

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

*Report of the Panel*



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<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.<sup>1</sup> 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.<sup>2</sup>

### 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.<sup>3</sup> 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.<sup>4</sup> 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".

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<sup>1</sup> WT/DS301/1.

<sup>2</sup> WT/DS301/2.

<sup>3</sup> WT/DS301/3, attached as Annex.

<sup>4</sup> 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.<sup>5</sup>

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.

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<sup>5</sup> 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.

#### IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties are set out in their submissions to the Panel, and their answers to the questions. The parties' arguments are summarized in this section.

##### A. BACKGROUND

4.2 **Korea** asserts that this dispute arises from an attempt by the European Communities to take the law into its own hands. According to Korea, the European Communities alleged that Korea has subsidized certain of its shipyards, an "unfair trade practice" that has caused "adverse effects" and "serious prejudice" to the European Communities and its shipbuilding industry. Based solely on these allegations, the European Communities has taken countermeasures against Korea as contained in the Temporary Defensive Mechanism ("TDM"), an EC Council Regulation. The European Communities has explicitly linked these countermeasures to the initiation and pendency of the WTO dispute, not its conclusion. This case is about EC unilateralism.

4.3 According to Korea, the European Communities explicitly adopted a two-track strategy to challenge alleged Korean subsidies. It (i) made a determination of subsidization and implemented countermeasures against Korea and (ii) initiated a WTO dispute alleging violations by Korea of the SCM Agreement. These countermeasures are found in the TDM that is the subject of this dispute. This TDM is inextricably tied to the WTO dispute settlement proceedings. By its terms, it was effective on the day consultations began pursuant to Article 4 of the DSU and it will be terminated upon completion of such proceedings. Korea argues that the European Communities and its member States, in adopting the TDM and associated measures, violated several provisions of the WTO Agreement, namely, Article 23 of the DSU, Articles 4, 7 and 32.1 of the SCM Agreement, and Articles I:1 and III:4 of the GATT 1994.

4.4 The **European Communities** dismisses Korea's characterization of the TDM Regulation and the "twin-track" strategy adopted by the European Communities in 2002, asserting that Korea's allegations are politically unjust and legally unfounded. According to the European Communities, the world shipbuilding sector has been subject to serious crises and injurious pricing due to overcapacity and government intervention. The European Communities has been actively engaged in seeking multilateral solutions to the problems of subsidisation and injurious price competition in the shipbuilding sector. However, negotiations at the OECD failed and Korea decided to ignore its bilateral commitments on injurious pricing agreed with the European Communities (the Agreed Minutes signed in 2000). That notwithstanding, since the 1990s the EC industry has engaged in a major process of restructuring and operating aid has been gradually reduced and eventually abolished by the European Communities.

4.5 When the EC industry was threatened with full collapse, it exercised its right to launch a complaint under the EC Trade Barriers Regulation ("TBR Regulation"). The investigation provided factual evidence of (i) Korean subsidies; and (ii) injury in certain sectors of the EC industry. The European Communities then decided under its TBR Regulation to launch a WTO dispute settlement proceeding against Korea that seeks cessation of a number of narrowly defined subsidies (WT/DS273).

4.6 To the European Communities, the TDM Regulation and national subsidy programmes (the measures attacked by Korea in this case) are pure state aid measures. They must be seen in the context of EC state aid law, which prohibits the granting of subsidies unless a specific exception is provided for by the EC Treaty, as the main source of EC state aid law, or by the secondary legislation adopted on the basis of this Treaty. Throughout the 1990s operating aid was progressively reduced, and ultimately was abolished as of 1 January 2001. The European Communities asserts that the TDM

Regulation provides for the limited re-authorisation of state aid to shipbuilding that had previously been phased out. According to the European Communities, the link between the WTO dispute and the TDM is purely political. Moreover, both tracks of the “twin-track-strategy” address the same broader problem, but neither resolves it.

B. PRELIMINARY ISSUES

1. EC Conditional Request for Preliminary Ruling

4.7 The **European Communities** asserts that Korea expanded the scope of its claim to “individual instances of application” of the TDM Regulation by the Commission and the respective EC member States, the application of the TDM scheme in specific cases, or TDM contributions provided pursuant to the TDM framework. The European Communities claims that the request for the establishment of the Panel does not explicitly identify as impugned measures any individual grants. The European Communities also claims that Korea in the request for the establishment of the panel explicitly distinguished between the national schemes as such and “particular instances” of subsidisation in its description of the consultations<sup>6</sup> and can therefore not claim that the term “implementing measure” comprises individual grants. Such expansion of the claims would be contrary to Article 6.2 of the DSU because individual measures under the national TDM measures were not covered by Korea’s request for establishment of the Panel. Therefore, the European Communities submits that the claim insofar as it relates to individual instances of applications is contrary to Article 6.2 of the DSU and requests that it be dismissed.

4.8 **Korea** argues that the granting of the European Communities' request would amount to ruling that, even if the European Communities' authorizing measures are found inconsistent with the European Communities' WTO obligations, the individual disbursements will be legal. Korea also argues that the European Communities' argument is groundless because of the lack of legal precedents supporting its position and of the absence of any prejudice stemming from the lack of specificity in Korea's panel request, so as to cause the European Communities' due process rights to be adversely affected.

4.9 Korea further maintains that the European Communities' preliminary ruling request is factually inaccurate, because it is based on a misquotation of Korea's request for establishment of a panel, as it was clear from such request that it included other measures than those specifically identified therein, through the use of the expression *inter alia*. Moreover, Korea alleges further that the request for consultations included reference to Article XXIII:1(b) of the GATT 1994. In Korea's view, the somewhat different legal basis of such claims requires a more detailed exploration of the actual disbursement patterns over the relevant period in order to see whether there was a reasonable expectation of no further subsidization. The Panel in the GATT case *EEC – Oilseeds I* looked at whether there had been an increase in subsidization beyond that already in existence at the time of the tariff binding in deciding whether there had been a non-violation nullification or impairment. Thus, a review of specific subsidy patterns was relevant. However, the present Panel does not have Article XXIII:1(b) of the GATT 1994, nor DSU Article 26 within its terms of reference and with respect to the violation claims, such information is useful, but not necessary, background information.

4.10 Korea also notes that the European Communities' statement not only ignores the *chapeau* of the referenced paragraph and the context of the description of the consultations, but it also ignores the reference to disbursements in the statement of claims. The first bullet of the description of the actual claims states: "Articles I:1 and III:4 of the GATT 1994 because 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.** . ." Korea submits that this statement is a clear reference to the individual grants.

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<sup>6</sup> Request for the Establishment of a Panel by Korea of 6 February 2004, WT/DS301/3, p. 1.

4.11 Korea also alleges that the European Communities' request is legally insupportable, in that reference to the individual grants was not needed in order to include such grants within the parameters of the dispute. Korea argues that the effect of granting the European Communities' request for a preliminary ruling here would be to force complainants to list all of the actual trade damaging instances as claims and then assume an undue burden of proof in establishing them. For Korea, such ruling would be contrary to the Appellate Body decision in *EC – Bananas III*, where it upheld the panel's decision on the grounds that there is no need to show trade damage to substantiate a claim of nullification or impairment, based on Article 3.8 of the DSU. The Appellate Body has reinforced the breadth of this provision in its Report in *US – Offset Act (Byrd Amendment)*.<sup>7</sup>

4.12 Korea argues that should the Panel exclude these *applications* of the challenged measures, every complainant would be required to list in its panel request all of the instances of inconsistency in addition to identifying the inconsistent measures themselves. This would be impossibly burdensome, would surely miss many applications that actually occurred but were not publicly known (as is the case with the disbursements in the European Communities) and necessarily would exclude all the illegal transactions that took place after the submission of the request for establishment. For Korea, this would undermine the very security and predictability of the multilateral trading system that the Article 3.2 of the DSU says is the fundamental purpose of the dispute settlement system.

4.13 Korea further submits that legal provisions not listed in a panel request nevertheless can be within the scope of the terms of reference if they are “directly related” to the identified measures.<sup>8</sup> Thus, if the Panel were to consider the grants as measures, Korea submits that they would clearly be “directly related” as they are pursuant to the TDM and EC member State laws. However, in Korea's view, the Panel need not reach this issue because these are not new measures, but rather are mere applications of the TDM and the EC member State implementing laws.

4.14 Korea argues that if a measure were to be found inconsistent with a Member's WTO obligations, while any specific applications were to be excluded unless individually listed in the request for establishment, the result would seem to be that such applications could continue, at least to the extent that they had been committed, but not paid, prior to the DSB's rulings and recommendations. However, such a result would be directly contrary to the Appellate Body Report in *Brazil – Aircraft (Article 21.5)* wherein the Appellate Body stated 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.”<sup>9</sup>

4.15 At the first substantive meeting with the Panel<sup>10</sup>, the **European Communities** explained further why an importation into this dispute of individual disbursements would have severely hampered its due process rights. Individual disbursements are granted by the member States and the European Communities would have needed considerable time to obtain the relevant evidence from the member States. Moreover, the European Communities would have needed to request additional working procedures for the protection of Business Confidential Information. It is for that reason that

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<sup>7</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)* at para. 212.

<sup>8</sup> See, e.g., *Argentina – Footwear (EC)* at paras 8.24-8.45, citing *EC – Bananas III*, *Japan – Film* and *Australia – Automotive Leather II*.

<sup>9</sup> Appellate Body report in *Brazil – Aircraft, Article 21.5* at para 45. Korea recognizes that SCM Article 4.7 refers to withdrawal without delay, while DSU Article (which is applicable in the present dispute) uses somewhat different language; i.e., bringing a measure into conformity. Nonetheless, the analogy holds. Indeed, in Korea's view the language in SCM Article 4.7 is simply the particular application of DSU Article 19.1 in the context of a prohibited subsidies case. This is in contrast with SCM Article 7.8 which provides for an additional possible remedy of removal of the adverse effects.

<sup>10</sup> The remarks of the European Communities as reflected in this paragraph, and the remarks of Korea as reflected in the next paragraph, 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.

the European Communities sought clarification whether or not Korea had pursued a claim on the basis of individual grants. The European Communities raised this issue through a conditional request for a preliminary ruling so as to allow the issue to be settled by a simple clarification by Korea. The European Communities also disagreed with Korea's argument that the description of these implementing measures as "involving the bestowal of grants to shipyards on a vessel-specific and product related basis" in the context of the Article III:4 GATT claim can be read as identification or reference to individual disbursements to warn the European Communities that such measures will be covered by the dispute. That phrase only refers to the "implementing measures" defined previously as the general schemes. The European Communities then noted that Korea had confirmed, in its Oral Statement, that it does not base its case on individual grants. Indeed, independently from the scope of the request for the establishment of the Panel, Korea had not pursued, in its first submission, any claim relating to individual grants which would have required identification of such instances. On that basis the European Communities withdrew its conditional request for a preliminary ruling, after having expressed its disagreement with Korea on the scope of a future implementation phase in this case (under the remedy sought in this proceeding, only the general measure could be targeted and withdrawn) and the interplay between the measures covered under this dispute and those covered under another dispute settlement proceeding (the individual disbursements that are the subject of a separate request for consultations under WT/DS307).

4.16 **Korea** expressed its concerns about the withdrawal of the request for a preliminary ruling, in that it could bring a fundamental misunderstanding about the nature of the disbursements, as the European Communities is classifying them as "measures". For Korea, the disbursements are not measures and even if they were they would be "directly related" and therefore properly before the Panel.<sup>11</sup>

4.17 During the first substantive meeting with the Panel, the Panel expressed its view on the matter, as follows:

"[...] 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."

4.18 Subsequently, **Korea** requested the Panel to "make a decision as to whether or not it considers the disbursements to be separate measures".<sup>12</sup> Korea argued that if the Panel were to find the disbursements to be distinct, the Panel should also find them to be covered in the request for establishment of the panel because they are "directly related" to the cited measures and therefore are inconsistent with the European Communities' obligations under the WTO provisions referenced in the request for the establishment of the Panel. If, on the other hand, the Panel were to agree with Korea that they should not be considered separate measures and are simply the implementation of measures found to be illegal, Korea requested the Panel to make an affirmative recommendation pursuant to Article 19.1 that the European Communities immediately cease any further disbursements of illegal funding. Otherwise, the European Communities' statements would lead to the conclusion that circumvention of prospective DSB rulings and recommendations was already being contemplated by the respondent.

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<sup>11</sup> See footnote 10.

<sup>12</sup> Second submission of Korea, at para. 32.

4.19 In Korea's view, the EC statement that the national measures "are likely to expire" before the issuance of the Panel Report and that therefore there is no basis for an Article 19.1 recommendation, in fact illustrates the necessity of such a recommendation. First, Korea notes that the European Communities qualifies this conclusion with the reference "are likely to" rather than "will" expire. Second, and most importantly, the point is that the disbursements might continue for a period of years after the expiration of the authority under the TDM as long as they were approved before such expiration. Thus, the European Communities highlights perfectly the need for an Article 19.1 recommendation.

4.20 The **European Communities** responds that for the reasons provided there is no basis to consider (non identified) disbursements as separate measures and to make a separate recommendation on them.

## 2. Other Preliminary Issues

4.21 The **European Communities** alleges that Korea identified five subsidy measures<sup>13</sup> adopted by EC member States. However, in response to a Panel question, Korea claims that it has specifically included in its request for establishment of a panel all member States "implementing provisions" including those in new member States and those which entered into force since this request.<sup>14</sup>

4.22 According to the European Communities, Korea cannot ask the Panel to make findings on measures that were not included in the request for the establishment of the Panel and could indeed not even have existed at that time. The request explicitly includes the TDM Regulation and the five member State schemes existing at the time of the request. While the European Communities accepted in good faith that the request covers the two extensions of these five schemes (the other three expired), Korea cannot expand the scope of this proceeding to any future measures of all future possible new EC member States. According to the European Communities, the member State measures are not implementing measures of the TDM Regulation. They are autonomous decisions on whether or not to make use of the derogation from the prohibition under EC law of contract-related operating aid in the shipbuilding sector.

4.23 Since this is the first EC state aid measure at issue in a WTO proceeding, the European Communities attaches great importance to the correct appreciation of the legal status of the TDM Regulation and the five national measures identified by Korea. The European Communities states that the TDM Regulation has the nature of a *limited derogation* from a general prohibition of subsidisation; it is not a "specific authorisation" and the five member States measures are not "implementing" measures. Moreover, Korea has identified five national measures. The scope of this proceeding does not extend to other such measures (if any), in particular measures taken by any of the new member States that acceded after the commencement of the Panel proceeding.

4.24 **Korea** disagrees with the European Communities' argument that new measures of EC member States that might come into effect should not be subject to any rulings by the Panel.<sup>15</sup> Korea refers the Panel to its discussion of "directly related" measures in this regard.<sup>16</sup> Korea also disagrees with the European Communities' statement that the only respondent in this dispute is the European Communities as such and not its member States.<sup>17</sup> Korea's position is that all EC member States are independently WTO Members, and that internal EC constitutional issues cannot adversely affect the rights of Korea or any other WTO Member.

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<sup>13</sup> Oral statement of Korea at the first substantive meeting of the Panel with the parties, at para. 8.

<sup>14</sup> Response of Korea to Panel Question 4.

<sup>15</sup> Second submission of the European Communities, para. 33.

<sup>16</sup> Attachment 2 to oral statement of Korea at the first substantive meeting of the Panel with the parties.

<sup>17</sup> Response of Korea to Panel Question 4.

4.25 The **European Communities** submits further preliminary comments on the legal claims presented by Korea. First, the European Communities claims that Korea's description of the measure at issue is unclear. Korea first attacks the "twin-track-strategy" (described through a number of press releases), refers to the "Temporary Defensive Mechanism and associated measures", then lists five national schemes and finally refers to "individual instances of applications of the TDM in the respective member States." However, the European Communities alleges that Korea nowhere specifies any individual grants under these five national measures.

4.26 Second, the European Communities asserts that the TDM Regulation is not a legally relevant measure. Contrary to what Korea alleges, the TDM Regulation does not prescribe rules for regulating the provision of state funded payments to EC shipbuilders which is then implemented by EC member States. It only contains a limited exemption from the general prohibition of (contract-related operating) aid. It does not oblige or even encourage member States to grant such types of aid. If at all, the national measures can be measures that set forth positive action.

4.27 Third, according to the European Communities, the five national TDM programmes attacked by Korea expired on 31 March 2004, and only two (the French and Netherlands measures) had been prolonged.<sup>18</sup> Fourth, the European Communities further argues that Korea makes strikingly little reference to the TDM Regulation or the national TDM programmes, but refers instead to a wide variety of press releases. Korea does not claim that these statements constitute measures and generally statements can only serve as further confirmation of a set of facts that have already been found to exist. Therefore, the European Communities asks the Panel to base its analysis of the measure on the measure itself. The press releases selectively cited by Korea are politically motivated statements by individual Commissioners that cannot and do not contain a legally binding or otherwise relevant interpretation of the TDM Regulation and its legal nature.

4.28 **Korea** responds to the first EC point by recalling its arguments discussed above regarding the necessary illegality of any disbursements or implementation of measures found to be inconsistent with the European Communities' obligations by the DSB.

4.29 Korea also takes issue with the European Communities' argument that the TDM is somehow a "limitation" on subsidies. Korea recalls the Appellate Body's decision in *India – Patents (US)* that a panel is not constrained by a Member's proffered interpretation of its own laws in examining the consistency of such measures with international obligations.<sup>19</sup> Moreover, the European Communities' argument regarding the characterization of the TDM makes no sense. The European Communities has acknowledged that, prior to the TDM, the EC member States did not have the authority to promulgate laws or regulations providing for the discriminatory funding described in the TDM. Thus, at that point, there was no legal authority for any funding. After the TDM, such authority existed. Hence, it clearly is an authorizing regulatory measure.

4.30 Regarding the third point, Korea stated that the attempts by the European Communities to deny the evidentiary value and relevance of EC press releases, memoranda and documents, and its arguments that such evidence should be "disregarded" are legally and factually unsupported. The European Communities' position is a futile attempt to try to explain away the massive quantity of testimony that all point in the same direction to confirm what is clearly discernable from the TDM Regulation and EC member State measures themselves – that they are unilateral retaliatory measures which discriminate against Korea in violation of the above-cited WTO provisions. There is no legal or procedural basis for contending that this type of evidence should be "disregarded" in this case. The European Communities itself has conceded that in any event "the press releases do not in any way contradict the content of the measures."<sup>20</sup> And as noted by the Panel in *Chile-Alcoholic Beverages*,

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<sup>18</sup> Response of the European Communities to Panel Question 2.

<sup>19</sup> Appellate Body Report, *India – Patents (US)* at para. 66.

<sup>20</sup> First submission of the European Communities, para. 106.

“statements by a government against WTO interests, e.g., indicating a protective purpose or design, are most probative.”<sup>21</sup>

C. LEGAL CLAIMS

1. Article III:4 of the GATT 1994

4.31 **Korea** asserts that the Appellate Body has held that three main elements must be satisfied for a violation of Article III:4 of the GATT 1994 to be established:

- the measure at issue is a “law, regulation or requirement affecting [a product’s] internal sale, offering for sale, purchase, transportation, distribution or use”;
- the imported and domestic vessels at issue are “like products”;
- the imported products are accorded “less favorable treatment than that accorded to like domestic products.”<sup>22</sup>

4.32 Korea submits that the TDM Regulation, as a generally applicable Council Regulation adopted in accordance with the legislative procedures laid down in the Treaty Establishing the European Community, clearly qualifies as a “law” or “regulation.”

4.33 Furthermore, the TDM Regulation “affects” the internal sale, offering for sale, purchase etc. of imported products. The word “affecting” in Article III:4 has been interpreted by previous panels as having a broad scope of application and covers measures which in a broad sense have an effect on imported goods.<sup>23</sup> In *Canada – Automobiles*, the Panel elaborated that “the word ‘affecting’ implies a measure that has ‘an effect on’ and this indicates a broad scope of application.” The Panel noted that the word ‘affecting’ in Article III:4 of the GATT 1994 covers any laws or regulations which might adversely modify the conditions of competition between domestic and imported products.”<sup>24</sup>

4.34 Korea maintains that the contributions scheme provided for by the TDM clearly affects and adversely modifies the conditions of competition between, on the one hand, domestically produced container ships, product/chemical tankers and LNG carriers, and on the other hand, Korean origin imported vessels of the same type. The TDM Regulation only applies when there is direct competition between a Korean and EC shipyard bidding for a particular vessel sale and where the EC shipyard concerned supplies evidence that a competing Korean yard is offering a lower price.<sup>25</sup> The injection of the TDM retaliatory contributions in favour of the EC yard, but not the Korean yard, allows the EC shipbuilder to artificially lower the price for the ship being offered and thereby the TDM alters the conditions of competition – especially price competition – between the EC and Korean products to the clear disadvantage of the Korean product, Korea claims.

4.35 As noted by the Panel in *Indonesia – Autos*, subsidies can be found to affect imports in a manner violating Article III when they have a component that introduces discrimination between

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<sup>21</sup> Panel Report, *Chile – Alcoholic Beverages*, paras 7.118 and 7.119.

<sup>22</sup> Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

<sup>23</sup> Korea notes the statement of the Appellate Body in *EC – Bananas III*, para. 220, in the context of its discussion of Article I:1 of the GATS that:

the ordinary meaning of the word “affecting” implies a measure that has “an effect on,” which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term “affecting” in the context of Article III of the GATT is wider in scope than such terms as “regulating” or “governing.” [Emphasis added by Korea].

<sup>24</sup> Panel Report, *Canada – Autos*, para. 10.80.

<sup>25</sup> Article 2.1, TDM Regulation.

foreign and domestic products.<sup>26</sup> Clearly, the contract-related and vessel-specific TDM contributions introduce precisely such discrimination between domestic and imported (Korean) products. Indeed, as the TDM retaliatory contribution directly aims at and affects the price of the vessel, the ship-owner is the ultimate beneficiary of the TDM retaliatory contribution as he effectively settles the lower price for the vessel subject of the TDM contribution.

4.36 Korea also states that the TDM Regulation applies to Korean and EC “like products”. According to well-established GATT/WTO jurisprudence, the physical properties of the products themselves, their end-use, consumer tastes and habits and the tariff classification of the product are taken into account for determining whether products are “like”.<sup>27</sup> In *EC – Asbestos*, the Appellate Body noted that the definition of “likeness” in Article III:4 of the GATT 1994 must be read in the light of the overarching objective of Article III, which is to provide equality of competitive conditions for imported products in relation to domestic products. Since it is products that are in a competitive relationship in the marketplace that could be affected by measures treating imports less favourably than the treatment accorded to domestic products, the Appellate Body concluded that “it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are – or could be – in a competitive relationship in the marketplace”.<sup>28</sup>

4.37 With respect to vessels covered by the TDM Regulation, Korea asserts that the “competitive relationship” between the imported (i.e. Korean) and domestic vessels could not be more manifest. By its terms, the TDM Regulation provides that TDM contributions may only be granted where it is established that an EC yard is competing with a “Korean shipyard offering a lower price” in the context of a specific shipbuilding bid.<sup>29</sup> By requiring competition from a Korean-origin vessel, the TDM Regulation operates so as to limit its application exclusively to cases where Korean and EC origin vessels are “in a competitive relationship in the marketplace.” The TDM Regulation moreover requires that this competitive relationship be present on a contract-by-contract basis since TDM contributions apply only where there has been competition from a Korean yard in relation to a specific individual shipbuilding contract.

4.38 Moreover, Korea argues, the competing EC and Korean vessels subject to the TDM will have nearly or identical physical properties. This is because in the context of such shipbuilding bids, the ship-owner and broker lay down concrete specifications for the precise characteristics of the ship they are seeking to purchase. The Korean and EC shipyards will thus inherently be competing to provide a ship with identical or nearly identical physical properties (in accordance with the purchaser’s pre-determined specifications and requirements). In each case, the competing Korean and EC vessels will fall within the definition of container ships, product or chemical tankers or LNG carriers laid down in Article 1(a)-(d) of the TDM Regulation. In addition, the competing vessels will be even more narrowly tailored to the purchaser’s further specifications in terms of weight, size, and other characteristics. The EC and Korean vessels subject to the TDM Regulation are therefore inescapably “like” by virtue of the way the TDM operates.

4.39 Under the TDM Regulation, competing EC and Korean vessels will have identical end-uses as well. For example, LNG carriers meeting the product definition of such carriers specified in Article 1.(d) of the TDM Regulation encompass “ships designed with a single deck hull with fixed

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<sup>26</sup> Panel Report, *Indonesia - Autos*, para. 14.45.

<sup>27</sup> Korea notes that the Appellate Body in *Japan - Alcoholic Beverages II*, p. 21, held that uniform classification in tariff nomenclature can serve as a useful basis for confirming the likeness of products but should not be the determining factor. See also the Appellate Body Report in *EC - Asbestos*, para. 101. Korea notes that the Appellate Body found in *EC - Asbestos* that the like product definition in Article III:4 was broader than that utilized in Article III:2. However, given the operation of the terms of the TDM, the breadth of the definition should not matter in this regard.

<sup>28</sup> Appellate Body Report, *EC – Asbestos*, paras. 99 and 103.

<sup>29</sup> Article 2.1, TDM Regulation.

integral and/or independent tanks suited to carry natural gas in liquid form.”<sup>30</sup> The end-use of LNG carriers is clearly for the transport of natural gas in liquid form. In addition, the prospective purchaser who has laid down requirements in advance will obviously have the same end-use in mind, whether the Korean or EC origin vessel is eventually selected. Korea submits that Korean and EC vessels covered by the TDM Regulation are therefore “like products” for the purposes of Article III:4 of the GATT 1994.

4.40 Finally, the TDM Regulation accords to the Korean vessels concerned treatment less favourable than to the like EC vessels. This requirement in Article III:4 of the GATT 1994 has been consistently interpreted to mean that a Member’s measures must ensure effective equality of opportunities between imported products and domestic products.<sup>31</sup>

4.41 Korea submits that since a fundamental objective of Article III is the protection of expectations on the competitive relationship between imported and domestic products, a measure can be found to be inconsistent with Article III:4 merely because of its potential discriminatory impact on imported products.<sup>32</sup> Hence, it is not necessary to show actual effects on trade flows.<sup>33</sup> Indeed, it suffices that the expectations regarding the competitive relationship between imported and domestic products are adversely affected to conclude to a violation of Article III:4. The notion of equal competitive opportunities between foreign and domestic products implies, at the very least, that foreign products be allowed equal access to the market compared to like domestic products. The TDM contributions clearly reduce opportunities for Korean vessels to compete under equal conditions with like vessels built in the European Communities. Because these contributions are only available if the vessels are built at an EC shipyard as opposed to a Korean yard, they produce an incentive for shipowners to place orders with EC shipyards. This artificial incentive provides treatment less favourable to the Korean products.

4.42 In light of the above, Korea maintains that the TDM Regulation violates Article III:4 of the GATT 1994. These conclusions apply *mutatis mutandis* to the EC member State implementing measures and TDM contributions provided pursuant to the TDM framework, and the EC Decisions approving such measures.

4.43 The European Communities responds that to fall under the scope of Article III:4 of the GATT 1994, a subsidy must have a structure or content that discriminates between domestic and foreign producers, e.g., through differential application of tax measures, or internal postal rates. Article III:8(b) of the GATT 1994 exempts from the scope of the national treatment clause the payment of subsidies to producers which involves the expenditure of revenue by a government. In short, it clarifies that WTO Members are not required to pay domestic subsidies to foreign producers by virtue of the national treatment rule. The European Communities also submits that it is undisputed between the parties that the entire structure, design and effect of the TDM Regulation and the national TDM measures is one of budgetary state aids to the producer. The measure is therefore within the scope of Article III:8(b) of the GATT 1994 and consequently outside the purview of Article III:4 of the GATT 1994.

4.44 Korea states that the European Communities does not offer any defence regarding Article III:4 itself. This is not surprising for the TDM provides for *de jure* discrimination against Korean ships. The European Communities’ *only* defence is that it is protected by the exception of Article III:8(b) which provides in relevant part: “The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers. . .”

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<sup>30</sup> Emphasis added by Korea.

<sup>31</sup> GATT Panel Report, *US - Section 337*, para. 5.11.

<sup>32</sup> GATT Panel Report, *US - Section 337*, paras. 5.11 and 5.13.

<sup>33</sup> Appellate Body Report, *Japan - Alcoholic Beverages II*, p. 16 and Panel Report, *EC - Bananas III*, para. 7.179.

4.45 Korea fails to see the relevance of Article III:8(b). With respect to Article III:4, Korea is challenging the TDM Regulation which is a regulatory framework, or as the European Communities states “the TDM is a state aid regulatory instrument”.<sup>34</sup> The European Communities has reiterated the argument that the TDM is a regulatory provision and not a subsidy provision merely three pages before it asserts exactly the opposite under Article III:8(b). The European Communities has stated that “[a]s noted above, the TDM Regulation does not result in any payment and cannot even assume that member States indeed decide to adopt a national scheme”.<sup>35</sup> Thus, the TDM does not satisfy the basic, elemental requirement of Article III:8(b). Furthermore, the Appellate Body in *Canada – Periodicals* made it clear that to qualify for the Article III:8(b) exception, the subsidies must consist of payments, i.e., actual outlays of funds. The TDM does not involve actual outlays (as the European Communities has made clear repeatedly, including in its request for a preliminary ruling).

4.46 Korea asserts that the EC Commissioner Monti has made very clear that the TDM is not meant as a general subsidies scheme but is a narrowly focused trade measure against Korea:

"The [TDM] is an exceptional response to difficult problem: it does not at all represent a general reintroduction of operating aid to shipbuilding, which came to an end on 31 December 2000, but will strengthen the Community's efforts to combat damaging anti-competitive practices by Korea."<sup>36</sup>

4.47 In the view of Korea, this is not a case against EC subsidies as such. This is a case against discriminatory EC regulatory measures. Dispute DS307 is in regard to Korea's broader allegations against EC subsidization and those claims are not before this Panel. Korea states that the European Communities appears to agree with Korea in this regard, which makes quite puzzling the basis for the European Communities' assertion of the exception of Article III:8(b).

4.48 In respect of the European Communities' argument that GATT 1994 Articles III and I do not apply because there are no imports, Korea states that this is simply unproven as a matter of fact and incorrect as a matter of law. As the panel stated in *US – Section 301* “[i]t is commonplace that domestic law in force imposing discriminatory taxation on imported products would, in and of itself, violate Article III irrespective of proof of actual discrimination in a specific case.”<sup>37</sup> While the European Communities has been invited to make the case that it is legally impossible to import ships, it has been unable to do so. In fact the European Communities' own tariff nomenclature, i.e., the Combined Nomenclature, contains Heading 8901 20 10 for sea going tankers; and Heading 8901 90 10 for sea going other vessels for the transport of goods and other vessels for the transport of both goods and persons. The European Communities' own statistical data show that imports take place under both headings.

4.49 With respect to the European Communities' argument that Article III:8(b) was an “exemption” rather than an “exception”, Korea claims that while the Appellate Body used the term “exempt” in its discussion of Article III:8(b) in *Canada – Periodicals*<sup>38</sup>, there was no indication that it put any significance on the term as a contrast to the term “exception”. Moreover, a review of the *US - Malt Beverages* GATT panel report, cited with approval by the Appellate Body in *Canada - Periodicals*, reveals that the panel drew an important distinction between Article III:8(a) which states that “this Article shall not apply” and Article III:8(b), which uses the words “shall not prevent”. According to the panel, the differences in language are important. The panel took the “shall not

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<sup>34</sup> First submission of the European Communities, para. 70.

<sup>35</sup> First submission of the European Communities, para. 210.

<sup>36</sup> Exhibit Korea – 9. See also Exhibit Korea – 2 wherein Commissioner Monti stated that the generalized operating aid had been “definitively abolished”.

<sup>37</sup> Panel Report, *US - Section 301 Trade Act*, para. 783.

<sup>38</sup> Appellate Body Report, *Canada – Periodicals*, p. 34. Korea notes that one of the seminal commentators in the area refers to Article III:8(b) as an exception: John H. Jackson, *World Trade and the Law of the GATT*, the Michie Company (1969) at p. 381.

apply” language of Article III:8(a) to be broader. The panel went on to note that subsidies are covered by Article III, but that Article III:8(b) provides an exception for a specific type of subsidy, i.e., payments to producers.<sup>39</sup> This formulation by the panel clearly implies a narrow interpretation consistent with an exception, whatever it might be labelled.

4.50 The **European Communities** responds that Korea’s attempt to argue that Article III:8(b) of the GATT 1994 does not apply to the TDM Regulation because that Regulation in itself does not provide for the payment of money is without grounds. The fact that a measure is regulatory in nature or sets forth conditions does not automatically make it a "law, regulation or requirements affecting the internal sale of products" within the meaning of Article III:4 of the GATT 1994.<sup>40</sup> Korea does not identify any regulatory effect of the TDM Regulation that affects the internal sale of ships. As clarified by the Appellate Body in *Canada – Periodicals*, Article III:8(b) of the GATT 1994 does not exempt from the scope of the national treatment requirement measures that regulate internal sales in a discriminatory manner if they thereby provide a subsidy (e.g., the application of different postal rates). However, the TDM Regulation is neither a "subsidy" nor a "discriminatory regulation." If at all it can be seen as clearing the way for the provision of budgetary resources to domestic producers. If so, the TDM Regulation is covered by Article III:8(b) because apart from clearing the way for subsidies it does not have any other discriminatory legal effect.

4.51 Furthermore, the European Communities alleges that Korea in its rebuttal submission did not rebut the status of Article III:8(b) as exemption by noting that Article III:8(b) uses the term “prevent” instead of “apply” as used in Article III:8(a). The purpose of Article III:8(b) is clear. It was 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."<sup>41</sup>

4.52 Measures that provide for the payment of domestic subsidies to producers in the form of budgetary payments can therefore not constitute a violation of the national treatment rule. Consequently, such types of subsidies cannot be matters referred to in Article III:4 of the GATT 1994. Such measures are therefore also not covered by the most-favoured-nation ("MFN") obligation in Article I:1 of the GATT 1994 where it refers to advantages in connection with matters under Article III:4 of the GATT 1994.

## **2. Article I:1 of the GATT 1994**

4.53 **Korea** argues that Article I:1 of the GATT 1994 is concerned with discrimination among like products from or destined for different countries.<sup>42</sup> Under the TDM Regulation, Article 2.1 provides that "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 TDM Regulation is, Korea asserts, for all intents and purposes an instrument specifically and exclusively directed against Korea and not against any other WTO Member.

4.54 Korea submits that the following elements must be satisfied in order to establish that the TDM contributions are in breach of Article I:1 of the GATT 1994:<sup>43</sup>

- the TDM contributions fall within the scope of measures covered by Article I:1;

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<sup>39</sup> Panel Report, *US – Malt Beverages*, para 5.8

<sup>40</sup> Response of the European Communities to Panel Question 55.

<sup>41</sup> Analytical Index of the GATT with reference to E/CONF.2/C.3/A/W.49, p.2.

<sup>42</sup> Appellate Body Report, *Canada – Autos*, para. 84.

<sup>43</sup> See e.g., Panel Report, *Indonesia - Autos*, para. 14.138.

- the TDM contributions grant an “advantage, favor, privilege or immunity” of the type covered by Article I:1 to certain WTO Members in respect of the commercial vessels falling within its scope;
- this advantage is not "accorded immediately and unconditionally" to like vessels originating in Korea.

4.55 Korea claims that the TDM falls within the scope of Article I:1 of the GATT 1994 which applies, among others, with respect to “matters referred to in paragraphs 2 and 4 of Article III [of the GATT 1994].” As discussed elsewhere, the TDM falls within the matters referred to and covered by Article III:4 of the GATT 1994.

4.56 Moreover, the TDM Regulation grants an “advantage, favour privilege or immunity” within the meaning of Article I:1 of the GATT 1994 to certain WTO Members in respect of the commercial vessels falling within its scope. In *Canada – Autos*, the Appellate Body stressed that:

"The words of Article I:1 refer not to some advantages granted ‘with respect to’ the subjects that fall within the defined scope of the Article, but to ‘any advantage’; not to some products, but to ‘any product’; and not to like products from some other Members, but to like products originating in or destined for ‘all other’ Members."<sup>44</sup>

4.57 Korea maintains that the TDM Regulation creates an imbalance in the competitive opportunities the European Communities grants to Korean vessels vis-à-vis the competitive opportunities that the European Communities grants to like vessels originating in other WTO Members. The WTO Members other than Korea can export ships to the European Communities without having to face anti-competitive funding from EC member States as authorized by the TDM. One could consider that the avoidance of such anti-competitive regulation is a *privilege* accorded to those other Members, i.e., a *favour* of open competition that they are granted or an *advantage* in the competitive sphere that they enjoy. For example, Japanese or Chinese yards may attempt to compete and sell their products freely in the European Communities without fear of trade distortive interventions by the European Communities being directed against them. A Japanese shipyard, for example need not fear that if it happens to quote a price lower than a competing EC yard, this will trigger the provision of TDM contributions to its direct EC competitor, designed to allow the latter to lower its own price (and possibly thereby alter the outcome of the bidding process at the eleventh hour). Indeed, the TDM Regulation grants the Japanese (or other WTO Member's) yard full immunity from these damaging countermeasures, leaving it free to set whatever bid price it deems advantageous or viable. Only Korean competition is singled out for discriminatory and disadvantageous treatment.

4.58 Therefore, Korea alleges, 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 unilateral countermeasures in the form of TDM contributions to their competitors. This advantage or favour is not extended to Korea. Indeed it is solely singled out so that the gap in competitive opportunities widens. Put the other way around, Japanese and other non-Korean yards are granted complete immunity from having trade-distorting countermeasures in the form of TDM contributions applied against their bids. This immunity is not extended to Korea. The TDM Regulation thus grants a “favour,” “privilege” or “immunity” within the meaning of Article I:1 of the GATT 1994 to products originating in certain WTO Members, which is intentionally not provided to Korean-origin ships.

4.59 Moreover, Korea asserts that this discriminatory treatment is based solely on the origin of the shipyard/vessel concerned, which is the most blatant form of MFN violation imaginable. Since

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<sup>44</sup> Appellate Body Report, *Canada – Autos*, para. 79.

Article I:1 is concerned not with any individual trade volume but with equality of competitive opportunities, a favour, privilege or immunity which alters the competitive opportunities of some of the European Communities' WTO trade partners specifically at the expense of others goes to the very heart of an MFN violation and constitutes *de jure* discrimination.<sup>45</sup>

4.60 Finally, this favour, privilege or immunity granted to Japanese or other non-Korean shipyards and vessels is not accorded “immediately and unconditionally” to like vessels originating in Korea.

4.61 Thus, Korea argues, the TDM Regulation is inconsistent with the European Communities' MFN obligations and thereby violates Article I:1 of the GATT 1994. These conclusions apply *mutatis mutandis* to the EC member State implementing measures and TDM contributions provided pursuant to the TDM framework, and the EC Decisions approving such measures.

4.62 The **European Communities** responds that while WTO jurisprudence has interpreted Article I:1 of the GATT 1994 broadly to cover even *de facto* discrimination between Members arising from discriminations between a single firm of another Member, any such advantage or disadvantage must be related to measures imposed in connection with importation or relate to matters referred to in paragraph 2 and 4 of Article III of the GATT 1994. Subsidisation is not an advantage to any other country within the meaning of Article I:1 of the GATT 1994 in the form of a measure relating to customs duties or other measures in connection with importation or a matter referred to in paragraphs 2-4 of Article III of the GATT 1994.

4.63 The European Communities disputes Korea's broad allegation that the TDM Regulation is providing “highly discriminatory and focused contributions exclusively when a Korean yard is bidding with an EU competitor” and therefore disproportionately, specifically and exclusively hits Korea. Even if true, this does not establish a violation of Article I:1 of the GATT 1994. The allegation is not borne out by the operative parts of the TDM Regulation. Payments may be granted whenever there is competition from a Korean yard. It may well be that a Korean yard only made a first offer, but that Chinese and Japanese yards participated in the bidding process and the Korean yard did not make a second offer.

4.64 Most importantly, however, the particular singling out of Korea results from the non-implementation of the bilateral treaty between the two parties: the Agreed Minutes. The MFN obligation cannot prohibit such measures that fall outside the scope of advantages bound through Article I:1 of the GATT 1994 – it does not set forth a general prohibition of discrimination between WTO Members.

4.65 The European Communities states that Korea, following the Panel's request to clarify that it does not base its MFN claim on a measure relating to “importation”, now has changed its mind and surprisingly claims that the TDM Regulation was a measure in connection with importation. The European Communities submits that Korea nowhere identifies even in a rudimentary manner how the TDM Regulation could be seen as a “customs duty” or “charge” or “method of levying such duties” or “any rule or formality in connection with importation”.

4.66 **Korea** replies that, as the European Communities has admitted with respect to Article III:4, there is *de jure* discrimination against Korean ships. Article I:1 prohibits discrimination as between Members with respect to all matters referred to in paragraphs 2 and 4 of Article III. Thus, it follows that there is a violation of Article I.

4.67 Korea also asserts that the European Communities offers a repetition of its Article III:8(b) defence against this claim. As discussed before by Korea, this defence does not apply to the TDM

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<sup>45</sup> Although, Korea notes, the Appellate Body in *EC - Bananas III* made clear that Article I:1 GATT encompasses both *de jure* and *de facto* discrimination, para. 232.

which is a discriminatory regulatory measure, not a subsidy as such. Furthermore, even if Article III:8(b) were to apply with respect to the claims under Article III:4, it has no relevance to Article I claims at all. Article III:8(b) provides that: “The provisions of *this Article* shall not apply . . .” (emphasis added) Thus, Korea claims that, by its explicit terms, the exception provided in Article III:8(b) is expressly limited to Article III and does not apply to Article I:1. Moreover, Article I:1 does not incorporate by reference Article III; rather, it refers to “*all matters referred to in paragraphs 2 and 4 of Article III.*” Article III only describes the issues, it does not apply directly through Article I:1. Thus, Article III:8(b) is irrelevant to the analysis under Article I:1.

4.68 Indeed, for Korea, it would be quite surprising if Article I:1 was so limited. While the drafters of the GATT decided to provide an exception within Article III to accord with the rules that certain levels of subsidization to a domestic industry may be legal, there would be no reason at all to permit a Member to provide subsidies in a manner that discriminates between two other Members. There would be no legitimate developmental or social policy aspect to such discrimination; it would be punitive. Indeed, this is precisely what Korea has demonstrated: the EC measures are punitive measures aimed directly and exclusively at Korea, specifically against alleged Korean subsidization, and outside of the WTO dispute settlement system.

4.69 Korea takes issue with the European Communities' argument that a *de jure* discriminatory measure should not be proscribed because it is *de facto* non-discriminatory.<sup>46</sup> Korea is not aware of any such defence ever being asserted much less being successful. Korea takes note of the concerns of China that the TDM might have adverse spill-over effects in some instances. But such random damage to other Members' trade cannot refute the *de jure* discrimination in the wording of the TDM.

4.70 In addition, the *US - Malt Beverages* Panel report supports the view that a distinction must be made between Article III:8(a) which states that “this Article shall not apply” and Article III:8(b), which uses the words “shall not prevent”. The latter does not cover a broad derogation such as the exemption advocated by the European Communities. Article III:8(b) must be interpreted narrowly. Moreover, as that panel made clear, subsidies *are* covered by Articles III:2 and III:4. While the drafters of the GATT decided to provide an exception within Article III to accord with the rules that certain levels of subsidization to a domestic industry may be legal, there would be no reason at all to permit a Member to provide subsidies in a manner that discriminates between two other Members inconsistent with Article I:1 of the GATT 1994.

4.71 Korea submits that the European Communities misquotes Article I:1 of the GATT 1994. At the point where the two clauses are linked by the word “and”, the European Communities left out a phrase and two very crucial commas. The European Communities tries to make the provision read as if it is an accumulative provision that requires a showing of both of these elements while omitting the intermediate one. The missing commas make it clear that this is a list of independent clauses. Most significantly, the European Communities totally leaves out the critical fourth one. The European Communities' arguments hinging on this transparent misquoting and leaving out the very phrase applicable to this dispute cannot be accepted.

4.72 Korea further submits that Article I:1 is structured in such a way that certain substantive obligations apply with respect to four elements or categories of measures. The four categories are listed in the first half of Article I:1. The first and third are those identified by the European Communities. Including the missing second category, they are: (1) with respect to customs duties and charges of any kind; and (2) the method of levying such duties and charges; and (3) with respect to all rules and formalities in connection with importation or exportation. Then there is a fourth category which the European Communities also skipped. It is: (4) “and with respect to all matters referred to in paragraphs 2 and 4 of Article III.”

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<sup>46</sup> First submission of the European Communities, para. 241.

4.73 Korea asserts that with respect to all of these four categories, the Member has the substantive obligation to make certain that any advantage, favour, privilege or immunity granted by the Member is immediately accorded to all other Members.

4.74 Thus, Korea does not need to show that there were any customs duties or charges involved in the TDM and/or that it involved discrimination in terms of rules or formalities. Those are only two of the four categories of measures all of which the European Communities is obligated to apply in a non-discriminatory manner. Rather, Korea has only to show that the TDM and EC member State measures are matters referred to in Articles III:2 or III:4, which is the fourth category – one of the two the European Communities failed to quote.

### 3. Article 32.1 of the SCM Agreement

4.75 **Korea** asserts that Article 32.1 of the SCM Agreement requires that no “specific action against a subsidy of another Member” be taken except in accordance with the GATT 1994 as interpreted by the SCM Agreement. As previously explained, the TDM Regulation is designed to counteract the alleged Korean WTO-inconsistent shipbuilding subsidies found by the European Communities in its TBR investigations. Indeed, only those vessels types found to have been subsidized may benefit from the TDM contributions.<sup>47</sup> The TDM Regulation is therefore “specific” to subsidies.

4.76 Korea claims that the TDM Regulation is also an action “against” the alleged Korea subsidization. The Appellate Body in *US – Offset Act (Byrd Amendment)* noted that “against subsidization” means that the measure is “opposed to,” or has an “adverse bearing on” or tends to dissuade the subsidy practice complained of.<sup>48</sup> The TDM is clearly a measure aimed “against” the Korean alleged subsidies. The European Communities itself has noted that the TDM is a measure aimed at “fighting”<sup>49</sup> the Korean subsidy practices it found to exist. The Regulation does not apply against any other country and was designed to exclusively oppose alleged Korean subsidies. Moreover, the TDM measures “create an incentive to terminate [the] practices” in the form of the subsidies the European Communities alleges Korea to be providing. The TDM Regulation reinforces this incentive by effectively promising to suspend or promptly terminate the countermeasure if Korea resolves the dispute by ceasing the subsidy practices complained of.

4.77 Finally, Korea assert that the TDM Regulation is not a measure “taken in accordance with the provisions of the GATT” as interpreted by the SCM Agreement. In *US – Offset Act (Byrd Amendment)*, the Appellate Body determined that the GATT 1994 and the SCM Agreement provide four responses to a subsidy: price undertakings, provisional anti-dumping measures, definitive anti-dumping measures or multilaterally-sanctioned countermeasures under the WTO dispute settlement system. The TDM Regulation manifestly cannot fit into any of the above characterizations. The TDM Regulation is not therefore a measure taken in accordance with the GATT 1994 as interpreted by the SCM Agreement. In light of the above, Korea submits that the TDM Regulation violates Article 32.1 of the SCM Agreement. These conclusions apply *mutatis mutandis* to the EC member State implementing measures and TDM contributions provided pursuant to the TDM framework, and the EC Decisions approving such measures.

4.78 The **European Communities** maintains that contrary to what Korea suggests, it is not sufficient to establish some kind of general link between the measure and subsidisation. Two conditions must be met in order for a measure to be captured by Article 32.1 of the SCM Agreement.

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<sup>47</sup> Moreover, Korea states, Commissioner Monti specifically stated that this was not a *generalized* authorization for state aids. European Commission Press Release No IP/02/945, 27 June 2002. Provided in Exhibit Korea – 2.

<sup>48</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 254.

<sup>49</sup> European Commission Press Release No IP/01/1078. Provided in Exhibit Korea – 9.

First, the measure must be “specific” to subsidisation, i.e. taken only when the constituent elements of dumping or a subsidy are present. Second, the measure must be “against”, i.e. its design and structure is such that the measure has the effect of dissuading the practice of subsidisation, or creates an incentive to terminate such practice.

4.79 The European Communities states that Korea contents itself with interpreting a general temporal or political link into the measure and finds it sufficient that the TDM Regulation would make an implicit link to a TBR report. The European Communities asserts that Korea is only able to refer to language in the recitals of the TDM Regulation that motivates the limitation of its scope to market segments where the European Communities has found the existence of adverse effects and injury on the basis caused by “unfair practices”.

4.80 Concerning Korea's reading of the TDM Regulation, the European Communities argues first that the key motivation for the TDM Regulation is the non-implementation of the Agreed Minutes and indeed “unfair practices”. That term encompasses injurious pricing that is significantly broader than subsidisation and refers to the conduct of individual shipyards. The TDM Regulation refers to the TBR investigation only in order to limit the market segments where the EC industry experiences particularly severe problems, and which consequently can benefit from State aid. Second, the specificity of the action cannot be established, as attempted by Korea, on the basis of general political statements in the recitals or in accompanying press releases. Specific action against subsidisation has to be established on the basis of the operative part of the Regulation.

4.81 The European Communities further asserts that the relevant operational provision is Article 2.1 of the TDM Regulation which does not contain an inextricable link between the actual granting of a contract-related aid and the constituent elements of subsidies for four simple reasons: First, aid can be granted against an offer from any Korean yard, independently of whether it benefits from measures contested by the European Communities in DS273. Second, as acknowledged by Korea, aid can be granted against any Korean competition, without the need to determine how much lower the price is and whether that lower price is due to subsidisation or otherwise unfair pricing as described above. Third, the TDM Regulation itself does not result in any payments. Contract related aid is granted under a national measure and is not conditional on any new finding of subsidisation. Korea has grossly misrepresented the relationship between the TDM Regulation adopted at the Community level and the national TDM measures. The TDM Regulation does not require or even encourage the payment of subsidies by member States. The European Commission differs from governments of other WTO Members in that it does not pay subsidies to industrial products but *limits* them. The TDM Regulation, as any other state aid measure sets forth conditions and limits to the granting of subsidies, but does not itself provide for the payment of even 1€ Indeed, only a few member States currently have a national TDM measure in place and Korea has not pointed to any individual instances of subsidisation. Contract related aid is granted under a national measure and is equally not conditional on any finding of subsidisation by the member States. Finally, the fixed amount of six per cent contract-related aid is neither related to any amount of subsidy in terms of benefit to a Korean shipyard, nor to actual undercutting by a Korean bid or even to the undercutting margins found in the TBR investigation.

4.82 The European Communities proceeds to assert that, in short, the payments under the national TDM measures cannot only be made following a determination that the constituent elements of subsidisation are present, but in any situation where there is competition from a Korean yard offering a lower price independently of whether that yard has received subsidies.

4.83 The European Communities asserts that the object and purpose of Article 32.1 of the SCM Agreement is to codify and restrict the right to resort to self-help and the range of self-help measures that WTO Members can take unilaterally to counter a subsidy of another Member. However, Article 32.1 of the SCM Agreement does not prohibit *any* action that might have an effect on a

subsidy granted by another WTO Member. The key term limiting the scope of Article 32.1 is the criterion “specific”.

4.84 The European Communities asserts that the adjective “specific” before the phrase “action against a subsidy of another Member” means that a particular subsidy (i.e. a financial contribution and a benefit) must be targeted. The term “specific action” in the first paragraph of Article 32 has to be contrasted with the term “action”, as used in footnote 56 to Article 32 of the SCM Agreement. If any action broadly responding to a situation of which subsidisation may be one cause would be covered, the meaning of the term “specific” would run empty.

4.85 Second, Article 32.1 makes a close link between those unilateral actions that are *permitted* and those that are *prohibited*. All actions that are *permitted* (countervailing duties and prohibited and actionable subsidy actions) have one thing in common: they are conditioned on a specific determination that a subsidy exists. The phrase “no specific action against a subsidy of another Member can be taken” directly links the notion of a *prohibited* “specific action” with action taken “in accordance with the provisions of the GATT 1994, as interpreted by this Agreement”. Therefore, the nature of the *prohibited* actions must be comparable to that of the *permitted* measures in that they are conditioned on a specific determination that a subsidy exists.

4.86 The European Communities states that this was confirmed by the Appellate Body when it referred to measures “that may be taken *only* where the constituent elements of [a subsidy] are present”. In the two cases adjudicated thus far, the operation of the measure was circumscribed by a specific finding of dumping or subsidisation. It is true that the Appellate Body left explicitly open, whether a lesser degree of specificity is sufficient. However, the Appellate Body already clarified that to be a specific action against a subsidy, a “measure must be *inextricably linked to*, or *have a strong correlation with*, the constituent elements of [...] a subsidy”.

4.87 The European Communities asserts that Korea is not able to refer the Panel to such an inextricable link between subsidies granted by individual member States (if any) under the TDM Regulation and the constituent elements of a subsidy. Moreover, the European Communities argues that all of the arguments advanced by Korea point at best to a general political link or a factual coincidence between the TDM Regulation and the granting of subsidies by Korea. In particular, Korea’s case hinges on one reference to “adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition” in the third recital (as opposed to the operative part) of the TDM Regulation.

4.88 The phrase “unfair Korean competition” relates to injurious pricing. This is clear from the reference to the non-implementation of the Agreed Minutes in the first recital of the TDM Regulation. The Agreed Minutes are a bilateral agreement that sets forth a comprehensive scheme to ensure stability and fair competition in the shipbuilding sector in the future. In signing this treaty, Korea itself acknowledged that lower bids from Korean shipyards are not just a question of yards being subsidised by the government but result from numerous factors ranging from the lack of accounting and financial responsibility rules to pricing below value which may result from cross subsidisation by domestic sales of the same product or sales of other products. These factors may be totally independent from subsidisation by the government or a public body.

4.89 The European Communities clarifies that, when highlighting that injurious pricing may be due to many other factors than subsidisation, in particular dumping behaviour, the European Communities is not arguing that because the TDM Regulation covers both “dumping” and “subsidisation” or something third, it cannot be an action against subsidisation. For the European Communities, the salient point is that the TDM Regulation simply does *not* operate explicitly nor implicitly by reference to any act of subsidisation. It merely refers in its recitals to the state of the domestic EC industry in order to motivate the *limitation* of the re-introduced state aid. The findings of the TBR investigation have been used to identify market segments where the industry

experiences particularly severe problems, and which consequently can benefit from state aid. The sole purpose of the reference to adverse effects in the third recital is to motivate *limitation* of the state aid to as few market segments as possible.

4.90 As to the term “against”, the European Communities claims that the sole argument advanced by Korea is that the payment scheme is likely to intervene in the bidding process so as to modify the relative competitive position of the EC ship being offered for sale compared to the competitive position of the Korean ship offered for sale, to the disadvantage of the Korean product. This “conditions of competition” test has already been rejected by the Appellate Body in *US – Offset Act (Byrd Amendment)* for it would give to Article 32.1 of the SCM Agreement a scope of application that is overly broad. Indeed, if any measure that provides for payments to the domestic industry and that is capable of affecting the conditions of competition with subsidised exporters of other WTO Members would fall foul of Article 32.1 of the SCM Agreement, Articles 5 and 6 of the SCM Agreement would be rendered inutile.

4.91 The European Communities asserts that the structure and design of the national TDM schemes are not even remotely comparable to the measure at issue in *US – Offset Act (Byrd Amendment)*. The financial payments (if any) are financed through budgetary resources – not through countervailing duties on exporters of ships and bear no relation to any countervailing duties that any exporter could be liable to, or even with any investigation or finding of subsidisation. Moreover, the level of contract related aid (six per cent of the contract value) is even below what was considered necessary to ensure survival of the industry from injurious pricing under the previous EC shipbuilding aid programmes and therefore, entirely incapable of offsetting the effects of Korean subsidisation that one potential Korean bidder may have possibly received. Korean products are in no way hindered either on the Community market or on the world market. Furthermore, the European Communities alleges that Korea has not substantiated in any other way, how the granting of the six per cent operating aid (a level lower than the level of aid previously phased out) could have had any effect on Korea’s yards or Korea to the effect of dissuading the granting of a subsidy or stopping it.

4.92 Regarding the first issue (“specific”), i.e., whether the TDM was specifically against the alleged Korean subsidies, **Korea** responds that the European Communities has argued a version of its position regarding unilateralism; i.e., that the authorization of anti-Korean funding contained in the TDM had nothing to do with subsidies. The European Communities offers as the WTO legal standard an odd reading of the *US – Offset Act (Byrd Amendment)* case that would mean that if the challenged measure did not exactly track the SCM Agreement, then it would not be a specific action against subsidization. That is, it is a specific action against subsidization only if each separate element of subsidization as defined in the SCM Agreement is part of the determination in the challenged measure. As the third parties have aptly pointed out, this leaves an enormous loophole. A Member could take unilateral countermeasures against another Member’s alleged subsidies, but if that retaliating Member tweaks its countermeasure just slightly to vary it from the SCM Agreement, it would not be covered by Article 32 of the SCM Agreement.

4.93 Korea further submits that not only is the European Communities’ position illogical because it would strip Article 32.1 of all meaning and utility, but it also, of course, does not reflect at all what the Appellate Body has said. The Appellate Body in the *US – Offset Act (Byrd Amendment)* was discussing the close relationship of the Byrd Amendment to the provisions of the Antidumping Agreement and the SCM Agreement. That is, the facts in that case demonstrated the necessary specificity. There was no indication that this was intended as a *limiting* analysis by the Appellate Body. Because the Byrd Amendment was an integral part of the US antidumping and countervailing duty laws, it cannot be simply inferred that any measure that is *not* an integral part of a Member’s antidumping and countervailing duty implementing laws is *permissible*. In other words, to say that a particular set of facts led to an affirmative finding does not mean that any other set of facts *must* result in a negative determination.

4.94 According to Korea, one need only look as far as the decision in the *US – 1916 Act* case to see this. Indeed, a good deal of the US defence in that dispute was that the 1916 Act was highly dissimilar to an antidumping measure, despite its title, and was in fact an antitrust statute dealing with predatory pricing. The Appellate Body rejected this defence, noting that there might, in fact, be extra elements referred to in the 1916 Act, but that did not mean that it was not specifically against dumping or, in this case, subsidization.

4.95 Moreover, it is simply not accurate that the TDM Regulation itself does not establish the link to subsidization in the operative part. Article 4 of the TDM Regulation in particular clearly legally binds the duration of the TDM Regulation to the WTO dispute DS273, i.e., the alleged Korean subsidies which are the subject of that dispute.

4.96 According to Korea, the European Communities argues that Korean “unfair practices” referred to in the TDM Regulation does not mean subsidies, but rather relates to “injurious pricing” which is “broader” than subsidization.<sup>50</sup> Even assuming for the sake of argument that this were accurate, for Korea, the Appellate Body in *US – 1916 Act* made clear that a measure does not have to be exclusively restricted to the elements of dumping (or in this case subsidies) and nothing else in order for there to be a finding that the measure is specifically against dumping (or subsidization in this case).<sup>51</sup> Moreover, the European Communities implicitly concedes that even its own definition of “injurious pricing” encompasses subsidies even if it is supposedly “broader” and not “just [i.e. exclusively] a question of yards being subsidized.” Thus, even under the European Communities' own definition the TDM covers subsidization.

4.97 Korea asserts that the European Communities also tries to disassociate the TDM from the preceding TBR proceedings. For Korea, the TBR proceedings and decision are not directly subject to challenge in this dispute because Korea agrees that the TBR Report is not an operative measure in the sense of imposing penalties on Korea as the TDM does. However, it is very relevant in understanding the basis of the TDM and what it is intended to do. As Korea has pointed out, the European Communities explicitly stated that the TBR findings regarding subsidies were the basis for the TDM. This was also made quite clear by Commissioner Liikanen when he stated that LNG tankers could not be added to the TDM until the TBR process had established that the European Communities considered them to be subsidized.<sup>52</sup>

4.98 Korea maintains that the European Communities misses the point when it argues that the TDM remedy does not refer to all of the constituent elements of subsidization. The Panel and Appellate Body findings in the *US – Offset Act (Byrd Amendment)* dispute were not dependent on the *form* of the implementation of the measure; it could have been anything (say, treble damages as in the *US – 1916 Act* case). Korea's argument is not based on the individual payments under the authority of the TDM (although they clearly are illegal, too); rather, the TDM is itself at issue and the TDM is based upon the TBR process and is *legally dependent* on the European Communities' WTO dispute settlement challenge to the alleged Korean subsidization.

4.99 For Korea, the European Communities tries to persuade the Panel that interpretation of the TDM can only be made on the basis of the few words in the measure that the European Communities declares are operative. This argument also was made by the United States in the *US – Offset Act (Byrd Amendment)* case and firmly rejected by the Appellate Body which found that it was not necessary for the elements to be spelled out in the measure. Among other things, the European Communities claims that the preambular language is merely “political” and to be ignored. There is no basis for such an argument, Korea submits. Indeed, the European Communities argued exactly the opposite before the panel in the *EC – Sardines* case. That panel found, as a factual matter, that the

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<sup>50</sup> First submission of the European Communities, paras. 195-196.

<sup>51</sup> Appellate Body Report, *US – 1916 Act*, at para 132.

<sup>52</sup> See paragraph 47 of Korea's first submission and Exhibit Korea – 7.

complainant had discussed the measure in its entirety, including the preamble<sup>53</sup> and the Appellate Body completely upheld the Panel's reasoning and conclusion.<sup>54</sup>

4.100 Korea also recalls its earlier discussion of the complete illogic of the European Communities' argument trying to disassociate the TDM from its complaint against Korea under the SCM Agreement. If a measure is dependent on and coterminous with the outcome of a WTO dispute, it is incontestable that it is a measure specifically against the alleged subsidies subject to that dispute. Even if one were to incorrectly agree that the Agreed Minutes dealt with subsidies and then something extra as well, why would enforcement of those countermeasure provisions by the European Communities terminate upon the conclusion of the WTO dispute if the TDM were not at least in part related to the issue of subsidization? The European Communities' *post hoc* rationalization is both inconsistent with the explicit wording of the TDM and its extension. It is also simply illogical. The wording of the TDM (no matter how narrowly the European Communities wishes to read it) necessarily leads to the conclusion that it is specific action related to Korea's alleged subsidization.

4.101 According to Korea, the Agreed Minutes encapsulated an understanding that the minutes related to the application of the SCM Agreement to the shipbuilding sector, and how the parties would encourage WTO consistent behaviour. Korea rejects the European Communities' argument that the Minutes were in fact a type of international price-fixing agreement. The only thing a Member government can agree to under the WTO is with respect to subsidy matters. Beyond the possible indirect effects of subsidies, pricing is an issue between private parties. Under long-standing GATT and WTO jurisprudence, Korea states, antidumping prevention cannot be enforced by an exporting Member by border restrictions. The days of so-called voluntary restraint agreements have long since passed.

4.102 Moreover, Korea asserts that the "inextricable link" or correlation between the measure and the subsidy may be derived from the text of the measure itself but can also be derived from other evidence and can be implicit.<sup>55</sup> The Appellate Body in *US – Offset act (Byrd Amendment)* stated that a measure that may be taken only when the constituent elements of a subsidy are present is a "specific action" against such subsidization. However, this in no way implies that Article 32.1 of the SCM Agreement is restricted to measures that may only be taken when the constituent elements of a subsidy are present, as argued by the European Communities.<sup>56</sup> The correctness of Korea's interpretation is made crystal clear in the Appellate Body Report in *US – 1916 Act* where the Appellate Body, analyzing the Anti-dumping Agreement's 'equivalent' to Article 32.1 SCM Agreement<sup>57</sup> stated that "specific action against dumping must, at a minimum, encompass action that may be taken only when the constituent elements of 'dumping' are present."<sup>58</sup> The wording "at a minimum" clearly implies that "specific" action is broader.

4.103 According to Korea, the European Communities' argument that there is no inextricable link between the TDM measures and the constituent elements of a subsidy is flatly incorrect.<sup>59</sup> The European Communities appears to argue that by simply omitting explicit reference to "Korean WTO inconsistent subsidies" and detailing the constituent elements of the subsidies therein, the TDM Regulation escapes all scrutiny under Article 32.1 of the SCM Agreement. The Appellate Body has

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<sup>53</sup> Panel Report in *EC – Sardines* at paras 7.31-7.34.

<sup>54</sup> Appellate Body Report in *EC – Sardines* at 192, citing previous findings in this regard in the Appellate Body Report in *EC – Asbestos* at para. 64.

<sup>55</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 244.

<sup>56</sup> First submission of the European Communities, para 185, quoting the Appellate Body Report in *US – Offset Act (Byrd Amendment)* at para. 239.

<sup>57</sup> I.e., Article 18.1 of the Anti-dumping Agreement.

<sup>58</sup> Appellate Body Report, *US – 1916 Act*, para. 122. Underlining added by Korea. Italics in original.

<sup>59</sup> Oral statement of the European Communities at the first substantive meeting of the Panel with the parties, para. 24.

rejected such a formalistic approach by specifying that the link to a subsidy in a contested measure may well be implicit.<sup>60</sup>

4.104 With respect to the second element ("against"), Korea rebuts the European Communities' argument that the TDM is not "against" Korean subsidies, alleging that it is hard to imagine anything that is more against something. The Appellate Body has determined that "against" means "related to" or "associated with". The European Communities merely repeats the losing arguments of the United States in the *US – Offset Act (Byrd Amendment)* dispute. The European Communities bases its defence on the notion that a measure is not "against" subsidies if it is "legal". Of course, this is absolutely contrary to the findings in the *US – Offset Act (Byrd Amendment)* dispute. There was no finding that the Byrd Amendment subsidies were illegal. Quite the contrary, the Panel found that Mexico had failed to establish such claim of illegal subsidization.

4.105 In relation to the alleged rejection by the Appellate Body of a "conditions of competition" test in the *US – Offset Act (Byrd Amendment)* case, Korea maintains that the Appellate Body merely said that it was not necessary to go so far as to demonstrate that the conditions of competition were affected. Instead, the Appellate Body said the panel should only have looked at the structure of the measure itself. In this case, the structure and design of the TDM is that the measure provides for funds to be given to any EC shipyard that is in competition against – specifically and exclusively - a Korean shipyard and that asks for such funds. The design of the TDM is to counteract "unfair" Korean practices which Korea has established to mean alleged Korean subsidies. For Korea, it is hard to imagine anything more clearly "against" the alleged Korean subsidized products.

4.106 Korea asserts that, according to the Appellate Body Report in *US – Offset Act (Byrd Amendment)*, there is no requirement in Article 32.1 of the SCM Agreement that the TDM measure must take direct action against the Korean ships, the shipbuilders, or the Korean government responsible for the alleged subsidies in order for the TDM to be a measure "against" subsidization. On the contrary, the Appellate Body in *US – Byrd Amendment* found that even indirect actions – such as countermeasures taken against other products than the subsidized products - may constitute actions "against" a subsidy.<sup>61</sup>

4.107 On the European Communities' argument that the measure picks up all Korean ships, not just those that are allegedly subsidized, Korea states that that is not a question under the issue of "against", for if it is against all or just some Korean ships, it still is *against* something. That really goes to the issue of against *what*, against alleged subsidization or something else. Second, relating to both steps of the Article 32 argument, the TDM is clearly aimed at alleged Korea subsidies despite its scatter shot aspect that might cover all Korean ships. What the European Communities argues here is inconsistent with its arguments in DS273.

4.108 Finally, Korea recalls the explanation of the Appellate Body in *US – Offset Act (Byrd Amendment)* as to why the issue of "against" did not come up in the *US - 1916 Act* findings:

"[W]e did not focus on the word 'against' in our ruling in US 1916 Act, because there was no dispute there that the measure (imposing civil and criminal liabilities on importers) was indeed 'against' something – the question there was whether the action was against dumping, or some other conduct (predatory pricing)."<sup>62</sup>

4.109 Korea further notes that when a government provides companies with a subsidy, it does so with the aim of giving the company a market advantage over rivals. That advantage is offset if another government specifically subsidizes competitors of that company. This is certainly likely to

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<sup>60</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para 244.

<sup>61</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 251.

<sup>62</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 245.

dissuade or provide an incentive to stop granting the subsidy (provided the other government is prepared to do so) and therefore such subsidies can act “against” subsidization.

4.110 Korea also claims having provided a mass of evidence showing that the TDM is against subsidization, including characterizations by top EC officials themselves confirming over and over that the TDM is “specifically designed to counter unfair Korean practices”<sup>63</sup>, i.e., subsidies, for a period necessary for the conclusion of the WTO procedure. The TDM is variously described by EC officials as a “weapon” against Korean subsidies<sup>64</sup>, a “punishment” against the alleged Korean practices, “countermeasures”<sup>65</sup> against Korea pending the outcome in dispute DS273 concerning allegations of Korean subsidies, or a measure taken to “support” the European Communities' WTO action in DS273.

4.111 With respect to the “specific action” element of Article 32.1 of the SCM Agreement, the **European Communities** counters that Korea refuses to consider the operative part of the TDM Regulation, in particular Article 2.1, on the basis that it is not necessary to assess the double test on the basis of the measure. The European Communities also recalls Korea's claim that it is not necessary that a specific action is part of the general trade defence law as was the case in the Byrd Amendment dispute, but that the measure “as a whole” must be considered.

4.112 The European Communities maintains that Korea's attempt to ridicule the competition aspect of the Agreed Minutes by calling it an international “price fixing cartel” reveals the flaw of its own position. A price fixing cartel seeks to achieve prices on the market that do not reflect those resulting from a competitive market process.

4.113 The Agreed Minutes seek precisely the opposite, the European Communities asserts. They attempt to ensure the transparency of Korean price-determination with a view to combating anti-competitive behaviour. This cannot be equated with an international price fixing cartel. Obviously, measures that ensure pricing at normal costs do not fix prices since the prices will vary according to the normal costs of each producer and correspond to the prices that a rational economic operator would seek on the market.

4.114 The four distinct obligations (relating to banking, transparent accounting standards, commercially viable practices and co-operation) accepted by Korea in the Agreed Minutes are a first but important step to ensure fair and competitive conditions in the shipbuilding sector.

4.115 As regards the obligation to ensure commercially viable pricing practices that reflect “normal value” in Section 3 of the Agreed Minutes, the European Communities takes issue with Korea's argument that because the WTO Agreement only condemns dumping but does not oblige WTO Members to combat dumping practices, WTO Members are not *competent* to do so.

4.116 The European Communities fails to see where in the WTO Agreement Members limited their capacity to prevent dumping and anti-competitive behaviour by their companies. The European Communities also fails to see the relevance of Korea's reference to *Japan – Semiconductors*. That case concerned border restrictions that operate with respect to minimum prices. Specifically, the European Communities in that case challenged non-automatic export licenses as opposed to government control of dumping prices as such. The Panel found that Japan's system violated Article XI:1 of the GATT 1947 because the export licensing practices by Japan led to delays

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<sup>63</sup> Exhibit Korea – 19.

<sup>64</sup> Korea refers to his statement of 7 May 2001 referenced above as well as to the article in *Europolitique* dated 29 June 2002 referenced above also referring to the TDM Regulation as a weapon.

<sup>65</sup> Draft report on the proposal for a Council Regulation concerning a temporary defensive mechanism for shipbuilding (COM(2001)401 – C5-0393/2001 – 2001/0153(CNS)), Committee on Economic and Monetary Affairs, Rapporteur: Karin Riis-Jørgensen, Preliminary 2001/0153(CNS), 8 October 2001, Exhibit Korea - 31.

of up to three months in the issuing of licenses for semi-conductors destined to contracting parties other than the United States and therefore constituted restrictions on the exportation of such products inconsistent with Article XI:1 of the GATT 1947. The European Communities further argues that Korea can find no support in that Panel Report that Article VI of the GATT 1947 curbs the rights of exporting Members to take action against dumped exports. To the contrary, the Panel in that case explicitly noted that Article VI is “silent on actions by exporting countries”.

4.117 WTO Members are of course entitled to take actions against dumping or otherwise anti-competitive behaviour of their companies as long as such action does not take the form of an export restriction contrary to the GATT 1994, the European Communities submits. Otherwise, can Korea explain to the Panel, why it has engaged in OECD negotiations on that very topic since the early 1990s? And can Korea explain, why it has established its MOCIE authority responsible to combat anti-competitive behaviour that has in the past intervened in the contracted price offered by a Korean shipyard following a complaint by another Korean shipyard?

4.118 The European Communities states that Korea was unable to respond adequately to the Panel’s specific question on how Section 6 of the Agreed Minutes would confirm that the Agreed Minutes interpret WTO law, rather than addressing additional issues related to competition law. Essentially Korea claims that that section clarifies that the Agreed Minutes only seek to interpret WTO Agreement while at the same time ensuring that this interpretation does not affect other WTO Members.

4.119 The European Communities argues that Korea’s answer itself reveals the flaw of Korea’s position. There are two means of interpreting WTO law, either an interpretation via Article IX:2 of the WTO Agreement or through the dispute settlement system. A bilateral interpretation would have little value in a dispute before the WTO.

4.120 The European Communities submits that the stated goal of the Agreed Minutes as reflected in the first preambular paragraph is “promoting stability and fair competition”. Moreover, both sides expect, as recorded in the 3<sup>rd</sup> preambular paragraph, that the achievement of the four specific objectives set out in the Sections 1-5 of the Agreed Minutes will “contribute in a major way to restoring normal competitive conditions on the market, and to providing for an effective means of protection against sales of ships at price below cost”.

4.121 With respect to the "against" element of Article 32.1 of the SCM Agreement, the European Communities claims that Korea cannot demonstrate on the basis of the operative part of the TDM Regulation or any of the national measures any specific effect against a Korean subsidy. The European Communities recalls the letter of Article 4 of the TDM Regulation, which limits its temporary scope to the termination of the WTO dispute settlement proceedings. As the European Communities submitted<sup>66</sup>, it considers the dispute settlement to be resolved with the adoption by the DSB of the Report of the Panel (or the Appellate Body), whatever the outcome of the case is. The TDM Regulation cannot therefore force Korea to adopt any kind of position in the dispute settlement proceedings in question or to an early withdrawal of its subsidies. At most, the TDM Regulation might encourage Korea to come back to the negotiating table in the framework of the Agreed Minutes.

4.122 **Korea** takes issue with the European Communities' summary of its arguments on “against.” Korea challenges the EC statement that it has demonstrated that the TDM authorized funding applies to “any offer independently on [sic] whether there is a directly competing Korean offer.” The funding is not authorized *unless* there is a demonstration of a lower Korean offer. Korea also disagrees that the level of EC funding is unrelated to the level of alleged Korean subsidies, because, in its view the TDM is similar to *US – 1916 Act*, a dispute that involved treble damages, i.e., amounts that were not,

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<sup>66</sup> Response of the European Communities to Panel Question 6.

by definition, correlated to the actual alleged damages. The European Communities admits that its funding alters the conditions of competition. Moreover, the defence that counter-subsidies may be “legal” from the point of view of Part III of the SCM Agreement is irrelevant to Article 32.1 and flatly contradictory to the arguments raised by the European Communities that prevailed in *US – Offset Act (Byrd Amendment)*.

4.123 Regarding the issue of “against what”, Korea disagrees with the European Communities' argument that unless a challenged measure spells out in precise detail on its face every element of a subsidies case, it is not a specific measure against subsidies. Furthermore, the European Communities has “accepted that there may be a remote economic link between the subsidies allegedly granted by Korea and the state of the EC industry.” The European Communities argues as if it has reluctantly accepted some “remote” link that Korea or someone else forced upon it. However, the whole basis of the European Communities' request for establishment of the panel in DS273 was based on allegations of a strong causal link.

4.124 According to Korea, the strong correlation is in the words and structure of the TDM. It is a twin track strategy for dealing with the alleged Korean subsidization. It involves establishment of a panel (DS273) and a pre-emptive retaliation both of which are – by operation of the single legal instrument they are contained in – legally dependent upon and coterminous with the WTO dispute. The issues the European Communities listed in its request for establishment of Panel for DS273 are the constituent elements of subsidization, the same elements that underlie the TDM.

4.125 Korea states that it is simply illegal for a Member country to impose export price controls such as the European Communities is contending are at the heart of the Agreed Minutes. Its first defence was based on anti-dumping, but that has now shifted to competition issues. In this framework, the European Communities finally mentioned the seminal case on illegal minimum price controls, i.e., the *Japan- Semiconductors* case but misconstrues this case. This case was not only about restrictive licensing which is clear from the paragraph preceding paragraph 118 of the panel decision on which the European Communities relies, i.e.:

"The Panel concluded that the complex of measures constituted a coherent system *restricting the sale for export of monitored semi-conductors at prices below company-specific costs* to markets other than the United States, inconsistent with Article XI:1." (emphasis added)

4.126 This description also applies to the scheme that the European Communities now says it was trying to foist upon the world shipping markets. But Korea did not enter into such a blatantly WTO-illegal and anticompetitive agreement. The European Communities states in paragraph 70 of its Second Written Submission that the *Japan – Semiconductors* case does not stand for the proposition that Article VI limited the rights of Contracting Parties to impose anti-dumping measures. The European Communities cites paragraph 121 of the panel report which has nothing at all to do with the point the European Communities is trying to make. The issue there was that Japan tried to justify its export price-raising measures by stating that it was trying to control below-cost dumping and noting that Article VI provides that “dumping is to be condemned.”<sup>67</sup> The European Communities well understood this argument by Japan and argued that Article VI did not provide for independent authority to end anti-dumping pricing into third country markets.<sup>68</sup> The panel agreed completely with the European Communities and stated:

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<sup>67</sup> *Japan – Semiconductors* at paras 45 and 68.

<sup>68</sup> *Id.* at para. 47.

"The Panel therefore found that Article VI did not provide a justification for measures restricting the exportation or sale for export of a product inconsistently with Article XI."<sup>69</sup>

4.127 Korea asserts that the European Communities attempts to justify its right to compel Korea to impose border price measures on the basis of some vague competition law basis. But there is no international competition law agreement and the European Communities cannot enforce a non-existent agreement. If price controls at the border cannot be justified by reason of Article VI of the GATT which provides that dumping is to be condemned, they certainly cannot be justified on the basis of some invented competition law agreement.<sup>70</sup>

4.128 The **European Communities** asserts that Korea's argument (picked up from China), whereby it is not necessary under a countervailing duty measure that each duty is subject to a specific finding of subsidisation, turns against Korea. Articles 9.3 of the Anti-Dumping Agreement and 19.3 of the SCM Agreement clarify that any anti-dumping or countervailing duty must be established on an individual finding of dumping or subsidisation. The same is required for the other specific actions against a subsidy permitted by the SCM Agreement, an actionable or prohibited subsidy case.

4.129 Korea disregards the term "specific" and its context, the European Communities asserts. Indeed, it is noteworthy that Korea did not respond to one single argument made by the European Communities relating to the significance of the qualifier "specific". The context mandates a distinction between general "actions against subsidies" and "specific" actions against subsidies. Moreover, Article 32.1 clarifies what specific actions against subsidies are by referring to those that are permitted under the SCM Agreement. As explained before, these are all well targeted measures depending on a specific finding that at least the constituent elements of a subsidy are present, the European Communities adds.

4.130 The European Communities claims that a very broad political link between a subsidy measure that applies to entire market segments, independently from the existence of subsidisation, is simply not sufficient. Neither is a politically motivated temporal link to a WTO case limiting in time the re-authorisation of previously phased out subsidies.

4.131 The European Communities argues that, instead of responding to the detailed and reasoned explanation that it has advanced as to why the operation of the measure cannot be seen as inextricably linked to the constituent elements of a subsidy, Korea invokes the measure "as a whole", including its preamble. Yet, whatever term Korea points to in the whereas clauses of the TDM Regulation, i.e., "unfair competition", the Agreed Minutes or the "material injury and serious prejudice" suffered by the domestic industry, they cannot serve as a basis for establishing an inextricable link between the operation of the TDM Regulation and the specific subsidies at issue in an ongoing WTO case. These terms merely motivate the temporary reintroduction of operating aid and its limitation.

4.132 The European Communities continues its argumentation with respect to the "against" element of Article 32.1, taking issue with Korea's argument that Article 32.1 of the SCM Agreement prohibits "counter subsidies". The European Communities notes that the US made that argument without defining the notion of counter subsidies and with the explicit statement that it cannot assess whether the TDM is such a counter subsidy. The European Communities further explains that the term counter subsidy has no basis in the Agreement and that, similar to "matching aid", a counter subsidy would need to cancel out the effects of a particular other subsidy. There must be targeting. As explained before, the TDM Regulation does not operate with respect to any WTO inconsistent

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<sup>69</sup> Id. at para 120.

<sup>70</sup> Korea notes that it made these arguments in its general comments and considers the findings of the panel in *Japan – Semiconductors* to be equally applicable to the discussions regarding DSU Article 23.

subsidies of Korea. It merely grants subsidies to some EC shipyards at a level below the intensity of aid previously phased out.

4.133 Finally, for the European Communities, the TDM Regulation is defensive as opposed to offensive. This is clear, both from its name (“Temporary Defensive Mechanism”) and its operation: a general subsidy at a level below any previously authorised intensity of contract related aid. The need for such temporary aid is motivated by the non-implementation of the Agreed Minutes. As explained above, the Agreed Minutes are not about “subsidies” and in particular not subsidies that are covered in the DS273 case.

#### **4. Article 23 of the DSU**

##### **(a) General Arguments**

4.134 **Korea** states that the provisions of the TDM Regulation<sup>71</sup> as extended in product scope to cover LNGs<sup>72</sup>, and as extended in duration until March 2005<sup>73</sup>, are on their face inconsistent with the European Communities' obligations under Article 23 of the DSU. Individual instances of application of the TDM Regulation are likewise inconsistent with this provision.

4.135 Korea alleges that the TDM provides for special state-funded contributions on a contract-specific and product-specific basis, for the building of container ships, product and chemical tankers as well as LNG carriers when there has been competition from a Korean yard allegedly “offering a lower price”.<sup>74</sup> Furthermore, the TDM contributions amount to (maximum) six per cent of the contract value prior to the contribution.<sup>75</sup> The contributions are made in support of contracts to be delivered within three years from the date of signing of the contract (though extension of the three-year delivery deadline remains possible in special circumstances).<sup>76</sup> Korea also asserts that the TDM Regulation allows the contributions only with respect to EC shipyards in those segments judged by the European Communities to have suffered “adverse effects” or “serious prejudice” caused by “unfair Korean competition”.<sup>77</sup>

4.136 Moreover, Korea asserts that the TDM Regulation is expressly designed to be coterminous with, and legally dependent upon initiation of, WTO dispute settlement proceedings (brought by the European Communities in the dispute *Korea – Commercial Vessels* (DS273)). The TDM Regulation applies to contracts signed from 24 October 2002, i.e. the date of the European Commission's Notice<sup>78</sup> announcing the initiation of WTO dispute settlement proceedings against Korea as a result of the investigation conducted under the EC Trade Barrier Regulation<sup>79</sup> concerning certain alleged subsidies received by the Korean shipbuilding industry, until one month after the

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<sup>71</sup> Council Regulation 1177/2002 Concerning a Temporary Defensive Mechanism for Shipbuilding, OJ (2002) L 172/1. Provided in Exhibit Korea - 4(a).

<sup>72</sup> Notice 2003/C 148/10 published on 25 June 2003. Provided in Exhibit Korea – 4(b).

<sup>73</sup> Council Regulation 502/2004 Amending Regulation 1177/2002 Concerning a Temporary Defensive Mechanism for Shipbuilding, OJ (2003) L 081/6. Provided in Exhibit Korea – 4(c).

<sup>74</sup> Article 2.1, TDM Regulation.

<sup>75</sup> Article 2.3, TDM Regulation.

<sup>76</sup> Article 2.4, TDM Regulation.

<sup>77</sup> Recital 4, Article 2.2 (with respect to LNG carriers) and Article 2.5, TDM Regulation.

<sup>78</sup> O.J. No C 257, 24.10.2002, p. 11.

<sup>79</sup> Council Regulation (EC) No. 3286/94 of 22 December 1994 laying down Community procedures in the field of the common commercial policy in order to ensure the exercise of the Community's rights under international trading rules, in particular those established under the auspices of the World Trade Organization, O.J. [1994] L 349/71, as amended by Council Regulation (EC) No. 356/95 of 20 February 1995, O.J. [1995] L 413. Provided in Exhibit Korea – 5.

European Commission gives notice in the Official Journal of the European Communities that these dispute settlement proceedings are resolved or suspended.<sup>80</sup>

4.137 Korea states that the TDM Regulation was supposed to expire on 31 March 2004. However, the duration of the TDM was extended by Council Regulation 502/2004 by one year to 31 March 2005. Recital 5 of Regulation 502/2004 explicitly states that the extension of the TDM beyond 31 March 2004 was necessary because “WTO disputes settlement proceedings are not expected to have been resolved by that date.”

4.138 On the matter of the relationship of these two measures (TDM contributions and WTO proceeding), Korea recalls official papers and pronouncements by EC Commissioners, for example: (i) European Commission Press Release IP/01/1078, Brussels, 25 July 2001; (ii) European Commission Press Release IP/02/945, Brussels, 27 June 2002; and, (iii) European Commission Press Release IP/03/895, Brussels, 25 June 2003. Korea emphasizes the importance of these statements. Korea argues that the European Communities' attempts to dismiss these statements of its own Commissioners, as merely “political” statements to be ignored, are unfounded. Korea further recalls that, in a background memorandum to the European Parliament with respect to the TDM Regulation, the European Communities stated that the so-called twin-track strategy involved the following:

"(i) the initiation of an action against the Republic of Korea at the World Trade Organisation (WTO) and (ii) the authorisation of temporary and limited contract related operating aid under the Temporary Defensive Mechanism (TDM) to assist Community shipyards in those segments where they have suffered adverse effects caused by unfair Korean competition.

[...] 3. [...]only those market segments where it has been demonstrated that the EU shipbuilding industry has suffered adverse effects caused by unfair Korean trade practices are eligible for aid: container ships; chemical and product tankers; as well as Liquefied Natural Gas (LNG) carriers. Second, the defensive mechanism expires on 31 March 2004, which was consistent with the anticipation, at the time of adoption of Regulation (EC) No. 1177/2002, that the relevant WTO proceedings would have been concluded at that date.

[...] 5. It should also be stressed that, from the outset, the two instruments making up the twin-track strategy were closely interrelated, in particular as regards timing. Pursuant to the TDM Regulation, the support mechanism could only be activated after the Commission had initiated WTO dispute settlement proceedings against Korea - which was done on 8 October 2002<sup>2</sup>. By the same token, it was expressly provided that the mechanism was to be applied only until the conclusion of these proceedings or the suspension of such proceedings on the grounds that the Community considered that the Agreed Minutes had been effectively implemented (and, in any case, not after 31/03/04). In other words, the twin-track strategy is built on a simultaneous use of its two instruments."<sup>81</sup>

4.139 Korea claims that this is entirely consistent with what the TDM itself stipulates, for instance in paragraphs (4) and (7) of its preamble.

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<sup>80</sup> Article 4, TDM Regulation.

<sup>81</sup> Korea notes that the text of the Commission Memorandum is referenced also in the Report to the European Parliament by German Social Democrat Christa Randzio-Plath (CNS/2004/0008). The European Parliament adopted the report on 26 February 2004, approving the extension of the TDM mechanism until 31 March 2005. Provided in Exhibit Korea – 1.

4.140 Moreover, Korea rejects the European Communities' argument that the legally coterminous and dependent link between the TDM and the WTO dispute DS 273 is a coincidence and was merely intended to limit the TDM scheme by reference to an "objective" date that was outside the discretion of the European Communities. The authorization in Article 4 of the TDM Regulation to provide funding to their shipyards when in competition with Korean shipyards is legally contingent upon the initiation and duration of a WTO dispute challenging alleged Korean subsidies pursuant to the SCM Agreement. The language of the TDM Regulation and other evidence cited by Korea make clear that the link is not coincidental and anything but "objective." The legal contingency for the beginning and the end of the TDM authority is linked exclusively and directly to the WTO dispute.

4.141 Korea also challenges the European Communities' argument that the TDM was not aimed at subsidies, but at injurious pricing as prohibited under the Antidumping Agreement as expressed in the Agreed Minutes. First of all, the Agreed Minutes do not say at all what the European Communities claims. Korea challenges the European Communities to point to one single commitment in the Agreed Minutes whereby Korea agreed to use border controls to impose pricing agreements. It is simply untrue that Korea agreed to take action to end dumping at its border. Nothing in Sections 3 and 4 of the Agreed Minutes commits either government to intervene directly in private pricing practices. An *a contrario* reading of these provisions leads to the logical conclusion that where there is a lack of any such commitment, there is no agreement to enforce. This must be the case because it is the only legally permissible conclusion under GATT and WTO jurisprudence and section 6 of the Agreed Minutes makes it clear that the Agreed Minutes must be interpreted in the context of the parties' WTO rights and obligations. Korea did not and emphatically does not agree that Korean shipyards are dumping. The shipyards that the European Communities claims are all selling below cost are all extremely profitable. Indeed, the only allegation the European Communities has come up with is that the companies are not burdened with the right amount of debt because the Korean Government has forgiven such debt. Korea disagrees, but that, of course, is exclusively a disagreement on a question of subsidization. Thus, the only permissible interventionist role for a WTO Member government can be with respect to subsidies. Dumping is an issue of private parties; more than that, it is a company-specific pricing issue. Thus, it must follow that, to the extent there are price effects, they run from the alleged subsidies and that was all that the Government of Korea could ever agree to.

4.142 Korea rebuts the European Communities' argument that the TDM was meant as an enforcement of the Antidumping Agreement and therefore is not relevant to Article 32 of the SCM Agreement. In this respect, Korea claims that what remains unanswered by the European Communities is how it could claim as a defence against the prohibition against unilateralism in DSU Article 23 that the European Communities was seeking to unilaterally enforce the provisions of the Antidumping Agreement rather than the SCM Agreement.

4.143 For Korea, the statements of the European Communities in its legal documents, its explanatory memoranda, and the very words of its highest officials make very clear exactly what the TDM was all about. It was an enforcement mechanism implemented at the initiation of a WTO dispute settlement proceeding, extended to remain coterminous with such a proceeding and scheduled to end when such a proceeding ended. If there were two completely different matters at issue under the TDM, why would it terminate when a totally unrelated matter terminated. If, as the European Communities argues, the Agreed Minutes had to do with the antidumping practices of private companies, of what possible relevance could it be if a WTO subsidies case was resolved. To illustrate the European Communities' illogic, Korea offers the following hypothetical:

Assume a Member has taken two actions: A and B. Another Member disagrees with both actions A and B.<sup>82</sup> In response, Member 2 begins a WTO dispute settlement

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<sup>82</sup> Of course, Korea states, in the present case, action A corresponds to the alleged subsidization and action B refers to the alleged failure to enforce the Agreed Minutes.

proceeding which it claims is with respect to only action A. It then imposes countermeasures only with respect to B. However, it states that the countermeasures will end upon the conclusion of either the WTO case against action A or the resolution of action B.

4.144 Korea submits that this makes no sense. If the countermeasures were taken only with respect to action B, there would be no reason at all for any reference to action A. Even if the reference to terminating the countermeasures referred to the end of both the WTO case and the resolution of action B, it would still be illegal. There is no permission under the DSU to take unilateral countermeasures if they apply to resolutions of WTO disputes *as well as something else in addition*. They cannot be used to resolve WTO disputes at all.

4.145 In addition, Korea notes, the language of the TDM does not support the European Communities' argument that there are two distinct matters. Article 4 of the TDM provides that it is effective until the EC Commission publishes a notice that "these dispute settlement proceedings are resolved or suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented." For Korea, there is only one sensible way of reading this statement. The resolution and suspension are with respect to "these dispute settlement proceedings". That is, the suspension upon agreement of effective implementation of the Agreed Minutes *is a suspension of the WTO proceedings*. This can only mean that the Agreed Minutes are the subject of the WTO proceedings, not of something distinct. The simple little word "or" destroys the European Communities' whole argument.

4.146 While the TDM language is not a model of clarity, the explanation in the second recital of the TDM extension confirms these points. It reads as follows:

"In particular, the temporary defensive mechanism was only authorized after the Community initiated dispute settlement proceedings against the Republic of Korea and could no longer be authorized **if these dispute settlement proceedings were resolved or suspended.**" (emphasis added)

4.147 Thus, reading the TDM and its extension together, it could not be clearer that there were not two different matters that were the subject of the TDM. The TDM referred only to the subsidization issue for which the European Communities initiated dispute settlement proceedings. The European Communities makes an inaccurate *post hoc* rationalization when it argues that the TDM referred to two distinct matters, i.e., on the one hand, the WTO proceedings with respect to the subsidies issue and, on the other hand, the Agreed Minutes with respect to something completely distinct.

4.148 Korea further addresses the European Communities' argument that DSU Article 23 only applies if the retaliation is pursuant to a formal determination. For Korea, apparently, a Member needs to put in the title of the offending measure "Contrary to Article 23, it is determined. . ." Nothing ever quite reads in this overly formalistic way. This common sense point is made very clear in the Panel Report in *US – Certain EC Products* wherein it was stated that:

"In the context of the WTO, we consider that a determination that a WTO violation has occurred is a decision that a WTO Member has violated the WTO Agreement and which bears consequences in WTO trade relations."<sup>83</sup>

4.149 For Korea, it must be beyond question that the TDM was a decision. And as it was made effective only upon initiation of a WTO dispute and terminates only upon resolution or suspension of such dispute, the conclusion is inescapable that it was a decision that Korea has violated the SCM

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<sup>83</sup> Panel Report, *US – Certain EC Products* at para. 6.98.

Agreement. Korea alleges that it is also indisputable that it had consequences in WTO trade relations. It imposed a highly discriminatory penalty against Korean products.

4.150 Korea states that the Appellate Body in *US – Certain EC Products* held that Article 23.1 of the DSU imposes a general obligation to redress violations “only by recourse to the rules and procedures of the DSU, and not through unilateral action.” Furthermore, Article 23.2(a)-(c) demonstrated the close connection to Article 23.1 and together “all concern the obligation of Members of the WTO not to have recourse to unilateral action.”<sup>84</sup>

4.151 Thus, the scope of Article 23 is quite broad. It is not limited to formal determinations that explicitly state that they are outside the DSU, nor to measures that involve suspension of concessions under the DSU.

4.152 Korea comments on European Communities' hypothetical,<sup>85</sup> arguing that it seems to equate the Agreed Minutes with the exception provided for Free Trade Agreements (“FTA”) contained in the GATT 1994 Article XXIV. For Korea, this is an over-stretched analogy that the European Communities leaves unexplained. Second, with an FTA, Article XXIV provides a specific exception to permit two or more WTO Members to offer each other special privileges not provided to other Members on an MFN basis. The European Communities posits a situation where, following a disagreement, some or all of those privileges are withdrawn, the exception no longer applies and the situation returns to standard WTO MFN status. Korea would like the European Communities to clarify just what extra privileges (i.e., WTO “plus” privileges) were being offered by Korea and the European Communities to each other through the Agreed Minutes. Clearly, there were none. That being the case, this is not a situation of withdrawing extra privileges and going back to the status quo; rather, it was an agreement on interpretation of WTO rules and the action taken by the European Communities is not a return to the WTO status quo, but an imposition of penalties. If the European Communities argues that it is a return to status quo because it removes the unfair trade practice of subsidization by Korea, the response is that only the DSB can make such rulings in the face of Korea's emphatic rejection of the European Communities' allegations of subsidization.

4.153 Korea offers the following hypothetical for the consideration of the Panel:

One WTO Member (the “complaining Member”) considers that another Member (the “responding Member”) has provided support and subsidies to a particular domestic capital goods industry. According to the complaining Member, such support and aids are inconsistent with both the WTO SCM Agreement as well as perhaps an earlier bilateral agreement; one reached in, to pick a hypothetical date, say 1992. The Trade Minister of the complaining Member states that he has had enough of the subsidies and price undercutting resulting from the breach of the 1992 Agreement by the responding Member and so he is putting into place a twin-track strategy that will bring the responding Member to the table so that it will fulfil its obligations. First, the complaining Member launches a WTO dispute settlement case under the SCM Agreement. Second, it suspends the landing rights of aircraft of the responding Member coterminous with the WTO dispute settlement case. The complaining Member's Trade Minister points out that, pursuant to the Annex on Air Transport Services to the GATS, bilateral air transport landing rights are not subject to WTO rules. Therefore, the complaining Member, when challenged regarding these twin tracks, replies that the suspension of landing rights has nothing to do with the SCM claims and the SCM claims are being dealt with exclusively under the dispute settlement portion of the twin track. It claims that the second track is related exclusively to the 1992 Agreement between the parties.

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<sup>84</sup> Appellate Body Report, *US - Certain EC Products*, at para 111.

<sup>85</sup> First submission of the European Communities, para. 137.

4.154 According to the European Communities' argument in this case, the complaining Member in the hypothetical will be correct in such an argument and there can be no possible challenge to the complaining Member's suspension of landing rights under either the DSU or the SCM Agreement. In Korea's view, any such interpretation is in contradiction with the explicit wording of DSU Article 23 and would leave the door wide open for WTO Members to retaliate in all sorts of non-covered sectors or areas, clearly affecting trade between WTO Members before any WTO dispute settlement proceeding is carried out or without such procedure ever being carried out, clearly thereby undermining the very letter and spirit of DSU Article 23.

4.155 The **European Communities** explains that the term "unilateral measures" referred to in existing case law and the negotiating history is confined to "wild" retaliation through suspension of concessions or other obligations leading to spirals of retaliations and destabilising the GATT system. However, Article 23 of the DSU was not meant to prohibit what is termed under public international law an "unfriendly act", a measure compatible with WTO law.

4.156 On the matter of whether Article 23 would contain more than a prohibition of unilateral suspensions of concessions, the European Communities notes that, according to the Panel in *US – Section 301*, the second paragraph of Article 23 prohibits certain particularly egregious cases of unilateral conduct. The Panel in that case clarified that the less egregious cases of conduct contrary to the dispute settlement procedures would be other procedural omissions, e.g. failure to consult before requesting a Panel.

4.157 In essence, the European Communities posits, Article 23.2 of the DSU records a deal between the then GATT contracting parties concerning the use of Section 301, a US law calling for the imposition of unilateral trade sanctions against other GATT contracting parties whenever the United States determined they were in violation of their GATT obligations.

4.158 The European Communities further alleges that the essential features of Section 301 were that it would have authorised a determination of WTO inconsistency and retaliation in form of suspension of concessions without awaiting the outcome of a WTO dispute settlement proceeding. In particular the phrase "*before* suspending concessions or other obligations under the covered agreements" in Article 23.2 reflects that Members wanted to curb such unauthorised retaliations. However, when agreeing to prohibit certain forms of unilateral conduct, GATT Parties did not agree to create a "locked circle" whereby Members would forego their right to take even perfectly legal measures in response to a WTO violation of another WTO Member.

4.159 The negotiating history further confirms that Article 23 of the DSU only meant to curb unilateral measures that were otherwise WTO inconsistent. The first drafts of the rules on "strengthening the multilateral system" envisaged that:

"The contracting parties shall: (i) abide by GATT dispute settlement rules and procedures; (ii) abide by the recommendations, rulings and decisions of the Contracting Parties (iii) not resort to unilateral measures or the threat of unilateral measures *inconsistent with GATT rules and procedures* and (iv) for the purposes of (iii), undertake to adapt their domestic trade legislation and enforcement procedures in a manner ensuring the conformity of all measures with GATT dispute settlement procedures." (emphasis is added)<sup>86</sup>

4.160 Negotiators wanted to prevent unilateralism in the form of unauthorised "countermeasures". These are defined under public international law as:

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<sup>86</sup> Report by the Chairman "Profile on the Status of the Work in the Group", MTN.GNG/N13/W/43 of 18 July 1990, p. 4; Secretariat Non-Paper 25 March 1991, p. 13; Draft Text on Dispute Settlement by the Negotiating Group on Dispute Settlement, MTN.GNG/NG13/W/45 of 21 September 1990; p. 7.

"A law enforcement measure which consist in a temporary dispensation from complying with the law. In relation to the classical unilateral peacetime remedies, this term should theoretically encompass the suspension of the treaty and the reprisals; that is to say, the two temporary measures which go beyond equivalence and which would in principle be unlawful if they were not resorted to as reactions to an international offense."<sup>87</sup>

4.161 The European Communities claims that countermeasures or unilateral measures do not comprise acts of retorsion. A retorsion is defined as:

"An unfriendly but nevertheless lawful act by the aggrieved party against the wrongdoer. As such retorsion is not circumscribed by the international legal order."<sup>88</sup>

4.162 The prohibition of unilateral measures under the DSU not only excludes retorsions, but also those acts that may be illegal under a bilateral agreement between the two disputing parties, but that are outside the scope of the WTO Agreement. The European Communities submits that the following hypothetical for the consideration of the Panel:

The European Communities and Korea have concluded a bilateral agreement not to grant any subsidies. The European Communities believes that Korea has violated its obligations not to grant export subsidies under the WTO Agreement and the bilateral Agreement. The bilateral Agreement does not have a dispute settlement mechanism. The European Communities seeks condemnation of the export subsidies in the WTO but also decides to suspend its bilateral obligation not to grant any subsidy by reinstating certain WTO compatible aids.

4.163 For the European Communities, the suspension of the bilateral obligation such as in this case is not a relevant measure under Article 23 of the DSU as long as it is not demonstrated that it violates a substantive WTO obligation. Article 23 of the DSU cannot prohibit conduct that is otherwise WTO compatible. The scope of the procedural obligation under the DSU in the form of an exclusive jurisdiction and special suspension clause must parallel the scope of the material obligations under the substantive Agreements.

4.164 The European Communities further maintains that had WTO Members indeed wished to create a locked circle, where WTO Members forego their right to resort to retorsions or measures that are otherwise compatible with WTO law they would have used much stronger language in Article 23 of the DSU. Article 23, entitled "*strengthening* the multilateral system" takes a first step into that direction by curbing unilateral suspensions of concessions and obligations. It does not create a basis for the far reaching consequence of "locking WTO Members in a multilateral system."

4.165 Therefore, the European Communities concludes by stating that the suspension of obligations under another international agreement or an act that is not even incompatible with any international norm but merely an unfriendly act, which does not fall under the scope of Article 23 of the DSU.

(b) Article 23.1 of the DSU

4.166 **Korea** submits that the TDM Regulation on its face is inconsistent with Article 23.1 of the DSU. According to Korea, Article 23.1 requires that in any case where a WTO Member "seeks redress" of an alleged WTO violation the Member must: (i) have exclusive recourse to the multilateral

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<sup>87</sup> Elisabeth Zoller, *Peacetime Unilateral Remedies/ An Analysis of Countermeasures*, (Transnational Publishers: 1984), p. 75.

<sup>88</sup> Zoller, p. 5.

dispute settlement process set out in the DSU; (ii) abide by the rules and procedures set out in the DSU.

4.167 By adopting the TDM Regulation, Korea submits that the European Communities “sought redress” for what it claimed to be Korean WTO violations. Indeed, the TDM Regulation was enacted following detailed investigations by the European Communities into alleged Korean shipbuilding subsidies under the European Communities' TBR investigative procedure.<sup>89</sup> The investigative reports of the Commission under this procedure concluded that Korean shipbuilding measures were *prima facie* WTO-inconsistent subsidies causing adverse effects and serious prejudice within the meaning of Articles 5 and 6 of the SCM Agreement.<sup>90</sup> In response, the European Communities sought redress for these alleged Korean WTO violations through the “twin-track” strategy, which involved pursuing WTO dispute settlement against Korea over the alleged subsidies, while at the same time seeking immediate and unilateral redress by adopting the TDM Regulation.

4.168 Moreover, Korea alleges that the TDM Regulation was adopted shortly thereafter and published in the Official Journal on 2 July 2002. The TDM Regulation sought to redress the “adverse effects” and “serious prejudice” the European Communities had (unilaterally) determined its shipyards suffered as a result of illegal Korean subsidization of its shipbuilding industry. Under the TDM, this “redress” takes the form of highly targeted contributions provided to EC shipyards *exclusively* when those shipyards can show they are in competition with a Korean yard offering a lower price in the bidding process for a specific TDM-covered vessel. As explained in Recital 3 to the TDM Regulation, the TDM was adopted as “...an exceptional and temporary measure...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...”<sup>91</sup>

4.169 Korea asserts that the language of Article 4 of the TDM Regulation<sup>92</sup> shows that both the TDM Regulation and the European Communities' pursuit of WTO dispute settlement proceeding are a response to, and a form of redress against, alleged Korean WTO violations. Otherwise there can be no rational explanation for the European Communities explicitly linking these two events in the legislation. The European Communities was fully aware that the WTO dispute settlement it was pursuing, and any favourable ruling it might hope to obtain in a panel or Appellate Body proceeding would of course take time. Rather than wait for the outcome of WTO dispute settlement, the European Communities took matters into its own hands by enacting the TDM and imposing retaliatory measures targeted exclusively at Korean competing ships.

4.170 For Korea, Article 23.1 of the DSU however provides that in cases where a Member considers another Member's measures to be WTO-inconsistent, the complaining Member *shall* have recourse to the dispute settlement system. The Panel in *US - Section 301 Trade Act* made it crystal clear that the

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<sup>89</sup> Council Regulation (EC) No. 3286/94, as amended. Provided in Exhibit Korea – 5.

<sup>90</sup> EC Commission Report to the Trade Barriers Committee on alleged obstacles to trade from Korean shipbuilding practices. Initial report presented to the Trade Barrier Regulation Committee on 8 May 2001. Supplementary report presented in July 2001. Updating reports presented on 9 May 2002 and in June 2003 on LNGs. All four provided in Exhibit Korea – 6.

<sup>91</sup> Recital 3, TDM Regulation.

<sup>92</sup> Article 4, TDM Regulation:

"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 suspended on the grounds that the Community considers that the Agreed Minutes have been effectively implemented." [Emphasis added].

words "shall have recourse to" means that Members must only and exclusively have recourse to the multilateral DSU framework. What is especially prohibited is *any* form of unilateral enforcement of WTO rights or obligations.<sup>93</sup> In adopting the TDM Regulation, the European Communities manifestly failed to have exclusive recourse to this multilateral framework contrary to Article 23.1.

4.171 Indeed, if Members are allowed to enforce their perceived rights unilaterally through any means as long as they do not involve a suspension of concessions or other obligations, then there obviously is no exclusivity. This provides fertile grounds for circumvention of the system. WTO dispute settlement simply becomes one option of many. Allowing unlimited extra-treaty enforcement of rights cannot be consistent with promoting the security and predictability of the multilateral trading system and would moreover unfairly favour the most powerful WTO Members.

4.172 Finally, Article 23.1 of the DSU requires that Members must "abide by" the rules and procedures of the DSU. The *US - Section 301 Trade Act* Panel confirmed that this requires abiding by all applicable DSU rules and procedures.<sup>94</sup> By unilaterally seeking redress through the TDM Regulation, the European Communities necessarily failed to "abide by" the DSU rules and procedures in violation of Article 23.1.<sup>95</sup>

4.173 The **European Communities** submits that to violate Article 23.1 of the DSU, a WTO Member must (i) "seek the redress" (ii) "of a WTO violation". According to the European Communities, the interpretation of this expression in its immediate context and purpose clarifies that only measures of a retaliatory nature are covered, that is measures amounting to a suspension of concessions or obligations under the WTO Agreement.

4.174 The European Communities asserts that the *chapeau* of Article 23.2 of the DSU, explicitly links the general obligation "shall seek to redress violations of WTO law" with three specific obligations in Article 23.2.(a)-(c) of the DSU through the phrase "in such cases, Members shall". Article 23.2 of the DSU is therefore linked to, and has to be read together with, Article 23.1 of the DSU. It follows that a prohibited unilateral action that redresses a WTO violation must have elements of the three sub-paragraphs, i.e., a determination that has the effect of suspending concessions or obligations without awaiting a reasonable period for implementation and prior authorisation through WTO dispute settlement proceedings.

4.175 The European Communities further argues that this is corroborated by the purpose of Article 23 of the DSU which is simply to set out a *lex specialis* to public international law rules on suspension of the operation of a treaty.

4.176 For the European Communities, the notion of countermeasures or retaliatory measures under public international law is confined to measures that would otherwise be incompatible with a treaty or an obligation of the state under public international law, because obviously, a treaty cannot prohibit a retaliatory measure outside the material scope of that treaty. The same applies to Article 23 of the DSU. If that Article were interpreted in the broad manner Korea suggests, the WTO dispute settlement would – via Article 23 of the DSU – become a means to discipline the conduct of states outside the realm of the WTO Agreement.

4.177 Korea's argument that the TDM Regulation is a countermeasure to a WTO law violation essentially rests on the fact that the timing of the TDM Regulation is coterminous with the WTO proceeding, the European Communities submits. However, there is a simple and rational explanation

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<sup>93</sup> Panel Report, *US – Section 301 Trade Act*, para. 7.43.

<sup>94</sup> Panel Report, *US – Section 301 Trade Act*, para. 7.43.

<sup>95</sup> Korea argues that the European Communities specifically challenged the right of another Member to impose measures concurrently with a WTO dispute proceeding when it requested the establishment of a panel in *US – Tariff Increases on EC Products*.

for this. The European Commission and Council agreed to exceptionally and partially re-authorise operating aid only under the condition that such aid is strictly limited (in time and scope). The link to the WTO proceeding merely aims at setting an objective time-limit and it is not the only temporal link contained in the TDM Regulation. In the case, the Agreed Minutes were implemented before the resolution of the WTO proceedings, no aid could be granted by virtue of Article 4 of the TDM Regulation.

4.178 According to the European Communities, Korea also claims that the TDM Regulation is linked to an alleged determination of WTO inconsistent subsidies granted by Korea. In fact, the term “subsidies” is not even mentioned. The exact wording “suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition” (recitals 3 and 4) refers to the state of the EC industry as a result of the broader problem of injurious pricing. This is made clear through the explicit reference in the 1<sup>st</sup> and 2<sup>nd</sup> recital of the TDM Regulation to the failure by Korea to implement the Agreed Minutes.

4.179 Korea then appears to argue that the TDM Regulation refers to “injury and adverse effects” established in the TBR investigations which led to the launching of the DS273 WTO case. The European Communities fails to understand the relevance of that fact. As mentioned earlier, it was necessary to limit the material scope of the TDM Regulation in the effort not to reintroduce to the full extent operating aid into the sector. The information gathered in the TBR investigation in respect of the state of the EC shipbuilding industry was simply the most appropriate and readily available basis to determine the precise needs of that industry at that time.

4.180 Korea does not explain how the TDM Regulation can be capable of “remedying” or “redressing” subsidisation granted by Korea. First of all, the TDM Regulation does not have any immediate effect. Only if a member State decides to devote budgetary resources to a scheme, and that scheme is approved by the Commission, an EC shipyard would be able to obtain operating aid. Even the national programmes of the member States have not such an immediate effect unless they are actually used. Second, the European Communities fails to see how the limited re-authorisation of subsidies (at a lower level than authorised before for many years) can be capable of inducing the cessation of WTO inconsistent subsidies or adverse effects thereof.

4.181 Finally, under no circumstances can the limited re-authorisation of subsidies be qualified as a suspension of concessions or obligations under the WTO Agreement. As the European Communities puts it, Korea nowhere even attempts to argue that the TDM Regulation authorises subsidies in violation of Articles 3 and 5 of the SCM Agreement, and there is no violation of Articles I:1 and III:4 of the GATT 1994 and Article 32.1 of the SCM Agreement.

4.182 The European Communities takes the view that Article 23 of the DSU contains: an exclusive jurisdiction clause for the WTO dispute settlement; a restatement of the obligation to follow the procedural rules otherwise in the DSU when bringing a WTO case; and a specific prohibition of particularly egregious unilateral conduct, in the form of suspension of concessions or other obligations following a unilateral determination that another WTO Member has violated WTO law.

4.183 On the issue of Article 23 of the DSU containing an “exclusive jurisdiction clause”, the European Communities asserts that the text of Article 23.1 of the DSU is entirely procedural in nature. As noted by the Panel in *US – Section 301 Trade Act* the phrase “[w]hen Members seek the redress of a violation of obligations under the covered agreements[...] they shall have recourse to, and abide by, the rules and procedures of this Understanding” is an “exclusive dispute resolution clause”. Moreover, the first important purpose of Article 23.1 of the DSU is to ensure the exclusivity of WTO jurisdiction over WTO law and the suspension of concessions. Secondly, the first paragraph of Article 23.1 reaffirms that “when bringing a dispute to the WTO, Members have to abide by the rules of the dispute settlement Understanding”. This exhausts the meaning of the first paragraph of Article 23 of the DSU, according to the European Communities.

4.184 According to the European Communities<sup>96</sup>, the meaning of Article 23.1 must therefore be ascertained by an interpretation that takes account of all interpretative means envisaged by Article 31 of the Vienna Convention. The European Communities has demonstrated that the first paragraph of Article 23 of the DSU when read in light of its context, purpose and (if necessary) public international rules on state responsibility or Article 60 of the Vienna Convention governing the suspension of obligations as well as circumstances of the conclusion or *travaux préparatoires* does not cause WTO Members to lose their rights to take measures that are not prohibited by WTO law.

4.185 Article 23 of the DSU is essentially a suspension clause specific to the one set out in Article 60 of the Vienna Convention. Article 23.1 of the DSU is of a procedural nature. It refers to the rules of the DSU, in particular those governing the suspension of concessions in Article 22 of the DSU. Indeed, the close relationship between Articles 23 and Article 22 of the DSU is reflected in the systematic position of Article 23 directly after Article 22.

4.186 The European Communities asserts that it suffices to note here that Korea cites with approval the discussion by the panel in *US – Certain EC Products* of the relationship between the DSU and Article 60 of the Vienna Convention (and otherwise public international law rules governing the taking of countermeasures). Indeed, the succinctness by which that panel describes the scope of Article 23 of the DSU stands for itself and should therefore be quoted in full (emphasis added):

"Even if it were true that the European Communities delayed DSB meetings and the arbitration process (and arguably violated the *DSU* and rules of the DSB meetings), it is clear that a Member cannot find in another Member's violation a justification to set aside the prescriptions of the *DSU*. The US argument (which implies that it considers itself justified to do what it did because what the European Communities would have done was WTO illegal) is exactly what is prohibited by Article 23 of the *DSU*: *unilateral determination that a WTO violation has occurred and the unilateral imposition of suspensions of concessions or other obligations. In short the regime of counter-measures, reprisals or retaliatory measures has been strictly regulated under the WTO Agreement.* It is now only in the institutional framework of the WTO/DSB that the United States could obtain a WTO compatible determination that the European Communities violated the WTO Agreement, and it is only in the institutional framework of the WTO/DSB that the United States could obtain the authorization to exercise remedial action.<sup>170</sup>

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<sup>170</sup> Therefore, in the WTO context, the provision of Article 60 of the Vienna Convention on the Laws of Treaties (1969) on this matter does not apply since the adoption of the more specific provisions of Article 23 of the *DSU*."

4.187 According to the European Communities, the *US – Certain EC Products* panel confirms in clear words the EC 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 counter measures, reprisals and retaliatory acts by prohibiting: "a unilateral determination that a WTO violation has occurred and the unilateral imposition of suspensions of concessions or other obligations". It therefore aims at regulating the unilateral conduct of WTO Members relating to the suspension of WTO concessions and obligations.

4.188 Absent Article 23 of the DSU, the European Communities submits, the public international rules on State responsibility and suspension of concessions would apply, in particular, Article 52.3 of the draft articles on Responsibility of States for internationally wrongful acts.

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<sup>96</sup> Responses of the European Communities to Panel Questions 12 and 23.

4.189 The European Communities recalls that, in its commentary to Article 52.3 of the draft articles on Responsibility of States for internationally wrongful acts, the ILC indicates that Paragraph 3 is based on the assumption that the court or tribunal to which it refers has jurisdiction over the dispute and also the power to order provisional measures. By contrast, if the judge does not have such power, i.e., if the system does not provide for efficient measures to prevent a situation to worsen, recourse to countermeasures is once again permitted. *A fortiori*, the European Communities maintains, recourse to retorsions (i.e., acts that do not involve a violation of international law) is permitted under public international law rules.

4.190 According to the European Communities, Korea recognised the interpretative relevance of the ILC draft articles on State Responsibility.<sup>97</sup> The European Communities fails to see how Korea can then read Article 23.1 of the DSU in the light of existing public international law to prohibit acts that are not prohibited under public international law rules although the DSU explicitly prohibits the suspension of concessions and obligations during a pending dispute; and although the DSU does not provide for interim protection or for retroactive remedies.

4.191 The European Communities claims that it is not only at the legal level that Korea's claim lacks any basis. Factually, the European Communities recalls that Korea nowhere has substantiated how the TDM Regulation constitutes a "redress" in the form of a "retaliation" as it now claims after having abandoned the term "counter measure", nor does Korea define the notion of "retaliation".

4.192 The European Communities argues that Korea has neither identified any legal view that was enforced by the European Communities on Korea, nor any effect of the TDM Regulation that could reasonably be understood by Korea as an attempt by the European Communities to force Korea to withdraw subsidies before a WTO Panel has given its view on it. The European Communities recalls that Korea has not even attempted to claim and specify any adverse effects by the hardly used TDM subsidies.

4.193 **Korea** disagrees with the European Communities' argument that there is no separate violation possible of Article 23.1 in and of itself. Article 23.1 uses the imperative "shall", indicating affirmative obligations. It instructs that redress for perceived violations of WTO rules shall be taken pursuant to the WTO dispute settlement system. As the *US – Section 301 Trade Act* panel found, this requires Members to use the WTO dispute settlement system exclusively.<sup>98</sup> Moreover, the panel in *US – Section 301* stated explicitly that Article 23.1 covers a "great deal more" than the examples in Article 23.2.<sup>99</sup> There is simply nothing in the language of Article 23.1 that would, in any way, imply that a measure could not be found inconsistent with its provisions alone, independent of Article 23.2.

4.194 Korea disputes the European Communities' contention that "redress" in DSU Article 23 is restricted to meaning a specific response intended to remedy a WTO violation. In fact, the panel in *US – Certain EC Products* found that "seeks redress" is a broad term. As Korea noted in response to Panel Question 12, there are three separate possibilities under Article 23.1. The redress could be redress with respect to perceptions of (1) a violation of obligations; (2) nullification or impairment of benefits under the covered agreements; or (3) an impediment to attainment of any objective of the covered agreements. As mentioned in Korea's response, the term "redress" has been defined by the panel in *US – Certain EC Products* as per its normal dictionary meaning as involving the reparation of or compensation for a wrong or consequent loss, the remedy for or relief from some trouble or correction or reformation of something wrong. In relation to the violation of WTO obligations, the panel stated that "redress" implies a reaction by a WTO Member against another WTO Member, because of a perceived (or WTO determined) WTO violation. If the TDM is not a measure seeking

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<sup>97</sup> Response of Korea to Panel Question 27.

<sup>98</sup> Panel Report, *US – Section 301 Trade Act*, para 7.43.

<sup>99</sup> Panel Report, *US – Section 301 Trade Act*, para 7.45.

redress then nothing is. It is clearly linked by its terms and by the numerous explanations provided by EC Commissioners and in official EC papers to the alleged Korean subsidies.

4.195 Korea asserts that there is no basis to support the European Communities' argument that the "ordinary meaning" of "seek to redress" means suspension of concessions. The European Communities then tries to rely on DSU Articles 3.2 and 3.7 for this constricted view of Article 23. Article 3.7 provides that suspension of concessions or other obligations should be a last resort. Somehow, the European Communities considers that this admonition not to take retaliation until all other avenues have been tried is actually permission to take retaliation at the outset, before any other avenues have been tried, as long as the retaliation is not a suspension of concessions or other obligations. This turns the policy purpose of Article 3.7 on its head.

4.196 Korea states that the European Communities apparently rejects the decision of the panel in *US – Section 301* to the effect that Article 23.1 is an independent provision, violation of which is not dependent on a finding of inconsistency with Article 23.2. For Korea, the European Communities makes a convoluted argument based on a reading of Article 60 of the Vienna Convention and Article 52 of the ILC's Articles on State Responsibility regarding "countermeasures" to the effect that Article 23.1 is merely descriptive or process oriented. There is no basis for incorporating any concepts from Article 60 into interpretation of Article 23 of the DSU. The European Communities' main argument is that Article 23 relates to "countermeasures" as described in Article 52 of the ILC draft. However, in doing so, the European Communities conveniently ignores Professor Crawford's statement to the effect that:

"Countermeasures are to be clearly distinguished from the termination or suspension of treaty relations on account of the material breach of a treaty by another State, as provided for in article 60 of the Vienna convention on the Law of Treaties."<sup>100</sup>

4.197 Korea recalls that the panel in *US – Section 301 Trade Act* found that there was a "great deal more" covered by Article 23.1 than was listed by Article 23.2.<sup>101</sup> As that panel then found, this requires Members to use the WTO dispute settlement system exclusively.<sup>102</sup> The European Communities has not provided any basis to depart from the reasoning in that case. Indeed, if Members are allowed to enforce their perceived rights unilaterally through any means as long as they do not involve a suspension of concessions or other obligations, then there obviously is no exclusivity. This provides fertile grounds for circumvention of the system.

4.198 Korea notes that the European Communities was unable to refute Korea's example of a Member removing aircraft landing rights as an "unfriendly act". The European Communities' only response was to shift to a completely different issue from that covered by the example and state that the example covered a situation that was a subject of both the SCM Agreement and a bilateral agreement while the European Communities alleges that the TDM has nothing at all to do with the SCM Agreement. Korea would like to make a further note regarding its example and just how enormously dangerous the European Communities' approach would be. In the hypothetical, what if the Member whose aircraft landing rights were suspended disagreed both with the legal interpretation of a violation and with the scale of the other Member's retaliation? Without the DSU, who is to judge whether the retaliation is equivalent to the alleged violation? Would the other Member then be free to counter-retaliate to "equalize" the state of affairs? It is just the sort of scenario that the European Communities now argues is legal that would lead to the "wild" spirals of retaliation that according to the European Communities the DSU was intended to prevent. Also, allowing unlimited extra-treaty enforcement of rights cannot be consistent with the promoting the security and

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<sup>100</sup> James Crawford, *The International Law Commission's Articles on State Responsibility, Introduction, Text and Commentaries*, Cambridge University press, 2002, at p. 282.

<sup>101</sup> Panel Report, *US – Section 301 Trade Act*, para 7.45.

<sup>102</sup> Panel Report, *US - Section 301 Trade Act*, para 7.43.

predictability of the multilateral trading system as required by DSU Article 3.2 and would moreover unfairly favour the most powerful WTO Members.

(c) Article 23.2 of the DSU

(i) *Article 23.2.(a) of the DSU*

4.199 **Korea** argues that by adopting the TDM Regulation, the European Communities made an impermissible “determination” to the effect that Korea was in violation of its WTO commitments, contrary to the requirements of Article 23.2(a). The term “determination” was considered by the Panel in *US – Certain EC Products* to mean “a decision that a WTO Member has violated the WTO Agreement and which bears consequences in WTO trade relations.”<sup>103</sup>

4.200 For Korea, the TDM Regulation includes a decision that Korea violated its WTO commitments. The TDM Regulation explicitly states that the Community shipyards “have suffered adverse effects in the form of material injury and serious prejudice caused by unfair Korean competition.”<sup>104</sup> It is clear that the “unfair” Korean practices, “adverse effects” and “serious prejudice” referred to in the Regulation refer to the WTO-inconsistent subsidies found in the preceding TBR investigation. This is further confirmed by the express link in the TDM Regulation between the duration of the TDM and the duration of the WTO dispute brought by the European Communities specifically concerning alleged Korean shipbuilding subsidies causing, among others, “serious prejudice” to the European Communities. As noted by the Commission Press Release IP/01/656:

"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 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."<sup>105</sup>

4.201 Korea submits that the TDM Regulation is also a decision that “bears consequences” in WTO trade relations. The TDM contributions are designed to alter the competitive position and opportunities of Korean vessels competing with EC-origin vessels in the marketplace. The European Communities, by making this determination unilaterally, failed to abide by the requirement to make any such determinations exclusively “through recourse to dispute settlement in accordance with the rules and procedures” of the DSU and “consistent with the findings contained in [a] Panel or Appellate Body report adopted by the DSB,” in clear violation of Article 23.2(a).

4.202 Korea further states that Article 23.2(a) does not refer to the determination of the *manner* of retaliation, it refers to the determination that there *is* a violation *per se*. The measure of whether there has been an improper determination, according to the panel in *US – Certain EC Products* was whether there were consequences in trade relations. In this case, Korea states that the European Communities has admitted that there are and that the European Communities acknowledges that it is taking “unfriendly acts” against Korea. This certainly affects trade relations dramatically. In addition and in any event, Korea recalls that it has demonstrated that the TDM violates Article 32.1 of the SCM Agreement and Articles I and III of the GATT 1994.

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<sup>103</sup> Panel Report, *US – Certain EC Products*, para. 6.98. (Emphasis added by Korea).

<sup>104</sup> TDM Regulation, recital 3 (Emphasis added by Korea).

<sup>105</sup> Provided in Exhibit Korea – 8. (Emphasis added by Korea.) Korea refers also to Commission doc. MEMO/01/167 which according to Korea sets out this linkage in a more formal document.

4.203 The **European Communities** submits that Korea's claim under Article 23.2.(a) of the DSU must equally fail. A "determination" that a WTO violation has occurred in the meaning of Article 23.2.(a) requires a decision that a WTO Member (i) has violated the WTO Agreement and (ii) which bears consequences in WTO trade relations. Korea fails to point to any "determination" in the TDM Regulation or otherwise whereby Korea has violated WTO law through the grant of subsidies. The mere use of evidence gathered in the TBR investigation was necessary to motivate the limited scope of the temporary re-authorisation of operating aid. It does not amount to a determination that Korea granted WTO inconsistent subsidies. Further, whatever "determination" Korea might still attempt to find, under no circumstances can it establish that such "determination" bore any consequences in WTO trade relations. The TDM Regulation does not suspend concessions or obligations under WTO law.

4.204 The European Communities asserts that Korea is unable to point to any "determination" by the European Communities of WTO inconsistent behaviour within the meaning of Article 23.2.(a) of the DSU. The European Communities also presents dictionary definitions of the term "determination":

- 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 settlement of a question by reasoning or argument.

4.205 In the view of the European Communities, the term "determination" involves a certain element of finality. Accordingly, the Panel in *US – Certain EC Products* clarified that not any internal measure by which a WTO Member decides to pursue the perceived violation of WTO law by another Member is a "determination" within the meaning of Article 23.2.(a) of the DSU. Rather such "determination" must bear "consequences in trade relations". It must be final in that it sets in motion the suspension of concessions or obligations under WTO law.

4.206 The European Communities submits that Korea attempts to interpret such a "determination" into a perceived "implicit" link between the TDM Regulation and certain TBR Reports. However, in whichever way one looks at this, neither these reports nor the TDM Regulation nor both can be qualified as a "determination." The reference to the state of the domestic industry in the recitals of the TDM Regulation (as opposed to its operative part) are merely to limit the re-introduction of operating aid. To do so, the legislative organs of the European Communities needed to use the information from the TBR investigation. That information was compiled in the TBR Reports. These TBR Reports are internal Commission documents without any legal status. They enabled the Commission services to propose to the Commission to launch a WTO case against Korea and motivate that decision. That internal determination of WTO inconsistency bears no relevant consequences in trade relations. The launching of the WTO case against Korea is a perfectly legal act. So is the TDM Regulation, which provides for subsidies that are not inconsistent with the WTO Agreement.

4.207 Furthermore, the European Communities argues that the term "determination" within the meaning of Article 23(2)(a) must: (a) have an element of finality (thereby excluding "internal determinations"); (b) be made for the purpose of suspending WTO concessions or obligations and be directed against another Member; or (c) be otherwise inextricably linked or the pre-condition for a suspension of concessions or obligations under WTO law. Moreover, where a Member has consistently followed certain procedures to make a determination of WTO violations through explicit acts that clearly spell out the WTO violations and the DSB ruling that confirmed them, it will be more difficult to read such a determination into unrelated acts in making an objective assessment of the matter.

4.208 The conditionality of the TDM subsidies on the commencement of the WTO dispute cannot constitute such a determination. The request for consultations is a perfectly legal exercise of a right. It was based on a preliminary internal finding that it “appears” that Korea grants subsidies. That finding in the Commission Decision closing the TBR procedure is explicitly not a final determination. Indeed, the basic TBR Regulation prohibits such final determinations before a WTO dispute settlement Panel has ruled.

4.209 Contrary to what Korea alleges, the European Communities has provided a reasonable explanation for the reference to the WTO case in Article 4 of the TDM Regulation. This was the most objective criterion to limit the duration of the TDM mechanism by reference to an outside event that is reasonably predictable.

4.210 According to the European Communities, the Panel’s analysis ought to end here. As explained again before, there is no basis to refer to any press releases or subsequent Commission acts, or to any preceding or subsequent acts merely describing in form of reports the political initiatives relating to shipbuilding. These cannot serve as the determination Korea looks for either.

4.211 According to the European Communities, there are no factual elements pointing towards a “determination”. None of the elements referred to by Korea can reasonably be interpreted as a “determination” by the European Communities to the effect that Korea has violated Articles 3, 5 and 6 of the SCM Agreement.

4.212 In this respect, the European Communities states that Recitals 3 and 4 do not equate “unfair Korean shipbuilding practices” with alleged subsidies at issue in DS273. The European Communities asserts that Korea has not responded to the EC explanation that these recitals simply motivate the choice of the market segments for the temporary re-introduction of the EC state aid. Moreover, Korea has not responded to the EC argument that those recitals merely refer to the state of the industry. Indeed, Korea confirms that the only affirmative finding contained in the TDM Regulation is one relating to the state of the EC industry, as reflected in the use of the past participle “suffered.” Moreover, Korea cannot convince the Panel that all elements of the WTO violations it mentioned (Articles 3, 5 and 6 of the SCM Agreement) are reflected in the recitals.

4.213 Concerning whether adverse effects in the sense of Article 5 of the SCM Agreement in themselves constitute a violation of the WTO Agreement, the European Communities asserts that Korea had to admit that adverse effects are not the only element of a violation of Article 5 of the SCM Agreement. Article 5 of the SCM Agreement is fulfilled only where a WTO Member applies (i) a subsidy to (ii) cause (iii) adverse effects. An analysis of Article 5 of the SCM Agreement thus commences with the identification of a subsidy. Korea’s attempt to read into the phrase “unfair competition” or into the “Agreed Minutes” a reference to specific subsidies has been rebutted in the European Communities’ arguments concerning Article 32.1 of the SCM Agreement. A mere reference to *effects* that may be caused by many different factors cannot constitute a determination of a WTO violation.

4.214 As to the alleged determination of a violation by Korea of Article 3 of the SCM Agreement, the European Communities cannot even identify any argument by Korea to demonstrate to the Panel on the basis of the text of the TDM Regulation the elements of a violation of Article 3 of the SCM Agreement, that is a subsidy that is contingent upon exportation. Because there is none, Korea then carries on to import into the TDM Regulation (a state aid measure) the internal TBR Reports produced by the Commission Services in preparation of a Commission Decision whether to launch a WTO case or not under the TBR Regulation.

4.215 Concerning the equation of unfair competition and subsidies at issue in the WTO dispute settlement proceeding DS273 in Recital 4 of the TDM Regulation, the European Communities submits that Korea again misrepresents the language of a three word phrase. The actual term used in

Recital 4 of the TDM Regulation is “unfair Korean competition”. This expression simply does not refer to a subsidy that causes adverse effects through price suppression and depression or is export contingent as is the claim of the European Communities in DS273.

4.216 With respect to the legal contingency in Recitals 7 and Article 4 of subsidy disbursement on commencement of WTO proceeding, neither the TBR Reports nor the Commission Decision concluding the TBR investigation can be seen as involving a *determination* of a subsidy. Indeed, Korea now acknowledges that the TBR Reports have no legal value and agrees with the Commission that *evidence* from the TBR investigation was used in motivating the scope of the TDM Regulation.

4.217 There is no reason why the European Communities should not be able to use the preliminary factual results of a TBR investigation also in other areas of EC competence, for instance for the purpose of adoption of a state aid measure like the TDM Regulation. In order to avoid a full reintroduction of operating aid, yet with the need for some limited support in mind, the Council determined the two sectors (and later included the LNGs) where the situation of EC shipbuilders was the most serious. Asserting that any evidence obtained in a trade investigation, whether contained in TBR reports or in the Commission Decision authorising the request for consultations in DS273, should be considered as a unilateral determination of violation is nonsensical. If Korea thought that the Commission Decision initiating DS273 constituted a unilateral determination, why did Korea not bring up this point at the time the latter decision was adopted? And why did Korea omit it from the factual part of its first written submission?

4.218 For the European Communities, the explicit terms of the TBR Reports and the Commission Decision concluding the TBR investigation clarify that these are internal factual findings of the Commission necessary to motivate a decision whether or not to launch a WTO case. Because the TBR Reports and the Commission Decision concluding the TBR investigation do not contain such a determination, they cannot be read into the TDM Regulation as the “determination” Korea is desperately looking for.

4.219 The European Communities asks the Panel to note that Korea nowhere responds to the EC argument that the sole Article of the Commission Decision N° 2002/818/EC provides that subsidies “*appear*” to be granted and that therefore a request for consultations should be made.

4.220 The European Communities submits that Korea has been equally unable to respond adequately to the Panel’s most pertinent question about the fact that the Commission Decision concluding the TBR investigation was only adopted *after* the adoption of the TDM Regulation. In response to this question Korea relies on the fact that the TDM Regulation is legally dependent on a request for DSU consultations.

4.221 The European Communities asserts that Korea is unable to explain how it can understand a request for consultations or the Commission Decision concluding the TBR investigation as inserting *ex post* into the TDM Regulation a specific finding of illegal Korean subsidisation while it did not attack the Commission Decision concluding the TBR investigation (and indeed omitted its existence in its factual part of its first written submission). Korea did not comment on this argument that this temporal condition is simply an objective criterion to limit the temporal scope of the TDM Regulation.

4.222 On Korea's consideration of the use of “affirmative language” in the TDM Regulation, the European Communities mentions that Korea refers to the definitive wording used in Recital 4 (“have suffered”). It is true that this wording has some kind of affirmative character. However, Recital 4 of the TDM Regulation does not affirm the existence of a WTO violation by Korea. As noted before, it describes the state of the industry in some market segments. It does so because it was necessary to motivate the limitation of the re-authorisation of state aid to a few sectors. Yet such descriptive

language in no way implies a legally relevant determination of a subsidy granted by Korea, the European Communities asserts.

4.223 Moreover, for the European Communities, it is noteworthy that Korea contradicts here its own argument that the TDM Regulation contains a determination of WTO inconsistency because of the link to the WTO Panel proceeding. Case DS 273 is not based on a claim of adverse effects through material injury to the domestic industry. It is based on a price suppression and depression claim. The reference to "material injury" "suffered" by the Community industry, in the TDM Regulation is nothing but a description of the state of the industry.

4.224 The European Communities further discusses the existence of other "elements" of a "determination" identified by Korea in the TDM Regulation. The European Communities asserts that none of these elements can alone or together be qualified as a "determination" within the meaning of Article 23.2(a) of the DSU. For the European Communities, wherever Korea searches for a "determination", there is none. Presumably for that reason, Korea continues to refer to the TDM Regulation "as a whole" and its background, which now is not only to include political statements of no relevance to this dispute, but also an April 2002 Report to the Council adopted several months before the TDM Regulation and the prolongation of the TDM Regulation in 2004.

4.225 The European Communities further submits that Korea cannot escape from its onus to identify a "determination" in the TDM Regulation by pointing to *EC – Sardines* where the Panel found that a measure must be examined as a *whole*, i.e., including all provisions and preambular paragraphs. Korea is unable to point to *any* element in the TDM Regulation that could possibly reflect the "determination" it seeks to interpret into it. In such situation, the reference to some kind of transcendental "whole" is nothing but an empty phrase and admission that the measure does not contain such determination. Neither in the operative part nor in the Preamble nor elsewhere.

4.226 As to the April 2002 Report cited to by Korea, the European Communities states that a reading of that Report immediately reveals that Korea has provided selective citations pasted together in the continuing effort to squeeze from the facts a "determination". For example, Korea takes out of context two paragraphs of the report which appear to link the TDM Regulation to the TBR proceeding examining whether Korea had granted subsidies in violation of the SCM Agreement. Yet, these paragraphs are preceded by a paragraph which details the failure of the Agreed Minutes. Thus, the "consequently" is linked to the two preceding paragraphs detailing how EC shipyards became threatened in their continued existence. The Report, thus, merely confirms the twin actions as already described by the Community: WTO proceedings against subsidization by Korea, a defensive TDM Regulation responding partially to the non-implementation of the Agreed Minutes. The European Communities fails to see how an April 2002 Report by the Commission to the Council, *preceding* the adoption of the TDM Regulation and generally describing current political initiatives, can constitute the "determination" Korea is searching for.

4.227 Similarly, Korea's reference to the prolongation decision of the TDM Regulation as containing a "determination" only reveals that there is no determination to the effect that Korea has violated its obligations under WTO law in the TDM Regulation. The sole legal effect of the 2004 prolongation Decision was to extend the temporal scope of the TDM Regulation. It cannot *ex post* make a determination of WTO violations that was not there before, nor do any other documents, statements or whatever Korea sees as "background" of the measure without defining it.

4.228 Finally, the European Communities maintains that there were no consequences in WTO trade relations stemming from the TDM Regulation. Even if the Panel found any determination of a violation of WTO obligations by Korea, such determination is entirely irrelevant in WTO relations and does not have consequences in WTO relations in the form of a suspension of concessions or obligations. The European Communities maintains that, as explained above, Korea has indeed not

identified any effect at all, neither in nor outside WTO relations other than an encouragement to resume the negotiations under the Agreed Minutes.

4.229 **Korea** states that in its long discussion about the TBR process, it is almost as if the European Communities has missed the Panel's question regarding the distinction between a conclusion and a determination. The European Communities is, in effect arguing that the TBR is a "conclusion" that it should initiate a WTO dispute. However, the question is whether the TDM is a prohibited determination, not whether the TBR process is a permitted conclusion. Had the European Communities merely initiated a WTO dispute after the conclusion of the TBR process and done nothing more, then there would be no DS301.

4.230 For Korea, the relevance of the TBR process is that it provides an illustration of, and background for, just what was contained in the determination that is actually the subject of the dispute; i.e., the TDM. The TBR process was about alleged subsidization with affirmative findings being made under Articles 3, 5 and 6 of the SCM Agreement; it never mentioned any of the competition issues that the European Communities now raises as *post hoc* interpretations of what the TDM was all about. If the TBR process was a necessary step to include products under the TDM authority and the TBR process was based on subsidies issues, then it follows that the TDM was about subsidies.

4.231 Korea also notes the European Communities' construction of a new test for what constitutes a "determination."<sup>106</sup> According to the European Communities, a Member's retaliatory measure does not constitute a "determination" unless it reads like a panel or Appellate Body report in the way it sets out the alleged violation of Articles 3, 5 and 6 of the SCM Agreement. This would make Article 23 extremely easy to circumvent.

4.232 Korea submits that the European Communities also raises again a question of timing by arguing that the TBR process concluded after the adoption of the TDM. As Korea has noted, the TDM was contingent upon the initiation of the WTO dispute, and which in turn could only be initiated upon completion of the TBR process. Thus, the TDM, even though adopted earlier would have been a dead letter had the European Communities not concluded the TBR process first and initiated the WTO proceeding. Thus, the TDM might have been adopted earlier, but the TDM's legal effectiveness was subsequent to the WTO proceeding initiated based on the results of the TBR process.

4.233 In Korea's view, the test used by the panel in *US – Certain EC Products* is a valid approach to the issue. It is a two-step test as to whether there was a "decision" that had consequences in international trade. Clearly, the TDM was a formal decision by the EC Council to authorize specific types of funding, Korea adds. It is just as clear that the TDM had consequences in international trade. Every competition for a sale of a ship by Korean producers was potentially faced with discriminatory funding of up to six percent by EC member State governments in an attempt to change the results of the competition. That certainly is consequential.

4.234 Finally, Korea notes that the United States questions as to whether the second step of the test is necessary. Korea sees some merit in the US position, particularly to the extent that there is a threat of trade consequences rather than just actual consequences. However, Korea does not think that this Panel needs to delve into the depths of this issue because it is clear that the TDM resulted in trade consequences and satisfies the second step of the test.

4.235 The **European Communities** responds that, as to Korea's counterarguments that under the EC standard Members could get off the hook by not writing into the act "contrary to Article 23 of the DSU I determine", this is a non-argument. Indeed, it is *Korea's* lax standard that turns political

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<sup>106</sup> Second submission of the European Communities, paras. 102-104.

statements which are part of the daily communication between political institutions and their citizens or WTO Members into a determination prohibited by Article 23.2 of the DSU. If Korea had its way, the political communication and information process would be frozen. Article 23.2(a) of the DSU does not protect WTO Members from bold political statements. It protects them from official determinations that can be reasonably expected to lead to a suspension of concessions or other WTO obligations.

4.236 Article 23.2(b) of the DSU when read in context of Article 3.2 of the DSU can only protect other WTO Members and their economic operators from acts that lead to a suspension of concessions or obligations on which they relied in their daily operations. The Korean shipyards could not have relied in their daily operations on the prohibition of subsidies in the European Communities as long as they are not export contingent or cause adverse effects. Indeed, they gained market share despite those subsidies. It is hard to see how the partial reintroduction of contract-related operating aid at a lower level and only for a very limited time, can have any relevant effect at all. In any event, it does not amount to a suspension of WTO concessions or other obligations.

4.237 The European Communities considers those points on the scope of the DSU highly pertinent, and argues that Korea did not respond to the European Communities' reference to Article II:1 of the WTO Agreement which limits its scope to the concessions and obligations in the covered Agreements. Moreover, the European Communities claims that Korea does not explain what justifies a prohibition of WTO Members to act in areas which are not yet covered by the WTO Agreement merely because there is a general political link to a WTO dispute.

4.238 Indeed, the European Communities asserts that Korea itself admits that its position has no legal basis by repeating, again, its unfounded allegation that the DSU cannot be interpreted in such a manner that gives special advantages and privileges to the largest Members beyond what they already have due to their size and resources. Contrary to what Korea opines, the European Communities is one of the promoters of a DSU that is open to all WTO Members, including the small ones and in particular developing country Members.

4.239 The European Communities also alleges that Korea itself does not add any facts to its generalisation that would demonstrate that the European Communities is a big Member and Korea a small Member in the context of this case. Indeed, the market share of the European Communities in the shipbuilding market and even more of its few member States that have decided to grant subsidies is negligible. For example, the Netherlands, to which Korea often refers, has a market share of 1.7 per cent in 2002 as opposed to 31.8 per cent in CGT of Korea and certainly does not have a bigger financial muscle than Korea to grant subsidies.

4.240 The European Communities claims that Korea does not explain why the European Communities and the US as *big* Members are not entitled to predictability in what they agree and not under the WTO Agreement. Nor does it explain why the 25 member States of the European Communities should be punished for having formed a regional trade block that goes significantly beyond WTO law by prohibiting subsidies. The European Communities submits that they should not.

(ii) *Article 23.2.(b) of the DSU*

4.241 **Korea** asserts that the European Communities took unilateral action against alleged Korean WTO violations through the TDM Regulation before any panel findings had been made, let alone the expiry of a reasonable period of time for the implementation of any rulings. For Korea, the European Communities thereby manifestly failed to follow the procedures set forth in Article 21 of the DSU, and thus violated Article 23.2(b) of the DSU which requires that Members “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.”

4.242 The **European Communities** asserts that Korea's claim that the TDM Regulation failed to await a reasonable period of time to implement the recommendations and ruling in breach of Article 23.2(b) of the DSU is based on the flawed assumption that the TDM Regulation is a countermeasure. The European Communities submits that even if the Panel found that the TDM Regulation involved a suspension of concessions and obligations, Article 23.2(b) of the DSU is not applicable in this particular case.

4.243 **Korea** asserts that the European Communities has made no arguments with respect to Article 23.2(b) that are not contingent on its single defence that anything other than suspension of concessions or other obligations is not prohibited by Article 23. Korea considers that the European Communities admits that there have been no rulings or recommendations made by the DSB. In the absence of such a DSB decision, the retaliatory steps taken by the European Communities cannot be in accordance with the rules for implementing such decisions including according a reasonable period of time pursuant to DSU Article 21. It follows that such retaliatory measures were not imposed in accordance with Article 21. Moreover, even if one were to accept the European Communities' flawed premise about the scope of Article 23, Korea has demonstrated that the EC retaliatory measures involve a suspension of the European Communities' obligations to Korea under Article 32.1 of the SCM Agreement and Articles I and III of the GATT 1994. Thus, the European Communities' sole defence does not stand, even under its own approach to this provision.

(iii) *Article 23.2.(c) of the DSU*

4.244 **Korea** submits that the TDM Regulation is also inconsistent with Article 23.2(c) because the European Communities manifestly failed to first obtain DSB authorization and follow the procedures laid down in Article 22 of the DSU before taking any countermeasures or suspending concessions or obligations towards Korea under the covered Agreements, as required under Article 23.2(c).

4.245 Korea also argues that Article 23.2(c) requires Members to follow the procedures of Article 22 to determine the level of suspension of concessions or other obligations and to obtain DSB permission to do so. The European Communities' premise is that if a lesser offence is prohibited (suspending concessions or other obligations unilaterally) then a greater offence of imposing retaliation before there is even a determination of inconsistency is *permitted*. That is, if there was no DSB ruling at all because the European Communities skipped the whole process then the European Communities considers that the DSB's silence is affirmative permission to take retaliatory steps. For Korea, this position must be rejected.

4.246 The **European Communities** states that Korea's claim that the TDM mechanism is in breach of Article 23.2(c) of the DSU by suspending concessions or other obligations without following the procedures set forth in Article 22 of the DSU fails because it is based on the flawed assumption that the TDM Regulation is a countermeasure. As explained above, the TDM Regulation does not suspend concession or WTO obligations.

4.247 The European Communities further asserts that Korea is not able to explain to the Panel how the explicit text of Article 23.2.(c) of the DSU can be seen to prohibit the taking of other forms of countermeasures than the suspension of concessions or obligations.<sup>107</sup> That notwithstanding, Korea claims that Article 23 prohibits any "retaliation... whether or not such retaliatory actions constitute a suspension of WTO concessions or obligations."

4.248 For the European Communities, Korea's argument reveals the weakness of its own position that Article 23 of the DSU governs more than the suspension of concessions. If Article 23 covered countermeasures other than suspension of concessions and obligations, then Article 22 would have to cover such other countermeasures as well. It does not. The DSU in Article 22 only foresees a

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<sup>107</sup> Response of Korea to Panel Question 29.

procedure to obtain authorisation for the suspension of concessions or obligations, which is focused on the balancing of the level of nullification and impairment.

4.249 In any event, the notion of “countermeasures” under public international law only encompasses illegal acts and Korea has had to concede this. Korea does not claim that the EC measures are otherwise incompatible with international law. They can, therefore, also not constitute countermeasures in addition to “suspensions of concessions or obligations”.

(d) The EC Member State Implementing Measures Violate Article 23.1 of the DSU

4.250 **Korea** submits that the EC member State implementing TDM Measures, including those of the Netherlands, Germany, Denmark France and Spain equally violate Article 23 of the DSU: the member State measures are legally based on the EC TDM Regulation and are simply a reflection and application of the EC TDM Regulation at the national level. Thus, the arguments above applying to the EC TDM Regulation apply *mutatis mutandis* to the EC implementing measures, which also violate Articles 23.1, 23.2(a), (b) and (c) of the DSU.

## 5. Articles 4 and 7 of the SCM Agreement

4.251 **Korea** submits that Articles 4 and 7 of the SCM Agreement contain additional dispute settlement provisions specific to cases involving actionable or prohibited subsidies under the SCM Agreement. In particular, paragraphs 4-12 of Article 4 and paragraphs 2-10 of Article 7 contain special or additional dispute settlement rules and procedures which are listed as such in Appendix 2 to the DSU. The injunction against WTO Members taking unilateral action against real or perceived subsidies outside the WTO framework is equally applicable in the context of Articles 4 and 7 of the SCM Agreement. These conclusions apply *mutatis mutandis* to the EC member State implementing measures and TDM contributions provided pursuant to the TDM framework, and the EC Decisions approving such measures.

4.252 The **European Communities** fails to see the legal basis for this claim separately from Article 23 of the DSU, and submits that Korea acknowledged<sup>108</sup> that its claims under Articles 4 and 7 of the SCM Agreement are not self-standing but should be read together with Article 23 of the DSU. In any case, the European Communities asserts that neither the TDM Regulation nor any of the national measures (as far as they still exist) is a countermeasure within the meaning of Articles 4.10 and 7.9 of the SCM Agreement. Therefore, Korea’s claim is without merit.

4.253 For the European Communities, Korea still does not explain how the European Communities failed to follow the procedures for the request for consultations and establishment of the Panel in DS273 as prescribed in Articles 4.1-4.4 and 7.1-7.4 of the SCM Agreement while at the same time it complains that the TDM Regulation was activated through the EC request for consultations and acknowledge that the European Communities has indeed requested a Panel. Nor does Korea explain how the European Communities can have violated Articles 4.5-4.9 and 7.5-7.9 which contain procedural rules governing the Panel process.

4.254 To the extent that Korea “draws special attention”<sup>109</sup> to Articles 4.10 and 7.9, the European Communities recalls that the TDM Regulation is not a “countermeasure” within the meaning of Articles 4.10 or 7.9 that has been applied without obtaining prior authorisation from the DSB. According to the European Communities, Korea has acknowledged that the term “countermeasures” refers to a suspension of concessions and other WTO obligations.<sup>110</sup>

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<sup>108</sup> Response of Korea to Panel Question 49.

<sup>109</sup> Response of Korea to Panel Question 50.

<sup>110</sup> Responses of Korea to Panel Questions 27 and 30.

4.255 The European Communities further submits that the TDM Regulation does not involve any suspension of concessions or obligations. As an aside, the European Communities would note that the reference in Articles 4 and 7 of the SCM Agreement, to countermeasures as opposed to “suspensions of concessions” indicates that the amount of the suspension is determined by the entire amount of the benefit as opposed to the level of the nullification or impairment that has been caused.

4.256 **Korea** denies having acknowledged that the term countermeasures refers to suspension of concessions or other WTO obligations. Of course, Korea specifically did not do so in the context of Articles 4 and 7. Korea acknowledged that the International Law Commission (“ILC”) used the term in that manner and stated that Korea had been using the term in a broader sense up to that point. Therefore, for purposes of clarity Korea would change to the term “retaliation”, which is a more accurate description of the European Communities' unilateral measure in any event.

4.257 In the context of Articles 4 and 7, Korea specifically stated that it had doubts about the applicability of the ILC language given that the terms came directly from the GATT Subsidies and Antidumping Codes that were negotiated long before the ILC came up with its draft. The issue of countermeasures has been the most contentious of all matters discussed by the ILC. Korea rejects any implication that the ILC draft or other aspects of substantive public international law are binding on WTO Members. Article 3.2 of the DSU provides for the applicability of the rules of interpretation of public international law and such rules, through a standard *a contrario* reasoning, lead to the conclusion that the substantive rules do not directly apply.

4.258 As for the European Communities' argument that the term “countermeasures” has a different meaning in Articles 4 and 7 than suspension of concessions or other obligations, Korea recalls the European Communities' attempts to relate DSU Article 23 and “countermeasures” in the ILC draft and stand them as *lex specialis* of Article 60 of the Vienna Convention. For Korea, the structure and operation of Article 60 is totally different from Article 23, thereby undercutting any useful parallels that might be drawn. The European Communities ignores Professor Crawford’s admonition that Article 60 is *in contrast* to “countermeasures”. This illustrates the convenience with which the European Communities adopts or discards the substantive rules of public international law and that is precisely why Korea notes that caution must be exercised.

## V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of the third parties, China, Japan, and the United States are set out in their submissions to the Panel, and their answers to the questions. The third parties' arguments as presented in their submissions are summarized in this section.

### A. INTRODUCTORY REMARKS

5.2 **Japan**, prior to discussing Korea’s individual claims, emphasizes the particular importance of the discipline over subsidies in the shipbuilding sector, which should be taken into due consideration as a background for this dispute. Korea’s claims and arguments tend to focus on the element of “unilateralism” of the EC measures at issue<sup>111</sup>, but Japan is of the view that it is equally or more important for the Panel to keep in mind that subsidies are particularly problematic in the shipbuilding sector.

5.3 First of all, as a direct effect, a subsidy will increase the possibility for a subsidy receiving shipbuilder to obtain an order which would not be possible without the subsidy. The price per unit of vessels is very high, and thus, the economic impact of a single lost sale is significant for other shipbuilders. More importantly, a subsidy in the shipbuilding sector would cause an indirect effect of a significant magnitude. It is widely acknowledged that a price reduction observed in any segment of

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<sup>111</sup> First submission of Korea at paras. 20, 106 and 132.

the shipbuilding market will be likely to impose a significant downward pressure on the price level of any other segment of the shipbuilding market and in any other country since the shipbuilding market is a single integrated market. This downward trend in all segments of the shipbuilding market tends to lead to severe price competition, often at prices below the level required to cover production costs. Subsidized shipbuilders can enjoy an artificially advantageous position in such competition.

5.4 Therefore, Japan is of the view that the unique nature of the shipbuilding industry demands that governmental intervention which “distorts the market” of shipbuilding be prohibited in general, as much and as broadly as possible. Otherwise, even the most competitive or efficient producers may not survive in global competition.

5.5 Despite the particular necessity for regulation of subsidies or any other governmental assistance, the existing worldwide restrictions on subsidy measures – in the form of the SCM Agreement – provide only insufficient disciplines for the shipbuilding sector.

5.6 The countervailing duty measure, which is considered to be effective to counteract injurious subsidization at national borders, is not practically effective in the shipbuilding sector due to the unique characteristics of this sector. It is widely perceived that the shipbuilding market is indeed an integrated global market. Since ship-owners can choose where to register their vessels, national borders have no significance at all; and accordingly, neither do border measures such as tariffs and anti-dumping and countervailing duties. Thus, new Shipbuilding Agreement has been negotiated in the OECD forum to regulate, among others, subsidies in the shipbuilding sector in a more stringent and effective manner.

5.7 Based upon the foregoing considerations, Japan expresses serious concern over the EC measures at issue, taken under the Temporary Defensive Mechanism measures, which grant subsidies to EC shipbuilders and thereby run a risk of causing negative effects in the shipbuilding market. At the same time, Japan would point out that the TDM measures might have been chosen at least partly due to the fact that countervailing duty measures are not effective in the shipbuilding sector. Japan shares the difficulties the European Communities is facing as a result of the Korean measures since shipbuilding industry of Japan has also been affected by Korea’s subsidies. However, even if the EC measures are a response to Korea’s non-implementation of the Agreed Minutes with respect to unfair practice in the shipbuilding sector, Japan does not consider that they are the most appropriate response.

## B. LEGAL CLAIMS

### 1. Article III:4 of the GATT 1994

5.8 **Japan** disagrees with Korea’s claim that the EC subsidy measures are inconsistent with Article III of the GATT 1994, without regard to recipients of the subsidy<sup>112</sup>, for Korea’s claim runs afoul of the explicit provisions of Article III of the GATT 1994.

5.9 According to Japan, Article III:8(b) of the GATT 1994 explicitly excludes “the payment of subsidies exclusively to domestic producers” from its scope. Korea seems to argue as a basis for its Article III claim of the GATT 1994 only that the EC TDM measures give an advantage to certain commercial vessels of EC origin in competition with “like” vessels of Korean origin.<sup>113</sup> In Japan’s view, however, the EC TDM measures can be deemed to be the payment of subsidies exclusively to domestic producer within the meaning of Article III:8(b) and therefore, need to be examined in light of the SCM Agreement rather than Article III of the GATT 1994.

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<sup>112</sup> First submission of Korea at para. 156.

<sup>113</sup> *Id.*, at paras. 153-154.

## 2. Article 32.1 of the SCM Agreement

5.10 The **United States** notes that Korea claims that the TDM Regulation and the other measures it cites are inconsistent with Article 32.1 of the SCM Agreement, because they constitute “specific action against a subsidy of another Member” – Korea – that is not taken “in accordance with the provisions of the GATT 1994, as interpreted by [the SCM Agreement].” Because Korea’s claim raises many factual issues, the United States offers no view on the ultimate resolution of that claim. Nevertheless, it appears to the United States that in this dispute the European Communities is advocating a surprisingly narrow interpretation of Article 32.1 that is not supported by the Appellate Body reports to which it cites.<sup>114</sup>

5.11 The United States asserts that the European Communities begins its discussion of Article 32.1 by misquoting the Appellate Body. In discussing the Appellate Body report in *US – Offset Act (Byrd Amendment)*, the European Communities makes the following statement:<sup>115</sup>

"According to the Appellate Body in *US – Offset Act (Byrd Amendment)*, Article 32.1 of the *SCM Agreement* covers

'a measure that may be taken *only* when the constituent elements of dumping or a subsidy are present.'"

5.12 This quotation of the *US – Offset Act (Byrd Amendment)* report is inaccurate, because in the report there is no period after the word “present.” Instead, the sentence continues, the full sentence reading as follows:

"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*."

5.13 In the view of the United States, there is a subtle but important difference between the two quotations. The EC version of the quotation suggests that coverage of Article 32.1 is limited to measures that may be taken “only” when the constituent elements of dumping or a subsidy are present. The full quotation, however, indicates that Article 32.1 includes, but is not necessarily limited to, “measures that may be taken only when the constituent elements of dumping or a subsidy are present.”

5.14 This understanding of that quotation is borne out by the report in *US – 1916 Act*, in which the Appellate Body found that: “‘Specific action against dumping’ of exports must, at a minimum, encompass action that may be taken *only* when the constituent elements of ‘dumping’ are present.”<sup>116</sup> By its use of the phrase “at a minimum”, the United States adds, the Appellate Body indicated that the universe of measures subject to Article 18.1 included, but was not necessarily limited to, “measures

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<sup>114</sup> At the outset, the United States wishes to note that both parties claim to be following the approach to Article 32.1 articulated by the Appellate Body in *US – Offset Act (Byrd Amendment)*. Although the United States continues to be troubled by that approach, in view of that common ground between the parties, the United States in this submission has limited itself to addressing the parties’ use of that approach.

<sup>115</sup> First submission of the European Communities, para. 185, quoting *US – Offset Act (Byrd Amendment)*, para. 239 (emphasis added by EC)

<sup>116</sup> Appellate Body Report, *US - 1916 Act*, para. 122 (underscoring added by the US; italics in original) The United States notes that the Appellate Body was discussing Article 18.1 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (“AD Agreement”), the provision of the AD Agreement that corresponds to Article 32.1 of the SCM Agreement.

that may be taken only when the constituent elements of dumping are present.” Indeed, the Appellate Body stated that it was not making any findings regarding the precise scope of Article 18.1.<sup>117</sup>

5.15 In the view of the US, the European Communities' discussion of the phrase “against subsidization” suffers from similar difficulties. The European Communities quotes the passage from the *US – Offset Act (Byrd Amendment)* report in which the Appellate Body stated that “the CDSOA effects a transfer of financial resources from the producers/exporters of dumped or subsidised goods to their domestic competitors.”<sup>118</sup> The sole purpose of this quotation appears to be to create the impression that only measures that involve a similar “transfer of financial resources” are capable of falling within the scope of Article 32.1 as interpreted by the Appellate Body. If this is the European Communities' aim, then it is misguided, because the Appellate Body did not find that the universe of actions “against subsidization” are limited to those involving a transfer of resources. Instead, it simply found that that universe includes actions involving a transfer of resources.<sup>119</sup>

5.16 More important, however, is the fact that the European Communities never explains why a system of counter-subsidies cannot, to use the language of the Appellate Body in *US – Offset Act (Byrd Amendment)*, dissuade the practice of subsidization or create an incentive to terminate such practice.<sup>120</sup> It seems obvious to the United States that when, for example, a government provides one of its companies with a subsidy, it does so with the aim of giving that company an advantage in the market. That advantage is offset, in whole or in part, if another government provides subsidies to competitors of that company. When this happens, the subsidy provided by the first government is, to some extent, wasted. Because a rational government presumably will not want to waste finite resources, under the Appellate Body's approach, counter-subsidies would be, in principle, capable of dissuading the practice of subsidization or creating an incentive to terminate subsidies. Thus, while the United States offers no views concerning the facts of this particular dispute, it would seem that under that approach, in principle, counter-subsidies are capable of falling within the scope of Article 32.1.

5.17 For the United States, the European Communities also appears to suggest that an action is not a “specific action” within the meaning of Article 32.1 if it deals with anything other than subsidization. Thus, the European Communities argues that because the TDM Regulation refers to “unfair practices” rather than “subsidization,” and because the Agreed Minutes between the European Communities and Korea suggest that there also was a problem concerning the dumping of ships, the TDM Regulation cannot constitute “specific action against a subsidy.”<sup>121</sup> This is a new position for the European Communities, directly contrary to that taken in disputes where the European Communities was a complaining party.<sup>122</sup>

5.18 The United States sees it as an interpretive stretch to read the phrase “specific action against subsidization” as including only actions that deal “exclusively” with subsidization. For one thing, such an interpretation would make it relatively easy to evade the scope of Article 32.1 of the SCM

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<sup>117</sup> Appellate Body Report, *US - 1916 Act*, note 66 (“We do not find it necessary, in the present cases, to decide whether the concept of ‘specific action against dumping’ may be broader.”).

<sup>118</sup> Appellate Body Report, *US - Offset Act (Byrd Amendment)*, para. 255.

<sup>119</sup> The United States asserts that in this regard, it is important to note that this portion of the *US – Offset Act (Byrd Amendment)* report is based upon a factual premise that is demonstrably inaccurate. The Appellate Body stated that the CDSOA effected a transfer of financial resources from producers/exporters to their domestic competitors, because “the CDSOA offset payments are financed from the anti-dumping or countervailing duties paid by the foreign producers/exporters.” *US – Offset Act (Byrd Amendment)*, para. 255. This statement is manifestly inaccurate, because US anti-dumping and countervailing duties are paid by US importers, not foreign producers/exporters. See WT/DSB/M/142 (6 March 2003), para. 56 (remarks of the United States).

<sup>120</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 256.

<sup>121</sup> First submission of the European Communities, paras. 195-196.

<sup>122</sup> See, e.g., Panel Report, *US – Offset Act (Byrd Amendment)*, para. 7.24.

Agreement and Article 18.1 of the AD Agreement as interpreted by the Appellate Body. A measure simply would have to purport to deal with both subsidization and dumping and it would not be subject to either provision, because the measure would not deal exclusively with “subsidization” or exclusively with “dumping.”<sup>123</sup>

5.19 The United States recalls the European Communities' assertion that: “Specific action against subsidisation has to be established on the basis of the *operative part* of the Regulation.”<sup>124</sup> The European Communities offers no support for this assertion, and the United States is not even certain what it means. In any event, Article 4 of the TDM Regulation appears to create a link between the TDM and DS273, the dispute commenced by the European Communities under the SCM Agreement. Thus, the TDM Regulation itself suggests that the purpose of the Regulation is to take action against subsidization.

5.20 Moreover, 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 elements of subsidization are not convincing.<sup>125</sup> The fact that subsidies can be granted against any Korean competition or offers from any Korean yard, regardless of the extent to which the Korean merchandise is subsidized, simply suggests that the counter-subsidies may be greater than necessary. Likewise, the limitation on contract-related subsidies to 6 percent may render the counter-subsidies too small to dissuade or terminate subsidization. However, these facts do not mean that the counter-subsidies are not “specific action against subsidization.” Would the offset payments at issue in *US – Offset Act (Byrd Amendment)* have been permissible if they had been automatically halved? Or doubled?

5.21 The United States finishes by stating that the European Communities' analysis of Article 32.1 and the Appellate Body reports discussing it is overly narrow. In *US – Offset Act (Byrd Amendment)*, the Appellate Body concluded that the SCM Agreement prohibits the provision of subsidies in response to another Member's subsidies.<sup>126</sup> Thus, the question for the Panel is whether the EC measures cited by Korea are in response to Korean subsidies.

5.22 **China** notes that the Appellate Body in *US – Offset Act* established two conditions to be met in order for a measure to be subject to the discipline of Article 32.1, namely, “specific action against a subsidy”.

(a) Specific action in response to subsidies

5.23 First, China submits that the scope of application of Article 32.1 is not necessarily limited to measures that may be taken only when the constituent elements of a subsidy are present. China submits that the ruling by the Appellate Body in *US -1916 Act* should not be misconstrued and that the analysis of whether the TDM measure constitutes a “specific action” in response to a subsidy should not end even if it is concluded that the TDM is not a measure taken only when the constituent elements of a subsidy are present.

5.24 Second, contrary to the EC argument, China considers it irrelevant that the actual granting of State aid is not subject to a finding of the constituent elements of subsidies. It is the TDM measure,

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<sup>123</sup> The United States notes that in this regard, it is interesting to consider the CDSOA that was at issue in the *US – Offset Act (Byrd Amendment)* dispute. Because the CDSOA authorized the distribution of both anti-dumping and countervailing duties, under the European Communities' logic in the instant dispute, the panel and the Appellate Body should not have found the CDSOA to be inconsistent with Article 18.1 or Article 32.1.

<sup>124</sup> First submission of the European Communities, para. 201.

<sup>125</sup> First submission of the European Communities, para. 205.

<sup>126</sup> Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 273 (“To be in accordance with the GATT 1994, as interpreted by the SCM Agreement, a response to subsidization must be either in the form of definitive countervailing duties, provisional measures or price undertakings, or in the form of multilaterally-sanctioned countermeasures resulting from resort to the dispute settlement system.”).

instead of each individual grant under the measure, that is under review in this proceeding. Therefore, the focus should be placed on whether the TDM measure is adopted as a specific action in response to Korean subsidies rather than on whether an individual grant is made in response to a subsidy.

5.25 Third, China submits that in these proceedings, in applying the test set forth by the Appellate Body in *US – Offset Act (Byrd Amendment)*, it should be assessed whether the scope of application of the TDM measure has a strong correlation with the constituent elements of Korean subsidies. China suggests distinguishing the concept of “the scope of application” of the measure and that of the qualifying condition of granting State aid. In China’s view, the scope of application of the TDM measure should be the three segments determined by the European Communities to be adversely affected by Korean subsidies while the qualifying condition of granting State aid is competition from a Korean shipyard offering a lower price.

(b) Action against subsidy

5.26 China submits that WTO precedents have clarified that such actions are not limited to those that directly counteract subsidized imports or entities responsible for such imports. An action that does not come into direct contact with the subsidized imports or the entities responsible for such imports may as well constitute a specific measure against a subsidy.

5.27 China further submits that, in judging whether a measure is against a subsidy, it is not required by Article 32.1 that the measure at issue must be capable of effectively dissuading the practice of subsidization. The word “against” does not carry with it such implications.

5.28 In addition, with respect to the relation between Articles 5 and 6 and Article 32.1, China holds that Article 5 and Article 32.1 of the SCM Agreement set forth two totally different types of obligations for WTO Members. Article 5 sets forth the discipline on the use of subsidies by imposing the obligation of not causing adverse effects to the interests of other Members while Article 32.1 is aimed at disciplining countermeasure that a Member may take against subsidies. Therefore, a measure that conforms with Articles 5 and 6 is not necessarily consistent with Article 32.1.

### 3. Article 23 of the DSU

(a) General Arguments

5.29 **Japan** expresses the view that the renunciation of unilateral trade measures in DSU is one of the most important disciplines established under the WTO Agreement. With respect to Article 23 of the DSU, as the panel on *US – Section 301 Trade Act* found correctly, “[f]irst, ‘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’”, and further, “[t]hese rules and procedures [ of the DSU] clearly cover much more than the ones specifically mentioned in Article 23.2.”<sup>127</sup>

5.30 Therefore, for Japan, the threshold issue to be resolved by the Panel in Korea’s claim of inconsistency with DSU Article 23 is whether or not the EC TDM measures are taken to seek the redress of an alleged WTO inconsistency or other nullification or impairment by Korea. In this regard, the European Communities argues that the EC TDM measures have been triggered by Korea’s non-implementation of a bilateral agreement, the “Agreed Minutes” signed between the European Communities and Korea, rather than by the violation of the WTO Agreement, as mentioned

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<sup>127</sup> Panel Report, *US - Section 301 Trade Act*, paras 7.43-7.44.

in the relevant Council Regulation.<sup>128</sup> Korea argues otherwise. Therefore, the Panel should carefully examine the relevant facts so as to resolve the issue before it.

5.31 The **United States** notes Korea's claims that the EC measures are inconsistent with its obligations under Article 23.1 and subparagraphs (a)-(c) of Article 23.2 of the DSU. In responding to these claims, the European Communities relies heavily on the argument that its counter-subsidies cannot be regarded as "countermeasures".<sup>129</sup> According to the European Communities: "A fundamental tenet of the subsidy disciplines enshrined in the SCM Agreement is that Members are permitted to grant or maintain specific subsidies to the extent that they do not constitute a prohibited subsidy within the meaning of Article 3 of the SCM Agreement and do not cause adverse effects within the meaning of Articles 5 and 6 of the SCM Agreement."<sup>130</sup>

5.32 This statement is only half right. The European Communities is correct that, under those articles of the SCM Agreement, Members are permitted to grant or maintain subsidies other than prohibited subsidies or actionable subsidies that cause adverse effects. The European Communities is incorrect, however, in asserting that the entirety of WTO subsidies disciplines are set forth in Articles 3, 5 and 6 of the SCM Agreement. One obvious example that this is not the case is Article III:4 of the GATT 1994, which has been interpreted so as to prohibit certain types of subsidies.<sup>131</sup> And, as discussed in the preceding section, Article 32.1 has been interpreted by the Appellate Body so as to prohibit counter-subsidies.

5.33 Thus, in order to evaluate the "countermeasure" element of the European Communities' arguments, the United States submits that it appears that the Panel may have to make a finding as to whether the measures challenged by Korea are prohibited by Article 32.1 of the SCM Agreement or another provision of the WTO Agreement under one of Korea's claims. If so, then the Panel may also need to address the other elements of what is essentially a claim by Korea that the European Communities has engaged in impermissible unilateral action. In so doing, the Panel may want to bear in mind the following observation of the European Communities:

"[I]f Members take the law into their own hands and unilaterally impose their own views on their rights under the WTO by threatening or taking measures violating their obligations, they risk provoking spirals of retaliatory actions that would jeopardise the results of half a century of trade negotiations."<sup>132</sup>

5.34 The United States believes 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 agreements. The first question to be answered under Article 23.1 in this context is whether the European Communities is seeking redress of a violation of WTO obligations. This question would appear closely linked to Article 23.2(a) in that a Member would only be seeking redress of obligations if the Member has determined that there is a breach of those obligations. In this instance, the first question then would be whether the European Communities has made such a determination outside the context of WTO dispute settlement. If so, then the European Communities would be in breach of Article 23.2(a) and by extension Article 23.1 of the DSU. If the measures taken in seeking redress amounted to a suspension of WTO concessions or other obligations, then there might also be a breach of Article 23.2(c).

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<sup>128</sup> Council Regulation (EC) No. 1177/2002 of 27 June 2002 concerning temporary defensive mechanism to shipbuilding, O.J. L172/1 (2.7.2002).

<sup>129</sup> First submission of the European Communities, paras. 168, 177, 178. Japan states that the European Communities appears to use the term "countermeasures" as a shorthand expression for the "suspension of concessions or other obligations", as used in Article 23 of the DSU.

<sup>130</sup> First submission of the European Communities, para. 168.

<sup>131</sup> See, e.g., Appellate Body Report, *US - FSC (Article 21.5-EC)*, para. 256(e).

<sup>132</sup> Panel Report, *US - Section 301 Trade Act*, para. 4.81.

5.35 If the European Communities has not made such a determination outside the context of dispute settlement, then Article 23.1 would appear not to be applicable and there would be no need to address, for purposes of DSU Article 23, the question of whether the measures taken were themselves consistent or inconsistent with the WTO.

5.36 The United States also explains that neither Article 60 of the Vienna Convention on the Law of Treaties nor Article 49(2) of the Draft ILC Articles on State Responsibility is relevant to the question presented.<sup>133</sup> With respect to the Draft Articles, the United States does not believe that a report prepared by the International Law Commission (not a body composed of WTO Members) of which the UN General Assembly simply “took note” in 2001 can inform the meaning of provisions of the WTO agreements that entered into force almost six years earlier. Nor do the Draft Articles set forth “customary rules of interpretation of public international law,” the standard by which WTO dispute settlement bodies are to clarify existing provisions of the covered agreements pursuant to Article 3.2 of the DSU.

5.37 With respect to Article 60 of the Vienna Convention, the United States observes that the Vienna Convention is not a covered agreement nor is it context for purposes of interpreting the WTO agreements. Furthermore, Article 60 does not reflect a customary rule of interpretation of treaties. Therefore, whatever the rules for suspension of a treaty might be under Article 60, they do not establish the rights and obligations actually provided by WTO covered agreements, and of course Article XV of the WTO Agreement provides the WTO rule for withdrawal from the WTO agreements.

5.38 The United States opines that the Panel need not address these subsidiary arguments of the European Communities. In the view of the United States, the first question to resolve is whether the TDM Regulation and the related measures are inconsistent with any provision of a WTO agreement other than Article 23 of the DSU. In this regard, one such provision cited by Korea is Article 32.1 of the SCM Agreement. As indicated in the US written submission, in order to determine whether the EC measures are inconsistent with Article 32.1, the Panel will need to determine whether the EC measures cited by Korea are in response to Korean subsidies.<sup>134</sup>

5.39 If the Panel determines that the EC measures are inconsistent with a provision other than Article 23 of the DSU, the Panel would seem to have two choices. First, it could invoke principles of judicial economy, and stop there. Finding an inconsistency with Article 23 of the DSU arguably does not provide much in the way of additional assistance to the parties or the Dispute Settlement Body. Alternatively, the Panel could go on to conduct the analysis under Article 23, in which case it would have to address the other issues raised by the parties concerning Article 23.

5.40 If, however, the Panel determines that the EC measures are not inconsistent with a provision other than Article 23 of the DSU, the Panel may wish to proceed to determine if the European Communities has made a determination contrary to DSU Article 23.1 and 23.2(a). In looking at the question of what would constitute a determination, the United States notes that this question would appear to be distinct from the question of whether there has been a suspension of concessions in breach of Article 23.2(c). In *US - Section 301 Trade Act*, the European Communities itself took the position that a determination only had to be formal and legally binding and could include determinations of WTO consistency.<sup>135</sup> The EC position in this dispute that there must also be trade consequences is a new position by the European Communities, and it is not clear what textual support there is for that new position.

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<sup>133</sup> First submission of the European Communities, paras. 132-135.

<sup>134</sup> Third party submission of the United States, para. 12.

<sup>135</sup> Panel Report, *US - Section 301 Trade Act*, para. 4.844.

5.41 In response to a question posed by the European Communities, the United States notes that it is difficult to discuss such broad concepts as the scope of DSU Article 23 in the abstract. In the context of this particular dispute, the United States has taken no position on whether the European Communities has made a determination that Korea has acted inconsistently with the WTO Agreement. However, the United States would observe that Article 23.1 requires Members to have recourse to the DSU when they “seek redress” of a violation of an obligation under the WTO Agreement. “Redress” is defined as

"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 of amendment of a thing, state, etc."<sup>136</sup>

5.42 The United States notes that various Members have explained that they are not in a position to suspend concessions effectively or have recourse to other modes of redress.<sup>137</sup> Therefore, the main form of redress or “assistance” available to them is a finding that another Member’s measure is inconsistent with the WTO Agreement.

5.43 Article 23.2(a) provides further support that a determination of a breach of the WTO Agreement can be a method of seeking redress. Article 23.2(a) specifically singles out a determination, outside DSU procedures, of a breach of the WTO Agreement as being inconsistent with the DSU. Article 23.2(a) does not require that the determination be accompanied by any other action or trade consequences.<sup>138</sup> As a result, it would appear that a determination of a breach of the WTO Agreement could be sufficient in and of itself to be proscribed by Article 23, irrespective of whether it is accompanied by actions with trade consequences. In this connection, the United States notes that, while the panel in *US - Certain EC Products* suggested that “determinations” under Article 23.2(a) are ones which bear consequences in WTO trade relations,<sup>139</sup> that panel’s Article 23.2(a) finding was reversed because the European Communities never even raised a claim under that provision – in other words, the parties never presented arguments on whether a determination need have “consequences for trade relations,”<sup>140</sup> and the panel’s statement is little more than an unsupported assertion.

5.44 According to the United States, if there is a determination inconsistent with Article 23.2(a), then that would be sufficient to establish a consequential breach of Article 23.1. There would appear to be little need then for the Panel, in its analysis of Korea’s Article 23 claims, to further examine whether any measures of the European Communities responding to such a determination are consistent with the WTO Agreement. It may, however, be appropriate to examine whether those measures are consistent with other provisions of the WTO Agreement that are the subject of Korea’s claims.

5.45 In response to a further question from the European Communities, the United States notes that Article 23.2 nowhere refers to measures other than a determination or the suspension of concessions

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<sup>136</sup> *The New Shorter Oxford English Dictionary*, 4th edition, vol. 2, p. 2515.

<sup>137</sup> The United States notes that, for example, this issue has arisen several times during the course of negotiations on the DSU.

<sup>138</sup> The United States is unclear as to what is meant by “consequences in WTO trade relations.” A determination that another Member is failing to abide by its WTO commitments would certainly appear to have potential “consequences in WTO trade relations,” if only with respect to the Member’s willingness to enter into further commitments with that other Member. However, for purposes of this reply the United States assumes the EC intends this term to refer to trade effects rather than simply the quality of the trade relationship between Members.

<sup>139</sup> Panel Report, *US – Certain EC Products*, para. 6.98.

<sup>140</sup> Appellate Body Report, *US – Certain EC Products*, paras. 107-115.

or other obligations. Accordingly it is difficult to see how measures consistent with the WTO Agreement would be covered by Article 23.2. Similarly, Article 23.1 simply commits Members to have recourse to, and abide by, the rules and procedures of the DSU. The DSU is not concerned with rules or procedures for a Member to adopt or maintain measures that are consistent with the WTO Agreement, so it is difficult to see how Article 23.1 would apply to such measures. Of course, in the context of this dispute, if the Panel were to determine that the EC measures at issue are inconsistent with the WTO Agreement, in particular the SCM Agreement, then Article 23 of the DSU could also apply to those measures.

5.46 In response to a question posed by the European Communities concerning the term “counter subsidy”, the United States notes that it used the term to refer to a subsidy provided by one Member in response, either in whole or in part, to a subsidy provided by another Member.

5.47 In response to questions posed by Korea concerning the European Communities' characterization of the DSU's negotiating history, the United States notes that Article 23 of the DSU records an agreement reached among all the Uruguay Round participants as to how WTO Members would conduct themselves in light of the new DSU being agreed. In this respect, it protected all Members, including the United States, against the actions described. Most fundamentally, the intent of a treaty provision is to be found in the language of the provision itself. DSU Article 23.2 by its terms is not limited to Section 301 of US law or to the determinations or suspensions of concessions by any particular Member; it applies equally to all Members. Had the Members intended a narrower application of the disciplines of Article 23.2, they would have drafted the provision accordingly.

5.48 In China's view, concerning the threshold for the application of Article 23 of the DSU, it should be firstly assessed whether the TDM is a measure seeking the redress of a WTO violation. China submits the following opinion on this threshold issue.

5.49 China does not agree with the European Communities that the term “seek to redress” covers “any action that is capable of inducing another Member to terminate a breach of WTO obligations”, or even only “measures amounting to a suspension of concessions or obligations under the WTO Agreement”. On the basis of the meanings of the terms “seeking” and “redress” considered by the Panel in *US – Certain EC Products*, it is essential to find out whether the purpose of the measure at issue is “with a view to remedying the situation” of a WTO violation.

5.50 Secondly, China submits, although only remedial actions envisaged in the WTO system can be used by a Member to redress a WTO violation, this does not mean that only such actions can be deemed as remedial actions falling within the ambit of Article 23. On the contrary, Article 23 covers any remedial action that is adopted against another Member and in response to a WTO violation. If Article 23 is interpreted to only cover a suspension of concessions or obligations, it would effectively mean that Members are free to take whatever actions they like to redress a WTO violation except for a suspension of concessions or obligations. This clearly runs against the DSU's object and purpose of protecting the security and predictability of the multilateral trading system.

5.51 Thirdly, China believes that the structure of Article 23 is: paragraph 1 provides for a general obligation to have exclusive recourse to the multilateral dispute settlement mechanism pursuant to the rules and procedures of the DSU while paragraph 2 provides for specific instances of prohibited unilateral actions. Therefore, China does not agree to the EC argument that “a prohibited unilateral action that redresses a WTO violation must have elements of the three sub-paragraphs” of Article 23.2. In China's opinion, each of the forms of unilateral actions provided for under Article 23.2 is explicitly prohibited.

5.52 Turning to the current dispute, China suggests that the following facts, if established by the Panel, should be helpful for ascertaining whether the TDM is a measure seeking the redress of a WTO violation: (i) the TDM is closely linked to the TBR investigation conducted by the

European Communities on the allegedly WTO-inconsistent subsidies provided by Korea. Via the TBR investigation, a link may be established between the TDM and the perceived WTO-inconsistent subsidies of Korea; (ii) in terms of the application period of the TDM measure, the TDM appears to be an ancillary instrument that comes into play while the WTO proceedings do not produce effective remedies for the European Communities as early as it desires; (iii) as indicated by the Press Release of the European Communities, the so-called “twin-track strategy” consists of the TDM and the WTO proceedings launched by the European Communities against Korean subsidies; (iv) the form of the TDM measure is direct aid for shipbuilding contracts in case of Korean competition. Thus, it is aiming at counteracting the low-price competition perceived by the European Communities as a result of subsidies granted by Korea.

5.53 China also submits that although the TDM was initially intended as a countermeasure against the perceived subsidies of Korea, it may have serious impact upon the world shipbuilding market. The TDM Regulation provides that an EC government may grant direct aid to EC shipyards in case of competition from Korean shipyards. However, it does not exclude its application to the situations where there are competitors from countries other than Korea. On the global market, it is extremely common that shipyards from not only the European Communities and Korea, but also other countries compete for a new shipbuilding order. The European Communities itself admits that “there is *per se* always competition from a Korean” yard. Therefore, the TDM measure, through direct government intervention in the bidding process participated by market players from all over the world, is likely to arm the EC shipyards with an artificial price edge of up to six per cent of the contract price and thereby seriously damage the normal competitive conditions of the world shipbuilding market.

5.54 On the basis of the above, China urges the Panel to take into account the impact of the TDM measure on the global trade order in the shipbuilding sector when assessing its consistency with Article 23 of the DSU.

(b) Article 23.2.(a) of the DSU

5.55 With respect to the issue of whether the TDM constitutes a determination within the meaning of Article 23.2(a) of the DSU, **China** firstly refers to the holding of the Panel in *US – Section 301 Trade Act*. That Panel considered that 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”.

5.56 Second, China submits that the following facts seem to indicate that the TDM is of the degree of firmness and immutability required by the meaning of a “determination” in Article 23.2(a): (i) the recitals of the TDM Regulation firmly conclude that certain segments in the EC shipbuilding industry have suffered “adverse effects in the form of material injury and serious prejudice”. In the context of the SCM Agreement, these words may be understood to be referring to adverse effects in the sense of Article 5 of the SCM Agreement; (ii) the act of authorizing direct aid specifically to certain segments identified by the TBR investigation seems to demonstrate the TDM Regulation’s nature of firmness and immutability.

5.57 Third, China considers that the phrase “to the effect” contained in Article 23.2(a) indicates that the measure under review does not need to clearly set out in its text that a WTO violation has occurred. China suggests that emphasis should be placed on the substantive implications of the measure rather than its forms. Such a point of view is supported by the Panel in *US – Section 301* which held that whether an act constitutes a “determination” is a more or less formal requirement that needs broad reading. China further submits that the vague language of the TDM Regulation should not be taken literally and linked to the “broader problem of injurious pricing” since the TDM Regulation is closely associated with the TBR investigation and the TBR Commission Decision manifestly concluded that “Korea has granted export and actionable subsidies within the meaning of the SCM Agreement”.

## 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 legitimized 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.<sup>141</sup> 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.<sup>142</sup> 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".<sup>143</sup>

7.6 In support of this request, the European Communities argued that the request of Korea for the establishment of a panel<sup>144</sup> 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.<sup>145</sup>

7.7 **Korea** requested the Panel to deny the request of the European Communities on the following grounds.<sup>146</sup> 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

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<sup>141</sup> Appellate Body Report, *US – Wool Shirts and Blouses*, p. 16.

<sup>142</sup> *Ibid.*

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

<sup>144</sup> WT/DS301/3, attached as Annex.

<sup>145</sup> First submission of the European Communities, paras. 107-113.

<sup>146</sup> 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 Panel<sup>147</sup>, 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 proceeding<sup>148</sup> 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.

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<sup>147</sup> 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.

<sup>148</sup> 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.<sup>149</sup>

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.<sup>150</sup>

(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.

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<sup>149</sup> 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.

<sup>150</sup> 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 panel<sup>151</sup> 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.<sup>152</sup> 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 consultations<sup>153</sup> 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.

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<sup>151</sup> WT/DS301/3, attached as Annex.

<sup>152</sup> Id.

<sup>153</sup> 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.<sup>154</sup> 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 payments<sup>155</sup>. 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.<sup>156</sup>

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 obligations<sup>157</sup>. 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

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<sup>154</sup> See cases discussed in *WTO Analytical Index*, at 1305—1308.

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

<sup>156</sup> 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)."

<sup>157</sup> 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".<sup>158</sup>

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.<sup>159</sup>

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.<sup>160</sup>

7.29 As noted above (paras. 7.18-7.19), Korea's request for the establishment of a panel<sup>161</sup> 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

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<sup>158</sup> Response of Korea to Panel Question 4.

<sup>159</sup> Second submission of the European Communities, paras. 32-33.

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

<sup>161</sup> 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.<sup>162</sup>

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"<sup>163</sup> 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".<sup>164</sup>

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

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<sup>162</sup> 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).

<sup>163</sup> First submission of the European Communities, para. 93.

<sup>164</sup> 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.<sup>165</sup>

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.<sup>166</sup>

## 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)<sup>167</sup>, 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.<sup>168</sup> 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 carriers<sup>169</sup> shall be considered compatible with the common market.<sup>170</sup>

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<sup>165</sup> 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.

<sup>166</sup> See *infra*, paras. 7.52-7.54 and footnotes 278 and 400.

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

<sup>168</sup> 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."

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

<sup>170</sup> 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 conditions<sup>171</sup>, 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

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(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.

<sup>171</sup> 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.<sup>172</sup>

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

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<sup>172</sup>Notice 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.<sup>173</sup>

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.<sup>174</sup>

(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 decisions<sup>175</sup> authorizing aid schemes notified by Germany<sup>176</sup>, the Netherlands<sup>177</sup>, Denmark<sup>178</sup>, France<sup>179</sup> and Spain<sup>180</sup> 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:<sup>181</sup>

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 scheepsbouwsector bij wijze van tijdelijke defensieve maatregel "Tijdelijke Regeling Ordersteun Scheepsniewbouw 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

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<sup>173</sup> 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.

<sup>174</sup> 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).

<sup>175</sup> Exhibits Korea 11-15.

<sup>176</sup> OJ C 108, 7.5.2003, p. 5.

<sup>177</sup> OJ C 221, 17.9.2003, p. 10 and OJ C 269, 8.11.2003, p. 23.

<sup>178</sup> OJ C 227, 23.9.2003, p. 7.

<sup>179</sup> OJ C 257, 25.10.2003, p. 2.

<sup>180</sup> OJ C 6, 10.1.2004, p.22.

<sup>181</sup> 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.<sup>182</sup>

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.<sup>183</sup> 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.<sup>184</sup>

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

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<sup>182</sup> Attachment EC-1.

<sup>183</sup> Response of the European Communities to Panel Question 2.

<sup>184</sup> 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.<sup>185</sup> 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 parties<sup>186</sup>

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.<sup>187</sup> 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.<sup>188</sup> 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*.<sup>189</sup> 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).<sup>190</sup> 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.<sup>191</sup>

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

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<sup>185</sup> First submission of the European Communities, p. 31.

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

<sup>187</sup> First submission of Korea, paras. 157-162.

<sup>188</sup> First submission of Korea, paras. 163-165.

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

<sup>190</sup> Second submission of Korea, paras. 200-215.

<sup>191</sup> 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.<sup>192</sup> 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.<sup>193</sup> 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).<sup>194</sup>

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.<sup>195</sup>

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.<sup>196</sup> 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.<sup>197</sup> 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.<sup>198</sup>

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.<sup>199</sup> 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.

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<sup>192</sup> First submission of the European Communities, para. 222.

<sup>193</sup> First submission of the European Communities, paras.224-228.

<sup>194</sup> First submission of the European Communities, paras. 292-232.

<sup>195</sup> See also second submission of the European Communities, paras. 40-42.

<sup>196</sup> First submission of Korea, para. 149.

<sup>197</sup> Response of Korea to Panel Question 51.

<sup>198</sup> Second submission of Korea, paras. 206-207 and Exhibit Korea 46.

<sup>199</sup> 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.<sup>200</sup>

## 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.<sup>201</sup> 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.<sup>202</sup>

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..."<sup>203</sup>

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

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<sup>200</sup> Third party submission of Japan, paras. 15-17.

<sup>201</sup> Responses of the European Communities to Panel question 51.

<sup>202</sup> 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.

<sup>203</sup> Appellate Body Report, *Korea - Various Measures on Beef*, para. 133.

granting of subsidies.<sup>204</sup> 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."<sup>205</sup>

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.<sup>206</sup>

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

<sup>205</sup> 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.

<sup>206</sup> 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 vessels<sup>207</sup> 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).<sup>208</sup> 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".<sup>209</sup> 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.

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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.

<sup>207</sup> 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.

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

<sup>209</sup> 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 parties<sup>210</sup>

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.<sup>211</sup> 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".<sup>212</sup> 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.<sup>213</sup>

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.<sup>214</sup> 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".<sup>215</sup> 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.<sup>216</sup>

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

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

<sup>212</sup> First submission of Korea, para. 181; second submission of Korea, para. 221.

<sup>213</sup> First submission of Korea, paras. 187-191.

<sup>214</sup> First submission of the European Communities, para. 238.

<sup>215</sup> First submission of the European Communities, para. 239.

<sup>216</sup> 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.<sup>217</sup> 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 measure<sup>218</sup>, 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.<sup>219</sup>

## 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,\*<sup>220</sup> 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

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

<sup>218</sup> Response of the European Communities to Panel Question 55.

<sup>219</sup> Response of the European Communities to Panel Question 54.

<sup>220</sup> 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".<sup>221</sup> 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.<sup>222</sup> 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:4<sup>223</sup> 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.

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

<sup>222</sup> *The New Shorter Oxford English Dictionary* (1993), p.1717.

<sup>223</sup> 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.<sup>224</sup> 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."<sup>225</sup>

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.<sup>226</sup> 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

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<sup>224</sup> First submission of Korea, para. 176.

<sup>225</sup> 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.' "

<sup>226</sup> 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...".<sup>227</sup>

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.<sup>228</sup> 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."<sup>229</sup>

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

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<sup>227</sup> 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)

<sup>228</sup> First submission of Korea, para. 176.

<sup>229</sup> 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 parties<sup>230</sup>

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 Body<sup>231</sup>, 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.<sup>232</sup>

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.<sup>233</sup>

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

<sup>231</sup> First submission of Korea, para. 105.

<sup>232</sup> 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.

<sup>233</sup> 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.<sup>234</sup> 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.<sup>235</sup>

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.<sup>236</sup> 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.<sup>237</sup>

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.<sup>238</sup> Korea only committed to refrain from granting subsidies and to continue implementing internationally recognized accounting principles.<sup>239</sup> 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.<sup>240</sup> 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.<sup>241</sup>

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 Body<sup>242</sup>, 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 targeted<sup>243</sup> and a specific determination must be made that a subsidy exists.<sup>244</sup> The Appellate Body

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<sup>234</sup> 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.

<sup>235</sup> 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.

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

<sup>237</sup> Second submission of Korea, para. 169.

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

<sup>239</sup> Response of Korea to Panel Questions 44-45.

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

<sup>241</sup> Second submission of Korea, paras. 170-176.

<sup>242</sup> First submission of the European Communities, paras. 185-187.

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

<sup>244</sup> 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."<sup>245</sup>

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".<sup>246</sup> 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.<sup>247</sup>

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.<sup>248</sup> 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.<sup>249</sup> The European Communities rejects Korea's characterization of the Agreed Minutes as an understanding regarding the interpretation of the SCM Agreement.<sup>250</sup> 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."<sup>251</sup>

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.<sup>252</sup> 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.<sup>253</sup> 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.<sup>254</sup>

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

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<sup>245</sup> 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.

<sup>246</sup> 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.

<sup>247</sup> First submission of the European Communities, para. 195.

<sup>248</sup> First submission of the European Communities, para. 196.

<sup>249</sup> 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.

<sup>250</sup> First submission of the European Communities, paras. 154-155.

<sup>251</sup> Responses of the European Communities to Panel Question 15.

<sup>252</sup> First submission of the European Communities, para. 198.

<sup>253</sup> First submission of the European Communities, para. 198.

<sup>254</sup> First submission of the European Communities, para. 199.

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

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.<sup>256</sup>

(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.<sup>257</sup>

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.<sup>258</sup>

(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:

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<sup>255</sup> 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.

<sup>256</sup> 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.

<sup>257</sup> Third party submission of the United States, paras. 4, 9 and 10.

<sup>258</sup> 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)*.<sup>259</sup> 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."<sup>66</sup>

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

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,

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

<sup>260</sup> 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."<sup>261</sup>

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."<sup>262</sup>

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".<sup>263</sup>

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".<sup>264</sup>

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.<sup>265</sup>

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

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

<sup>262</sup> 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.

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

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

<sup>265</sup> 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".<sup>266</sup>

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.<sup>267</sup> 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."<sup>268</sup>

7.122 Reports<sup>269</sup> 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.

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<sup>266</sup>As 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.

<sup>267</sup>First 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.

<sup>268</sup>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).

<sup>269</sup>Reproduced 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.<sup>270</sup> 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.<sup>271</sup>

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 Regulation<sup>272</sup>, 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.<sup>273</sup>

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

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<sup>270</sup> 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.

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

<sup>272</sup> See e.g., first submission of the European Communities, para. 158.

<sup>273</sup> 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.<sup>274</sup> 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.<sup>275</sup>

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.

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

<sup>275</sup> 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.<sup>276</sup>

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.<sup>277</sup> Since the proposal for a temporary defensive mechanism, described as "one

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<sup>276</sup> 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.

<sup>277</sup> 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.<sup>278</sup>

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

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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

<sup>278</sup> 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.<sup>279</sup> 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.<sup>280</sup>

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 removed<sup>281</sup>, 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.<sup>282</sup> 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.<sup>283</sup> 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.

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<sup>279</sup> 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*.

<sup>280</sup> 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.

<sup>281</sup> See SCM Agreement Articles 4.7 and 7.8.

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

<sup>283</sup> 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.<sup>284</sup> 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.<sup>285</sup> 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 arguments<sup>286</sup>

(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

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<sup>284</sup> 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).

<sup>285</sup> 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).

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

"creates an incentive to terminate such practices".<sup>287</sup> 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.<sup>288</sup> 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.<sup>289</sup> 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.<sup>290</sup>

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.<sup>291</sup> 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.<sup>292</sup> 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.<sup>293</sup>

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.<sup>294</sup>

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.<sup>295</sup> 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.<sup>296</sup> 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.<sup>297</sup>

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

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<sup>287</sup> First submission of Korea, para. 120.

<sup>288</sup> First submission of Korea, paras. 121-122.

<sup>289</sup> First submission of Korea, paras. 123-124.

<sup>290</sup> First submission of Korea, paras. 125-126.

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

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

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

<sup>294</sup> Second submission of Korea, paras. 188-189.

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

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

<sup>297</sup> 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)*<sup>298</sup> 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.<sup>299</sup> 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.<sup>300</sup> Third, in view of its modest amount, such aid cannot offset the effects of Korean subsidization.<sup>301</sup> 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.<sup>302</sup>

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.<sup>303</sup>

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.<sup>304</sup> 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.<sup>305</sup>

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.<sup>306</sup> 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

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<sup>298</sup> 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.

<sup>299</sup> 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.

<sup>300</sup> First submission of the European Communities, paras. 213-214.

<sup>301</sup> First submission of the European Communities, paras. 215-216.

<sup>302</sup> First submission of the European Communities, paras. 217-220.

<sup>303</sup> Response of the European Communities to Panel Question 47.

<sup>304</sup> Response of the European Communities to Panel Question 40.

<sup>305</sup> Response of the European Communities to Panel Question 40.

<sup>306</sup> 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.<sup>307</sup>

(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.<sup>308</sup> 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.<sup>309</sup> 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".<sup>310</sup>

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.<sup>311</sup> Second, a measure can be "against" a subsidy even though it is not effective in dissuading the practice of subsidization.<sup>312</sup> 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.<sup>313</sup>

(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.<sup>314</sup> As a consequence, the Appellate Body rejected the view

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<sup>307</sup> Second submission of the European Communities, para. 79.

<sup>308</sup> Third party submission of the United States, para. 6.

<sup>309</sup> Third party submission of the United States, para. 7.

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

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

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

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

<sup>314</sup> 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.<sup>315</sup>

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".<sup>316</sup>

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".<sup>317</sup> 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*".<sup>318</sup>

7.158 The Appellate Body's focus on the transfer of financial resources<sup>319</sup> 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

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<sup>315</sup> 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.

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

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

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

<sup>319</sup> 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".<sup>320</sup> 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."<sup>321</sup>

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."<sup>322</sup>

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.<sup>323</sup>

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<sup>320</sup> 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.

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

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

<sup>323</sup> 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.<sup>324</sup> 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.<sup>325</sup>

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

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"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.

<sup>324</sup> 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.

<sup>325</sup> 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.<sup>326</sup> 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

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<sup>326</sup> 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.<sup>327</sup> 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.<sup>328</sup> 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.<sup>329</sup>

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.<sup>330</sup> 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.<sup>331</sup> 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.<sup>332</sup> In particular Korea refers to statements that the adoption of the TDM Regulation signals to Korea the European Communities' determination to resolve the dispute;<sup>333</sup> that the TDM Regulation is part of a strategy "aimed at fighting these unfair [Korean practices]"<sup>334</sup>, that the TDM Regulation is part of the Commission's twin-track strategy,<sup>335</sup> that the TDM Regulation is

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<sup>327</sup> 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.

<sup>328</sup> First submission of Korea, para. 123.

<sup>329</sup> First submission of Korea, para. 124.

<sup>330</sup> 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.

<sup>331</sup> See, paras. 7.160-7.164, *supra*.

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

<sup>333</sup> First submission of Korea, para. 120.

<sup>334</sup> First submission of Korea, para. 121.

<sup>335</sup> First submission of Korea, para. 122.

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

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.<sup>339</sup>

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 application<sup>340</sup> 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*<sup>341</sup>

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.<sup>342</sup> According to Korea, the European Communities "imposed

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<sup>336</sup> Second submission of Korea, para. 194.

<sup>337</sup> Second submission of Korea, para. 197.

<sup>338</sup> Second submission of Korea, para. 198.

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

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

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

<sup>342</sup> 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".<sup>343</sup>

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"<sup>344</sup> and emphasizes that the term "seek redress" is "a broad formulation clearly intended to capture a wide range of potential measures and actions".<sup>345</sup> 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.<sup>346</sup> 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.<sup>347</sup> 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.<sup>348</sup>

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".<sup>349</sup> 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.<sup>350</sup>

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".<sup>351</sup> 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".<sup>352</sup> The European Communities

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<sup>343</sup> First submission of Korea, para. 20.

<sup>344</sup> Response of Korea to Panel Question 26.

<sup>345</sup> First submission of Korea, para. 42.

<sup>346</sup> E.g., response of Korea to Panel Question 18.

<sup>347</sup> 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.

<sup>348</sup> Response of Korea to Panel Question 27.

<sup>349</sup> First submission of Korea, para. 39.

<sup>350</sup> E.g., first submission of Korea, paras. 39-62.

<sup>351</sup> First submission of the European Communities, para. 129.

<sup>352</sup> Response of the European Communities to Panel Question 14.

submits that Article 23.1 of the DSU is entirely procedural in nature.<sup>353</sup> Its first purpose is "to ensure the exclusivity of WTO jurisdiction over WTO law and the suspension of concessions".<sup>354</sup> 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.<sup>355</sup> The only other aspect of Article 23.1 is the reaffirmation of the obligation to abide by the rules of the DSU.<sup>356</sup> 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.<sup>357</sup>

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.<sup>358</sup>

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.<sup>359</sup>

(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.<sup>360</sup> 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.<sup>361</sup>

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

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

<sup>355</sup> Responses of the European Communities to Panel Questions 16 and 19.

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

<sup>357</sup> Second submission of the European Communities, para. 85.

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

<sup>359</sup> E.g., first submission of the European Communities, paras. 144-166.

<sup>360</sup> Third party submission of China, paras. 4-8.

<sup>361</sup> 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.<sup>362</sup> Thus the suspension of concessions or other WTO obligations is not the only form of redress within the meaning of Article 23.1.<sup>363</sup> 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.<sup>364</sup> 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.<sup>365</sup> 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.<sup>366</sup>

(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

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

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

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

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

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

international law<sup>367</sup>, 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".<sup>368, 369</sup> 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".<sup>370</sup> 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".<sup>371</sup> 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."<sup>372</sup>

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<sup>367</sup> Art. 3.2 of the DSU.

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

<sup>369</sup> 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.

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

<sup>371</sup> Panel Report, *US - Certain EC Products*, paras. 6.22 and 6.23.

<sup>372</sup> 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.<sup>373</sup> 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".<sup>374</sup>

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.<sup>375</sup> 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. (...)"<sup>376</sup>

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

<sup>373</sup>The 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.

<sup>374</sup> Panel Report, *US - Certain EC Products*, para. 6.22.

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

<sup>376</sup> 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."<sup>377</sup>

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."<sup>378</sup>

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:

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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).

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

<sup>378</sup> 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."<sup>379</sup>

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".<sup>380</sup>

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

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

<sup>380</sup> 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.<sup>381</sup> 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".<sup>382</sup>

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".<sup>383</sup>

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

<sup>382</sup> First submission of the European Communities, paras. 123-129.

<sup>383</sup> 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".<sup>384</sup> 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.<sup>385</sup>

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.<sup>386</sup> The Panel notes the

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<sup>384</sup> Panel Report, *US - Certain EC Products*, para. 6.98.

<sup>385</sup> Appellate Body Report, *US - Certain EC Products*, paras. 107-115.

<sup>386</sup> 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".<sup>387</sup> 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).<sup>388</sup> 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.<sup>389</sup> An examination of the US statute<sup>390</sup> 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 Treaties<sup>391</sup>, and that Article 23 should

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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."

<sup>387</sup> Response of the European Communities to Panel Question 20.

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

<sup>389</sup> Panel Report, *US - Section 301 Trade Act*, para. 7.96.

<sup>390</sup> Panel Report, *US - Section 301 Trade Act*, Annex I.

<sup>391</sup> 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.<sup>392</sup> 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.<sup>393</sup> 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.<sup>394</sup>

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 Communities<sup>395</sup>, 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.<sup>396</sup>

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(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."

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

<sup>393</sup> 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.

<sup>394</sup> Second submission of the European Communities, para. 154.

<sup>395</sup> 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.

<sup>396</sup> 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.<sup>397</sup> 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 DSU<sup>398</sup>) as support for its position that the DSU "only protects Members from measures that offset the rights and obligations in the WTO Agreement".<sup>399</sup>

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?*

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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.

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

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

<sup>399</sup> 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".<sup>400</sup> 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."<sup>401</sup> 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.<sup>402</sup> The evidence before us indicates that the TDM Regulation was based on factual findings that clearly amounted to at

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<sup>400</sup> 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.

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

<sup>402</sup> 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."<sup>403</sup>

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.<sup>404</sup>

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

<sup>404</sup> 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.<sup>405</sup> 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

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<sup>405</sup> 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 parties<sup>406</sup>

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.<sup>407</sup> 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.<sup>408</sup> 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.<sup>409</sup>

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).<sup>410</sup> 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.<sup>411</sup>

#### (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.<sup>412</sup>

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

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

<sup>407</sup> First submission of Korea, paras. 72-85.

<sup>408</sup> First submission of Korea, paras. 86-88.

<sup>409</sup> First submission of Korea, paras.89-91.

<sup>410</sup> First submission of the European Communities, paras. 170-176.

<sup>411</sup> First submission of the European Communities, paras. 177-178.

<sup>412</sup> 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 parties<sup>413</sup>

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.<sup>414</sup> 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.<sup>415</sup> 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".<sup>416</sup>

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.<sup>417</sup>

### 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.

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

<sup>414</sup> First submission of Korea, paras. 134-135.

<sup>415</sup> First submission of Korea, paras. 137-139.

<sup>416</sup> Response of Korea to Panel Question 50.

<sup>417</sup> 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 Communities<sup>418</sup> 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.<sup>419</sup> 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

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<sup>418</sup> 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.

<sup>419</sup> 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.<sup>420</sup>

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<sup>420</sup> 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

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**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.

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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.

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