WORLD TRADE ORGANIZATION

RESTRICTED

WT/DSB/M/187
25 April 2005

(05-1683)

Dispute Settlement Body
11 April 2005

MINUTES OF MEETING

Held in the Centre William Rappard
on 11 April 2005

Chairman: Mr. Eirik Glenne (Norway)

1. Korea – Measures affecting trade in commercial vessels

(a) Report of the Panel (WT/DS273/R)

1. The Chairman recalled that at its meeting on 21 July 2003, the DSB had established a panel to examine the complaint by the European Communities pertaining to this matter. He noted that the Report of the Panel contained in WT/DS273/R had been circulated on 7 March 2005 as an unrestricted document, pursuant to the Procedures for the Circulation and Derestriction of WTO Documents contained in WT/L/452. The Panel Report was now before the DSB for adoption at the request of Korea. This adoption procedure was without prejudice to the right of Members to express their views on the Panel Report.

2. The representative of Korea said that his country wished to thank the members of the Panel and the Secretariat for their hard work in this complex and difficult case. He recalled that the proceedings in this case had been complicated by the passing away of Mr. Said El-Naggar, the original Chairman of the Panel. Mr. S. El-Naggar's intelligence, professionalism and personal warmth were all evident in this case and he would be greatly missed. Fortunately for the parties and the dispute settlement system, Mr. Julio Lacarte-Muró had been willing and completely able to step in to assume the duties as Chairman of the Panel. Korea was deeply grateful for his assistance and for the fine work that he and other panelists had done.

3. Korea was satisfied overall with the results of these proceedings. The issue of the restructuring was at the heart of the case that the EC had been pressing for years. As Korea maintained, no subsidization had taken place regarding the restructuring of certain Korean shipbuilding companies as a result of the Asian financial crisis. The IMF had previously stated that, as a general matter, Korea had done a good job of restructuring its financial sector on the basis of market principles. It was also noted generally that the restructurings of companies with much debt held by the domestic financial sector, had been based on market principles. The Panel had found that the specific restructurings at issue were market-based and did not involve subsidization. Korea welcomed the rejection of the EC's allegations in this regard. The Panel had also rejected the EC's contentions that the KEXIM[1] Act and advanced payment refund guarantees (APRGs) and pre-shipment loans (PSLs) offered by KEXIM were export subsidies "as such". The Panel had also determined that the APRG and PSL programs were not, as a factual matter, covered by items (j) and (k) of the Illustrative List of Export Subsidies. Korea accepted that factual finding, but believed that, the Panel could have simply halted at that point. Instead, the Panel had continued with a hypothetical

[1] The State-owned Export-Import Bank of Korea.

analysis of the issue of the *a contrario* reading of footnote 5 of the SCM Agreement and the so-called safe harbors that was in defiance of the Appellate Body's reasoning and had lent more confusion than clarity to the interpretation of the Illustrative List. Ultimately, it was not up to panels, the Appellate Body or the Secretariat to set the rules. It was the responsibility of WTO Members to do so. Perhaps it was time for a more thorough review of the interpretation and even continued viability of the Illustrative List.

4. He noted that the Panel had found that certain specific instances of APRGs and PSLs were export subsidies. Korea did not agree with the Panel's approach or analysis on these issues. In Korea's view, the Panel had shifted the burden of proof to the respondent regarding the issue of market benchmarks. Moreover, the methodology adopted by the Panel in determining the appropriate benchmarks did not reflect the commercial realities. However, even with that flawed methodology, the Panel had only found a limited number of instances of subsidization. More importantly, the Panel had confirmed that these subsidies did not cause serious prejudice to the interests of the EC within the meaning of Articles 5 and 6 of the SCM Agreement. The Panel had come to this conclusion even though, in Korea's view, it had adopted several erroneous interpretations of Articles 5 and 6. Nevertheless, these isolated instances were not sufficient to have any significant effect on the EC shipbuilding industries. Besides, all these instances of APRGs and PSLs were not only of *de minimis* levels, but were also historical since all such loans and guarantees had now been repaid or had expired and were no longer in effect. Accordingly, Korea was in compliance and no further actions were necessary to implement the DSB's recommendations and rulings in this dispute. Finally, Korea supported the adoption of the Panel Report by the DSB at the present meeting.

5. The representative of the European Communities said that the EC would first like to thank the DSB facilitator, the Panel and the WTO Secretariat for their work devoted to this case. The facilitator, which had been appointed by the DSB pursuant to Annex V of the SCM Agreement, Mr. A. Szepesi, had managed to guide the parties through a delicate and complex exercise under Annex V of the SCM Agreement. The EC also wished to pay particular respect to the late Mr. S. El-Naggar and his substantial work as Chairman of the Panel. This was a very long and, legally and factually, complex Report. The Panel had managed to clarify novel and important aspects of the SCM Agreement. In doing so, the Panel had followed in many respects, in its legal analysis, the views expressed by the EC during the proceedings. At the present meeting, the EC would not enter into specific details, it only wished, however, to underline its complete disagreement with the Panel's use of the so-called "mandatory/discretionary" doctrine. In that respect the Panel had failed to respond to many arguments raised by the EC, and had also misinterpreted the recent guidance of the Appellate Body on this issue.

6. In terms of the actual facts, the EC was pleased that the Panel had established that Korea had been providing illegal export subsidies to its industry for many years. These subsidies were in the form of loans and guarantees by the state-owned Export-Import Bank of Korea (KEXIM). Such subsidies were instrumental in giving Korean yards an unfair competitive advantage over their European counterparts. However, the Panel had not supported the EC's claim concerning the subsidization of Korean yards through debt restructuring measures. Even though it had been established that substantial amounts of debt held by three of Korea's most important shipyards were actually forgiven or otherwise restructured by state-owned and state-controlled banks, the Panel had not, on the basis of the evidence available, concluded that these measures were actionable subsidies. The EC noted its disagreement with that conclusion, but acknowledged that given the extremely factual intensive nature of the case and the tight deadlines which applied under the DSU, the Panel's task was not easy in that respect. Considering that the EC had very strict internal state aid rules dealing with restructuring cases, the result was to a certain extent disappointing, because it appeared to give rise to difficulties in ensuring a "level playing field" between WTO Members. However, the EC intended to continue its dialogue with Korea and other OECD Members with a view to finding a solution to the problem of injurious pricing in the shipbuilding sector. For that reason, the EC had

decided not to file an appeal despite its disagreement with the aspects of the Panel Report, which had been outlined above.

7. With regard to the issue of implementation, the EC disagreed with Korea that there was nothing to be done. Such a comment was quite surprising since the Panel had made a clear recommendation imposing an obligation on Korea to withdraw its subsidies within 90 days. The EC expected Korea to implement the recommendation within the prescribed time-limit, in accordance with its obligations under the SCM Agreement and the DSU. It would be for Korea to explain in detail after the 90 days period why nothing had to be done and the EC reserved all rights in this respect.

8. The representative of the United States said that the Panel Report in this dispute provided much food for thought, and the United States was still in the process of analyzing that Report. Furthermore, as a third party in this dispute, the United States was not in a position to comment on the Panel's ultimate findings. However, there were a few striking aspects of the Panel's analysis on which the United States wished to offer some brief comments. First, the United States wished to commend the Panel for its analysis and application of the mandatory/discretionary distinction. In particular, the United States referred Members to the Panel's discussion of the mandatory/discretionary distinction at paragraphs 7.60 to 7.64 of the Panel Report. The Panel's analysis was thorough and workmanlike, and reached the correct conclusion that a measure could not be found to be inconsistent "as such" with a Member's WTO obligations unless the measure mandated WTO-inconsistent action or precluded WTO-consistent action.

9. Unfortunately, there were other aspects of the Panel Report that were deeply troubling. First, there was the Panel's interpretation of the meaning of the phrase "entrusts or directs" under Article 1.1(a)(1)(iv) of the SCM Agreement. The Panel's analysis of this phrase was set forth at paragraphs 7.365 to 7.372 of the Panel Report. The Panel equated the phrase "entrusts or directs" with the phrase "delegation or command". However, the Panel's interpretation was inconsistent with the ordinary meaning of the terms "entrusts" and "directs" in their context and in light of the object and purpose of the SCM Agreement. The Panel's interpretation was too narrow, and had resulted in improperly excluding from the disciplines of the SCM Agreement the range of actions by which a government might provide subsidies through private bodies. The United States noted that the Panel in the current "US - DRAMS" dispute had applied the exact same interpretation. The United States had appealed the Panel Report in that dispute. The US appellant submission, which had been filed on 5 April and was available on the USTR website, contained a thorough critique of the Panel's interpretation.

10. Another problem with the Panel Report in "Korea - Vessels" was the Panel's articulation and application of a "probative and compelling" evidentiary standard with respect to issues of "entrustment or direction". The Panel had first set forth this standard at paragraph 7.372 of its Report. The United States had no problem with the use of the word "probative." Indeed, the statement that evidence must be "probative" was tautological in that "evidence" was not "evidence" unless it was "probative" of some fact or conclusion. However, the use of the word "compelling" was a totally different matter. The Panel had not explained what it thought this word meant, but – notwithstanding that this phrase was nowhere to be found in the SCM Agreement – dictionaries defined "compelling" as meaning "irrefutable" or "overwhelming". Thus, the Panel had appeared to be asserting that in order to prove a claim of government entrustment or direction of a private body, a complaining party must present "irrefutable" or "overwhelming" evidence of entrustment or direction. The Panel had never explained the source of the evidentiary standard that it proclaimed. There was no basis for such a standard in the SCM Agreement, the DSU or any other covered agreement. Again, the panel in "US - DRAMS" had taken the exact same approach as the Panel in "Korea - Vessels". The United States had also appealed this issue, and it again referred interested Members to the US appellant submission in that dispute.

11. The final problem that the United States wished to mention at the present meeting involved the Panel's analysis of footnote 13 of the SCM Agreement, which provided that the term "serious prejudice" was used in the same sense as it was used in Article XVI:1 of GATT 1994. At paragraphs 7.590 through 7.602 of its Report, the Panel had asserted that footnote 13 essentially codified the findings of the pre-WTO panels in the two Sugar Exports disputes brought against the European Communities by Australia and Brazil. The United States would not engage in a thorough critique of this rather startling finding of the Panel. Suffice it to say that there was absolutely no basis for the Panel's conclusion that by using the phrase "in the sense of" in footnote 13, the drafters of the SCM Agreement intended to codify pre-WTO panel reports involving claims of serious prejudice. Unfortunately, this aspect of the Panel's finding would not be subject to appeal. However, the United States trusted that future panels and the Appellate Body would not follow the Panel's erroneous reasoning.

12. The representative of Korea said that his delegation wished to briefly respond to a couple of points raised by EC and to one point made by the United States. He recalled that the EC had stated that the specific APRGs and PSRs, found to be inconsistent by the Panel, had given Korea shipbuilders an unfair competitive edge. In its statement, Korea had pointed out that that was not the case. A close reading of the Panel's reasoning revealed that there was really no meaningful effect at all from those isolated *de minimis* transactions. The EC shipbuilders could no longer blame Korea for their problems. Another point raised by the EC to which Korea wished to refer at the present meeting related to implementation. In this regard, Korea had pointed out that the loans and guarantees, which had been found to be inconsistent by the Panel, had now been repaid or had expired and were no longer in effect. Therefore, in Korea's view, it was not necessary to take any further action to implement the DSB's recommendations and rulings in this dispute. He noted that, after the establishment of the Panel to examine this case, it had taken one year and eight months to complete the proceedings. The EC had also had recourse to the procedures under Annex V of the SCM Agreement and this had, in fact, added another six months to the process. As a result, the Panel would now be adopted while the measures at issue had already expired. With regard to the reference made by the United States to the interpretation of "entrustment and direction" standards, he said that, as the United States had pointed out, this was an important issue in the proceedings of the "US - DRAMS" case currently under appeal. At the present meeting, he did not wish to enter into any substantive discussion on this issue, but only to indicate that Korea looked forward to meeting with the United States during the Appellate Body proceedings regarding this matter. Finally, Korea also wished to pay tribute to the contribution made by Mr. A. Szepesi, who had been appointed as the DSB representative pursuant to Annex V of the SCM Agreement, and who had originally been suggested by Korea for this task.

13. The DSB took note of the statements and adopted the Panel Report contained in document WT/DS273/R.