order to establish that a violation of Article III:4 has occurred, it must be demonstrated "that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution or use'; and that the imported products are accorded less favourable treatment than that accorded to like domestic products..."²⁰³

7.65 As to whether the measure at issue accords imported products less favourable treatment, the Panel recalls that, in respect of subsidies, violations of Article III:4 have been found where discrimination between domestic and imported products results from the conditions attached to the

²⁰⁰ Third party submission of Japan, paras. 15-17.

²⁰¹ Responses of the European Communities to Panel question 51.

²⁰² Thus in its comments on the Interim Report, the European Communities observed that "it wishes to clarify that it never defended itself legally by arguing that ships are not imported products within the meaning of Article III:4 of the GATT 1994". Comments of the European Communities on the Interim Report, 13 January 2005, p. 3.

²⁰³ Appellate Body Report, *Korea - Various Measures on Beef*, para. 133.

granting of subsidies.²⁰⁴ This is the case, for example, if a subsidy is granted on the condition that the recipient of the subsidy purchases products of domestic origin, thereby discriminating against the suppliers of the foreign-origin product. Korea's arguments on how the TDM Regulation affects the internal sale...of imported products and accords those products less favourable treatment within the meaning of Article III:4 would however appear to be based on the theory that the state aid provided under the TDM Regulation to Community shipyards adversely affects the conditions of competition between the domestic products produced by Community shipyards and the imported products from Korean yards, rather than on specific conditions linked to the subsidies that reward purchasers/users for discriminating in favour of domestic products.

7.66 However, the European Communities argues that in any event the TDM Regulation is not covered by Article III:4 of the GATT 1994 because the state aid permitted under this Regulation falls within the scope of Article III:8(b) of the GATT 1994.

7.67 Article III:8(b) of the GATT 1994 provides that:

"The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products."²⁰⁵

Article III:8(b) thus clarifies that "the payment of subsidies exclusively to domestic producers" is not to be construed as a breach of the national treatment requirement of Article III. The fact that Article III "shall not prevent" the payment of subsidies that meet the conditions of Article III:8(b) means that if a measure is covered by Article III:8(b), it cannot be inconsistent with any provision in Article III, including Article III:4.²⁰⁶

²⁰⁴ See, e.g. Panel Report in *Indonesia - Autos*, paras. 14.29-14.46.

²⁰⁵ Article III:8(b) of the GATT 1994 is identical to Article 18.8(b) of the Havana Charter for an International Trade Organization. That provision had been added to the draft Charter during the second session of the Preparatory Committee. It was explained during the Havana Conference by the Chairman of a Working Party examining this Article that this sub-paragraph "had been added to the Geneva draft because it was felt that if subsidies were paid on domestic and not on imported products, it might be construed that Members were not applying the 'national treatment' rule. The object of this sub-paragraph, in the view of the United Kingdom delegate, was to make it clear that internal taxes could be entirely non-discriminatory and that subsidies could be paid quite separately to domestic producers from the exchequer." (E/CONF.2/C.3/A/W/49, 10 February 1948, p.2) The sub-paragraph was redrafted at the Havana Conference "in order to make it clear that nothing in Article 18 could be construed to sanction the exemption of domestic products or the remission of such taxes. At the same time, the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of section C of Chapter IV ["Subsidies"]." (United Nations Conference on Trade and Employment, *Reports of Committees and Principal Sub-Committees*, Geneva: Interim Commission for the International Trade Organization, September 1948, p. 66) The drafters of Article 18 of the ITO Charter specifically rejected a proposal by Cuba at the Havana Conference that would have amended the Article to provide that "[t]he provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article 25 ["Subsidies in general"]." (E/CONF.2/C.3/6, 8 December 1947, p. 17.) We note in this regard that the GATT CONTRACTING PARTIES at their Second Session in September 1948 decided to replace the original text of GATT Article III with the text of Article 18 of the Havana Charter *mutatis mutandis*. This change was effected through a Protocol Modifying Part II and Article XXVI, which entered into force on 14 December 1948. The text of Article III has not been amended since the entry into force of that Protocol. See *Guide to GATT Law and Practice* (1995), p. 206.

²⁰⁶ It is not necessary in order to resolve this dispute for the Panel to express an opinion on whether Article III:8(b) is an "exemption", which "clarifies" that Article III is inherently inapplicable to subsidies paid

7.68 Turning to the conditions of Article III:8(b), the "payment of subsidies" "not prevented" by Article III:8(b) only covers subsidies "exclusively to domestic producers" of a given product. We understand this to mean that a subsidy is not inconsistent with Article III:4 merely because it is granted only to domestic producers of a product and not to foreign producers of that product.

7.69 Applying these conditions to the TDM Regulation, the Panel recalls that the TDM Regulation creates the legal basis for the European Commission to authorize the adoption of aid schemes by the member States providing for "direct aid in support of contracts for the building of" container ships, product tankers, chemical tankers and LNG carriers, i.e. state aid to member State producers of these products. The availability of the state aid only to domestic producers of certain vessels²⁰⁷ but not to foreign producers of those vessels is precisely the kind of different treatment that is covered by Article III:8(b) and thus not inconsistent with Article III.

7.70 The Panel is not persuaded by Korea's argument that Article III:8(b) is not relevant to this case because Korea challenges the TDM Regulation as a discriminatory regulatory framework, rather than the subsidies as such. In particular, Korea's claim that the TDM Regulation as such is inconsistent with Article III:4 of the GATT 1994 is based on the subsidies that can be provided within the framework of that Regulation. The "discriminatory" character of the "regulatory framework" alleged by Korea consists of the impact of the subsidies authorized by that Regulation on price competition between Community yards and Korean yards. Since the subsidies paid under the framework are covered by Article III:8(b), however, the "regulatory framework" within which these subsidies are provided cannot be inconsistent with Article III:4 of the GATT 1994.

7.71 Korea, referring to *Canada – Periodicals*, argues that since the TDM Regulation itself does not involve an actual outlay of funds it cannot be covered by Article III:8(b).²⁰⁸ The Panel does not consider *Canada – Periodicals* to be relevant to this dispute, however. What matters in the Panel's view is not whether the TDM Regulation itself involves outlays of funds by governments, but rather that the measures provided for under the TDM Regulation, state aids, are outlays of funds by governments.

7.72 Korea also argues that the TDM Regulation is not covered by Article III:8(b) because the subsidies it provides for are not general in nature. The Panel, however, can see no basis in the text of Article III:8(b) for the proposition that its applicability depends not only upon whether a measure constitutes "the payment of subsidies exclusively to domestic producers", but also upon whether that measure serves "the general public purposes of economic development".²⁰⁹ The Panel also notes that Korea has failed to explain how this argument is supported by the text, context or object and purpose of Article III:8(b).

7.73 The Panel notes that Korea argues, although not specifically in connection with Article III:8(b), that the formal recipient of the subsidies provided for under the TDM Regulation is irrelevant because the ultimate beneficiary of the subsidy is the ship-owner. The Panel can find no textual support in Article III:8(b) for the view that a distinction must be made, for purposes of application of that provision, between the "formal recipient" and the "ultimate beneficiary" of a subsidy solely on the grounds that the subsidy allows the producer to sell a product at a lower price.

exclusively to domestic producers, or an "exception", which removes from the scope of Article III:4 measures that would otherwise be covered by that provision.

²⁰⁷ As confirmed by WTO and GATT dispute settlement reports, Article III:8(b) does not apply to the payment of subsidies to processors or users of the product with respect to which discrimination is alleged. E.g. Panel Report, *Indonesia – Autos*, para. 14.43; Panel Report, *EEC – Oilseeds I*, para. 137; Panel Report, *Italy – Agricultural Machinery*, para. 14. In the Panel's view, Korea has not submitted arguments and evidence to contest the fact that the TDM Regulation provides for aid only to producers of the product with respect to which discrimination is alleged.

²⁰⁸ Korea refers to the Appellate Body Report in *Canada – Periodicals*, p. 33.

²⁰⁹ Second submission of Korea, para. 215.

Indeed, were such a price effect a sufficient basis to conclude that a subsidy is not a "payment of subsidies exclusively to domestic producers", Article III:8(b) would be deprived of its effectiveness as production subsidies can have such an effect in many instances.

7.74 In short, while the Panel realizes that the state aid provided for by the TDM Regulation may adversely affect the conditions of competition between domestic and Korean products, that effect is not relevant to whether Article III:8(b) applies to the aid.

7.75 The Panel **concludes** that the state aid provided for by the TDM Regulation is covered by Article III:8(b) of the GATT 1994 and that, as a consequence, the TDM Regulation is not inconsistent with Article III:4 of the GATT 1994. Therefore, the Panel also **concludes** that the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain and the Decisions of the European Commission authorizing those schemes, are not inconsistent with Article III:4 of the GATT 1994.

C. CLAIM UNDER ARTICLE I OF THE GATT 1994

1. Arguments of the parties²¹⁰

7.76 In support of its claim that the TDM Regulation is inconsistent with Article I:1 of the GATT 1994, **Korea** submits three main arguments. First, the TDM Regulation is covered by the phrase "all matters referred to in paragraphs 2 and 4 of Article III" in Article I:1 because it is a measure affecting the "internal sale, offering for sale, purchase, transportation, distribution or use" of imported products within the meaning of Article III:4.²¹¹ Second, the TDM Regulation grants an advantage, favour, privilege or immunity within the meaning of Article I:1 to certain WTO Members in respect of the commercial vessels within its scope. Specifically, the TDM Regulation "grants Japanese and other non-Korean yards and vessels the advantage or favour of being able to trade on equal terms with EC competitors without the prospect of provoking reprisals or countermeasures in the form of TDM contributions to the competitors".²¹² Third, the advantage granted by the TDM Regulation in respect of the container ships, product and chemical tankers and LNG carriers of certain WTO Members is not accorded immediately and unconditionally to like vessels originating in Korea. Korea submits that the TDM Regulation amounts to *de jure* discrimination.²¹³

7.77 The **European Communities** argues that the TDM Regulation is not within the scope of Article I:1 of the GATT 1994 because subsidization is not an "advantage" covered by Article I:1.²¹⁴ Article I:1 cannot apply to the TDM Regulation because Article III:8(b), which exempts the TDM Regulation from Article III:4, thereby also removes the Regulation from the scope of "all matters referred to in paragraphs 2 and 4 of Article III".²¹⁵ For the same reason, the fact that the TDM Regulation targets Korea is not a basis for finding a violation of the MFN clause in Article I:1 of the GATT 1994. Apart from the fact that the TDM subsidies will in many cases affect competitors from other countries, the targeting of Korea results from the non-implementation by Korea of the Agreed Minutes. Article I:1 of the GATT 1994 is not a general prohibition of discrimination between WTO Members and cannot prohibit such measures if they are not advantages within the meaning of that provision.²¹⁶

²¹⁰ For a more detailed account of the arguments of the parties see Section IV.C.2.

²¹¹ First submission of Korea, para. 177; response of Korea to Panel Question 56; second submission of Korea, para. 224.

²¹² First submission of Korea, para. 181; second submission of Korea, para. 221.

²¹³ First submission of Korea, paras. 187-191.

²¹⁴ First submission of the European Communities, para. 238.

²¹⁵ First submission of the European Communities, para. 239.

²¹⁶ First submission of the European Communities, para. 242. See also the response of the European Communities to Panel Question 53.

7.78 **Korea** rejects the defence of the European Communities based on Article III:8(b). According to Korea, this provision is irrelevant because, firstly Korea does not challenge the TDM Regulation as a subsidy but as a regulatory framework, and, secondly, Article III:8(b) is expressly limited to the provisions of Article III. In Korea's view, the matters "referred to" in paragraphs 2 and 4 of Article III are the matters "mentioned" in those paragraphs, including "all laws, regulations and requirements affecting...", regardless of whether they are subject to the obligations of Article III. Korea also submits that there was no reason for the drafters of the GATT to permit discrimination between products of different countries in the provision of subsidies to domestic producers.²¹⁷ The **European Communities** submits that it is irrelevant for purposes of Article III:4 that Korea challenges the TDM Regulation not as a subsidy but as a regulatory measure²¹⁸, and that Korea misconstrues the relationship between Articles III:8(b) and I:1 of the GATT 1994. According to the European Communities, Article III:8(b) is not an "exception" but an "exemption" in that it clarifies that the granting of a subsidy to a domestic producer from budgetary resources is not a regulatory requirement affecting the sale of that product.²¹⁹

2. Evaluation by the Panel

7.79 Article I:1 of the GATT 1994 provides:

"With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,^{*220} any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members."

In order to determine whether a measure is inconsistent with the most-favoured-nation (MFN) treatment required by Article I:1, it must first be established that that measure is covered by the subject matter of that clause. Korea argues that the TDM Regulation results in a denial of MFN treatment to imported Korean products in that bids by Korean shipyards will lead to the granting of subsidies to Community shipyards that compete with the Korean shipyards whereas bids by shipyards of countries other than Korea will not lead to the granting of such subsidies. We must determine, therefore, whether the provision of the subsidies referred to in the TDM Regulation falls within the subject matter of Article I:1.

7.80 Article I:1 of the GATT 1994 applies to: (i) "customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of

²¹⁷ Oral statement of Korea at the first meeting, paras. 60-67; second submission of Korea, paras. 216-219.

²¹⁸ Response of the European Communities to Panel Question 55.

²¹⁹ Response of the European Communities to Panel Question 54.

²²⁰ Ad Article I:1 of the GATT 1994 reads as follows:

"The obligations incorporated in paragraph 1 of Article I by reference to paragraphs 2 and 4 of Article III and those incorporated in paragraph 2(b) of Article II by reference to Article VI shall be considered as falling within Part II for the purposes of the Protocol of Provisional Application.

The cross-references, in the paragraph immediately above and in paragraph 1 of Article I, to paragraphs 2 and 4 of Article III shall only apply after Article III has been modified by the entry into force of the amendment provided for in the Protocol Modifying Part II and Article XXVI of the General Agreement on Tariffs and Trade, dated September 14, 1948." [footnote omitted.]

payments for imports or exports"; (ii) "the method of levying such duties and charges"; (iii) "all rules and formalities in connection with importation and exportation"; and (iv) "all matters referred to in paragraphs 2 and 4 of Article III".

7.81 Korea claims that the TDM Regulation is a measure within the scope of Article III:4 of the GATT 1994 which is thereby subject to Article I:1 by virtue of the phrase "all matters referred to in paragraphs 2 and 4 of Article III".²²¹ We recall, however, that we have concluded that the TDM Regulation is a measure that falls within the scope of Article III:8(b) of the GATT 1994 because it provides for "the payment of subsidies exclusively to domestic producers" and that the TDM Regulation is therefore not inconsistent with Article III:4. In that connection, we have rejected the argument of Korea that since Korea challenges the TDM Regulation as a regulatory framework, Article III:8(b) is irrelevant. The question that is now before us is whether our conclusion that the TDM Regulation is covered by Article III:8(b) and hence not inconsistent with Article III:4 means that the TDM Regulation is also outside the scope of the MFN obligation in Article I:1 as applied to "all matters referred to in paragraphs 2 and 4 of Article III".

7.82 It should be emphasized that the issue here is not whether Article III:8(b) somehow affects the scope of Article I in its entirety. Rather, the question is limited to whether and if so how Article III:8(b) affects the scope of "all matters referred to in paragraphs 2 and 4 of Article III". In this connection, the argument of Korea that Article III:8(b) only refers to "the provisions of this Article" and therefore does not apply to Article I is unpersuasive. To the extent that Article III:8(b) plays a role in determining the scope of the matters referred to in Article III:2 and III:4, a direct reference to Article I is not necessary.

7.83 In considering whether Article III:8(b) affects the meaning of "all matters referred to in paragraphs 2 and 4 of Article III" in Article I, we note that Articles III:2 and 4 lay down substantive legal obligations. In light of this use of the word "matters" to refer to provisions containing legal obligations, we consider that among the various dictionary definitions, "subject" and "substance" are particularly pertinent to define the meaning of the word "matters" as used in Article I:1.²²² Therefore, interpreting the ordinary meaning of the terms used in their context, the Panel considers that the phrase "matters referred to in..." in Article I:1 refers to the subject matter of those provisions in terms of their substantive legal content. Understood in this sense, it is clear to us that the "matters referred to in paragraphs 2 and 4 of Article III" cannot be interpreted without regard to limitations that may exist regarding the scope of the substantive obligations provided for in these paragraphs. If it is explicitly provided that a particular measure is not subject to the obligations of Article III, that measure in our view does not form part of the "matters referred to" in Articles III:2 and 4. Thus, since Article III:8(b) provides that Article III "shall not prevent the payment of subsidies exclusively to domestic producers", such subsidies are not part of the subject matter of Article III:4²²³ and cannot be covered by the expression "matters referred to in paragraphs 2 and 4 of Article III" in Article I:1.

7.84 Therefore, the Panel considers that Korea's argument that "matters referred to..." means the "measures mentioned" in Articles III:2 and 4, including measures explicitly not subject to the obligations of those provisions, is unsupported by the text and context of the phrase "all matters referred to in paragraphs 2 and 4 of Article III". Nor can we find support for this proposed interpretation in the supplementary means of treaty interpretation invoked by Korea. If anything, those supplementary means suggest the opposite.

²²¹ See, e.g., first submission of Korea, para. 176; response of Korea to Panel Question 56; second submission of Korea, para. 224.

²²² *The New Shorter Oxford English Dictionary* (1993), p.1717.

²²³ We recall that we do not express a view on whether Article III:8(b) must be characterized as an "exemption" or "exception".

7.85 In support of its reading of "all matters referred to in paragraphs 2 and 4 of Article III", Korea argues that this phrase was inserted during the Geneva Session of the ITO Preparatory Committee in 1947 in order to extend the grant of MFN treatment to all matters dealt with in those paragraphs regardless of whether national treatment is provided for in respect of such matters.²²⁴ We note in this respect that during that session of the ITO Preparatory Committee the United States made a proposal to amend the text of what was then draft Article 14 (general most-favoured-nation treatment) of the ITO Charter by replacing the phrase "with respect to all matters in regard to which national treatment is provided for in Article 15" (national treatment) with "with respect to all matters referred to in paragraphs 1,2,3, and 4 of Article 15". The explanation of this proposal was:

"The changes proposed in line 8 of paragraph 1 are designed to extend the grant of most-favoured-nation treatment to all matters dealt with in Article 15 (except governmental operations under paragraph 5 of Article 15) regardless of whether national treatment is provided for in respect of such matters."²²⁵

The statement thus makes it clear that the proposed drafting change would apply the MFN clause to "all matters referred to in paragraphs 1,2,3 and 4 of Article 15" but not to "governmental operations under paragraph 5 of Article 15". At the time the United States made this proposal, paragraph 5 of Article 15, which eventually became paragraph 8 of Article 18 of the Havana Charter and of Article III of the GATT, provided that the national treatment obligations would not apply to government procurement.²²⁶ The statement of the delegate of the United States made it clear that under the proposed amendment to Article 14, the MFN clause would not apply to "governmental operations" that were explicitly removed from the scope of the national treatment clause under paragraph 5 of Article 15. Therefore, we fail to see how this statement can support the position taken by Korea in this dispute that a measure expressly removed from the scope of the national treatment obligation in Article III can nevertheless be among the "matters referred to in paragraphs 2 and 4 of Article III".

7.86 It is noteworthy in this regard that in a discussion on draft Article 18.8(a) of the Havana Charter corresponding to Article III:8(a), it was observed at a meeting in February 1948 that:

"...the Sub-Committee had considered that the language of paragraph 8 would except from the scope of Article 18 [national treatment] and hence from Article 16 [MFN

²²⁴ First submission of Korea, para. 176.

²²⁵ United Nations Economic and Social Council, Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, E/PC/T/W/146 (30 May 1947). The statement in the *Guide to GATT Law and Practice*, Vol. I (1995), p.30, referred to by Korea in support of its argument contains an incomplete quotation: "This phrasing was inserted during the Geneva session of the Preparatory Committee in 1947, in order 'to extend the grant of most-favoured-nation treatment to all matters dealt with in [these paragraphs] regardless of whether national treatment is provided for in respect of such matters.' "

²²⁶ The proposal of the United States was made in May 1947. Shortly thereafter, it was suggested to expand paragraph 5 to exclude subsidies to domestic producers from the scope of the national treatment article. Thus paragraph 5 of the draft national treatment article (18) resulting from the Geneva Session of the ITO Preparatory Committee provided as follows:

"The provisions of this Article shall not apply to the procurement by governmental agencies of products purchased for governmental purposes and not for resale or use in the production of goods for sale, nor shall they prevent the payment to domestic producers only of subsidies provided for under Article 25, including payments to domestic producers derived from the proceeds of internal taxes or charges and subsidies effected through governmental purchases of domestic products."

Report of the Second session of the Preparatory Committee of the United Nations Conference on Trade and Employment, E/PC/T/186 (10 September 1947), p. 19.

treatment], laws, regulations and requirements governing purchases effected for governmental purposes where resale was only incidental...".²²⁷

This clearly suggests that negotiators understood that the reference to government procurement in Article 18.8(a) would also apply in the context of the MFN clause (Article 16).

7.87 Thus the relevant drafting history that we are aware of shows that the exclusion of government procurement from the national treatment article would also apply to the MFN clause. Given that the reference to "the payment of subsidies paid exclusively to domestic producers" appeared in the same paragraph as the reference to government procurement, the logical implication is that the drafters also intended to remove such subsidies from the application of the MFN clause to internal measures.

7.88 We also note the argument of Korea that "GATT practice and panels" provide support for its interpretation of how Article I:1 applies to internal taxation and regulation covered by Article III.²²⁸ The factual basis for this assertion is unclear. Korea does not refer to specific GATT/WTO dispute settlement reports to substantiate this assertion. While there would appear to have been no panel report that directly addresses this issue in respect of Article III:8(b), the Report of the Panel on Complaints in *Belgian Family Allowances* is relevant to the issue of whether Article III:8(a) limits the scope of "all matters referred to in paragraphs 2 and 4 of Article III" for the purposes of Article I:1.

7.89 The measure at issue in that case was a levy charged by Belgium on foreign products purchased by public bodies when the products originated in a country whose family allowance did not meet certain requirements. The Panel first determined that the levy was an internal charge within the meaning of Article III:2 of the GATT and then found that the levy was subject to Article I:1 as a matter referred to in paragraph 2 of Article III. Since Belgium had granted exemptions from this levy to certain countries, it was required to extend this advantage unconditionally to other GATT Contracting Parties. In this respect, the Panel considered, but rejected, the application of Article III:8(a) as follows:

"The Panel did not feel that the provisions of paragraph 8 (a) of Article III were applicable in this case as the text of the paragraph referred only to laws, regulations and requirements and not to internal taxes and charges."²²⁹

If the Panel had considered that the phrase "all matters referred to in paragraphs 2 and 4 of Article III" in Article I:1 applies to any measure in the field of internal taxation and regulation, irrespective of whether the national treatment obligation applies to such measure, it would not have been necessary for the Panel to consider the applicability of Article III:8(a) to the facts of this particular case. The fact that the Panel considered it necessary to state that Article III:8(a) was not applicable to this case because this provision only deals with laws, regulations and requirements and not with internal taxes and charges clearly suggests that the Panel was of the view that Article III:8(a) would remove from the scope of Article I:1 a measure relating to government procurement in the form of law, regulation or requirement.

7.90 Therefore, to the extent that there exists relevant GATT/ITO drafting history and GATT practice, it confirms our understanding that "matters referred to in paragraphs 2 and 4 of Article III" should be construed in light of the scope of the substantive obligations in those provisions. The

²²⁷ United Nations Conference on Trade and Employment, Third Committee: Commercial Policy, Summary Record of the Forty-First Meeting, E/CONF.2/C.3/SR.41 (23 February 1948), p. 3. (Emphasis added)

²²⁸ First submission of Korea, para. 176.

²²⁹ Panel Report, *Belgium - Family Allowances*, para. 4. The Panel notes that the text of Article III:8(a) of the GATT 1994 is identical to the text of Article III:8(a) of the GATT 1947 examined in the *Belgian Family Allowances* dispute.

payment of subsidies exclusively to domestic producers is not a "matter referred to in paragraphs 2 and 4 of Article III" because it is excluded from the subject matter of Article III as a whole. Since we have concluded that the TDM Regulation is covered by Article III:8(b), we find that the TDM Regulation is not a measure falling within the scope of the subject matter of Article I:1 of the GATT 1994. Thus the question whether and how this measure results in different treatment of imported products of different countries does not arise.

7.91 The Panel **concludes** that the TDM Regulation is not inconsistent with Article I:1 of the GATT 1994. It follows that the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain, and the Decisions of the European Commission authorizing those schemes, are also not inconsistent with Article I:1 of the GATT 1994.

D. CLAIM UNDER ARTICLE 32.1 OF THE SCM AGREEMENT

7.92 The Panel will first consider whether the TDM Regulation is a "specific" action within the meaning of Article 32.1 of the SCM Agreement before turning to the question of whether it is action "against" a subsidy of another Member.

1. Whether the TDM Regulation constitutes "specific" action within the meaning of Article 32.1 of the SCM Agreement

(a) Arguments of the parties²³⁰

7.93 **Korea** argues that the TDM Regulation is "specific" action within the meaning of Article 32.1 of the SCM Agreement, as that term has been interpreted by the Appellate Body²³¹, because the TDM measures "are inextricably linked to or have a strong correlation with the constituent elements of a subsidy". While the TDM Regulation does not expressly refer to "the constituent elements of a subsidy", these elements can be derived from other evidence and are implicit in the TDM Regulation.²³²

7.94 Korea argues that, since "adverse effects" and "serious prejudice" are concepts under Articles 5 and 6 of the SCM Agreement that refer to situations where subsidies within the meaning of Article 1 of that Agreement are generating such effects and which have no meaning under EC law independent of their use under the SCM Agreement, the fact that the TDM Regulation provides that aid may be provided in those sectors of the EC shipbuilding industry that have suffered "adverse effects" such as "material injury" and "serious prejudice" caused by "unfair Korean practices" necessarily implies a determination that the constituent elements of a subsidy are present. Related to this, Korea refers to the fact that the evidence on the existence of those "adverse effects" was based on findings made by the European Commission in an investigation under the European Communities' Trade Barriers Regulation that certain subsidies granted by Korea had caused material injury and serious prejudice.²³³

²³⁰ For a more detailed account of the arguments of the parties, see Section IV.C.3.

²³¹ First submission of Korea, para. 105.

²³² First submission of Korea, paras. 106-117; oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 27-29; responses of Korea to Panel Questions 34, 37, 38 and 39; second submission of Korea, paras. 35-81, 142 and 155.

²³³ First submission of Korea, paras. 108-114; response of Korea to Panel Question 37; second submission of Korea paras. 71-78. Korea refers to reports submitted by the Commission to the EC Trade Barriers Regulation Committee in May 2001, July 2001, May 2002 and (with respect to LNG carriers) June 2003, and cites the finding in the May 2001 Report, confirmed in the subsequent reports, that export-contingent subsidies granted by Korea are causing adverse effects to the Community industry. First written submission of Korea, paras. 109-112; second submission of Korea, paras. 75-79; Exhibit Korea- 6.

7.95 Korea argues that Recital 7 and Article 4 of the TDM Regulation, which provide that the TDM will be coterminous with the WTO case launched by the EC against Korea, demonstrate that the measures of Korea that are the subject of the dispute settlement case are the same measures that prompted adoption of the TDM Regulation.²³⁴ Korea submits that the existence of a link between the TDM Regulation and the constituent elements of a subsidy is also demonstrated by various Commission press releases and memoranda indicating that, as part of a "twin-track" strategy to respond to alleged Korean subsidies, the TDM Regulation was designed to accompany a WTO dispute settlement proceeding against Korea.²³⁵

7.96 Korea submits that the TDM Regulation itself is specific because it is premised on the conclusion drawn by the European Commission regarding the existence of subsidies provided by Korea and is legally dependent upon the WTO dispute settlement. Consequently, it is without relevance that individual payments of subsidies are not actually subject to a finding of subsidization.²³⁶ In any event, it is factually incorrect that the TDM Regulation does not establish a link with the existence of subsidization in its operative part because the Regulation legally binds its duration to the WTO dispute settlement proceeding instituted by the European Communities with respect to alleged Korean subsidies.²³⁷

7.97 Korea submits that the Agreed Minutes between the European Community and Korea relating to the world shipbuilding market ("Agreed Minutes") encapsulated an understanding relating to the application of the SCM Agreement to the shipbuilding sector. The Agreed Minutes did not contain a commitment on the part of Korea to impose price controls on exports to end dumping.²³⁸ Korea only committed to refrain from granting subsidies and to continue implementing internationally recognized accounting principles.²³⁹ Korea argues that the relationship established in Article 4 of the TDM Regulation between the effective implementation of the Agreed Minutes and the possible solution or suspension of the WTO case demonstrates that the Agreed Minutes are the subject of the WTO dispute settlement proceedings.²⁴⁰ Korea argues that even assuming *arguendo* that "unfair practices" referred to injurious pricing as a problem which is broader in scope than subsidization, the TDM Regulation would still be specific because a measure does not have to be exclusively restricted to the constituent elements of a subsidy to be specific.²⁴¹

7.98 The **European Communities** submits that the TDM Regulation is not a "specific" action against a subsidy of another Member, as that term has been interpreted by the Appellate Body²⁴², because there is no inextricable link, implicit or explicit, between the TDM Regulation and the constituent elements of a subsidy. In order for an action to be specific, a particular subsidy must be targeted²⁴³ and a specific determination must be made that a subsidy exists.²⁴⁴ The Appellate Body

²³⁴ First submission of Korea, paras. 116-117; oral statement of Korea at first meeting, paras. 33-37; responses of Korea to Panel Questions 34 and 35.

²³⁵ First submission of Korea, paras. 113-114; oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 27-29; second submission of Korea, paras. 35-61.

²³⁶ Oral statement of Korea at the first substantive meeting of the Panel with the parties, para. 51; second submission of Korea, para. 168.

²³⁷ Second submission of Korea, para. 169.

²³⁸ Oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 5, 30-33 and 71.

²³⁹ Response of Korea to Panel Questions 44-45.

²⁴⁰ Oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 34-35.

²⁴¹ Second submission of Korea, paras. 170-176.

²⁴² First submission of the European Communities, paras. 185-187.

²⁴³ Oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 21.

²⁴⁴ Oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 21.

has confirmed this understanding of the meaning of "specific" action when referring to measures "that may be taken only where the constituent elements of [a subsidy] are present."²⁴⁵

7.99 The European Communities contends that the language in the Recitals of the TDM Regulation cited by Korea only serves to motivate the limitation of the scope of the TDM Regulation to market segments where the Commission has found the existence of adverse effects and injury caused by "unfair practices".²⁴⁶ The expression "unfair practices" does not demonstrate a link with a finding of subsidies, but encompasses the problem of injurious pricing, which is significantly broader in scope than subsidization and refers to the conduct of individual shipyards.²⁴⁷

7.100 In the latter regard, the European Communities argues that the principal motivation for the adoption of the TDM Regulation is the non-implementation by Korea of the Agreed Minutes.²⁴⁸ The Agreed Minutes go beyond the SCM Agreement in that they acknowledge that lower prices by Korean shipyards are due not only to subsidization but also to inadequate accounting and financial responsibility rules and to below cost pricing resulting from cross-subsidization of export sales by domestic sales, which can be completely independent of any government subsidies.²⁴⁹ The European Communities rejects Korea's characterization of the Agreed Minutes as an understanding regarding the interpretation of the SCM Agreement.²⁵⁰ The European Communities also rejects the argument of Korea that the Agreed Minutes concern the subsidies at issue in the WTO dispute settlement case brought by the European Communities against Korea. The European Communities submits in this respect that the discretion provided to the Commission to suspend the WTO proceeding in case the Agreed Minutes had been implemented was meant to create an incentive for Korea "to come back to the negotiating table in the framework of the Agreed Minutes."²⁵¹

7.101 The European Communities argues that the TBR Report cited by Korea cannot constitute a determination of the existence of the constituent elements of a subsidy as it is merely an internal working document of the Commission without any legal effect and that the formal decision of the Commission of 8 October 2002 on the outcome of this investigation only announced that there was sufficient evidence to warrant initiation of a WTO case.²⁵² The TDM Regulation uses the findings of injury and serious prejudice and links them more broadly to the failure of Korea to implement the Agreed Minutes.²⁵³ According to the European Communities, this link between the TDM Regulation and the findings made in the Trade Barriers Regulation investigation is of a purely political nature.²⁵⁴

7.102 The European Communities argues that the choice of the WTO dispute settlement proceeding as one of the criteria to limit the temporal scope of the TDM Regulation was "politically motivated" in that it sought to clarify that the previously abolished state aid would not be generally reintroduced. The link with the WTO dispute settlement case established an "objective" criterion in the sense that

²⁴⁵ First submission of the European Communities, para. 185; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 22.

²⁴⁶ First submission of the European Communities, paras. 194 and 200; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 29.

²⁴⁷ First submission of the European Communities, para. 195.

²⁴⁸ First submission of the European Communities, para. 196.

²⁴⁹ First submission of the European Communities, para. 196; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, paras. 26-27.

²⁵⁰ First submission of the European Communities, paras. 154-155.

²⁵¹ Responses of the European Communities to Panel Question 15.

²⁵² First submission of the European Communities, para. 198.

²⁵³ First submission of the European Communities, para. 198.

²⁵⁴ First submission of the European Communities, para. 199.

expiration of the TDM Regulation was made dependant upon an event external to the European Communities.²⁵⁵

7.103 The European Communities submits that whether the TDM Regulation is specific must be established on the basis of the operative part of the Regulation and not on the basis of the motives mentioned in the Recitals or accompanying political statements accompanying its adoption. The conditions defined in the operative part of the TDM Regulation are not inextricably linked to the constituent elements of a subsidy. An analysis of the relevant operative provision- Article 2(1) of the TDM Regulation- shows that: (i) aid can be granted under the TDM Regulation against an offer from any Korean shipyard regardless of whether that yard benefits from subsidies; (ii) aid can be granted against any competition from Korea without the need to determine to what extent the price of the Korean offer is lower and whether that lower price is due to subsidization or unfair pricing; (iii) the TDM Regulation by itself does not result in any payments; and (iv) there is no relationship between the fixed amount of 6 per cent contract-related aid and any actual undercutting by a Korean bid or even the undercutting margins found in the TBR investigation. Thus contrary to the situation in *US-Offset Act (Byrd Amendment)*, the payment of aid under the national TDM measures cannot be made only following a determination that the constituent elements of a subsidy are present but in any situation involving competition from a Korean shipyard offering a lower price, irrespective of whether that shipyard has received subsidies.²⁵⁶

(b) Arguments of third parties

7.104 The United States argues that the Appellate Body Reports in *US - Offset Act (Byrd Amendment)* and *US - 1916 Act* indicate that the coverage of Article 32.1 of the SCM Agreement is not limited to measures that may be taken "only" when the constituent elements of a subsidy are present. The United States also submits that specific action against a subsidy is not limited to actions that deal exclusively with subsidization. Finally, the United States considers that the European Communities provides no support for its assertion that whether the TDM Regulation is specific action against a subsidy must be established on the basis of the operative part of the TDM Regulation and that in any event the reasons cited by the European Communities as to why Article 2.1 of the TDM Regulation does not contain an inextricable link with the constituent elements of a subsidy are unconvincing.²⁵⁷

7.105 **China** submits that the scope of the phrase "specific action against a subsidy" is not confined to measures that may be taken only when the constituent elements are present. In light of the criteria formulated by the Appellate Body, the TDM Regulation is specific because of the relationship between the scope of application of the TDM Regulation and the constituent elements of a subsidy. In this respect, it is irrelevant that the granting of state aid in individual cases does not require a determination of the existence of a subsidy.²⁵⁸

(c) Evaluation by the Panel

7.106 Article 32.1 of the SCM Agreement provides:

"No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement."

A footnote (56) to this sentence provides:

²⁵⁵ First submission of the European Communities, para. 147; response of the European Communities to Panel Question 11; second submission of the European Communities, para. 59.

²⁵⁶ First submission of the European Communities, paras. 201-207; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, paras. 31-36.

²⁵⁷ Third party submission of the United States, paras. 4, 9 and 10.

²⁵⁸ Oral statement of China at the first substantive meeting of the Panel with the parties, paras. 4-6.

"This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate."

7.107 The question addressed by the Panel in this section of its report is whether the measures at issue constitute "specific" action within the meaning of Article 32.1.

7.108 The Panel notes that the parties to the dispute base their arguments on the meaning of "specific action against a subsidy of another Member" on the analysis of the Appellate Body in *US - 1916 Act* and *US - Offset Act (Byrd Amendment)*.²⁵⁹ While they differ in their interpretation of the exact meaning of some of the statements made by the Appellate Body, they clearly accept the Appellate Body's general approach in those cases.

7.109 The Appellate Body first elaborated its views as to the interpretation of "specific" action in Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement in *US - 1916 Act*. In that dispute, the Appellate Body stated that:

"In our view, the ordinary meaning of the phrase 'specific action against dumping' of exports within the meaning of Article 18.1 is action that is taken to respond to the constituent elements of 'dumping'. 'Specific action against dumping' must, at a minimum, encompass action that may be taken only when the constituent elements of 'dumping' are present."⁶⁶

⁶⁶ We do not find it necessary, in the present case, to decide whether the concept of 'specific action against dumping' may be broader."²⁶⁰

Thus, the Appellate Body tells us in *US - 1916 Act* that there is "specific action" in respect of dumping (or subsidization) *at a minimum* where, as in that case, action could be taken only where the constituent elements of dumping (or subsidization) are present. As this was all that was necessary to decide that case, the Appellate Body explicitly did not go further to examine whether the outer boundary of the phrase extended further.

7.110 In *US - Offset Act (Byrd Amendment)*, the Appellate Body explained and further developed its interpretation of the concept that there must be a "specific action". The Appellate Body stated that:

"We recall that, in *US - 1916 Act*, the United States argued that the 1916 Act did not fall within the scope of Article VI of the GATT 1994 because it targeted predatory pricing, as opposed to dumping. We disagreed, and determined that the 1916 Act was a 'specific action against dumping' because the constituent elements of dumping were 'built into' [Footnote omitted] the essential elements of civil and criminal liability under the 1916 Act. We also found that the 'wording of the 1916 Act ... makes clear that these actions can be taken *only* with respect to conduct which presents the constituent elements of 'dumping'." [Footnote omitted] Accordingly, a measure that may be taken only when the constituent elements of dumping or a subsidy are present, is a 'specific action' in response to dumping within the meaning of Article 18.1 of the *Anti-Dumping Agreement* or a 'specific action' in response to subsidization within the meaning of Article 32.1 of the *SCM Agreement*. In other words, the measure must be inextricably linked to, or have a strong correlation with,

²⁵⁹ See, e.g., first submission of Korea, paras. 103-104; first submission of the European Communities, paras. 183-192.

²⁶⁰ Appellate Body Report, *US - 1916 Act*, para. 122.

the constituent elements of dumping or of a subsidy. Such link or correlation may, as in the 1916 Act, be derived from the text of the measure itself."²⁶¹

7.111 In *US – Offset Act (Byrd Amendment)*, the Appellate Body therefore provides a clear and explicit explanation of the nature of the link that must exist between a measure and the "constituent elements of dumping or of a subsidy" in order for the measure to constitute a "specific action" related to dumping or subsidization. Specifically, the measure must "be inextricably linked to, or have a strong correlation with, the constituent elements of dumping or a subsidy."²⁶²

7.112 With respect to how to examine whether this test is met, the Appellate Body observed in *US – Offset Act (Byrd Amendment)* that the criterion articulated in *US-1916 Act*

"...is not whether the constituent elements of dumping or of a subsidy are explicitly referred to in the measure at issue, nor whether dumping or subsidization triggers the application of the action, nor whether the constituent elements of dumping or of a subsidy form part of the essential components of the measure at issue".²⁶³

Rather, this test may be met where the constituent elements of dumping or of a subsidy "are implicit in the express conditions for taking such action".²⁶⁴

7.113 In light of the foregoing, the task before this Panel is to consider whether the TDM is inextricably linked to, or has a strong correlation with, the constituent elements of a subsidy.²⁶⁵

7.114 It is clear that the TDM Regulation is a measure adopted by the Council of the European Union in response to certain conduct of the Government of Korea and practices of Korean shipyards. The rationale of the TDM Regulation, as expressed in the introductory Recitals, can be summarized as follows: as a consequence of Korea's failure to implement the Agreed Minutes, and in order to assist those segments of the Community shipbuilding industry that have suffered adverse effects in the form of material injury or serious prejudice due to unfair Korean competition or practices, it is necessary to establish a temporary defensive mechanism in the form of operating aid aimed at enabling Community shipyards to overcome Korean competition. State aid can be authorized on the basis of the TDM Regulation only when there is competition from Korea.

7.115 While the TDM Regulation is clearly directed at Korea, neither the operative part nor the explanatory Recitals of the TDM Regulation refer explicitly to subsidies. According to Article 2 (1) of the TDM Regulation, state aid may be provided "when there has been competition for the contract from a Korean shipyard offering a lower price". Moreover, the introductory Recitals of the TDM Regulation refer to: "fair and transparent competitive conditions" (Recital (1)); "ensuring an effective price surveillance mechanism" (Recital (1)); "competition not respecting normal competitive conditions" (Recital (2)); "adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition" (Recitals (3) and (4)); "material injury and serious prejudice...caused

²⁶¹ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 242.

²⁶² The Appellate Body further explained that the role of footnote 56 to Article 32.1 is to confirm that an action that is not "specific" within the meaning of Article 32.1 but is nevertheless related to subsidization, is not prohibited by that Article. Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 262. Although the European Communities has referred to footnote 56 as context relevant to interpreting the term "specific", it has not asserted that the TDM is "action under other relevant provisions of GATT 1994" within the meaning of that footnote.

²⁶³ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 244.

²⁶⁴ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 244.

²⁶⁵ We note that Article 1 of the SCM Agreement contains a definition of the term subsidy "[f]or the purpose of this Agreement". It follows that the constituent elements of a subsidy for the purposes of Article 32.1 are those set forth in Article 1. See Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 240.

by unfair Korean practices " (Recital (5)); and "unfair Korean competition" (Recital (6)). Thus the problem that prompted adoption of the TDM Regulation is described as competition that is unfair, abnormal or non-transparent, but there is nothing to indicate explicitly that this problem of unfair competition or unfair practices is caused by subsidies.

7.116 Notwithstanding this lack of express references to subsidies, the Panel finds that the text of the TDM Regulation and the context of its adoption demonstrate that the Regulation is related to subsidies allegedly provided by the Government of Korea to its shipbuilding industry.

7.117 The Panel notes, in this regard, that the eligibility for state aid pursuant to the national aid schemes approved under the TDM Regulation is limited to certain sectors of the Community shipbuilding industry.

7.118 Recitals (3), (4) and (5) and Article 2(2) of the TDM Regulation indicate that the inclusion of a particular segment of the Community shipbuilding industry within the scope of the Regulation was dependent upon whether that segment had suffered adverse effects in the form of material injury and serious prejudice caused by " unfair Korean competition" or "unfair Korean practices". Recitals 3-5 provide:

"However, as an exceptional and temporary measure, and in order to assist Community shipyards in those segments that have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition, a temporary defensive mechanism should be authorised for limited market segments and for a short and limited period only, ...

The situation in the Community shipbuilding industry is heterogeneous. According to the Commission's Fourth and Fifth Reports on the Situation in World Shipbuilding, approximately half of all compensated gross tonnage produced in Community shipyards concerns the market segments in which Community shipyards are in a strong position on the international market. However, in other segments, there is evidence that Community shipyards have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition. Therefore, contract-related temporary support may be authorised in certain circumstances in those segments, namely container ships and product and chemical tankers.

Considering the exceptional development in the sector of LNG carriers, the Commission will continue to monitor this market. Contract-related temporary support may be authorised in this sector if the Commission confirms, on the basis of investigations covering the period of 2002, that the Community industry has suffered material injury and serious prejudice in this sector caused by unfair Korean practices to the same extent as has been found for container ships and product and chemical tankers."

Article 2(2) of the TDM Regulation provides:

"Direct aid in support of contracts for the building of LNG carriers may only be authorised under this Article for final contracts signed after the Commission gives notice in the Official Journal of the European Communities that it confirms, on the basis of investigations covering the period of 2002, that Community industry has suffered material injury and serious prejudice in this market segment caused by unfair Korean practices."

7.119 It is clear, therefore, that the limitation of the eligibility of state aid to container ships and product and chemical tankers was based on evidence that Community shipyards in those segments had "suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition", and that the possible future inclusion of LNG carriers within the scope of the Regulation was conditional on confirmation by the European Commission that the Community industry in this sector "has suffered material injury and serious prejudice in this market segment caused by unfair Korean practices".²⁶⁶

7.120 The Panel realizes that the above-mentioned Recitals and provision of the TDM Regulation refer to "unfair Korean competition" and "unfair Korean practices", and that the Regulation does not expressly mention subsidies provided by the Government of Korea. However, the TDM Regulation employs terms -- "adverse effects", "material injury" and "serious prejudice" -- which, in the SCM Agreement, denote the effects of actionable subsidies. If, as argued by the European Communities, the concepts of "unfair competition" and "unfair practices" as used in the TDM Regulation do not refer to subsidies but to a broader problem of "injurious pricing", the Panel finds it hard to understand why the Regulation in describing the effects of this "unfair competition" and these "unfair practices" employs terminology so intimately connected with the SCM Agreement.

7.121 Moreover, it is undisputed that the evidence of the existence of the "adverse effects", "material injury" and "serious prejudice" referred to in Recitals 3-5 and Article 2(2) of the TDM Regulation was the result of an investigation conducted by the European Commission pursuant to the European Community's Trade Barriers Regulation.²⁶⁷ The practices subject to this investigation were certain subsidies allegedly granted by the Government of Korea to its shipbuilding industry:

"The investigation was directed against subsidies allegedly granted by the Government of the Republic of Korea to its shipbuilding industry that benefited production between 1997 and 2000 and will benefit future production. Alleged Korean subsidies have included, export contingent financing, debt forgiveness, debt-for-equity-swaps, interest relief and special tax concessions in the context of preferential restructuring packages provided in order to save various shipbuilding enterprises from imminent collapse."²⁶⁸

7.122 Reports²⁶⁹ on the results of this investigation submitted by the Commission to an Advisory Committee consisting of representatives of the member States found that subsidies within the meaning of Article 1 of the SCM Agreement granted by Korea were causing adverse effects in the form of injury and serious prejudice within the meaning of Article 5 of the SCM Agreement and Article 2 of the Trade Barriers Regulation to the Community producers of product and chemical tankers and container ships.

²⁶⁶As noted above, in June 2003, the European Commission published a notice under Article 2(2) of the Regulation confirming, on the basis of investigations covering the period of 2002, that Community industry had suffered material injury and serious prejudice in the market segment of LNG carriers caused by unfair Korean practices.

²⁶⁷First submission of the European Communities, paras. 158-162. The Trade Barriers Regulation is a mechanism "laying down Community procedures in the field of common commercial policy in order to ensure the exercise of the Community's rights under international trade rules, in particular those established under the auspices of the World Trade Organization". Council Regulation (EC) No 3286/94.

²⁶⁸Commission Decision of 8 October 2002 under the provisions of Council Regulation (EC) No 3286/94 concerning trade practices maintained by Korea affecting trade in commercial vessels, OJ L 281, 19.10.2002, p. 15, Recital (5).

²⁶⁹Reproduced in Exhibit Korea-6. Article 8(8) of the Trade Barriers Regulation requires that in an investigation under this Regulation the Commission must report to the Advisory Committee "when it has concluded its examination," and that this "report should normally be presented within five months of the announcement of initiation of the procedure, unless the complexity of the examination is such that the Commission extends the period to seven months."

7.123 The Panel notes that, at the time of the adoption of the TDM Regulation, the “findings” of the European Commission on the adverse effects of subsidies allegedly granted by the Government of Korea were not yet embodied in instruments with a formal legal status under Community law but in reports submitted by the Commission to an Advisory Committee, which could in some sense be considered to be “internal” and that the formal Decision in which the Commission reported on the outcome of the investigation under the Trade Barriers Regulation was promulgated only in October 2002.²⁷⁰ Nevertheless, these “internal” reports formed the basis upon which the Commission in May and July 2001 proposed a particular course of action, including adoption of the TDM Regulation.

7.124 Consequently, it is clear to the Panel that the sectoral scope of the TDM Regulation was determined on the basis of evidence of the existence of adverse effects caused by subsidies within the meaning of Article 1 of the SCM Agreement allegedly provided by the Government of Korea to its shipbuilding industry.²⁷¹

7.125 The European Communities acknowledges that it used the evidence of the existence of adverse effects from the investigation conducted under its Trade Barriers Regulation in determining the scope of the TDM Regulation²⁷², but submits that the use of this evidence about the state of the domestic industry is explained by the need to limit the material scope of the TDM Regulation so as not to reintroduce to the full extent operating aid into the sector.²⁷³

7.126 The Panel does not contest that the scope for providing contract-related operating aid under the TDM Regulation is significantly more limited than was the case until 31 December 2000 under Article 3 of Council Regulation 1540/98, and that this was due to the fact that the scope of the Regulation was defined on the basis of evidence obtained in the investigation under the Trade Barriers Regulation on the existence of adverse effects to certain segments of the European Community shipbuilding industry. However, the fact remains that the adverse effects in question were adverse effects caused by subsidies allegedly granted by Korea, and that, consequently, the limitation of the scope of the TDM Regulation was based on the effects of subsidies. Therefore, that the reference to adverse effects served the important political purpose of explaining the reintroduction of operating aid only in certain sectors does not mean that there is no relationship between the scope of the TDM Regulation and the effects of subsidies allegedly granted by the Government of Korea.

7.127 The Panel also considers relevant the fact that the TDM Regulation makes a link between the temporal application of the Regulation and the initiation and resolution or suspension of the WTO dispute settlement proceeding that the European Communities initiated against Korea in October 2002 regarding certain subsidies allegedly provided by the Government of Korea to its shipbuilding industry.

7.128 The relationship between the TDM Regulation and the WTO dispute settlement proceeding is expressed in Recital (7) and Article 4 of the TDM Regulation. Recital (7) provides:

"The temporary defensive mechanism should only be authorised after the Community initiates dispute settlement proceedings against Korea, by requesting consultations with Korea, in accordance with the World Trade Organisation's Understanding on the Rules and Procedures for the Settlement of Disputes and may no longer be authorised

²⁷⁰ Commission Decision of 8 October 2002 under the provisions of Council Regulation (EC) No 3286/94 concerning trade practices maintained by Korea affecting trade in commercial vessels, *Official Journal of the European Communities*, L 281/15, 19.10.2002.

²⁷¹ We recall that the “constituent elements” of a subsidy are those identified in Article 1 of the SCM Agreement. See footnote 265.

²⁷² See e.g., first submission of the European Communities, para. 158.

²⁷³ First submission of the European Communities, paras. 161-162 and 200; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 29.

if these dispute settlement proceedings are resolved, or suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented."

Article 4 of the TDM Regulation reads:

"The Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry, with the exception of final contracts signed before the Community gives notice in the *Official Journal of the European Communities* that it has initiated dispute settlement proceedings against Korea by requesting consultations in accordance with the World Trade Organisation's Understanding on the Rules and Procedures for the Settlement of Disputes and final contracts signed one month or more after the Commission gives notice in the *Official Journal of the European Communities* that these dispute settlement proceedings are resolved, or suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented."

7.129 It is evident from Article 4 that there is a direct operational link between the duration of the authority to provide aid under the Regulation and the resolution or suspension of the WTO dispute settlement case brought by the European Communities. The Panel sees this operational linkage between the TDM Regulation and the WTO dispute settlement case initiated by the European Communities against Korea as further evidence to support the proposition that the practices that the TDM Regulation is designed to address are the same practices – i.e., subsidies -- that are the subject of the WTO dispute settlement case.

7.130 The Panel next considers issues relating to the relationship between the TDM Regulation and the Agreed Minutes. In this regard, the European Communities argues that the references in the TDM Regulation to "adverse effects" of "unfair practices" and "unfair competition" must be understood to refer to the problem of "injurious pricing", which is distinguishable from subsidies. The European Communities submits in this respect that the principal reason for the adoption of the TDM Regulation was the non-implementation by Korea of its commitments under the Agreed Minutes, which relate to "injurious pricing", an issue distinct from subsidies.²⁷⁴ The European Communities refers in this regard to references to the Agreed Minutes in the "whereas" clauses to the TDM Regulation.

7.131 The Panel first emphasizes that its review of the text of the Agreed Minutes only serves the purpose of enabling it to decide a factual issue on which the parties disagree and that it is not interpreting the Agreed Minutes in order to determine the rights and obligations of the parties under that bilateral agreement.²⁷⁵

7.132 The Panel notes that certain provisions of the Agreed Minutes clearly pertain to subsidies. The first operative clause of the Agreed Minutes contains the following commitments regarding "action by public authorities in respect of shipyards in financial difficulties":

"Both sides agree that all financial institutions shall conduct their business with shipbuilders in a commercially sound manner.

In that respect, the Korean Government will continue to supervise strictly the asset soundness of the financial institutions.

²⁷⁴ E.g., first submission of the European Communities, paras. 151-154 and 196.

²⁷⁵ We note in this regard that the Agreed Minutes are not a "covered agreement" within the meaning of Article 1 and 2 of the DSU. See e.g., Appellate Body Report, *EC – Poultry*, para. 79.

In line with the Korean Government's policy of non-intervention, and conscious of the imbalance in world shipbuilding markets, the Korean authorities will ensure, in the context of bank supervision, that banks in which the Korean Government has a shareholding or private banks acting on its behalf will only extend new loans, write off or roll over existing loans or provide any type of support on a commercial basis. The Korean Government confirms that it will not provide these financial institutions with public support for the purpose of covering losses resulting from their business relations with any specific enterprise or industry.

The Korean Government agrees that KAMCO should purchase bad loans related to shipyards at prices that reflect actual and expected recovery rates as well as funding costs, and at minimal prices for unsecured loans.

The Korean Government confirms that:

-It will not extend support to its shipbuilders which is inconsistent with Korea's international obligations.

-The management takeover of Samho by Hyundai will not be accompanied by publicly supported debt restructuring and/or moratoria operations.

While under government ownership Korean banks will, when dealing with shipbuilding companies, be operated on a fully commercial basis. The Korean Government will not be involved in the day-to-day management. Public banks will grant no favourable repayment guarantees for shipbuilding contracts entered into by shipyards in financial difficulties or under court receivership. Further to that, the conditions for repayment guarantees shall reflect the substantial commercial risk stemming from the shipyards' precarious situation."

This first Section clearly includes several commitments on the part of Korea to refrain from providing certain forms of public support to financial institutions and to shipbuilders.

7.133 The Panel further notes that Section (3) of the Agreed Minutes deals with "injurious pricing":

"Both sides recognize that injurious pricing of ships should be remedied or prevented to ensure normal competitive conditions in the world shipbuilding market.

In this regard, the Korean Government agrees that the level of ship prices shall reflect all the factors of costs according to the definition of a normal value under the WTO anti-dumping Agreement."

This Section clearly does not contain a commitment by Korea to refrain from the granting of subsidies but this does not mean that the provisions in this Section are unrelated to subsidies. Given the background of the conclusion of the Agreed Minutes, particularly the timing and nature of certain subsidies allegedly granted by Korea, the recognition of the need to remedy or prevent injurious pricing of ships and of the need for prices of ships to reflect all the factors of cost can be explained at least in part as an attempt to address the continuing effects of past subsidies granted by Korea. Action relating to prices of ships may well have been viewed as necessary to prevent subsidies granted in the past by the Government of Korea from continuing to cause adverse effects. The Panel notes that Article 18 of the SCM Agreement, which provides for the possibility of price undertakings as an

alternative to the application of countervailing duties, suggests that commitments by exporters regarding pricing can be a remedy against subsidies.²⁷⁶

7.134 Thus, it appears that the Agreed Minutes relate to an important extent to subsidies in that they contain commitments of Korea either to refrain from granting certain subsidies or to take action that would mitigate the adverse effects of past subsidies. The Panel considers, therefore, that the Agreed Minutes as a whole cannot be characterized as pertaining to a problem of injurious pricing that is distinct from subsidies. In any event, even assuming that the Agreed Minutes deal with "injurious pricing" as distinct from subsidies, the Panel finds no indication in the text of the introduction or of the operative part of the TDM Regulation that this problem of "injurious pricing" was a factor determining the scope, design and structure of the TDM Regulation. As discussed above, the information before the Panel indicates that the sectoral scope of the TDM Regulation was determined on the basis of evidence on the adverse effects of certain subsidies granted by Korea. There is nothing to suggest that the sectoral scope depended upon an assessment of the effects of "injurious pricing" as distinct from subsidies. The reference to the Agreed Minutes in the introduction to the Regulation does not detract from the link between the scope of the TDM Regulation and the adverse effects of subsidies allegedly granted by Korea.

7.135 In fact, the Panel considers that the linkages between the TDM Regulation, the WTO dispute settlement case and the Agreed Minutes support the view that the TDM relates at least in part to subsidies allegedly provided by Korea. The Panel notes that Article 4 of the TDM Regulation provides that the TDM may no longer be applied if the WTO dispute settlement proceedings are either (i) "resolved" or (ii) "suspended" on the basis that the European Communities considers that Korea has effectively implemented the Agreed Minutes. The effective implementation of the Agreed Minutes necessarily implies effective implementation of the commitments contained therein with respect to subsidies. Thus measures taken by Korea, including with respect to the type of subsidies identified in the Agreed Minutes, can lead to the suspension of the WTO dispute settlement proceeding, which in turn results in the termination of the authority to provide state aid under the TDM Regulation.

7.136 Although we have focused our analysis on the elements that can be derived from the TDM itself, we note that our conclusions find confirmation in public statements of the European Commission. These statements indicate that the TDM Regulation was designed as part of a twin-track strategy that was adopted following the findings made in the Trade Barriers Regulation investigation that subsidies granted by the Government of Korea were causing adverse effects to the Community industry.²⁷⁷ Since the proposal for a temporary defensive mechanism, described as "one

²⁷⁶ In referring to Article 18 of the SCM Agreement, the Panel does not wish to suggest that Section 3 of the Agreed Minutes contains a price undertaking within the meaning of that Article. The key point from the Panel's perspective is simply that a provision on pricing is not necessarily unrelated to subsidies. The Panel does not deem it necessary for it to characterize the precise nature of the commitment undertaken by Korea under this Section with regard to prices of ships.

²⁷⁷ Thus, on 8 May 2001, when the Commission submitted its first report on this investigation, which contained evidence that certain subsidies granted by Korea were causing adverse effects, the Commission issued a press release the summary of which stated *inter alia*:

"Further to the adoption of its fourth report on the state of the EU shipbuilding industry last week, the Commission today approved the strategy it will propose to the Council of Ministers on 14/15 May, in order to address the persistent problems posed to the European shipbuilding industry by unfair trade practices by Korean shipyards. The investigation into subsidies carried out under the Trade Barriers Regulation (TBR) has established that substantial subsidies have been granted to Korean shipyards through both export and domestic programmes which contravene the WTO's 1994 Subsidies Agreement. On this basis, the Commission will recommend that the matter be taken before the WTO through the initiation of a dispute settlement procedure by 30 June unless an amicable solution can be reached in the interim period. In parallel, the Commission will propose accompanying measures in the form

element of the Commission's two-part strategy against unfair Korean practices in this sector", was adopted following an investigation "which found evidence of substantial subsidies that are incompatible with WTO rules", it is reasonable to conclude that "unfair Korean practices" in this connection refers to the subsidies found in the investigation conducted under the Trade Barriers Regulation. These statements provide further confirmation that the TDM Regulation was designed to address adverse effects to certain segments of the EC shipbuilding industry in the form of material injury and serious prejudice caused by subsidies allegedly provided by Korea.²⁷⁸

7.137 In light of the aforementioned considerations concerning the scope of the Regulation; the use of terminology intimately connected with the SCM Agreement; the relationship of the TDM Regulation to the findings made in the investigation under the Trade Barriers Regulation of adverse effects caused by subsidies; and the relationship between the temporal application of the TDM Regulation, the WTO dispute settlement case and the "effective" implementation of the Agreed Minutes, the Panel is of the view that the TDM Regulation is an action taken by the European Communities related to subsidies allegedly provided by Korea.

7.138 While the Panel has found that the TDM Regulation is in fact related to subsidies allegedly provided by Korea, the question remains whether the closeness of the relationship is such that, in the words of the Appellate Body, the measure is "inextricably linked to, or [has] a strong correlation to", the constituent elements of the subsidy.

7.139 The Panel recalls a variety of features of the TDM that demonstrate the strength of the link and correlation between the subsidies identified by the European Communities and the eligibility of aid pursuant to the TDM. These features are in substantial part the same features that were relevant for establishing that the TDM was more generally a response to those subsidies. First, a European shipyard is only eligible for aid where there has been competition for the contract from a Korean

of a temporary support mechanism to European shipyards for the market segments considerably injured by unfair Korean trade practices and for the period required for the conclusion of the WTO procedure. Its entering into force will be simultaneous with the effective start of the WTO action." IP/01/656, 8 May 2001, Exhibit Korea-8

In July 2001, when the Commission submitted its proposal to the Council, it issued a press release which stated:

"The Commission today adopted a proposal for a Council Regulation which would put in place a temporary defensive mechanism for European shipbuilding. The proposal is one element of the Commission's two-part strategy against unfair Korean practices in this sector and will cover the market segments that are considerably injured by these practices. It comes after a series of negotiations between the Commission and Korea, which failed to produce an agreement that would restore normal trading conditions. The proposal is an accompanying measure to dispute settlement proceedings against Korea, which will be initiated in the WTO as soon as the Council expresses its favourable position on the temporary defensive mechanism. ...

The proposal for a defensive temporary support mechanism follows a Commission investigation which found evidence of substantial subsidies that are incompatible with the WTO rules. Despite a series of negotiations between the Commission and the Korean Government, no amicable solution has yet been achieved. Accordingly, the Commission has instigated its two part strategy for fighting these unfair practices: proposing a temporary defensive mechanism and the initiation of dispute settlement proceedings.

The proposal for the temporary defensive mechanism is limited to those market segments in which the Commission investigation found that EU industry had been considerably injured by unfair Korean trade practices, namely container ships and product and chemical tankers." IP/01/1078, Exhibit Korea-9

²⁷⁸ We acknowledge that the TDM Regulation was adopted by the Council not by the Commission but consider nevertheless that in view of the role of the Commission in initiating this legislation it is not inappropriate to accord some evidentiary weight to these press releases to reinforce a conclusion derived from an analysis of the text of the Regulation.

shipyard offering a lower price. Thus, there is a correlation between the Member found to be providing subsidies in the TBR investigation and the scope of the TDM Regulation. Second, the scope of the TDM Regulation correlates closely with the sectors of the Korean shipbuilding industry found to be subsidized. Thus, European shipbuilders may only be eligible for aid where the competition with a Korean shipyard relates to container ships, chemical tankers, product tankers and LNG carriers. As previously noted, these are precisely the categories of ships for which affirmative findings of adverse effects caused by Korean subsidies were made in the TBR investigation.²⁷⁹ Put simply, the TDM allows European shipbuilders to receive aids only with respect to contracts where there is competition from a country found to be providing subsidies and in regard to particular categories of ships with respect to which adverse effects resulting from subsidies were found.²⁸⁰

7.140 We further recall that the temporal application of the TDM is linked to the resolution of the WTO dispute regarding Korean subsidies or its suspension based upon the "effective implementation" of the Agreed Minutes. Resolution of the WTO dispute implies either a recommendation that the alleged subsidies be withdrawn or their adverse effects removed²⁸¹, or findings that the measures are not subsidies, are not prohibited subsidies, and/or do not cause adverse effects. Effective implementation of the Agreed Minutes implies, *inter alia*, not applying certain subsidies in the future and taking steps to remove the price effects of subsidies applied in the past. In other words, the TDM Regulation would cease to apply if Korea were to cease future subsidization and remove the effects of past subsidization by Korea as reflected in resolution of the WTO dispute settlement case or effective implementation of the Agreed Minutes. These linkages establish a further temporal correlation between the continued existence of alleged subsidies and their adverse effects and the continued application of the TDM.

7.141 The Panel acknowledges that the Regulation does not provide that state aid can only be granted if it is determined on a case-by-case basis that the particular shipyard with which a Community producer is in competition for a contract has been subsidized with respect to the transaction in question. The Panel further realizes that the measures that were found to be specific by the Appellate Body in *US - 1916 Act* and *US - Offset Act (Byrd Amendment)* were linked to formal determinations of the existence of dumping or subsidization.²⁸² The Panel does not believe, however, that a finding of a "strong correlation" or "inextricable link" between the measure and the constituent elements of a subsidy requires a case-by-case determination. Indeed, to specify that a finding of "specific action" requires such a determination in all cases would be a recipe for circumvention of Article 32.1.²⁸³ That may well explain why the Appellate Body did not require a perfect match between the scope of the measure and the constituent elements of the subsidy. What it required is a "strong correlation" or an "inextricable link". Thus, what is crucial is the closeness of the correlation or link.

²⁷⁹ As previously noted, while these findings were not yet embodied in instruments with formal status under Community law when the TDM Regulation was adopted, they formed the basis on which the Commission proposed, *inter alia*, adoption of the TDM Regulation. Findings of the Commission were published a few months later. See para. 7.123 *supra*.

²⁸⁰ We recognize that the TDM Regulation correlates only to the subset of alleged subsidies considered by the European Communities to be causing adverse effects. The presence of this further limiting consideration does not in our view negate the existence of a strong correlation between the TDM Regulation and alleged subsidies. We note in this respect that a similar limitation existed in respect of *US - Offset Act (Byrd Amendment)*, in that offset payments could be made only where duties had been collected on dumped or subsidized imports, which duties in turn could only be collected pursuant to a finding that the dumped or subsidized imports had caused or threatened to cause material injury to a domestic industry.

²⁸¹ See SCM Agreement Articles 4.7 and 7.8.

²⁸² See, e.g., Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 242.

²⁸³ For example, if a case-by-case determination of subsidization were required, a Member could preclude a finding of "specific action" by designing a measure that, while directed at subsidization, swept somewhat more broadly to include some non-subsidized transactions.

7.142 In this case, the Panel notes that, with respect to three major Korean shipyards, the European Communities found the existence of non-recurring subsidies (in particular, restructuring subsidies). These (alleged) restructuring subsidies would as a matter of logic confer a benefit with respect to all transactions entered into by the yards over a number of years.²⁸⁴ Thus, it may reasonably be inferred that the European Communities had in fact made *ex ante* findings that contracts relating to those shipyards were subsidized. While other (alleged) subsidies may have been transaction-specific in nature, they were provided pursuant to programmes that the European Communities considered to be available to all shipyards and used by all investigated shipyards.²⁸⁵ Thus, the link or correlation is very close as it is clear that the TDM was specifically tailored to make aid available in a manner that was targeted with substantial precision to alleged Korean subsidization.

7.143 Therefore, the Panel **finds** that the TDM Regulation is "specific action" within the meaning of Article 32.1 of the SCM Agreement because it has a strong correlation and inextricable link with the constituent elements of a subsidy.

2. Whether the TDM Regulation constitutes specific action "against" a subsidy within the meaning of Article 32.1 of the SCM Agreement

(a) Main arguments²⁸⁶

(i) *Arguments of the parties*

7.144 **Korea** argues that the TDM Regulation is specific action "against" a subsidy of another Member because, in the words of the Appellate Body Report in *US - Offset Act (Byrd Amendment)*, the structure and design of the Regulation are clearly "opposed to" the practice of subsidization or

²⁸⁴ As explained by the Commission in its report to the Trade Barriers Regulation Committee regarding LNGs:

"The subsidies granted to Korean shipbuilders during the restructuring process constituted one-off events involving large amounts which benefited their present and future production. This is because non-recurring subsidies (i.e. subsidies which are granted on a one-off basis) are normally linked to the acquisition of fixed assets and therefore the total value of the subsidy is spread over the normal life of the assets."

The Commission proceeded to note that the life of machinery and equipment in the shipbuilding industry was 10-12 years. Report to the Trade Barriers Regulation Committee, *Examination Procedure Concerning an Obstacle to Trade Within the Meaning of Council Regulation (EC) No 3286/94, Consisting of Trade Practices Maintained by Korea Affecting Trade in Commercial Vessels – Supplementary Report on Adverse Effects Concerning LNG Carriers*, p. 5.

More generally, we recall that statement by the Commission in its Decision of 8 October 2002 that:

"The investigation was directed against subsidies allegedly granted by the Government of the Republic of Korea to its shipbuilding industry that benefited production between 1997 and 2000 and will benefit future production."

Commission Decision of 8 October 2002 under the provisions of Council Regulation (EC) No 3286/94 concerning trade practices maintained by Korea affecting trade in commercial vessels, OJ L 281, 19.10.2002, p. 15, Recital (5).

²⁸⁵ See Report to the Trade Barriers Regulation Committee, *Examination Procedure Concerning an Obstacle to Trade Within the Meaning of Council Regulation (EC) No 3286/94, Consisting of Trade Practices Maintained by Korea Affecting Trade in Commercial Vessels – Supplementary Report on Export Subsidies*, pp. 21, 27 (all shipyards investigated used the pre-shipment loan and advanced payment guarantee schemes).

²⁸⁶ For a more detailed account of the arguments of the parties, see Section IV.C.3.

"creates an incentive to terminate such practices".²⁸⁷ That the TDM Regulation constitutes "motion or action in opposition to" and "in hostility or active opposition to" alleged subsidies of Korea is evident from statements of EC Commission officials; from the fact that the Regulation targets Korea; and from the fact that the Regulation is similar in intent, character and purpose to the action taken by the European Communities in launching a WTO dispute settlement case against Korea as both actions were part of a twin-track strategy.²⁸⁸ In Korea's view, the TDM Regulation "creates an incentive to terminate" the alleged Korean subsidies because it establishes a link between the suspension or termination of the Regulation, on the one hand, and the resolution of the WTO dispute settlement case and Korea's implementation of the Agreed Minutes, on the other.²⁸⁹ Korea also submits in this connection that the TDM Regulation creates a competitive disadvantage for Korean products in relation to domestic products and other foreign products.²⁹⁰

7.145 Korea submits that the argument of the European Communities that a measure cannot be "against" a subsidy if the measure is legal is contrary to the conclusion of the Appellate Body in the *US - Offset Act (Byrd Amendment)* case in which the Appellate Body did not find that the monies disbursed under the Byrd Amendment were illegal subsidies.²⁹¹ Second, the Appellate Body in *US-Offset Act (Byrd Amendment)* did not actually reject a "conditions of competition" test but stated that it was not necessary to go so far as to demonstrate effects on competition and that the focus of the analysis should instead be on the structure of the measure. In this regard, Korea submits that since the TDM Regulation provides for funds to be given to any Community shipyard that is in competition with a Korean shipyard, it is hard to imagine anything more clearly "against" the alleged Korean subsidized products.²⁹² Third, Korea rejects as irrelevant the fact that the subsidies under the TDM Regulation are available in the event of any competition from Korean ships, not just those ships that have actually been subsidized.²⁹³

7.146 Korea argues that the TDM is not an ordinary subsidy in that it is specifically and exclusively directed against Korea, and more particularly against Korean subsidization. Nonetheless, Korea agrees with the argument of the United States that counter-subsidies can be actions "against" a subsidy of another Member under Article 32.1 of the SCM Agreement.²⁹⁴

7.147 Korea argues that, contrary to what the European Communities asserts, the TDM Regulation applies only when there is a demonstration of a lower Korean offer.²⁹⁵ It is irrelevant in Korea's view that the level of EC funding is unrelated to the level of the alleged Korean subsidies because to be against does not involve exact amounts.²⁹⁶ Regarding the argument that the TDM Regulation does not involve a transfer of resources, Korea asserts that Parts II and III of the SCM Agreement provide actions against subsidies other than countervailing duties.²⁹⁷

7.148 The **European Communities** argues that the TDM Regulation is not a measure "against" a subsidy of another Member. First, the impact that any aid granted by member States may have on the competitive position of Korean yards is not a sufficient basis to conclude that such aid is a form of action "against" the subsidy of another Member. Korea's argument, in this regard, reflects a

²⁸⁷ First submission of Korea, para. 120.

²⁸⁸ First submission of Korea, paras. 121-122.

²⁸⁹ First submission of Korea, paras. 123-124.

²⁹⁰ First submission of Korea, paras. 125-126.

²⁹¹ Oral statement of Korea at the first substantive meeting of the Panel with the parties, para. 55; second submission of Korea, para. 187.

²⁹² Oral statement of Korea at the first substantive meeting of the Panel with the parties, para. 56; second submission of Korea, paras. 184-185.

²⁹³ Oral statement of Korea at the first substantive meeting of the Panel with the parties, para. 57-58.

²⁹⁴ Second submission of Korea, paras. 188-189.

²⁹⁵ Oral statement of Korea at second substantive meeting of the Panel with the parties, para. 43.

²⁹⁶ Oral statement of Korea at the second substantive meeting of the Panel with the parties, para. 44.

²⁹⁷ Second submission of the European Communities, para. 46.

"conditions of competition" test that has already been rejected by the Appellate Body in *US - Offset Act (Byrd Amendment)*²⁹⁸ and that is inconsistent with a basic tenet of the SCM Agreement that Members may grant specific subsidies provided they do not cause adverse effects within the meaning of Articles 5 and 6 of that Agreement.²⁹⁹ Second, the state aid provided by EC member States under the TDM Regulation is very different from the type of measure at issue in the *US - Offset Act (Byrd Amendment)* in that it is financed through budgetary resources, not through countervailing duties, bears no relationship with a finding of subsidization and only serves to help the domestic shipbuilding industry to survive until the problem of injurious pricing is resolved through implementation of the Agreed Minutes.³⁰⁰ Third, in view of its modest amount, such aid cannot offset the effects of Korean subsidization.³⁰¹ Fourth, the link between the TDM Regulation and the WTO dispute settlement case launched by the European Communities against Korea does not establish that the Regulation is an action against a subsidy of another Member. The Regulation and the dispute settlement case both relate to the broad objective of addressing injurious pricing, but their immediate goals are entirely different in that the WTO dispute settlement case seeks to secure the cessation of WTO-inconsistent subsidies whereas the TDM Regulation seeks to address the non-implementation of the Agreed Minutes by providing subsidies necessary for the survival of the EC domestic industry. Fifth, the aid does not influence the behaviour of Korea and does not penalize the unfair practices of Korean shipyards.³⁰²

7.149 The European Communities submits that the fact that a subsidy is granted to any Community shipyard that is in competition with a Korean shipyard does not mean that the subsidy is against the allegedly subsidized Korean products because the granting of a subsidy to producers of products that are in competition with other producers known to receive subsidies does not *ipso facto* amount to action "against" a subsidy.³⁰³

7.150 Regarding the argument of the United States that Article 32.1 of the SCM Agreement is not limited to measures involving a transfer of financial resources from the producers of the imported product to the producers of the domestic product, the European Communities argues that existing case law only concerns measures involving this type of transfer of resources and that this was considered to be the decisive element by the Appellate Body in finding that the Byrd Amendment Act constituted action against dumping and subsidies.³⁰⁴ The only general conclusion that can be drawn from the Panel and Appellate Body Reports in *US - Offset Act (Byrd Amendment)* is that the nature of the measure as a subsidy does not prevent that measure from being covered by Article 32.1 of the SCM Agreement.³⁰⁵

7.151 The European Communities asserts that Korea has been unable to demonstrate any specific effect of the TDM Regulation or the national measures against a Korean subsidy.³⁰⁶ Regarding the argument of Korea that the effect of the TDM Regulation is to force Korea to accept the interpretation of the European Communities of Korea's WTO obligations, the European Communities submits that Article 4 of the TDM Regulation limits the temporal scope of the Regulation to the termination of the

²⁹⁸ To support its assertion that the Appellate Body Report in *US - Offset Act (Byrd Amendment)* rejects a "conditions of competition" test for determining whether a measure is "against" a subsidy of another Member, the European Communities refers to paras. 253-254 and 257 of that Report.

²⁹⁹ First submission of the European Communities, paras. 209-212. The European Communities refers to para. 258 of the Appellate Body's Report. The European Communities elaborates on its argument about the irrelevance of a "conditions of competition test" in paras. 37-40 of its oral statement at the first meeting of the Panel.

³⁰⁰ First submission of the European Communities, paras. 213-214.

³⁰¹ First submission of the European Communities, paras. 215-216.

³⁰² First submission of the European Communities, paras. 217-220.

³⁰³ Response of the European Communities to Panel Question 47.

³⁰⁴ Response of the European Communities to Panel Question 40.

³⁰⁵ Response of the European Communities to Panel Question 40.

³⁰⁶ Second submission of the European Communities, para. 77.

WTO dispute settlement case, regardless of the outcome. Therefore, the Regulation cannot force Korea to adopt any particular position in the dispute settlement case or to an early withdrawal of its subsidies. At most, the Regulation might encourage Korea to resume negotiations in the framework of the Agreed Minutes.³⁰⁷

(ii) *Arguments of third parties*

7.152 The **United States** submits that the Appellate Body Report in *US - Offset Act (Byrd Amendment)* does not support the view that only measures involving a transfer of financial resources similar to the Byrd Amendment payments can constitute action "against" a subsidy.³⁰⁸ Second, the United States argues that the European Communities fails to explain why "a system of counter subsidies" could not dissuade the practice of subsidization or create an incentive to terminate such practice. A rational government may well be dissuaded from granting subsidies if the competitive advantage generated by those subsidies is offset by subsidies granted by other countries.³⁰⁹ Finally, the United States asserts more generally that the European Communities adopts an overly narrow interpretation of the ruling in *US - Offset Act (Byrd Amendment)*; according to the United States, the Appellate Body in that case "concluded that the SCM Agreement prohibits the provision of subsidies in response to another Member's subsidies".³¹⁰

7.153 **China** argues that for a measure to be action "against" a subsidy, it is not necessary for that measure "to directly counteract subsidized imports or entities responsible for such imports." As indicated by the Appellate Body in *US - Offset Act (Byrd Amendment)*, multilaterally sanctioned countermeasures are a form of action "against" a subsidy notwithstanding that they do not directly affect the subsidized products.³¹¹ Second, a measure can be "against" a subsidy even though it is not effective in dissuading the practice of subsidization.³¹² Third, the fact that subsidies that do not cause adverse effects within the meaning of Article 5 and 6 are permitted under the SCM Agreement does not mean that a counter subsidy cannot be in violation of Article 32.1 of the SCM Agreement.³¹³

(b) *Evaluation by the Panel*

7.154 Having found that the TDM Regulation is a "specific" action, the question which the Panel must now address is whether the TDM Regulation is also an action "against" a subsidy of another Member within the meaning of Article 32.1 of the SCM Agreement.

7.155 The Appellate Body examined the meaning of the word "against" in Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement in its Report in *US - Offset Act (Byrd Amendment)*. The Appellate Body analyzed the possible relevance to the ordinary meaning of the word "against" as used in these provisions of three dictionary definitions posited by the United States: (1) "of motion or action in opposition"; (2) "in hostility or active opposition to"; and (3) "in contact with." According to the Appellate Body, the third definition cited by the United States was inconsistent with "the idea of opposition, hostility or adverse effect" conveyed by the word "against" as used in these provisions.³¹⁴ As a consequence, the Appellate Body rejected the view

³⁰⁷ Second submission of the European Communities, para. 79.

³⁰⁸ Third party submission of the United States, para. 6.

³⁰⁹ Third party submission of the United States, para. 7.

³¹⁰ Third party submission of the United States, para. 12. The United States refers here to para. 273 of the Appellate Body Report.

³¹¹ Oral statement of China at the first substantive meeting of the Panel with the parties, para. 7.

³¹² Oral statement of China at the first substantive meeting of the Panel with the parties, para. 8.

³¹³ Oral statement of China at the first substantive meeting of the Panel with the parties, para. 9.

³¹⁴ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, paras. 248-250.

advanced by the United States that an action against dumping or a subsidy must have direct contact with the imported good, or the entity responsible for the dumped or subsidized good.³¹⁵

7.156 Having rejected "in contact with" as an appropriate definition of the meaning of "against" in the context of Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement, the Appellate Body observed:

"Recalling the other two elements of the definition of "against" from the *New Shorter Oxford Dictionary* relied upon by the United States, namely "of motion or action in opposition" and "in hostility or active opposition to", to determine whether a measure is "against" dumping or a subsidy, we believe it is necessary to assess whether the design and structure of a measure is such that the measure is "opposed to", has an adverse bearing on, or, more specifically, has the effect of dissuading the practice of dumping or the practice of subsidization, or creates an incentive to terminate such practices. In our view, the CDSOA has exactly those effects because of its design and structure".³¹⁶

7.157 With respect to the measure at issue in that dispute -- the Continued Dumping and Subsidies Offset Act -- the Appellate Body concluded that its design and structure had the effect of dissuading the practice of dumping or the practice of subsidization, or created an incentive to terminate such practices, because the Act "effects a transfer of financial resources from the producers/exporters of dumped or subsidized goods to their domestic competitors".³¹⁷ It is clear from the text of the Report that the Appellate Body attached decisive importance to this aspect:

"All these elements lead us to conclude that the CDSOA has an adverse bearing on the foreign producers/exporters in that the imports into the United States of the dumped or subsidized products (besides being subject to anti-dumping or countervailing duties) result in the financing of United States competitors—producers of like products—through the transfer to the latter of the duties collected on those exports. Thus, foreign producers/exporters have an incentive not to engage in the practice of exporting dumped or subsidized products or to terminate such practices. Because the CDSOA has an adverse bearing on, and, more specifically, is designed and structured so that it dissuades the practice of dumping or the practice of subsidization, and because it creates an incentive to terminate such practices, the CDSOA is undoubtedly an action "against" dumping or a subsidy, within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*".³¹⁸

7.158 The Appellate Body's focus on the transfer of financial resources³¹⁹ as the basis for its conclusion that the Continued Dumping and Subsidies Offset Act was a measure "against" dumping or a subsidy differed from the Panel's analysis, which had concluded that the Act was a measure

³¹⁵ The Appellate Body also considered that this argument of the United States was contradicted by the fact that Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement refer to measures against dumping or a subsidy and not to measures against dumped or subsidized products or entities responsible for dumped or subsidized products; by the inclusion of multilaterally sanctioned countermeasures in the SCM Agreement; and by the object and purpose of Article 18.1 of the Anti-Dumping Agreement and 32.1 of the SCM Agreement. Appellate Body Report, *US - Offset Act (Byrd Amendment)*, paras. 251-253.

³¹⁶ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 254.

³¹⁷ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 255.

³¹⁸ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 256 (emphasis added).

³¹⁹ The Panel notes that the United States in its third party submission in this dispute questions whether the Appellate Body's characterization of the Continued Dumping And Subsidies Offset Act as entailing a transfer of financial resources was factually accurate. Third party submission of the United States, para. 6, footnote 6. The Panel does not need to pronounce on this issue.

"against" dumping mainly on the ground that the combination of offset payments and anti-dumping duties had an adverse impact on the competitive relationship between dumped imports and goods produced by "affected domestic producers".³²⁰ The Appellate Body considered in this regard that:

"...in order to determine whether the CDSOA is 'against' dumping or subsidization, it was not necessary, nor relevant, for the Panel to examine the conditions of competition under which domestic products and dumped/subsidized imports compete, and to assess the impact of the measure on the competitive relationship between them. An analysis of the term 'against', in our view, is more appropriately centred on the design and structure of the measure; such an analysis does not mandate an economic assessment of the implications of the measure on the conditions of competition under which domestic product and dumped/subsidized imports compete."³²¹

7.159 The Appellate Body again emphasized the transfer of financial resources from foreign producers and exporters to domestic competitors as the key element in its conclusion that the Act was a measure "against" dumping or a subsidy in a passage in which it explained that it was not necessary for the Panel to inquire into the intent of the legislators:

"The text of the CDSOA provides sufficient information on the structure and design of the CDSOA, that is to say, on the manner in which it operates, to permit an analysis whether the measure is 'against' dumping or a subsidy. Specifically, the text of the CDSOA establishes clearly that, by virtue of that statute, a transfer of financial resources is effected from the producers/exporters of dumped or subsidized goods to their domestic competitors. This essential feature of the CDSOA constitutes, in itself, the decisive basis for concluding that the CDSOA is 'against' dumping or a subsidy—because it creates the 'opposition' to dumping or subsidization, such that it dissuades such practices, or creates an incentive to terminate them."³²²

7.160 The Appellate Body's ruling in *US - Offset Act (Byrd Amendment)* provides the Panel with the relevant parameters for assessing whether a measure is "against" the subsidy of another Member. First, the Appellate Body indicated that an analysis whether a measure is "against" a subsidy must assess whether the design and structure of the measure has the effect of dissuading the practice of dumping or subsidization, or creates an incentive to terminate such practices. Second, the Appellate Body in applying its "design and structure" analysis focused almost exclusively on the existence of a "transfer of financial resources" between foreign producers/exporters and their domestic competitors. Put simply, we understand the Appellate Body to be saying that the "decisive basis" for ruling that the *Offset Act* was a "measure" against dumping or subsidization was the fact that the greater dumping or subsidization, the more financial resources were taken from the foreign exporters/producers and given to domestic competitors. It was the dissuasive nature of this aspect of the design or structure of the *Offset Act* that made it a measure "against" dumping or subsidization. By contrast, the Appellate Body not only did *not* rely on the existence of subsidization in response to dumping or subsidization as the basis for its ruling, but it ruled that it was neither necessary nor relevant for the Panel to have conducted an examination of the effects of the subsidy on conditions of competition between domestic and imported products.³²³

³²⁰ Panel Report, *US - Offset Act (Byrd Amendment)*, paras. 7.35-7.41. The Panel found further support for its view of the Act as a measure against dumping or a subsidy in the incentives which the Act created for domestic producers to file or at least support application for the initiation of anti-dumping or countervailing duty investigations. *Ibid.*, paras. 7.42-7.45.

³²¹ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 257.

³²² Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 259 (emphasis added).

³²³ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 257. This was consistent with the approach of the panel in that dispute, which stated:

7.161 While the transfer of financial resources may be something that is peculiar to the facts of the *Byrd Amendment* case, nevertheless it is indicative of the high standard that must be met in determining whether a measure "has the effect of dissuading ...the practice of subsidization, or creates an incentive to terminate such practices". The need for such a high standard is supported by a reading of that provision in the broader context of the SCM Agreement. If the mere fact that a subsidy granted by a Member to its domestic producers mitigates, or is intended to mitigate, the competitive impact of a subsidy granted by another Member to its domestic producers were sufficient to treat the subsidy granted by the first Member as action "against" the subsidy of the second Member, this would create a new type of substantive disciplines on the provision of subsidies in addition to the disciplines already contained in Parts II and III of the SCM Agreement. Subsidies that in themselves are not prohibited because they are not subsidies of the kind covered by Article 3, and which do not necessarily even produce the effects that are the basis for a successful challenge under Articles 5 and 6 of the SCM Agreement, would nevertheless be prohibited because they are granted in reaction to subsidies of other Members. The Panel considers it unlikely that the drafters, having created a structure for the Agreement under which prohibited subsidies were regulated by in Part II of the Agreement and actionable subsidies by Part III, would have then inserted a very significant additional prohibition in the concluding provisions of the Agreement.

7.162 This interpretation finds further support in the consideration of the Agreement's object and purpose. A broad interpretation of "against" that relied on the effects of a subsidy on conditions of competition would create an incentive for a Member to be "first in" with a subsidy and would treat less favourably a Member which responded in kind by providing an identical subsidy. Specifically, the Member initiating the subsidy competition could be challenged in WTO dispute settlement only if its subsidy could be shown to be prohibited under Part II of the SCM Agreement or demonstrated to cause adverse effects under Part III thereof. By contrast, the Member responding to subsidization initiated by another Member could be challenged independently of whether its subsidy was inconsistent with Part II or III of the SCM Agreement, merely because its subsidy was responsive in nature.³²⁴ Such an interpretation would thus have the perverse effect of encouraging Members to beat their competitors to the provision of subsidies in order to gain the advantage. We consider that a reading of Article 32.1 which in fact would encourage Members to be "first in" with subsidies would be very difficult to square with the object and purpose of the SCM Agreement of providing strengthened disciplines on the use of trade-distorting subsidies.³²⁵

7.163 We find confirmation of this interpretation of the scope of Article 32.1 in the historical development of that provision. We note that Article 32.1 is a verbatim transposition of Article 19.1 of

"We wish to emphasize that our findings and conclusions relate exclusively to the CDSOA, which combines the imposition of anti-dumping/countervail orders with the bestowal of offset payments in very particular circumstances, such as to constitute 'specific action against dumping'/subsidization. Though we consider that subsidization should not generally be used as a surrogate contingent trade remedy, our conclusion (that the CDSOA constitutes 'specific action against dumping') is not based on a finding that subsidization in and of itself necessarily constitutes 'specific action against dumping'/subsidization." Panel Report, *US - Offset Act (Byrd Amendment)*, para. 7.52.

³²⁴ This is in fact precisely what has happened in the case of shipbuilding. The European Communities has brought a case against Korea under Parts II and III of the SCM Agreement with respect to Korea's alleged subsidies See *Korea – Measures Affecting Trade In Commercial Vessels*, WT/DS273. While Korea's initial response to the European Communities' alleged responsive subsidies under the SCM Agreement involved both serious prejudice claims under Part III and its claims in this dispute, it has limited its panel request to Article 32.1 of the SCM Agreement and the other non-SCM claims before this Panel. See *European Communities – Measures Affecting Trade in Commercial Vessels*, request for consultations by Korea, WT/DS/301 (11 September 2003), Section IV.

³²⁵ See, e.g. Appellate Body Report, *US – Carbon Steel*, para. 73. ("Taken as a whole, the main object and purpose of the *SCM Agreement* is to increase and improve GATT disciplines relating to the use of both subsidies and countervailing measures".)

the Tokyo Round Subsidies Code, and that the basic idea underlying Article 19.1 had already been articulated at the time of the GATT/ITO negotiations.³²⁶ The results of the GATT/ITO negotiations reflect *no* substantive disciplines on the provision of subsidies – the only requirement of the original Article XVI of GATT 1947 was a consultation obligation – and the sole action possible against subsidies was therefore countervailing action. Even at the time of the Tokyo Round Code, subsidies disciplines were quite limited indeed, with a prohibition applicable solely to export subsidies provided by developed countries in respect of other than primary products, and what were in effect non-binding rules on serious prejudice. Nor have we been able to identify any substantive discussion in the Uruguay Round negotiations relating to the transposition of Article 19.1 into the current Agreement, much less an indication that the same language was intended to take on a different meaning in the new Agreement. Given that there were effectively no multilateral disciplines on subsidies when the idea underlying Article 32.1 was conceived, and very few when the precise language now contained in Article 32.1 was drafted, it seems to us very unlikely indeed that the idea reflected in Article 32.1 was to prohibit the provision of counter-subsidies, as Korea seems to suggest.

7.164 Taking the Appellate Body's reasoning in *US - Offset Act (Byrd Amendment)* into account, we conclude that a subsidy provided in response to another Member's subsidy – that is to say, a counter-subsidy – will not, merely because of its impact on conditions of competition, constitute specific action "against" that subsidy and therefore be proscribed by the SCM Agreement. Rather, there must be some *additional* element, inherent in the design and structure of the measure, that serves to dissuade, or encourage the termination of, the practice of subsidization. One such element would be where the counter-subsidy was funded through a transfer of financial resources between the foreign producer/exporter and the domestic competitor. There may well be other elements which would satisfy this requirement, although we will not attempt *ex ante* to define what those elements might be. The Panel will therefore examine the TDM Regulation in light of these conclusions.

7.165 The Panel considers that the factual and legal arguments of Korea do not warrant a conclusion that the design and structure of the TDM Regulation demonstrate its nature as an action "against" a subsidy of another Member.

7.166 The Panel observes that the essential feature of the TDM Regulation is that it creates the legal basis necessary under European Community state aid law for the provision by EC member States of contract-related operating aid to certain sectors of the Community shipbuilding industry whenever there is competition from a Korean shipyard offering lower prices.

7.167 Korea submits that the fact that the TDM Regulation applies specifically and exclusively in the context of competition for a particular contract between Community shipyards and Korean shipyards shows that its design and structure is such that it acts "against" a subsidy of another Member. However, the arguments of Korea in this regard essentially concern the impact of the Regulation as a subsidy on the conditions of competition between Community shipyards and Korean

³²⁶ In September 1948, the CONTRACTING PARTIES to the GATT adopted a report of a working party that had considered amendments to be made to the GATT in light of the Havana Charter. This report recommended the substitution of the text of Article VI of the GATT by the text of Article 34 of the Havana Charter:

"While agreeing that there is no substantive difference between Article VI of the General Agreement and Article 34 of the Charter, the working party recommends the replacement of that article, as the text adopted at Havana contains a useful indication of the principle governing the operation of that article and constitutes a clearer formulation of the rules laid down in that article. The working party, endorsing the views expressed by Sub-Committee C of the Third Committee of that Havana Conference, agreed that measures other than compensatory anti-dumping and countervailing duties may not be applied to counteract dumping or subsidization except in so far as such other measures are permitted under other provisions of the General Agreement." GATT, *Basic instruments and Selected Documents*, Vol. II. (May 1952), p. 41 (emphasis added).

shipyards.³²⁷ We do not dispute that a counter-subsidy may reduce or even eliminate the competitive advantages another Member may be seeking to achieve through subsidies and thus may in some sense dissuade or provide an incentive to terminate the subsidization. For the reasons discussed above, however, we do not consider that this is a sufficient reason to find that the TDM Regulation is action "against" a subsidy of another Member. Rather, there must be some additional element, inherent in the design and structure of the TDM Regulation, that goes beyond the effects on conditions of competition between Korean and European shipyards of the subsidies provided for under the TDM Regulation. Korea has not identified any such additional element in this dispute.

7.168 With reference to Article 4 of the TDM Regulation, Korea asserts that the Regulation reinforces the incentive to terminate the practice of subsidization by effectively promising to suspend or promptly terminate the countermeasure in return for Korea either implementing the Agreed Minutes or ensuring that the WTO dispute settlement proceeding is resolved at the earliest opportunity.³²⁸ Closely related to this, Korea argues that by adopting the TDM Regulation the European Communities sought to provide an inducement for Korea to try to settle the WTO dispute, which implied that Korea would agree to stop the alleged subsidization, and that the TDM Regulation was thereby also a bargaining chip with which to build pressure on Korea.³²⁹

7.169 We do not doubt that the linkages between the TDM, the dispute settlement case and the Agreed Minutes represent a signal that the European Communities will eliminate the TDM if Korea takes steps to address its alleged subsidies and the adverse effects allegedly flowing from them.³³⁰ Indeed, we have placed significant emphasis on these linkages in our analysis as to whether the TDM is a "specific action". Nor do we doubt that the TDM Regulation constitutes pressure by the European Communities on Korea. The Panel however recalls that the possible dissuasive impact arising from the effects of a subsidy on conditions of competition is not sufficient to make a measure "against" subsidies.³³¹ Rather, there is a need for some additional element beyond the effect of the subsidies themselves, such as a transfer of financial resources. The linkage between the TDM, dispute settlement and the Agreed Minutes does not represent such an additional element. Rather, it is merely evidence – albeit rather compelling evidence – of the connection between the TDM and the Korean subsidies. As such, the linkage is not decisive in our analysis of whether the TDM is "against" Korean subsidies.

7.170 Finally, Korea relies to an important extent upon statements of the European Commission and of its individual members to support its assertion that the TDM Regulation is action "against" a subsidy of another Member.³³² In particular Korea refers to statements that the adoption of the TDM Regulation signals to Korea the European Communities' determination to resolve the dispute;³³³ that the TDM Regulation is part of a strategy "aimed at fighting these unfair [Korean practices]"³³⁴, that the TDM Regulation is part of the Commission's twin-track strategy,³³⁵ that the TDM Regulation is

³²⁷ First submission of Korea, para. 125; oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 56-57; second submission of Korea, para. 185.

³²⁸ First submission of Korea, para. 123.

³²⁹ First submission of Korea, para. 124.

³³⁰ We recall that, under Article 4 of the TDM Regulation, operating aid can only be provided in respect of contracts signed during a period beginning when the Commission gives notice of the initiation of a WTO dispute settlement proceeding against Korea and ending one month after the Commission gives notice that these proceedings are resolved, or suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented. The dispute settlement proceeding is resolved within the meaning of Article 4 when the DSB adopts the report of the Panel established in this proceeding or of the Appellate Body.

³³¹ See, paras. 7.160-7.164, *supra*.

³³² First submission of Korea, paras. 120-121; second submission of Korea, paras. 192-194 and 198.

³³³ First submission of Korea, para. 120.

³³⁴ First submission of Korea, para. 121.

³³⁵ First submission of Korea, para. 122.

specifically designed to counter unfair Korean practices for a period necessary for the conclusion of the WTO procedure,³³⁶ that the TDM Regulation is intended to increase the weapons arsenal *vis-à-vis* alleged Korean subsidies,³³⁷ and that Commissioner Lamy wants to use subsidies as leverage against South Korea to stop supporting its industry.³³⁸

7.171 In the Panel's view, Korea's reference to such statements does not demonstrate how through its design and structure the Regulation operates in a manner that dissuades the practice of subsidization or creates an incentive to terminate that practice other than through the competitive impact of the subsidies provided for under the TDM Regulation. In addition, apart from the issue of whether the European Commission and its members can be considered to be "legislators" in relation to an act adopted by the Council of the European Union, the Panel also recalls the statement of the Appellate Body that a finding of whether a measure is "against" a subsidy of another Member cannot be based on the intent of legislators.³³⁹

7.172 In light of the above considerations, the Panel **finds** that the TDM Regulation is not an action "against" a subsidy of another Member within the meaning of Article 32.1 of the SCM Agreement.

7.173 The Panel **concludes** that the TDM Regulation is not a "specific action against a subsidy of another Member" inconsistent with Article 32.1 of the SCM Agreement.

7.174 The Panel also **concludes**, as a consequence, that the TDM aid schemes of Denmark, France, Germany, the Netherlands, and Spain, and the Decisions of the European Commission authorizing those aid schemes, are not "specific actions against a subsidy of another Member" inconsistent with Article 32.1 of the SCM Agreement.

E. CLAIMS UNDER ARTICLE 23 OF THE DSU

1. General

7.175 **Korea** claims that the TDM Regulation, its member State implementing provisions as well as any instances of application³⁴⁰ of the TDM scheme, and any EC Decisions approving member State implementing provisions pursuant to the TDM scheme, are inconsistent with the obligations of the European Communities and its member States under Articles 23.1, 23.2(a), 23.2(b) and 23.2(c) of the DSU.

2. Article 23.1

(a) Main arguments

(i) *Arguments of the parties*³⁴¹

7.176 In support of its claim of a violation of Article 23.1 of the DSU, **Korea** submits that by adopting the TDM Regulation the European Communities sought the redress of a violation by Korea of its obligations under the SCM Agreement without having recourse exclusively to, and abiding by, the rules and procedures of the DSU.³⁴² According to Korea, the European Communities "imposed

³³⁶ Second submission of Korea, para. 194.

³³⁷ Second submission of Korea, para. 197.

³³⁸ Second submission of Korea, para. 198.

³³⁹ Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 259.

³⁴⁰ The Panel recalls its discussion in section VII.A.4(a) of the conditional preliminary objection raised by the European Communities.

³⁴¹ For a more detailed account of the arguments of the parties, see Section IV.C.4.

³⁴² E.g., first submission of Korea, paras. 36-62, 63-67, and 68-71.

retaliatory measures directed specifically against Korea as a weapon to induce compliance with the European Communities' interpretation of Korea's WTO obligations under the SCM Agreement".³⁴³

7.177 In Korea's view, Article 23.1 of the DSU prohibits any form of remedial action of a Member in response to what that Member considers to be a violation by another Member of its WTO obligations that does not involve exclusive recourse to the DSU. Korea interprets Article 23.1 as a "broad prohibition on unilateralism"³⁴⁴ and emphasizes that the term "seek redress" is "a broad formulation clearly intended to capture a wide range of potential measures and actions".³⁴⁵ Article 23.1 is a legally binding provision that can be violated in many situations other than those identified in Article 23.2 of the DSU.³⁴⁶ Korea rejects the view of the European Communities that Article 23 cannot prohibit measures that do not involve a suspension of concessions or obligations under a covered agreement.³⁴⁷ In the latter regard, Korea's use of the terms "countermeasures" and "retaliation" in relation to the TDM Regulation is meant to refer to actions other than just suspension of concessions or obligations.³⁴⁸

7.178 With reference to the discussion of the meaning of "seek the redress of a violation..." in the Panel Report on *US - Certain EC Products*, Korea points to a number of factors demonstrating that the TDM Regulation embodies an "attempt" or "effort" by the European Communities to obtain a "remedy or relief from trouble" which the European Communities perceived to be caused by Korean illegal subsidies and that the TDM Regulation was also "a reaction" by the European Communities against another Member because of a perceived violation of a WTO obligation "with a view to remedying the situation".³⁴⁹ These factors include the fact that the temporal application of the TDM Regulation is legally dependant upon the WTO dispute settlement case launched by the European Communities in respect of certain subsidies allegedly provided by Korea; the terms and design of the TDM Regulation; various background documents and statements of the European Commission and statements by its individual members; the relationship of the TDM Regulation with an investigation conducted by the European Communities under the Community's Trade Barriers Regulation; the link between the TDM Regulation and the Agreed Minutes; and the wording of the Regulation that extended the duration of the TDM Regulation.³⁵⁰

7.179 The **European Communities** submits that, while taken in isolation the term "redress" might lend itself to a broad interpretation, when viewed in context and in light of the purpose of Article 23, its drafting history and international public law rules on state responsibility and the suspension of treaty obligations, it is clear that "the general obligation not to seek redress of a WTO violation outside the WTO system cannot prohibit measures other than retaliatory measures in the form of suspension of WTO concessions or obligations".³⁵¹ Thus the phrase "seek the redress of a violation..." in Article 23.1 does not apply generally to any kind of reaction by a Member to a measure of another Member that it considers to be in violation with that Member's obligations under the WTO Agreement. Rather, a "measure seeking redress of a WTO violation must at least identify a particular WTO violation and suspend concessions or obligations with a view to inducing compliance by the other Member or to re-establish the balance of rights and obligations".³⁵² The European Communities

³⁴³ First submission of Korea, para. 20.

³⁴⁴ Response of Korea to Panel Question 26.

³⁴⁵ First submission of Korea, para. 42.

³⁴⁶ E.g., response of Korea to Panel Question 18.

³⁴⁷ Oral statement of Korea at the first substantive meeting of the Panel with the parties, paras. 40-45; second submission of Korea, paras. 110-118.

³⁴⁸ Response of Korea to Panel Question 27.

³⁴⁹ First submission of Korea, para. 39.

³⁵⁰ E.g., first submission of Korea, paras. 39-62.

³⁵¹ First submission of the European Communities, para. 129.

³⁵² Response of the European Communities to Panel Question 14.

submits that Article 23.1 of the DSU is entirely procedural in nature.³⁵³ Its first purpose is "to ensure the exclusivity of WTO jurisdiction over WTO law and the suspension of concessions".³⁵⁴ The obligation to have recourse to the DSU is an exclusive jurisdiction clause and requires Members to have recourse only to WTO dispute settlement as opposed to another international tribunal.³⁵⁵ The only other aspect of Article 23.1 is the reaffirmation of the obligation to abide by the rules of the DSU.³⁵⁶ In the view of the European Communities, Article 23.1 cannot prohibit unilateral acts other than those listed in Article 23.2 of the DSU and acts that are otherwise inconsistent with the DSU.³⁵⁷

7.180 The European Communities also argues that it is difficult to imagine how redress within the meaning of Article 23.1 of the DSU is being sought in the absence of a determination that a violation of obligations under the WTO Agreement has occurred, and refers in this respect to its arguments to rebut Korea's claim that the TDM Regulation contains a determination contrary to Article 23.1 of the DSU.³⁵⁸

7.181 The European Communities also rejects Korea's claim of a violation of Article 23.1 of the DSU on more factual grounds. In particular, the European Communities submits that the relationship between the temporal application of the TDM Regulation and the WTO dispute settlement proceeding initiated by the European Communities against Korea is explained by the need for an objective criterion to limit the duration of the aid; that the reference made in the TDM Regulation to injury caused by "unfair Korean competition" does not refer to WTO-inconsistent subsidies; that the primary motivation for the adoption of the TDM Regulation was the non-implementation by Korea of its commitments under the Agreed Minutes; and that Korea has failed to explain how the TDM Regulation can be effective as a form of remedy or redress.³⁵⁹

(ii) *Arguments of third parties*

7.182 **China** submits that the TDM measures are covered by Article 23.1 of the DSU because they were adopted by the European Communities to "seek the redress of a violation..." as that phrase has been interpreted by the Panel in *US - Certain EC Products*. The criterion to decide whether a measure falls within the scope of Article 23.1 is whether the measure is adopted with a "view to remedying the situation". Thus, Article 23.1 is not limited in scope to measures involving a suspension of concessions or obligations under the WTO Agreement but covers any other remedial action taken against another Member in response to a violation of the WTO Agreement.³⁶⁰ China points to the close relationship of the TDM Regulation with the investigation under the Trade Barriers Regulation; the temporal linkage between the TDM Regulation and the WTO dispute settlement proceeding initiated by the European Communities against Korea; the fact that the TDM Regulation was adopted as part of a twin-track strategy and the targeted nature of the TDM measures as factual elements demonstrating that the TDM measures were taken to "seek the redress of a violation..." within the meaning of Article 23.1 of the DSU.³⁶¹

³⁵³ Oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 47.

³⁵⁴ Oral statement of the European Communities at the first substantive meeting of the Panel with the parties., para. 48.

³⁵⁵ Responses of the European Communities to Panel Questions 16 and 19.

³⁵⁶ Oral statement of the European Communities at the first substantive meeting of the Panel with the parties, paras. 49-50.

³⁵⁷ Second submission of the European Communities, para. 85.

³⁵⁸ Oral statement of the European Communities at the second substantive meeting of the Panel with the parties, para. 75.

³⁵⁹ E.g., first submission of the European Communities, paras. 144-166.

³⁶⁰ Third party submission of China, paras. 4-8.

³⁶¹ Third party submission of China, paras. 14-19.

7.183 The **United States** argues that the European Communities has skipped a step in arguing that Article 23.1 of the DSU does not prohibit measures that are otherwise permitted by the WTO Agreement. If the European Communities has made a determination in the sense of Article 23.2(a) outside the framework of the DSU, it would be in breach of Article 23.2(a) and thereby Article 23.1. There might also be a breach of Article 23.2(c) if the measures taken by the European Communities in seeking the redress of a violation amounted to a suspension of WTO concessions or other obligations.³⁶² Thus the suspension of concessions or other WTO obligations is not the only form of redress within the meaning of Article 23.1.³⁶³ Article 23.2(a) provides further support that a determination of a breach of the WTO Agreement can be a method of seeking redress because it does not require that the determination be accompanied by any other action or trade consequences.³⁶⁴ In response to a question, the United States also submits that Article 23.2 of the DSU nowhere refers to measures other than a determination or the suspension of concessions or other obligations and that Article 23.1 only commits Members to have recourse to, and abide by, the rules and procedures of the DSU, and that it is therefore difficult to see how Article 23.1 applies to measures that are consistent with the WTO Agreement.³⁶⁵ The United States considers that Article 60 of the Vienna Convention on the Law of Treaties and Article 49(2) of the Draft ILC Articles on State responsibility are not relevant to the question presented to the Panel.³⁶⁶

(b) Evaluation by the Panel

7.184 Article 23.1 of the DSU provides:

"Strengthening of the Multilateral System

1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding."

7.185 As noted above, the arguments of the parties as to whether or not the TDM Regulation is inconsistent with Article 23.1 of the DSU reflect fundamental differences of interpretation of the scope and nature of the obligations contained in that provision, particularly with regard to the requirement that Members "have recourse to" the rules and procedures of the DSU when they "seek the redress of a violation of obligations..." Whereas Korea asserts that this requirement prohibits any form of unilateral conduct whereby a Member attempts to remedy a violation by another Member of its obligations under the WTO Agreement, the European Communities submits that this requirement is of a purely procedural nature and cannot prohibit a measure that does not involve the suspension of concessions or obligations under the WTO Agreement.

7.186 The Panel recalls that it has found that the TDM Regulation is not inconsistent with Articles I and III of the GATT 1994 and Article 32.1 of the SCM Agreement. Consequently, if the Panel were to agree with the interpretation of Article 23.1 advanced by the European Communities, it would not be necessary to examine the detailed arguments of the parties regarding specific factual aspects of Korea's claim. Therefore, the Panel must first interpret the scope and nature of the requirement in Article 23.1 of the DSU that Members "have recourse" to the DSU when "seeking the redress of a violation...". In so doing, the Panel must apply customary rules of interpretation of public

³⁶² Oral statement of the United States at the first substantive meeting of the Panel with the parties, paras. 2-3.

³⁶³ Replies of the United States to the questions from the European Communities and Korea, para.1.

³⁶⁴ Replies of the United States to the questions from the European Communities and Korea, para.2.

³⁶⁵ Replies of the United States to the questions from the European Communities and Korea, para. 4.

³⁶⁶ Oral statement of the United States at the first substantive meeting of the Panel with the parties, paras. 5-6.

international law³⁶⁷, as set out in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (1969). As expressed in Article 31.1 of that Convention, the fundamental rule is that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose".

(i) *Meaning of the requirement to have recourse to the DSU when Members seek the redress of a violation*

7.187 The obligation in Article 23.1 to have recourse to (and abide by) the rules and procedures of the DSU applies "when Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements".^{368, 369} Thus, an essential element in the interpretation of the scope of this obligation is the meaning of "seek the redress of a violation..."

7.188 The phrase "seek the redress of a violation..." implies that one necessary condition of the application of Article 23.1 of the DSU is that a Member acts in response to what it considers to be conduct of another Member that is in violation of that Member's obligations. In the words of the Panel in *US - Section 301 Trade Act*, a decision by a Member to "seek the redress of a violation..." means that "in its preliminary view, there may be a WTO inconsistency".³⁷⁰ The Panel in *US - Certain EC Products* referred to this aspect of "seek the redress of a violation..." as action "because of a perceived (or WTO determined) WTO violation" and "action in response to what [a WTO Member] views as a WTO violation".³⁷¹ We agree with this approach.

7.189 With regard to the meaning of "seek the redress of a violation", the Panel notes the definition of "redress" in the New Shorter Oxford English Dictionary:

"1. Reparation of or compensation for a wrong or consequent loss. 2(a). Remedy for or relief from some trouble; assistance, aid, help. (b) (obsolete) Correction or reformation of something wrong. 3(a) A means of redress; an amendment, an improvement. (b) (obsolete) A person who or thing which affords redress. 4. The act of redressing; correction or amendment of a thing, state, etc."³⁷²

³⁶⁷ Art. 3.2 of the DSU.

³⁶⁸ Hereinafter, we shall use "seek the redress of a violation..." to refer to these three causes of action.

³⁶⁹ We note that Part III of the SCM Agreement contains specific provisions that apply when a Member considers that another Member causes adverse effects to its interests by using a subsidy within the meaning of Article I of the SCM Agreement. These provisions on "actionable" subsidies in effect define causes of action in terms that differ in part from those of Article 23.1 of the DSU. In the Panel's view, however, Article 23.1 also applies to instances in which a Member seeks to redress conduct that is WTO-inconsistent within the meaning of Part III of the SCM Agreement. To hold otherwise would yield an absurd result. It would mean, for example, that while a Member is required to have recourse to the DSU when it seeks the redress of a non-violation nullification or impairment of benefits, it would not be required to have recourse to the DSU when it seeks the redress of serious prejudice caused by a subsidy of another Member.

³⁷⁰ Panel Report, *US - Section 301 Trade Act*, para. 7.50, footnote 657.

³⁷¹ Panel Report, *US - Certain EC Products*, paras. 6.22 and 6.23.

³⁷² The Panel also notes that the Panel in *US - Certain EC Products* interpreted the phrase "seek the redress ..." as follows:

"The term 'seeking' or 'to seek' is defined in the Webster New Encyclopedic Dictionary as: 'to resort to, ... to make an attempt, try'. This term would therefore cover situations where an effort is made to redress WTO violations (whether perceived or WTO determined violations). The term 'to redress' is defined in the New Shorter Oxford English Dictionary as 'repair (an action); atone for (a misdeed); remedy or remove; to set right or rectify (injury, a wrong, a grievance etc.); obtaining reparation or compensation'. The term 'redress' is defined in the New Shorter Oxford English Dictionary as: 'reparation of or compensation for a wrong or

The fact that "redress" can mean "reparation of" or "compensation for" a wrong or consequent loss but also "remedy for" or "relief from" some trouble suggests that "the redress of a violation..." within the meaning of Article 23.1 of the DSU can take various forms. One obvious modality of "redress" of a violation that a Member will "seek" is action by another Member to bring itself into conformity with its obligations by removing a WTO-inconsistent measure, but "redress" includes other possible "remedies", such as compensation or suspension of concessions or obligations. Therefore, to "seek the redress of a violation..." may include but is not limited to a suspension of concessions or obligations.³⁷³ As observed by the Panel in *US - Certain EC Products*, the phrase "seek the redress of a violation..." in the context of Article 23.1 of the DSU can be defined rather broadly as a "reaction against another Member, because of a perceived (or WTO determined) WTO violation, with a view to remedying the situation".³⁷⁴

7.190 In interpreting the phrase "seek the redress of a violation...", the Panel must also take into account as one relevant contextual element the fact that this phrase appears in a clause contained in an article designed explicitly with a view to "strengthening the multilateral system". These words must therefore be given a meaning consistent with that stated objective. Another relevant element of the context of the phrase "seek the redress of a violation..." in Article 23.1 is that the DSU clearly provides for different types of "remedy". In the Panel's view, an interpretation of Article 23.1 in light of the objective of Article 23 and its context in the DSU suggests that it must apply to any act whereby a Member seeks to obtain unilaterally results that can be achieved via the remedies of the DSU through means other than recourse to the DSU.³⁷⁵ If Members were free to attempt to seek the redress of a violation by trying to achieve unilaterally what could be obtained through the DSU, it is difficult to see how the obligation to have recourse to the DSU could contribute to the "strengthening of the multilateral system".

7.191 In this regard, the Panel considers that the obligation "to have recourse" to the DSU is necessarily of an exclusive character. The Panel finds confirmation of its view on this exclusive character of Article 23.1 in the statement made by the Appellate Body in *US - Certain EC Products*:

"Article 23.1 of the DSU imposes a general obligation on Members to redress a violation of obligations or other nullification or impairment of benefits under the covered agreements only by recourse to the rules and procedures of the DSU, and not through unilateral action. Subparagraphs (a), (b) and (c) of Article 23.2 articulate specific and clearly-defined forms of prohibited unilateral action contrary to Article 23.1 of the DSU. There is a close relationship between the obligations set out in paragraphs 1 and 2 of Article 23. They *all* concern the obligation of Members of the WTO not to have recourse to unilateral action. (...)"³⁷⁶

consequent loss; remedy for or relief from some trouble; correction or reformation of something wrong'. Panel Report, *US - Certain EC Products*, para. 6.22.

³⁷³The Panel also notes the argument of the United States that for Members who are not in a position to suspend concessions effectively or have recourse to other modes of redress, the main form of redress or assistance available is a finding that another Member's measure is inconsistent with the WTO Agreement. See replies of the United States to the Questions from the European Communities and Korea, para.1.

³⁷⁴ Panel Report, *US - Certain EC Products*, para. 6.22.

³⁷⁵ This does not preclude Members from engaging in informal consultations or reaching mutually agreed solutions.

³⁷⁶ Appellate Body Report, *US - Certain EC Products*, para. 111. The Panel also notes that the Panel in *US - Certain EC Products* discussed Article 23.1 of the DSU as follows:

"An important reason why Article 23 of the DSU must be interpreted with a view to prohibiting any form of unilateral action is because such unilateral actions threaten the stability and predictability of the multilateral trade system, a necessary component for 'market conditions conducive to individual economic activity in national and global markets' which, in

The fact that Article 23.1 contains a *general* obligation to have recourse to the DSU, instead of acting unilaterally to "seek the redress of a violation", and that Articles 23.2(a)-(c) are "specific...forms of prohibited unilateral action contrary to Article 23.1" indicates that Article 23.1 constitutes an independent obligation not limited in scope to the particular instances of unilateral conduct identified in Article 23.2.

7.192 We note that the Panel Reports in *US - Section 301 Trade Act* and *US - Certain EC Products* express a similar view on the nature and scope of Article 23.1 as an independent obligation. Thus, for example, the Panel Report in *US - Section 301 Trade Act* states *inter alia* that:

"There is a great deal more State conduct which can violate the general obligation in Article 23.1 to have recourse to, and abide by, the rules and procedures of the DSU than the instances especially singled out in Article 23.2."³⁷⁷

The Panel in *US - Certain EC Products* considered that:

"The structure of Article 23 is that the first paragraph states the general prohibition or general obligation, i.e. when Members seek the redress of a WTO violation, they shall do so only through the DSU. This is a general obligation. Any attempt to seek 'redress' can take place only in the institutional framework of the WTO and pursuant to the rules and procedures of the DSU.

The prohibition against unilateral redress in the WTO sectors is more directly provided for in the second paragraph of Article 23. From the ordinary meaning of the terms used in the chapeau of Article 23.2 ("in such cases, Members shall"), it is also clear that the second paragraph of Article 23 is 'explicitly linked to, and has to be read together with and subject to, Article 23.1'. That is to say, the specific prohibitions of paragraph 2 of Article 23 have to be understood in the context of the first paragraph, i.e. when such action is performed by a WTO Member with a view to redressing a WTO violation.

We also agree with the *US - Section 301* Panel Report that Article 23.2 contains 'egregious examples of conduct that contradict the rules of the DSU' and which constitute more specific forms of unilateral actions, otherwise generally prohibited by Article 23.1 of the DSU."³⁷⁸

7.193 It follows from this conception of Article 23.1 as a general obligation not to act unilaterally when seeking redress of a violation of an obligation under the WTO that the requirement to have recourse to the DSU is not limited to an "exclusive jurisdiction clause", in the sense in which that expression is used by the European Communities. Interpreted in light of its context and purpose, Article 23.1 not only ensures the exclusivity of the WTO *vis-à-vis* other international fora but also protects the multilateral system from unilateral conduct.

7.194 We note in this respect that the European Communities refers to the notion of "exclusive dispute resolution clause" in the Panel Report in *US - Section 301 Trade Act* as support for its interpretation of Article 23.1 as simply an "exclusive jurisdiction clause". The relevant paragraph of that Report reads as follows:

themselves, constitute a fundamental goal of the WTO. Unilateral actions are, therefore, contrary to the essence of the multilateral trade system of the WTO." Panel Report, *US - Certain EC Products*, para. 6.14 (footnote omitted).

³⁷⁷ Panel Report, *US - Section 301 Trade Act*, para. 7.45 (footnotes omitted).

³⁷⁸ Panel Report, *US - Certain EC Products*, paras. 6.17-6.19 (footnotes omitted).

"Article 23.1 is not concerned only with specific instances of violation. It prescribes a general duty of a dual nature. First, it imposes on all Members to 'have recourse to' the multilateral process set out in the DSU when they seek the redress of a WTO inconsistency. In these circumstances, Members have to have recourse to the DSU dispute settlement system to the exclusion of any other system, *in particular a system of unilateral enforcement of WTO rights and obligations*. This, what one could call 'exclusive dispute resolution clause', is an important new element of Members' rights and obligations under the DSU."³⁷⁹

Thus it is clear from the context that the Panel used the term "exclusive dispute resolution clause" to refer in particular to the prohibition of "unilateral enforcement of WTO rights and obligations".

7.195 To summarize, based on an interpretation of Article 23.1 in light of the ordinary meaning of its terms and in light of its context and object and purpose, and having regard to the reasoning of the Appellate Body and panels in previous disputes concerning Article 23, we consider that the requirement "to have recourse to" the DSU when Members "seek the redress of a violation..." is broader in scope than suggested by the expression "exclusive jurisdiction clause" used by the European Communities. This requirement is violated not only when Members submit a dispute concerning rights and obligations under the WTO Agreement to an international dispute settlement body outside the WTO framework but also when Members act unilaterally to seek to obtain the results that can be achieved through the remedies of the DSU. As a consequence, we reject the view of the European Communities that Article 23.1 of the DSU cannot prohibit acts other than those that are inconsistent with Article 23.2 or with other DSU rules.

7.196 As discussed above, the Panel considers that Article 23.1 must be interpreted to mean that Members may not seek to obtain results that can be achieved through the remedies of the DSU by means other than recourse to the DSU. The Panel in *US - Certain EC-Products* observed that the "remedial actions" envisaged in the WTO system:

"relate to restoring the balance of rights and obligations which form the basis of the WTO Agreement, and include the removal of the inconsistent measure, the possibility of (temporary) compensation and, in the last resort, the (temporary) suspension of concessions or other obligations authorised by the DSB (Articles 3.7 and 22.1 of the DSU). The latter remedy is essentially retaliatory in nature".³⁸⁰

This statement is consistent with our view of what "seek the redress of a violation" means. Therefore, the phrase "seek the redress of a violation..." covers any act of a Member in response to what it considers to be a violation of a WTO obligation by another Member whereby the first Member attempts to restore the balance of rights and obligations by seeking the removal of the WTO-inconsistent measure, by seeking compensation from the other Member, or by suspending concessions or obligations under the WTO Agreement in relation to that Member. In the case of actionable subsidies, seeking the removal of the WTO-inconsistent measure includes seeking the removal by the subsidizing Member of the adverse effects of the subsidy. In our view, any unilateral attempt to obtain these results would be a violation of Article 23.1 of the DSU.

7.197 In the Panel's view, however, the concept of "seeking the redress of a violation" does not encompass the situation where a Member takes actions to compensate or attenuate the harm caused to actors within the aggrieved Member as a result of the allegedly WTO-consistent action, provided those actions are not designed to influence the conduct of the Member taking the allegedly WTO-inconsistent action, as outlined in the preceding paragraph. Thus, for example, trade adjustment assistance provided to help companies or workers affected by an allegedly WTO-inconsistent

³⁷⁹ Panel Report, *US - Section 301 Trade Act*, para. 7.43 (emphasis added).

³⁸⁰ Panel Report, *US - Certain EC Products*, para. 6.23.

quantitative restriction to shift into other economic activities may be a response to WTO-inconsistent behaviour but would not constitute "seeking redress". This type of palliative action might address the harm caused to particular actors within a WTO Member by an alleged WTO violation but it is not designed to restore the balance of rights and obligations between Members.

7.198 We have rejected the argument of the European Communities that, to the extent that Article 23.1 is an independent obligation, it is simply an "exclusive jurisdiction clause". Another key argument of the European Communities is that the relationship between Articles 23.1 and 23.2 and between Articles 23.2(a) and (c) of the DSU provides contextual support for an interpretation of Article 23.1 according to which acts not involving a suspension of WTO concessions or other obligations cannot be covered by the phrase "seek the redress of a violation..." in Article 23.1 of the DSU.³⁸¹ The European Communities refers in particular to the close textual link between Articles 23.1 and 23.2 of the DSU and cites the view of the Panel in *US - Certain EC Products* that the term "determination" in Article 23.2(a) must "bear consequences in WTO trade relations". The European Communities infers from this that a determination within the meaning of Article 23.2(a) must lead to the suspension of concessions or obligations within the meaning of Article 23.2(c) of the DSU and that "this confirms contextually that the general obligation not to seek redress of a WTO violation outside the WTO system cannot prohibit measures other than retaliatory measures in the form of suspension of WTO concessions or obligations".³⁸²

7.199 Article 23.2 sets forth three more specific obligations that apply when a Member "seek[s] the redress of a violation...":

"2. In such cases, Members shall:

(a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;

(b) follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and

(c) follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time."

7.200 In the Panel's view, the close connection between the two paragraphs of Article 23 means that, as stated by the Appellate Body in *US - Certain EC Products*, "[s]ubparagraphs (a), (b) and (c) of Article 23.2 articulate specific and clearly-defined forms of prohibited unilateral action contrary to Article 23.1" and that there is a "close relationship between paragraphs 1 and 2 of Article 23 in that they all concern the obligation of Members of the WTO not to have recourse to unilateral action".³⁸³

³⁸¹ See in particular first submission of the European Communities, paras. 122-129.

³⁸² First submission of the European Communities, paras. 123-129.

³⁸³ Appellate Body Report, *US - Certain EC Products*, para. 111. The need to read Article 23.2 together with Article 23.1 was also highlighted by the Panel Report in *US - Section 301 Trade Act*, paras. 7.44-7.45.

The Panel is not persuaded, however, by the argument of the European Communities that the relationship between Articles 23.1 and 23.2 means that acts not amounting to a suspension of obligations or concessions are not covered by the phrase "seek the redress of a violation" in Article 23.1, for the very reason that the Panel is not persuaded that a determination within the meaning of Article 23.2(a) must be linked to a suspension of concessions or other obligations within the meaning of Article 23.2(c). The wording of Article 23.2(a) does not support an interpretation according to which a unilateral determination that another Member has violated obligations under the WTO Agreement is only inconsistent with this provision if such a determination is made in connection with the application of a measure involving a suspension of concessions or other obligations under the WTO Agreement. If, as argued by the European Communities, Article 23.2(a) only covers determinations made for the purpose of suspending concessions or obligations under Article 23.2(c), the drafters of the DSU could easily have used a formulation to express that linkage. The fact that unilateral determinations are covered by a separate clause, without an explicit textual linkage to Article 23.2 (c), as part of an article aimed at "strengthening the multilateral system" suggests that such determinations by themselves were viewed by the drafters as contrary to the multilateral system.

7.201 The Panel notes, in this regard, that the Panel Report in *US - Certain EC Products*, referred to by the European Communities as support for the proposition that a determination within the meaning of Article 23.2(a) must be linked to a suspension of concessions or obligations, offers no explanation for its view that a determination under Article 23.2(a) must "bear consequences in WTO trade relations".³⁸⁴ Moreover, the Panel did not elaborate on the meaning of "consequences in WTO trade relations". In any event, the Panel did not expressly link this notion of "consequences in WTO trade relations" to the suspension of concessions or obligations under Article 23.2(c) of the DSU, and its finding of a violation of Article 23.2(a) was not dependent upon a finding of a violation of Article 23.2(c). Thus, it is not at all clear that "consequences in trade relations" as used in that report necessarily refers to a suspension of concessions or other obligations under the WTO Agreement. The fact that the Panel in *US - Certain EC Products* found that the United States acted inconsistently with Article 23.2(a) by making a unilateral determination and did not base this finding on the link between this unilateral determination and a suspension of concessions in our view confirms that Article 23.1 can prohibit acts that do not involve a suspension of concessions or obligations. The Panel further notes that the Appellate Body reversed the finding of that Panel under Article 23.2(a) of the DSU on procedural grounds.³⁸⁵

7.202 Finally, the Panel also notes that the earlier Panel Report in *US - Section 301 Trade Act* does not make any mention of the idea of "consequences in WTO trade relations" or of similar notions in its discussion of the meaning of "determination" in Article 23.2(a) of the DSU.³⁸⁶ The Panel notes the

³⁸⁴ Panel Report, *US - Certain EC Products*, para. 6.98.

³⁸⁵ Appellate Body Report, *US - Certain EC Products*, paras. 107-115.

³⁸⁶ Panel Report, *US - Section 301 Trade Act*, para. 7.50, footnote 657:

"(...) Both parties also agree that determinations under Section 304 meet the second of the four elements, a determination in the sense of Article 23.2(a). We agree. Some of the relevant dictionary meanings of the word "determination" in the context of Article 23.2(a) are: 'the settlement of a suit or controversy by the authoritative decision of a judge or arbiter; a settlement or decision so made, an authoritative opinion ... the action of coming to a decision; the result of this; a fixed intention' (*The New Shorter Oxford English Dictionary*, Ed. Brown, L., Clarendon Press, Oxford, Vol. 1, p. 651). Without there being a need precisely to define what a 'determination' in the sense of Article 23.2(a) is, we consider that – given its ordinary meaning – a 'determination' implies a high degree of firmness or immutability, i.e. a more or less final decision by a Member in respect of the WTO consistency of a measure taken by another Member.

Given that Article 23.2(a) only deals with 'determinations' in case a Member is seeking redress of WTO inconsistencies, we are of the view that a 'determination' can only occur *subsequent* to a Member having decided that, in its preliminary view, there may be a WTO inconsistency,

argument of the European Communities that "the decision of the Panel in *US - Section 301 Trade Act* was based on the understanding that a determination of WTO inconsistency under section 304 (b) is inextricably linked to a suspension of rights and concessions, i.e. a decision that may have legal effects on the balance of rights and obligations".³⁸⁷ Assuming that this is factually correct, the fact remains, however, that while the Panel Report in *US - Section 301 Trade Act* contains a careful analysis of the meaning of the word "determination" in Article 23.2 (a) and of the conditions under which determinations under Section 304 would be inconsistent with Article 23.2, that analysis nowhere relates the term "determination" within the meaning of Article 23.2(a) to the suspension of concessions or obligations under Article 23.2(c).³⁸⁸ In fact, the Panel in *US - Section 301 Trade Act* made a preliminary conclusion that Section 304 violated Article 23.2(a) simply because it mandated a determination, potentially of WTO inconsistency, prior to any DSB action.³⁸⁹ An examination of the US statute³⁹⁰ indicates that a determination under Section 304 could, but does not necessarily, lead to the suspension of WTO concessions or obligations. In some cases, following such a determination, the USTR has discretion as to whether to take action at all (Section 301(b)) and even in those cases where action is normally mandated (Section 301(a)), there are exceptions (see Section 301(a)(2)(B)). The list of potential actions that the USTR is authorized to take includes actions that do not involve suspension of WTO concessions or obligations (see Section 301(c)). Moreover, the potential actions are defined as including those "that are within the power of the President with respect to trade in any goods and services, or with respect to any other area of pertinent relations with the foreign country" (Section 301(a)(1) & 301(b)(2)). Thus, the *US - Section 301 Trade Act* Panel Report stands for the proposition that there may be a violation of Article 23.2(a) independently of Article 23.2(c).

7.203 Therefore, the Panel considers that a determination can be inconsistent with Article 23.2(a) of the DSU regardless of whether and how that determination is connected to a suspension of concessions or other obligations under Article 23.2(c). This confirms that a violation of Article 23.1 does not require a suspension of concessions or obligations. Thus, although Article 23.2 is part of the context for the interpretation of Article 23.1, Articles 23.2(a) and (c) of the DSU do not provide contextual support for the view of the European Communities that the obligation in Article 23.1 of the DSU to have recourse to the DSU cannot prohibit acts not involving a suspension of WTO concessions or other obligations.

7.204 The European Communities also asserts that the purpose Article 23 of the DSU is to set out a *lex specialis* in relation to public international law rules on the suspension of the operation of a treaty, particularly Article 60 of the Vienna Convention on the Law of Treaties³⁹¹, and that Article 23 should

i.e. only once that Member has decided to seek redress of such inconsistency. Mere opinions or views expressed before that stage is reached, are not intended to be covered by Article 23.2(a). However, once a Member does bring a case under the DSU, in particular once it requests the establishment of a panel, one can assume that this preliminary stage has been passed and the threshold of a 'determination' met. Such reading of the term 'determination' is confirmed by the exception provided for 'determinations' made 'through recourse to dispute settlement in accordance with' the DSU, an exception that explicitly allows for the 'determination' implicit in pursuing a case before a panel. In any event, what is decisive under Article 23.2(a) is not so much whether an act constitutes a 'determination' – in our view, a more or less formal requirement that needs broad reading -- but whether it is consistent with DSU rules and procedures, the fourth element discussed below."

³⁸⁷ Response of the European Communities to Panel Question 20.

³⁸⁸ Panel Report, *US - Section 301 Trade Act*, para. 7.50, footnote 657.

³⁸⁹ Panel Report, *US - Section 301 Trade Act*, para. 7.96.

³⁹⁰ Panel Report, *US - Section 301 Trade Act*, Annex I.

³⁹¹ Article 60 provides:

"Termination or suspension of the operation of a treaty as a consequence of its breach

1. A material breach of a bilateral treaty by one of the parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part.

2. A material breach of a multilateral treaty by one of the parties entitles:

be interpreted in light of that provision.³⁹² In the view of the European Communities, the purpose of Article 23 was to prevent the unilateral resort to "countermeasures" as that term is used in public international law on state responsibility, i.e. measures that would otherwise be incompatible with a State's international obligations, as distinguished from acts of retorsion.³⁹³ The European Communities asserts that the Panel Report in *US - Certain EC Products* confirms its view that Article 23 of the DSU is a more specific rule to the international regime governing the suspension of concessions under Article 60 of the Vienna Convention and countermeasures, reprisals and retaliatory acts.³⁹⁴

7.205 The Panel recalls that it has concluded, based on an interpretation of Article 23.1 of the DSU in accordance with the ordinary meaning of its terms and in light of the object and purpose of the provision, that measures not involving a suspension of WTO concessions or other obligations are not excluded from its scope. While the Panel realizes that in a number of WTO dispute settlement and arbitration cases reference has been made to the public international law concepts invoked by the European Communities³⁹⁵, the Panel can see no basis for using these concepts to read into Article 23.1 a limitation that is unsupported by an interpretation based on its text, context and object and purpose.³⁹⁶

(a) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either:

- (i) in the relations between themselves and the defaulting State, or
- (ii) as between all the parties;

(b) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State;

(c) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every party with respect to the further performance of its obligations under the treaty.

3. A material breach of a treaty, for the purposes of this article, consists in:

- (a) a repudiation of the treaty not sanctioned by the present Convention; or
- (b) the violation of a provision essential to the accomplishment of the object or purpose of the treaty.

4. The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.

5. Paragraphs 1 to 3 do not apply to provisions relating to the protection of the human person contained in treaties of a humanitarian character, in particular to provisions prohibiting any form of reprisals against persons protected by such treaties."

³⁹² First submission of the European Communities, paras. 132-133; second submission of the European Communities, para. 151.

³⁹³ First submission of the European Communities., paras. 134-136; oral statement of the European Communities at the first substantive meeting of the Panel with the parties, paras. 58-63; response of the European Communities to Panel Question 27; second submission of the European Communities, paras. 153-159.

³⁹⁴ Second submission of the European Communities, para. 154.

³⁹⁵ Thus, for example, the Appellate Body has referred to "the rules of general international law on state responsibility, which require that countermeasures in response to breaches by states of their international obligations be commensurate with the injury suffered". Appellate Body Report, *US - Cotton Yarn*, para. 120. See also Appellate Body Report, *US - Line Pipe*, para. 259. The concept of countermeasures as used in the international law on state responsibility has also been referred to in *US - FSC (Article 22.6-US)*, paras. 5.58-5.60; *Brazil - Aircraft (Article 22.6-Brazil)*, para. 3.44 and *EC - Bananas III (US) (Article 22.6-EC)*, para. 6.16.

³⁹⁶ We also note that the Panel in *US - Certain EC Products* stated that because of the more specific provision of Article 23, Article 60 of the Vienna Convention "does not apply" in the WTO context, but that the

7.206 The Panel notes that in response to a question by the Panel, the European Communities refers to Article 3.2 of the DSU as support for its position on the scope of Article 23.1 of the DSU.³⁹⁷ However, the assertion that the DSU protects the stability and predictability of the multilateral trading system and that the multilateral trading system is composed of the rights and obligations of Members under the WTO Agreement begs the question of what those rights and obligations are. We note in this respect that it is clear from Article 1 of the DSU that the DSU not only protects rights and obligations under a covered agreement but also applies to disputes concerning rights and obligations under the DSU. Thus, Article 3.2 is not directly relevant to the particular question of interpretation before us, i.e. whether WTO Members have assumed an obligation under Article 23.1 to refrain from acts that are not otherwise inconsistent with their obligations under the WTO Agreement. We consider in this respect that the argument of the European Communities based on Article 3.2 involves circular reasoning. The same applies to the reference made by the European Communities to other WTO provisions, (Article II of the WTO Agreement and Articles 3.3, 3.7 and 4.2 of the DSU³⁹⁸) as support for its position that the DSU "only protects Members from measures that offset the rights and obligations in the WTO Agreement".³⁹⁹

7.207 In sum, the Panel considers, based on an interpretation of Article 23.1 of the DSU in accordance with the ordinary meaning of its terms in their context and in light of the object and purpose of the provision, that the obligation to have recourse to the DSU when Members "seek the redress of a violation..." covers any act of a Member in response to what it considers to be a violation of a WTO obligation by another Member whereby that first Member attempts unilaterally to restore the balance of rights and obligations by seeking the removal of the WTO-inconsistent measure, by seeking compensation from that Member, or by suspending concessions or obligations under the WTO Agreement in relation to that Member.

(ii) *Whether by adopting the TDM Regulation the European Communities acted in violation of Article 23.1 of the DSU by unilaterally seeking the redress of a violation without having recourse to the DSU.*

7.208 In light of its conclusion above, the Panel must now proceed to a factual assessment to determine, in light of its interpretation of Article 23.1, whether the European Communities, by adopting the TDM Regulation, sought the redress of a violation by Korea of its obligations under the WTO Agreement without having recourse to the DSU. This means that the Panel must determine whether the European Communities acted in response to what it considered to be a violation of WTO obligations by Korea, and, if so, whether the European Communities sought redress of that violation by unilaterally attempting to restore the balance of rights and obligations by seeking the removal by Korea of the WTO-inconsistent measure or of the adverse effects of the alleged Korean subsidization, by seeking compensation from Korea, or by suspending concessions or obligations under the WTO Agreement in respect of Korea. In this case, the precise issue is whether the European Communities sought redress of a perceived WTO violation by taking unilateral action to obtain the removal by Korea of the allegedly WTO-inconsistent measures (or their effects). We first consider whether the European Communities acted in response to what it considered to be a violation by Korea of its WTO obligations. We then consider whether the European Communities acted unilaterally to obtain the removal by Korea of the measures at issue.

Did the European Communities act in response to what it considered to be a violation by Korea of its obligations under the WTO Agreement?

Panel did not state that the coverage of Article 23 of the DSU is confined to that of Article 60. Panel Report, *US - Certain EC Products*, para. 6.133.

³⁹⁷ Response of the European Communities to Panel Question 23, paras. 47-48.

³⁹⁸ Response of the European Communities to Panel Question 23, paras. 49-53.

³⁹⁹ Response of the European Communities to Panel Question 23, para. 52.

7.209 In considering whether the European Communities' adoption of the TDM Regulation was in response to what it considered to be a violation by Korea of its WTO obligations, the Panel recalls that it has already discussed a closely related issue at length. In paragraphs 7.114-7.143 we considered the relationship of the TDM Regulation to Korean subsidization and found that the TDM Regulation had a close correlation and inextricable link to the constituent elements of subsidization, in large part because of the use in the Regulation and related materials of terms taken from the SCM Agreement's provisions disciplining the use of subsidies. Thus, much of our discussion in those paragraphs is relevant to the question of whether the European Communities acted in response to a perceived violation by Korea of the WTO Agreement and we incorporate it into this section, and, in addition, highlight the following points.

7.210 On its face, the TDM Regulation does not indicate that it is designed as a response to a violation by Korea of its obligations under the WTO Agreement. According to Korea, the TDM Regulation was based on an allegation that Korea had violated its obligations under Articles 3, 5 and 6 of the SCM Agreement. Neither the introductory section nor the operative part of the TDM Regulation contains an explicit statement that Korea has acted inconsistently with its obligations under the SCM Agreement. Nevertheless, the Panel considers that the TDM Regulation reflects an allegation of WTO-inconsistent conduct.

7.211 The TDM Regulation uses terminology that is intimately connected with the provisions of Articles 5 and 6 of the SCM Agreement. The third Recital observes that a temporary defensive mechanism should be authorized for limited market segments and for a short and limited period only, "as an exceptional and temporary measure, and in order to assist Community shipyards in those segments that have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition". Article 2(2) allows for the extension of the Regulation to LNG carriers if the Commission gives notice that it confirms that "[the] Community industry has suffered material injury and serious prejudice in this market segment caused by unfair Korean practices". The Regulation was proposed by the Commission when an investigation under the Trade Barriers Regulation had produced evidence that subsidies granted by Korea were causing adverse effects within the meaning of the SCM Agreement to certain segments of the Community shipbuilding industry. We note that in explaining the background to the proposed TDM mechanism, the European Commission stated in July 2001 that this proposal "follows a Commission investigation which found evidence of substantial subsidies that are incompatible with the WTO rules".⁴⁰⁰ When the Commission issued its first report on the results of this investigation, it stated publicly that "substantial subsidies have been granted to Korean shipyards through both export and domestic programmes which contravene the WTO's 1994 Subsidies Agreement."⁴⁰¹ These factors demonstrate a clear factual link between the adoption of the TDM Regulation and the findings of WTO-inconsistent conduct by Korea. In the Panel's view, the application of Article 23.1 of the DSU is not limited to cases involving an explicit allegation of WTO-inconsistent conduct.

7.212 The Panel recalls its observation above that when a Member seeks "the redress of a violation..." it has necessarily arrived at a "preliminary view" that a violation has occurred. The Panel agrees with the remark of the Panel in *US - Section 301 Trade Act* that such a preliminary view is distinct from a "determination" within the meaning of Article 23.2(a) of the DSU.⁴⁰² The evidence before us indicates that the TDM Regulation was based on factual findings that clearly amounted to at

⁴⁰⁰ IP/01/1078, 25 July 2001, Exhibit Korea 9. We acknowledge of course that the TDM Regulation was adopted by the Council not by the Commission but consider nevertheless that in view of the role of the Commission in initiating this legislation it is not inappropriate to accord some evidentiary weight to these press releases to reinforce a conclusion derived from an analysis of the text of the Regulation. We note that the Panel in *US - Certain EC Products* relied *inter alia* on a USTR press release and statements of a deputy USTR at a press conference as evidence in support of its finding that the United States was "seeking the redress of a violation..." Panel Report, *US - Certain EC Products*, paras. 6.25 and 6.31.

⁴⁰¹ IP/01/656, 8 May 2001, Exhibit Korea 8.

⁴⁰² Panel Report, *US - Section 301 Trade Act*, para. 7.50, footnote 657.

least a "preliminary view" that Korea had committed breaches of its obligations under the SCM Agreement. It is not necessary to ascertain whether or not these findings, as contained in the reports submitted by the European Commission to the Advisory Committee, qualify as determinations within the meaning of Article 23.2(a) of the DSU.

7.213 The Panel also notes that the TDM Regulation is specifically directed against Korea. Article 2(1) of the Regulation provides that:

"Subject to paragraphs 2 to 6, direct aid in support of contracts for the building of container ships, product and chemical tankers as well as LNG carriers shall be considered compatible with the common market when there has been competition for the contract from a Korean shipyard offering a lower price."

The possibility to provide contract-related operating aid is confined to precisely those segments of the Community shipbuilding industry found by the European Communities to have suffered adverse effects of "unfair *Korean* competition" or "unfair *Korean* practices" and such aid may be provided only in cases where there has been competition for a particular contract from a *Korean* shipyard offering a lower price. The temporal application of the TDM Regulation depends upon the initiation and resolution or suspension of a WTO dispute settlement proceeding brought by the European Communities against *Korea*. The focus on Korea is also evident in that the introductory Recitals motivate the adoption of the Regulation by referring to Korea's alleged non-implementation of the Agreed Minutes relating to world shipbuilding and to the adverse effects on certain segments of the Community shipbuilding industry caused by "unfair *Korean* competition" or "unfair *Korean* practices". The fact that the Regulation singles out Korea in its manner of operation and its motivation demonstrates that the Regulation is "a reaction by a Member against another Member".

7.214 In light of these considerations, the Panel is satisfied that by adopting the TDM Regulation the European Communities acted in response to what it considered to be a violation by Korea of its obligations under the WTO Agreement.

Did the European Communities seek to restore the balance of rights and obligations?

7.215 With regard to whether the TDM Regulation is a unilateral act whereby the European Communities sought to restore the WTO balance of rights and obligations by seeking removal of Korea's allegedly WTO-inconsistent measure (or its effects), the Panel considers the following factors particularly relevant.

7.216 A key element of the design and structure of the TDM Regulation is that its application is explicitly limited to contracts signed during a period determined by the initiation and resolution or suspension of a WTO dispute settlement proceeding against Korea. This is stipulated in Article 4:

"The Regulation shall be applied to final contracts signed from the entry into force of this Regulation until its expiry, with the exception of final contracts signed before the Community gives notice in the *Official Journal of the European Communities* that it has initiated dispute settlement proceedings against Korea by requesting consultations in accordance with the World Trade Organisation's Understanding on the Rules and Procedures for the Settlement of Disputes and final contracts signed one month or more after the Commission gives notice in the *Official Journal of the European Communities* that these dispute settlement proceedings are resolved, or suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented."

The fact that once the WTO dispute settlement case is resolved or suspended the TDM mechanism ceases to apply suggests that this mechanism serves to seek the same type of redress as the WTO

dispute settlement case. The Panel recalls in this respect that the WTO dispute settlement case and the TDM Regulation are closely linked elements of the European Communities' "twin-track" strategy to deal with unfair Korean practices in the shipbuilding sector.

7.217 Thus, when the Commission submitted its first report on the investigation under the Trade Barriers Regulation, it stated the following in a press release:

"Further to the adoption of its fourth report on the state of the EU shipbuilding industry last week, the Commission today approved the strategy it will propose to the Council of Ministers on 14/15 May, in order to address the persistent problems posed to the European shipbuilding industry by unfair trade practices by Korean shipyards. The investigation into subsidies carried out under the Trade Barriers Regulation (TBR) has established that substantial subsidies have been granted to Korean shipyards through both export and domestic programmes which contravene the WTO's 1994 Subsidies Agreement. On this basis, the Commission will recommend that the matter be taken before the WTO through the initiation of a dispute settlement procedure by 30 June unless an amicable solution can be reached in the interim period. *In parallel, the Commission will propose accompanying measures in the form of a temporary support mechanism to European shipyards for the market segments considerably injured by unfair Korean trade practices and for the period required for the conclusion of the WTO procedure.* Its entering into force will be simultaneous with the effective start of the WTO action."⁴⁰³

In July 2001, when the Commission submitted a formal proposal to the Council, it issued a press release which stated:

"The Commission today adopted a proposal for a Council Regulation which would put in place a temporary defensive mechanism for European shipbuilding. *The proposal is one element of the Commission's two-part strategy against unfair Korean practices in this sector* and will cover the market segments that are considerably injured by these practices. It comes after a series of negotiations between the Commission and Korea, which failed to produce an agreement that would restore normal trading conditions. *The proposal is an accompanying measure to dispute settlement proceedings against Korea, which will be initiated in the WTO as soon as the Council expresses its favourable position on the temporary defensive mechanism.*
...

The proposal for a defensive temporary support mechanism follows a Commission investigation which found evidence of substantial subsidies that are incompatible with the WTO rules. Despite a series of negotiations between the Commission and the Korean Government, no amicable solution has yet been achieved. *Accordingly, the Commission has instigated its two part strategy for fighting these unfair practices: proposing a temporary defensive mechanism and the initiation of dispute settlement proceedings.*

The proposal for the temporary defensive mechanism is limited to those market segments in which the Commission investigation found that EU industry had been considerably injured by unfair Korean trade practices, namely container ships and product and chemical tankers.⁴⁰⁴

⁴⁰³ IP/01/656, 8 May 2001, Exhibit Korea 8 (emphasis added).

⁴⁰⁴ IP/01/1078, 25 July 2001, Exhibit Korea 9 (emphasis added)

7.218 Moreover, that the period during which Community shipyards can receive aid under the TDM Regulation is so explicitly linked to the WTO dispute settlement case also creates an incentive for Korea to alter its conduct regarding the measures at issue in that dispute settlement case. The state aid provided for under the national aid schemes adopted within the framework of the TDM Regulation is designed to shift the balance of competitive advantages in favour of Community shipyards relative to Korean shipyards.⁴⁰⁵ Article 4 of the TDM Regulation makes it clear that Korea can limit the period during which its shipyards will be confronted with this competitive disadvantage if it takes steps with regard to the practices at issue in the dispute so as to make an early resolution of the dispute possible, or if it takes steps with regard to the implementation of the Agreed Minutes, which as seen above, relates to an important extent to subsidies and the continuing effects of subsidies on prices. The Panel realizes that it has no information before it demonstrating that the impact on Korean shipyards of the state aid provided as a result of the TDM Regulation has actually influenced the conduct of the Government of Korea in the dispute initiated by the European Communities. In the Panel's view, however, the decisive consideration is that Article 4 of the TDM Regulation is designed to have an effect of inducing Korea to take steps to remove the alleged WTO-inconsistent measure. Since the TDM Regulation is designed to influence Korea's conduct, the Panel does not consider as persuasive the argument of the European Communities that the link between the TDM Regulation and the WTO dispute settlement case is merely of a political nature and is explained simply by the need for an objective criterion to limit the duration of the aid scheme.

7.219 As noted above, the simple fact that a Member responds to a perceived WTO violation by seeking to compensate or attenuate the harm caused to actors within the Member resulting from an alleged violation does not in itself represent "seeking redress" provided the action is not designed to restore the (perceived) balance of rights and obligations between the Members. Thus, if the European Communities had simply reinstated in 2002 its former system authorizing member State aid to shipbuilding, such an action would likely not raise issues under DSU Article 23. However, in the view of the Panel, the TDM Regulation goes beyond a measure whereby the European Communities seeks to compensate or to attenuate the harm resulting from an alleged violation by Korea of its obligations under the SCM Agreement. The TDM Regulation, by its design and structure, is explicitly tied to WTO dispute settlement. That tie is confirmed by the Commission statements quoted above. In our view, the TDM Regulation operates directly and exclusively to alter the conditions of competition between Korean and Community shipyards in respect of individual transactions and is clearly designed to restore the balance of rights and obligations by inducing Korea to remove the alleged WTO-inconsistent measure.

7.220 In light of all the above factors, the Panel considers that the European Communities has sought unilaterally to achieve results that Article 23.1 requires to be sought through recourse to the DSU. By adopting the TDM Regulation, the European Communities acted in response to what it considered to be a violation by Korea of its obligations under the WTO Agreement and sought to restore the balance of rights and obligations by inducing Korea to remove the alleged WTO-inconsistent measure. As such, the TDM Regulation is a measure subject to the requirement of Article 23.1 of the DSU that Members "have recourse" to the DSU when they "seek the redress of a violation...", covered by Article 23.1 of the DSU. We emphasize that this conclusion is based on an analysis of the design and structure of the TDM Regulation and does not depend upon whether the

⁴⁰⁵ In our analysis under Article 32.1 of the SCM Agreement, we have identified several considerations supporting the view of the Appellate Body that the effect of a subsidy on conditions of competition is not a relevant factor in determining whether that subsidy is an action "against" a subsidy of another Member. In particular, we referred to the overall structure of the SCM Agreement, its object and purpose, and the historical background of the concept embodied in Article 32.1 of the SCM Agreement. These considerations do not apply in the context of Article 23.1 of the DSU. Since the purposes and background of Article 23 of the DSU and Article 32.1 of the SCM Agreement are very different, a given set of factual elements that would not be sufficient for a measure to be an action "against" a subsidy in the sense of Article 32.1 of the SCM Agreement might still be sufficient for a finding that a measure "seeks the redress of a violation..." within the meaning of Article 23 of the DSU.

European Commission has actually authorized the member States to adopt TDM aid schemes and whether member States have actually provided state aid within the framework of such schemes. In the Panel's view, the TDM Regulation by itself is action taken by the European Communities that "seeks the redress of a violation..." .

7.221 Since it is undisputed that the European Communities adopted the TDM Regulation without having recourse to the DSU, the Panel **concludes** that by adopting the TDM Regulation the European Communities acted inconsistently with Article 23.1 of the DSU.

7.222 The Panel also **concludes**, as a consequence, that since the TDM aid schemes of Denmark, France, Germany, the Netherlands, and Spain, and the Decisions of the European Commission authorizing those aid schemes, are measures taken in application of the TDM Regulation, they are also inconsistent with Article 23.1 of the DSU.

3. Article 23.2

(a) Arguments of the parties⁴⁰⁶

7.223 **Korea** submits that the TDM Regulation is inconsistent with Article 23.2(a) because it includes a "determination" that Korea has acted inconsistently with its obligations under the WTO Agreement that was not made through exclusive recourse to dispute settlement in accordance with the rules and procedures of the DSU.⁴⁰⁷ Korea also argues that the TDM Regulation violates Article 23.2(b) of the DSU because the European Communities adopted the Regulation without following the procedures set forth in Article 21 of the DSU to determine the reasonable period of time for the Member concerned to implement recommendations and rulings.⁴⁰⁸ Finally, Korea submits that the European Communities acted inconsistently with Article 23.2(c) of the DSU in that it failed to first obtain DSB authorization and follow the procedures laid down in Article 22 of the DSU before applying any countermeasures or suspending concessions or obligations towards Korea.⁴⁰⁹

7.224 The **European Communities**, referring to the interpretation of the word "determination" in Article 23.2(a) by the Panel in *US - Certain EC Products*, argues that the TDM Regulation does not contain a finding of WTO inconsistency and bears no consequences in WTO trade relations. Therefore, the Regulation is not inconsistent with Article 23.2(a).⁴¹⁰ The European Communities rejects Korea's claims under Article 23.2(b) and (c) on the grounds that the TDM Regulation is not a countermeasure because it does not suspend WTO concessions or obligations.⁴¹¹

(b) Evaluation by the Panel

7.225 We note the guidance provided by the Appellate Body as to the exercise of judicial economy. We are not required to examine all claims raised by Korea but only those claims that must be addressed to resolve the matter at issue in this dispute. However, as stated by the Appellate Body in *Australia - Salmon*, we must address those claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member in order to ensure effective resolution of disputes to the benefit of all Members.⁴¹²

7.226 We consider that action by the European Communities to comply with a DSB recommendation based on our conclusion that the TDM Regulation, the Commission Decisions and

⁴⁰⁶ For a more detailed account of the arguments of the parties, see Section IV.C.4.

⁴⁰⁷ First submission of Korea, paras. 72-85.

⁴⁰⁸ First submission of Korea, paras. 86-88.

⁴⁰⁹ First submission of Korea, paras.89-91.

⁴¹⁰ First submission of the European Communities, paras. 170-176.

⁴¹¹ First submission of the European Communities, paras. 177-178.

⁴¹² Appellate Body Report, *Australia - Salmon*, para. 223.

the national aid schemes are inconsistent with Article 23.1 of the DSU would also remove any inconsistency with Article 23.2 of the DSU.

7.227 In light of these considerations, the Panel does not consider it necessary to examine whether in addition to Article 23.1 of the DSU, the measures at issue are also inconsistent with Article 23.2 of the DSU.

F. CLAIMS UNDER ARTICLES 4 AND 7 OF THE SCM AGREEMENT

1. Main arguments of the parties⁴¹³

7.228 Korea argues that by acting unilaterally outside the framework of the dispute settlement provisions of the SCM Agreement, the European Communities violated Articles 4.1-4 and 7.1-4 of that Agreement.⁴¹⁴ Korea also claims that the European Communities acted inconsistently with Articles 4.10 and 7.9 of the SCM Agreement by failing to seek and obtain authorization of the DSB to apply countermeasures.⁴¹⁵ In response to a question by the Panel, Korea subsequently stated that "SCM Articles 4.2 to 4.12 and 7.2 to 7.10 have been violated, for the reasons explained in paragraphs 132-140 of Korea's First Written Submission. Korea draws special attention to SCM Articles 4.4, 4.10, 7.4 and 7.9".⁴¹⁶

7.229 The European Communities argues that there is no legal basis for Korea's claims under Articles 4 and 7 of the SCM Agreement separately from Korea's claim under Article 23 of the DSU and that even when considered in conjunction with Korea's claim under Article 23, these claims must be rejected because the European Communities has strictly adhered to the DSU. Moreover, the TDM Regulation and the national measures adopted within the framework of the Regulation are not countermeasures within the meaning of Articles 4 and 7 of the SCM Agreement. In the view of the European Communities, Korea has failed to explain how the European Communities has acted in violation of specific procedural requirements of Articles 4 and 7.⁴¹⁷

2. Evaluation by the Panel

7.230 The Panel notes that Articles 4.1-4 and 7.1-4 of the SCM Agreement define certain procedural rights of Members with respect to consultations and the establishment of panels in disputes concerning prohibited subsidies and actionable subsidies. In our view, the claims of Korea under these Articles involve the same fundamental issue of unilateral conduct by the European Communities outside the framework of the WTO dispute settlement procedures that we have already found to be in breach of Article 23.1 of the DSU. We recall our discussion above in the context of Article 23 of the guidance provided by the Appellate Body in respect of the exercise of judicial economy. Applying the considerations articulated by the Appellate Body, we do not consider that findings under Articles 4 and 7 of the SCM Agreement, in addition to the finding already made under Article 23.1 of the DSU, are necessary to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by the European Communities in order to ensure effective resolution of this dispute. We also note in this respect that Korea has submitted little detailed argumentation to support its claims under these provisions and that while they are discussed in Korea's first submission, Korea's second submission is silent on these claims.

7.231 Therefore, we decide not to examine Korea's claims under Articles 4 and 7 of the SCM Agreement.

⁴¹³ For a more detailed account of the arguments of the parties see Section IV.C.5.

⁴¹⁴ First submission of Korea, paras. 134-135.

⁴¹⁵ First submission of Korea, paras. 137-139.

⁴¹⁶ Response of Korea to Panel Question 50.

⁴¹⁷ First submission of the European Communities, paras. 179-181; second submission of the European Communities, paras. 141-148.

VIII. CONCLUSIONS AND RECOMMENDATION

8.1 The Panel concludes:

(a) the TDM Regulation, the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain, and the European Commission Decisions authorizing those schemes, are not inconsistent with Article III:4 of the GATT 1994;

(b) the TDM Regulation, the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain, and the European Commission Decisions authorizing those schemes, are not inconsistent with Article I:1 of the GATT 1994;

(c) the TDM Regulation, the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain, and the European Commission Decisions authorizing those schemes, are not inconsistent with Article 32.1 of the SCM Agreement;

(d) the TDM Regulation, the national TDM schemes of Denmark, France, Germany, the Netherlands and Spain, and the European Commission Decisions authorizing those schemes, are inconsistent with Article 23.1 of the DSU; and

(e) in light of its finding in respect of Article 23.1 of the DSU, it is not necessary for the Panel to make findings regarding the claims of Korea under Articles 23.2(a),(b) and (c) of the DSU and under Articles 4 and 7 of the SCM Agreement.

8.2 Under Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits under that agreement. Accordingly, we conclude that, to the extent the European Communities has acted inconsistently with the provisions of the DSU, it has nullified or impaired benefits accruing to Korea under that agreement.

8.3 In light of these conclusions, we recommend that the DSB request the European Communities⁴¹⁸ to bring its measures listed in paragraph 1(d) into conformity with its obligations under the DSU.

8.4 We are aware that the TDM aid schemes of Denmark, Germany and Spain expired on 31 March 2004 and were not renewed. The Appellate Body Report in *US - Certain EC Products* suggests that it is inappropriate to make a recommendation within the meaning of Article 19 in respect of a measure that no longer exists.⁴¹⁹ However, the notion of a measure that no longer "exists" is not always straightforward. In the present case, it is clear from the information before the Panel that where national aid schemes have expired, no new applications for TDM aid can be submitted. On the

⁴¹⁸ We have already explained in Section VII.A.4(c) of this Report why we consider that in the circumstances of this case a recommendation addressed only to the European Communities is sufficient.

⁴¹⁹ Appellate Body Report, *US - Certain EC Products*, para. 129.

other hand, however, we cannot determine with certainty whether and to what extent it is possible that subsidies continue to be provided pursuant to applications made before the expiry of those schemes. Therefore, the Panel considers that its recommendation does not apply to the schemes that have expired, except to the extent that those schemes continue to be operational.⁴²⁰

⁴²⁰ We have explained in Section VII.A.4(a)(ii) of this Report why we consider that we cannot make the specific recommendation requested by Korea in respect of disbursements of funds. In its comments on the Interim Report, Korea requests us at least to make "clarifying suggestions" pursuant to our authority under Article 19.1 of the DSU. For the reasons discussed in paragraph 7.23 of this Report, we do not think it would be appropriate to do so.

IX. ANNEX

**WORLD TRADE
ORGANIZATION**

WT/DS301/3
6 February 2004

(04-0470)

Original: English

**EUROPEAN COMMUNITIES – MEASURES AFFECTING TRADE
IN COMMERCIAL VESSELS**

Request for the Establishment of a Panel by Korea

The following communication, dated 5 February 2004, from the delegation of Korea to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

On 3 September 2003, the Republic of Korea ("Korea") requested consultations with the European Communities ("EC") and its Member States pursuant to Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)*, Article XXIII:1(a) of *General Agreement on Tariffs and Trade 1994 ("GATT 1994")*, Article XXIII:1(b) of GATT 1994 and Articles 4, 7 and 30 of the *SCM Agreement* with regard to measures affecting trade in commercial vessels, as elaborated below.

Consultations were held on 9 October and 14 November 2003. The consultations held between Korea and the EC related to various EC and Member State measures in relation, *inter alia*, to the following:

- i. The provisions of EC Regulation 1177/2002 (the "TDM Regulation") and EC Regulation 1540/98 as such, as well as the EC Member States' implementing provisions as such. The above provisions provides for granting of subsidies in favour of commercial vessels, whether directly to the shipbuilders or indirect aid, including operating aid, restructuring aid, insolvency and closure aid, aid for regional or other investment, research and development aid and aid for environmental protection;
- ii. The EC and its Member States have in particular instances, through federal, regional or local authorities and government-owned or government-controlled financial institutions, provided subsidies in direct or indirect support of commercial vessels built in the EC particularly but not exclusively in the form of (a) operating aid granted on a contractual basis in forms such as grants, export credits, guarantees or tax breaks, (b) restructuring aid, (c) regional or other investment aid, (d) research and development aid, (e) environmental protection aid and (f) insolvency and closure aid.

Unfortunately, these consultations have failed to resolve the dispute between parties as regards the TDM Regulation (and proposed extension) and the EC Member States' implementing

provisions. Korea hereby requests that a panel be established pursuant to Articles 6 of the *DSU* and Article XXIII:2 of *GATT 1994* with respect to the measures described as below.

The measures that are subject of this request are the EC and its Member States' legal provisions and decisions providing for the supply of grants to shipbuilders for containerships, product tankers, chemical tankers and liquid natural gas carriers ("LNGs") adversely affecting the conditions of competition and seeking a unilateral redress of a perceived violation of Korea's obligations under the *SCM Agreements*. In particular, Korea considers that the following measures are inconsistent with the European Communities' obligations under the *SCM Agreement*:

- (i) The provisions of the TDM Regulation as extended to cover LNGs by Notice 2003/C 148/10 published on 25 June 2003 (currently proposed to be extended until 31 March 2005 pursuant to European Commission proposal COM(2004)26 final of 21 January 2004);
- (ii) The EC Member State implementing provisions of the TDM Regulation and the European Commission Decisions approving these implementing provisions, including:
 - Germany:

"Richtlinien des Bundesministerium für Wirtschaft und Arbeit zu befristeten Schutzmassnahmen für den Schiffbau", 24 October 2002;

Case N 744/2002, Commission Decision (2003)788 fin of 19 March 2003.
 - Denmark

"Lov om midlertidig, kontraktbetinget driftsstotte til bygning af visse skibstyper, LOV No 305", dated 30 April 2003;

Case N 141/2003, Commission Decision (2003)1765 fin of 24 June 2003.
 - The Netherlands

"Tijdelijke regeling ordersteun scheepsnieuwbouw, Regeling van de Staatssecretaris van Economische Zaken, No WJZ3040972", 17 July 2003;

Case N 780/2002, Commission Decision (2002)2019 fin of 9 July 2003 and Case N 339/03, Commission Decision (2003)3378 of 18 September 2003.
 - France

Application du Règlement N° 1177/2002 du Conseil par la décision d'une commission interministérielle (as referred to by the European Commission in the publication of the approval of the French aid for LNGs).

Case N 232/03, Commission Decision (2003)3234 fin of 17 September 2003.
 - Spain

Real Decreto 442/1994 of 11 March 1994 as amended by Real Decreto 1274/2003 of 10 October 2003;

Case N 812/02, Commission Decision (2003)4079 fin of 11 November 2003.

Korea considers that the EC and its Member State measures referred to above are in breach of the EC and its Member State obligations under the following provisions:

- Articles I:1 and III:4 of *GATT 1994* because the TDM Regulation and Member State implementing measures involving the bestowal of German, Danish, Dutch, French and Spanish grants to shipyards on a vessel-specific and product-related basis, adversely modify conditions of competition between Korean commercial vessels and the like vessels built in third countries and Korean commercial vessels and the like vessels built in the EC, respectively;
- Article 23(1) and (2) of the *DSU*, as well as Articles 4 and 7 of the *SCM Agreement*, because the 'TDM Regulation and Member States' implementing measures – which are aimed at assisting EC or its Member State shipyards in those segments that are claimed to have suffered from subsidies allegedly granted to Korean shipyards - have been effectively designed and implemented as unilateral measures seeking redress of a perceived violation of Korea's obligations under the *SCM Agreement* which should occur exclusively through dispute settlement and not through unilateral action;
- Article 32(1) of the *SCM Agreement*, as well as Articles 4 and 7 of the *SCM Agreement*, because the TDM Regulation and Member State implementing measures constitute specific actions against perceived subsidies of another Member not in accordance with the *GATT 1994* as interpreted by the *SCM Agreement*.

Korea requests that a panel be immediately established with standard terms of reference, in accordance with Articles 6 and 7 of the *DSU* and Article 30 of the *SCM Agreement*.

Korea asks that this request for establishment of a panel be placed on the agenda for the next meeting of the Dispute Settlement Body, which is scheduled to take place on 17 February 2004.
