

WORLD TRADE ORGANIZATION

Dispute Settlement Reports

2000

Volume IX

Pages 4091-4589

THE WTO DISPUTE SETTLEMENT REPORTS

The *Dispute Settlement Reports* of the World Trade Organization (the "WTO") include panel and Appellate Body reports, as well as arbitration awards, in disputes concerning the rights and obligations of WTO Members under the provisions of the *Marrakesh Agreement Establishing the World Trade Organization*. The *Dispute Settlement Reports* are available in English, French and Spanish. Starting with 1999, the first volume of each year contains a cumulative index of published disputes.

This volume may be cited as DSR 2000:IX

TABLE OF CONTENTS

	<i>Page</i>
Brazil –Export Financing Programme for Aircraft Recourse by Canada to Article 21.5 of the DSU (WT/DS46)	
Report of the Panel	4093
Canada – Measures Affecting the Export of Civilian Aircraft Recourse by Brazil to Article 21.5 of the DSU (WT/DS70)	
Report of the Appellate Body.....	4377
Canada - Measures Affecting the Export of Civilian Aircraft Recourse by Brazil to Article 21.5 of the DSU (WT/DS70)	
Report of the Panel	4315
Canada - Term of Patent Protection (WT/DS170)	
Award of the Arbitrator under Article 21.3(c) of the DSU	4537
United States - Anti-Dumping Act of 1916 (WT/DS136, WT/DS162)	
Report of the Appellate Body	4553

**BRAZIL - EXPORT FINANCING PROGRAMME
FOR AIRCRAFT**

Recourse by Canada to Article 21.5 of the DSU

Report of the Panel

WT/DS46/RW

Adopted by the Dispute Settlement Body

on 4 August 2000

as Modified by the Appellate Body Report

TABLE OF CONTENTS

	Page
I. PROCEDURAL BACKGROUND	4095
II. FACTUAL ASPECTS.....	4096
III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES.....	4098
IV. ARGUMENTS OF THE PARTIES AND THIRD PARTIES	4098
V. INTERIM REVIEW	4098
VI. FINDINGS	4100
A. Introduction and Claims of Canada.....	4100
B. May Brazil Continue to Issue NTN-I Bonds Pursuant to Letters of Commitment Issued under PROEX as it Existed before 18 November 1999?	4101
C. Are Payments Pursuant to the PROEX Scheme as Modified by Brazil Consistent with the SCM Agreement?.....	4105
1. Steps Taken by Brazil to Comply with the Recommendation of the DSB	4106
2. Assessment of the Panel	4107
(a) May the First Paragraph of Item (k) be Used to Establish that an Export Subsidy is "Permitted"?.....	4107
(i) Has this Issue Already Been Addressed by the Appellate Body?.....	4108
(ii) The Relationship between Article 3.1(a) and the Illustrative List of Export Subsidies	4109
(iii) The Role of Footnote 5 to the SCM Agreement.....	4110

	Page
(iv) The Material Advantage Clause and the Principle of Effective Treaty Interpretation.....	4113
(v) Developing Countries and the Object and Purpose of the SCM Agreement.....	4114
(vi) Conclusion	4121
(b) Are Payments under PROEX "Payments" within the Meaning of the First Paragraph of Item (k) which are "Used to Secure a Material Advantage in the Field of Export Credit Terms"?.	4121
(i) Are Payments under PROEX "Payments" within the Meaning of the First Paragraph of Item (k)?	4122
(ii) Are PROEX Payments "Used to Secure a Material Advantage in the Field of Export Credit Terms"?.	4123
(c) Conclusions and Closing Remarks	4135
VII. CONCLUSION	4136
ANNEX 1: SUBMISSIONS OF CANADA.....	4138
1-1 FIRST SUBMISSION OF CANADA	4138
1-2 REBUTTAL SUBMISSION OF CANADA.....	4153
1-3 ORAL STATEMENT OF CANADA.....	4169
1-4 RESPONSES BY CANADA TO QUESTIONS OF THE PANEL.....	4186
1-5 CANADA'S COMMENTS ON BRAZIL'S RESPONSES TO QUESTIONS OF THE PANEL.....	4202
ANNEX 2: SUBMISSIONS OF BRAZIL.....	4207
2-1 FIRST SUBMISSION OF BRAZIL	4207
2-2 REBUTTAL SUBMISSION OF BRAZIL	4215
2-3 ORAL STATEMENT OF BRAZIL.....	4226
2-4 RESPONSES BY BRAZIL TO QUESTIONS OF THE PANEL..	4243
2-5 BRAZIL'S COMMENTS ON CANADA'S RESPONSES TO QUESTIONS OF THE PANEL AND BRAZIL.....	4254
2-6 BRAZIL'S COMMENTS ON THE INTERIM REVIEW.....	4260
ANNEX 3: SUBMISSIONS OF THIRD PARTIES	4261
3-1 SUBMISSION OF THE EUROPEAN COMMUNITIES.....	4261
3-2 SUBMISSION OF THE UNITED STATES	4267
3-3 ORAL STATEMENT OF THE EUROPEAN COMMUNITIES ..	4275

	Page
3-4 ORAL STATEMENT OF THE UNITED STATES	4284
3-5 RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS OF THE PANEL.....	4289
3-6 RESPONSES OF THE UNITED STATES TO QUESTIONS OF THE PANEL.....	4294

I. PROCEDURAL BACKGROUND

1.1 On 20 August 1999, the Dispute Settlement Body ("DSB") adopted the Appellate Body Report in WT/DS46/AB/R, and the Panel Report in WT/DS46/R as modified by the Appellate Body Report, in the dispute *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*").

1.2 The DSB recommended that Brazil bring its export subsidies found in the Appellate Body Report, and in the Panel Report as modified by the Appellate Body report, to be inconsistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*") into conformity with its obligations under that Agreement. The DSB further recommended that Brazil withdraw the export subsidies for regional aircraft within 90 days.

1.3 On 19 November 1999, Brazil submitted to the Chairman of the DSB, pursuant to Article 21.6 of the Dispute Settlement Understanding ("DSU"), a status report (WT/DS46/12) on implementation of the Appellate Body's and the Panel's recommendations and rulings in the dispute. The status report described measures taken by Brazil which, in Brazil's view, implemented the DSB's recommendation to withdraw the measures within 90 days.

1.4 The status report indicated that the interest rate equalisation payments under PROEX would be granted only to the extent that the net interest rate applicable to a transaction under that programme was brought down to the appropriate international market "benchmark". The implementing legislation included: (i) a Resolution by the National Monetary Council altering its own Resolution 2576 dated 17 December 1998, which establishes the criteria applicable to PROEX interest rate equalisation payments; and (ii) a Central Bank Circular Letter which establishes new maximum equalisation percentages and revokes Circular Letter 2843 dated 25 March 1999.

1.5 On 23 November 1999, Canada submitted a communication to the Chairman of the DSB (WT/DS46/13), seeking recourse to Article 21.5 of the DSU. In that communication, Canada indicated that there was a disagreement between Canada and Brazil as to whether the measures taken by Brazil to comply with the 20 August 1999 rulings and recommendations of the DSB in fact bring Brazil into conformity with the provisions of the *SCM Agreement* and result in the withdrawal of the export subsidies to regional aircraft under PROEX and Canada, therefore, requested that the DSB refer the matter to the original panel, pursuant to Article 21.5 of the DSU. Canada attached the terms of an agreement reached by Canada and Brazil concerning the procedures to be followed pursuant to Articles 21 and 22 of the DSU.

1.6 At its meeting on 9 December 1999, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Canada in document WT/DS46/13. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS46/13, the matter referred to the DSB by Canada 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."

1.7 The Panel was composed as follows:

Chairperson: Dr. Dariusz Rosati
Members: Prof. Akio Shimizu
Mr. Kajit Sukhum

1.8 Australia, the European Communities and the United States reserved their rights to participate in the Panel proceedings as third parties.

1.9 The Panel met with the parties on 3-4 February 2000. It met with the third parties on 4 February 2000.

1.10 The Panel submitted its interim report to the parties on 31 March 2000. On 7 April 2000, Brazil submitted a written request that the Panel review precise aspects of the interim report. Neither party requested an interim meeting. The Panel submitted its final report to the parties on 28 April 2000.

II. FACTUAL ASPECTS

2.1 As described in our original Panel Report,¹ PROEX was created by the Government of Brazil on 1 June 1991 by Law No. 8187/91 and is currently being maintained by provisional measures issued by the Brazilian government on a monthly basis.² PROEX provides export credits to Brazilian exporters either through direct financing or interest rate equalisation payments.³

2.2 With direct financing, the Government of Brazil lends a portion of the funds required for the transaction. With interest rate equalisation, underlying legal instruments provide that the "National Treasury grant[s] to the financing party an equalisation payment to cover, at most, the difference between the interest charges contracted with the buyer and the cost to the financing party of raising the required funds."⁴

2.3 The financing terms for which interest rate equalisation payments are made are set by Ministerial Decrees. The terms, determined by the product to be exported, vary normally from one year to ten years. In the case of regional aircraft, however, this term has often been extended to 15 years, by waiver of the relevant PROEX guidelines. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to 2.5 percentage points per annum, for a term of nine years or more.⁵ The spread is fixed and does not vary depending on the lender's actual cost of

¹ Panel Report, *Brazil - Export Financing Programme for Aircraft ("Brazil - Aircraft")*, WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221, paras. 2.1-2.6.

² As of the date of Canada's request for the matter of implementation to be referred to the original panel, the relevant legal instrument was Provisional Measure 1892-33 of 23 November 1999.

³ Law No. 8187 of 1 June 1991, replaced by Provisional Measure No. 1629 of 12 February 1998.

⁴ See, for example, Resolution No. 2380 of 25 April 1997.

⁵ See Central Bank of Brazil Circular Letter No. 2881 of 19 November 1999.

funds.⁶ As discussed in Section VI of this Report, Resolution No. 2667 of 19 November 1999 provides that, in respect of regional aircraft financing, "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."

2.4 PROEX is administered by the *Comitê de Crédito as Exportações* ("Committee"), a 13-agency group, with the Ministry of Finance serving as its executive. Day-to-day operations of PROEX are conducted by the Banco do Brasil. For applications for financing transactions not exceeding US\$5 million, whose terms otherwise fall within PROEX guidelines, Banco do Brasil has pre-approved authority to provide PROEX support without requesting the approval of the Committee. All other applications are referred to the Committee, which has the authority to waive some of the published PROEX guidelines. In the case of regional aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.

2.5 PROEX involvement in aircraft financing transactions begins when the manufacturer requests a letter of commitment from the Committee prior to conclusion of a formal agreement with the buyer. This request sets forth the terms and conditions of the proposed transaction. If the Committee approves, it issues a letter of commitment to the manufacturer. This letter commits the Government of Brazil to providing support as specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into within a specified period of time, usually 90 days (and provided the aircraft is exported, as explained below). If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.

2.6 PROEX interest rate equalisation payments, pursuant to the commitment, begin after the aircraft is exported and paid for by the purchaser. PROEX payments are made to the lending financial institution in the form of non-interest-bearing National Treasury Bonds (*Notas do Tesouro Nacional - Série I*), referred to as NTN-I bonds. The bonds are issued by the Brazilian National Treasury to its agent bank, Banco do Brasil, which then passes them on to the lending banks financing the transaction. The bonds are issued in the name of the lending bank which can decide to redeem them on a semi-annual basis for the duration of the financing or discount them for a lump sum in the market. PROEX resembles a series of zero-coupon bonds which mature at six-month intervals over the course of the financing period. The bonds can only be redeemed in Brazil and only in Brazilian currency at the exchange rate prevailing at the time of payment. If the lending bank is outside of Brazil, it may appoint a Brazilian bank as its agent to receive the semi-annual payments on its behalf.

⁶ *Evaluation of the Brazilian Export Program ("Finan Report")* p. 2.7.

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

3.1 **Canada** requests that the Panel find that Brazil's measures are not in compliance with the recommendations and rulings of the DSB in that, *first*, Brazil continues to pay export subsidies committed on exports of regional aircraft not yet granted as of 18 November 1999; and, *second*, Brazil has failed to implement measures that would bring the PROEX export subsidy programme into conformity with the *SCM Agreement*, because: (a) PROEX payments continue to constitute prohibited export subsidies, (b) the first paragraph of item (k) of the Illustrative List of Export Subsidies, Annex I, *SCM Agreement* ("Illustrative List"), does not give rise to an *a contrario* exception, and (c) even if item (k) were considered to give rise to an *a contrario* exception, PROEX export subsidies are not "payments" of the kind referred to in the first paragraph of item (k) and PROEX export subsidies under the revised programme would continue to "secure a material advantage" in the field of export credit terms. Canada further requests that the Panel suggest, in accordance with Article 19.1 of the DSU, that the parties develop verification procedures so as to permit verification that future Brazilian financing of exported regional aircraft conforms with the *SCM Agreement* without the need for further recourse to the DSU.

3.2 **Brazil** requests the Panel to reject Canada's claims in their entirety, and find that Brazil is in full compliance with all of its obligations under the *SCM Agreement*, as interpreted by the Panel and the Appellate Body, with regard to PROEX interest rate equalisation payments for regional aircraft.

IV. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

4.1 The Panel has decided, with the agreement of the parties, that in lieu of the traditional descriptive part of the Panel report setting forth the arguments of the parties, the parties' submissions will be annexed in full to the Panel's report. Accordingly, the submissions of Canada are set forth in Annex 1, and the submissions of Brazil are set forth in Annex 2. In addition, the submissions of the third parties - the European Communities and the United States - are set forth in Annex 3. Australia made neither a written nor an oral submission.

4.2 In addition, both parties have incorporated by reference their arguments in the original dispute with reference to whether the first paragraph of item (k) of the Illustrative List may be used to establish that an export subsidy is "permitted" and whether payments under PROEX are "payments" within the meaning of the first paragraph of item (k) of the List.⁷

V. INTERIM REVIEW

5.1 Canada did not provide any comments on the interim report of the Panel.

⁷ Original panel report, *Brazil - Aircraft*, *supra*, footnote 1, paras. 4.53-4.71 and paras. 4.72-4.78, respectively.

5.2 Brazil submitted the following comments. Brazil notes that, in paragraph 6.41, *infra*, the Panel states that it does not appear that Brazil argued that its *a contrario* interpretation of paragraph 1 of item (k) of the Illustrative List applied even when the subsidies "do not fall within the scope of footnote 5". Brazil states that it does not recall confining its interpretation of item (k) to the "scope of footnote 5", and certainly did not intend to do so. In this regard, Brazil notes that, in response to a question from the Panel, Brazil stated, "Footnote 5 to the SCM Agreement makes clear that the List has a purpose other than pure illustration."⁸ Beyond this, Brazil submits, the response deals with the text of item (k), not the scope of footnote 5.

5.3 With reference to Brazil's argument that its interpretation of item (k) was not confined to the scope of footnote 5, we note that, in the original dispute, Brazil's arguments appeared to evolve over time.⁹ In Brazil's first submission in the original dispute, the focus of Brazil's arguments was not on footnote 5.¹⁰ However, in its second submission in the original dispute, Brazil argued that the "material advantage" clause fell within the scope of footnote 5.¹¹ Brazil has not, however, limited its arguments regarding the interpretation of item (k) to the scope of footnote 5, and we have, therefore, made appropriate modifications to paragraph 6.41 of this Report. In any event, as we have indicated in paragraph 6.41, we consider that footnote 5 controls the interpretation of item (k) with respect to when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy.

5.4 Brazil also notes that, in paragraph 6.53 of this Report, the third sentence begins, "Because *banks* in many cases have a lower cost of borrowing than the governments of developing countries ..." (Emphasis added by Brazil). Brazil argues that, if banks were the only actors in the market for aircraft financing, Brazil would not need to provide interest rate support for Embraer's transactions. It is the fact that *governments* (Emphasis added by Brazil) - particularly Canada through its Export Development Corporation - are able to offer potential customers financing support on terms that are more attractive than the terms offered by banks that requires Brazil to act.

5.5 In respect of Brazil's comments regarding the Panel's reference to the cost of borrowing of banks, the Panel wishes to point out that paragraph 6.53 of this Report represents a discussion of the way in which developing-country governments can utilise commercial lenders rather than provide direct export credit financing. The Panel in fact paraphrases Brazil's own arguments as to the relative cost of different modalities of providing export credits.¹² In that context, it is clear that utilising commercial lenders would be less expensive than providing direct financing, because the government can take advantage of the lower cost of borrowing enjoyed by commercial lenders. Footnote 53 is merely an illustration of this fact. Paragraph 6.53 is in no

⁸ See Response of Brazil to Question 10 from the Panel, *infra*, Annex 2-4, p. 133.

⁹ As indicated in para. 4.2, *supra*, Brazil has incorporated by reference its arguments in the original dispute regarding whether the first para. of item (k) of the Illustrative List may be used to establish that an export subsidy is "permitted". See Response of Brazil to Further Question 1 from the Panel, *infra*, Annex 2-4, p. 137.

¹⁰ See original Panel Report, *Brazil - Aircraft*, *supra*, footnote 1, paras. 4.53-4.54.

¹¹ *Ibid.*, at para. 4.67.

¹² See Oral Statement of Brazil, paras. 11-20, *infra*, Annex 2-3, p. 115.

sense intended to suggest that Brazil argues that it provides PROEX interest rate equalisation in order to meet competition from export credit financing provided by commercial banks. We have, therefore, made appropriate modifications to paragraph 6.53 of this Report.

VI. FINDINGS

A. *Introduction and Claims of Canada*

6.1 This dispute under Article 21.5 of the DSU concerns a disagreement between Canada and Brazil as to the existence or consistency of measures taken by Brazil to comply with the recommendation of the DSB pursuant to Article 4.7 of the *SCM Agreement* that Brazil withdraw export subsidies for regional aircraft under PROEX without delay.¹³

6.2 In the dispute ("original dispute") giving rise to this Article 21.5 dispute, the Panel found that the prohibition on export subsidies in Article 3.1(a) of the *SCM Agreement* applied to Brazil because Brazil had failed to comply with certain of the conditions of Article 27.4 of that Agreement. The Panel further found that PROEX payments were subsidies contingent upon export performance within the meaning of Article 3.1(a). Finally, the Panel rejected Brazil's defence that PROEX payments were "permitted" because they were "payments" within the meaning of the first paragraph of item (k) which were not "used to secure a material advantage in the field of export credit terms". The Panel found that, *assuming* that the first paragraph of item (k) could be used to establish that a subsidy that is contingent upon export performance was "permitted", and that PROEX payments were "payments" within the meaning of that paragraph, Brazil had failed to establish that PROEX payments were not "used to secure a material advantage in the field of export credit terms". Accordingly, the Panel requested that the DSB recommend that Brazil withdraw the prohibited subsidies without delay. The Appellate Body modified certain aspects of the Panel's reasoning but upheld the Panel's conclusions as stated above.

6.3 In this Article 21.5 dispute, Canada raises two issues regarding the existence or consistency with the *SCM Agreement* of measures taken by Brazil to comply with the recommendation of the DSB.

First, Canada contends that Brazil cannot, consistent with the recommendation of the DSB, continue to issue NTN-I bonds pursuant to letters of commitment issued under PROEX as it existed prior to the end of the implementation period, *i.e.*, 18 November 1999. Brazil responds that the DSB's recommendation to withdraw the prohibited subsidy does not require it to cease issuing NTN-I bonds pursuant to such pre-existing letters of commitment.

Second, Canada contends that payments in respect of regional aircraft pursuant to PROEX as modified by Brazil continue to be subsidies contingent upon export performance within the meaning of Article

¹³ Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR, 1999:III, 1161, para. 197. ("Appellate Body Report").

3.1(a) of the *SCM Agreement* and thus prohibited. Brazil responds that under PROEX as modified payments no longer are "used to secure a material advantage in the field of export credit terms" and therefore are "permitted" by the *SCM Agreement*.

We will take up each of these issues in turn.

B. May Brazil Continue to Issue NTN-I Bonds Pursuant to Letters of Commitment Issued under PROEX as it Existed before 18 November 1999?

6.4 Canada claims that Brazil has failed to withdraw the export subsidies for regional aircraft under PROEX, because it continues to grant, through the issuance of NTN-I bonds, PROEX subsidies found to constitute prohibited export subsidies pursuant to commitments made prior to 18 November 1999, the date by which Brazil was required to withdraw the export subsidies in question. Brazil considers that, in fulfilling its pre-18 November 1999 commitments through the issuance of NTN-I bonds after that date upon the export of regional aircraft, it is "not creating new subsidies"¹⁴ and therefore not acting in a manner inconsistent with its obligations under the *SCM Agreement*.

6.5 Canada notes that Brazil is required to withdraw the prohibited export subsidies, and submits that the word "withdraw", in its plain meaning, conveys as a minimum the notion of ceasing to grant or maintain the illegal subsidies. Article 3.2 of the *SCM Agreement* provides that a Member shall not "grant or maintain" prohibited subsidies. Canada recalls that the Appellate Body had found that PROEX subsidies are granted for the purposes of Article 27.4 of the *SCM Agreement* when Brazil issues NTN-I bonds. There is no reason in Canada's view to interpret the word "grant" differently for the purposes of Article 3.2 than for the purposes of Article 27.4. Accordingly, Brazil must, in Canada's view, cease issuing NTN-I bonds in respect of pre-18-November-1999 letters of commitment.

6.6 In Brazil's view, Canada has confused the finding of the Appellate Body as to when PROEX subsidies are granted for the purposes of Article 27.4 of the *SCM Agreement* with the issue of when PROEX subsidies come into existence within the meaning of Article 1 of that Agreement. Brazil considers that under Article 1 a subsidy shall be deemed to exist when there is a financial contribution by a government and a benefit is thereby conferred. In the case of PROEX subsidies, the benefit arises when Brazil makes a legally binding commitment to provide PROEX support.¹⁵ Because the financial contribution must logically precede or coincide with the benefit, the financial contribution must be in the form of a potential direct transfer of funds. In the view of Brazil, an interpretation of Article 1 that resulted in the conclusion that PROEX subsidies come into existence only when aircraft are exported would render whole clauses of Part III of the *SCM Agreement* ("Actionable Subsidies") a nullity

¹⁴ Second Submission of Brazil, para. 3.

¹⁵ In the early phases of this proceeding, Brazil stated that the subsidy comes into existence when the letter of commitment is issued. Subsequently, Brazil clarified that in its view the subsidy exists when a sales contract is signed pursuant to a letter of commitment. Response of Brazil to Question 12 of the Panel.

because, although the impact of PROEX on the domestic industry of a competitor would be felt when Embraer obtains an order, no subsidy would exist and thus no countervailing measure be possible until the aircraft was exported. Finally, Brazil argues that it is legally obligated to issue bonds pursuant to letters of commitment issued prior to the date of implementation of the DSB's recommendations or be subject to damages for breach of contract.

6.7 In considering this issue, we first note that Brazil does not deny that it continues to issue NTN-I bonds in respect of commitments made prior to 18 November 1999. Further, Brazil has stated, in response to a question from the Panel, that Resolution 2667 does not modify pre-existing PROEX commitments pertaining to aircraft to be exported after 22 November 1999, the date of publication of Resolution 2667.¹⁶ We recall that, in the original dispute, the Panel found that PROEX payments on exports of Brazilian regional aircraft were export subsidies prohibited by Article 3.1(a) of the *SCM Agreement*. This finding was upheld by the Appellate Body. We also recall that the DSB recommended, pursuant to Article 4.7 of the *SCM Agreement*, that Brazil "withdraw the [export] subsidies ... without delay".

6.8 The issue Canada has put before us is whether the continued issuance of NTN-I bonds in respect of commitments entered into prior to 18 November 1999, on terms found by the Panel and the Appellate Body to give rise to a prohibited export subsidy, is inconsistent with Brazil's obligation to withdraw the export subsidies in question. Thus, we need not for the purposes of this dispute develop a comprehensive understanding of the scope of the obligation to "withdraw" a prohibited subsidy. Rather, it suffices to conclude - and Brazil does not contest - that a Member cannot be deemed to have withdrawn prohibited subsidies if it has not ceased to act in a manner inconsistent with the *WTO Agreement* in respect of those subsidies. We are therefore of the view that the DSB's recommendation that Brazil withdraw the prohibited subsidies in question clearly includes an obligation on the part of Brazil to cease violating the *SCM Agreement* by the end of the implementation period in respect of the measures in question.¹⁷

¹⁶ Response of Brazil to Question 4 of the Panel.

¹⁷ We are aware that a panel established under Article 21.5 of the *DSU* recently found that a recommendation to "withdraw" a prohibited subsidy under Article 4.7 of the *SCM Agreement* "is not limited to prospective action only but may encompass repayment of the prohibited subsidy." Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States ("Australia - Automotive Leather II (Article 21.5 - US)"),* WT/DS126/RW, adopted 11 February 2000, DSR 2000:III, 1189, para. 6.39. In that dispute, which involved one-time subsidies paid in the past whose retention was not contingent upon future export performance, the United States as complainant argued that the "prospective portion" of the subsidy granted by Australia, *i.e.*, \$A26 million out of a total grant of \$A30 million, had to be repaid. In this dispute, Canada has not claimed that the non-repayment, in whole or in part, of subsidies granted by Brazil represents a failure to "withdraw" the prohibited export subsidies in question. We recall that, under Article 3.7 of the *DSU*, the aim of the dispute settlement mechanism is to secure a positive resolution to a dispute, and that our role under Article 21.5 is to render a decision "where there is disagreement" as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations or rulings of the DSB. Accordingly, we shall address only claims that are put before us. Our silence on issues that are not before us should not be taken as expressing any view, express or implied, as to whether or not a recommendation to "withdraw" a prohibited subsidy may encompass repayment of that subsidy.

6.9 Article 3.2 of the *SCM Agreement* provides as follows:
 "A Member shall neither grant nor maintain subsidies [contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I]."

It follows that the continuing granting or maintaining of prohibited export subsidies after the end of the implementation period would be inconsistent with Brazil's obligation to withdraw those subsidies. Accordingly, we must consider whether the continued issuance of NTN-I bonds by Brazil pursuant to letters of commitment issued under PROEX prior to its modification constitutes the "grant" of prohibited export subsidies within the meaning of Article 3.2 of the *SCM Agreement*.

6.10 In the original dispute, we held that, for the purposes of Article 27.4, export subsidies for regional aircraft under PROEX are "granted" for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the *SCM Agreement* when the NTN-I bonds are issued. Brazil appealed this finding. The Appellate Body confirmed our holding, finding that:

"We agree with the Panel that 'PROEX payments may be 'granted' where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet occurred.' We also agree with the Panel that the export subsidies ... have not yet been 'granted' when the letter of commitment is issued, because, at that point, the export sales contract has not yet been concluded and the export shipments have not yet occurred. For the purposes of Article 27.4, we conclude that the export subsidies ... are 'granted' when all the legal conditions have been fulfilled that entitle the beneficiary to receive the subsidies. We share the Panel's view that such an unconditional legal right exists when the NTN-I bonds are issued."¹⁸

6.11 We note that Article 3.2 and Article 27.4 are provisions of the same Agreement. Further, both provisions relate to the prohibition on export subsidies set out under that Agreement. We do not perceive any basis to attribute to the term "grant" as used in Article 3.2 of the *SCM Agreement* a meaning different from that attributed to that term by this Panel and the Appellate Body as used in Article 27.4 of the *SCM Agreement*. It follows that the issuance of NTN-I bonds by Brazil constitutes the granting of export subsidies within the meaning of Article 3.2.

6.12 Brazil urges the Panel to consider the issue of when a subsidy may be deemed to exist under Article 1 of the *SCM Agreement*, and the form of the financial contribution involved, when deciding when PROEX subsidies are granted for the purposes of Article 3.2. Thus, Brazil states, in response to a question from the Panel, that:

"... a financial contribution is made and a benefit is conferred within the meaning of Article 1 of the *SCM Agreement*, and a subsidy is thereby granted within the meaning of Article 3.2 of the *SCM Agreement*, when contracts are signed pursuant to letters of commitment." (emphasis added)

¹⁸ Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 13, para. 158.

6.13 We recall however that the Panel, in order to respond to the question of when PROEX payments should be considered to have been granted for the purposes of Article 27.4 in the original dispute, also focused on the language of Article 1 of the *SCM Agreement*. The Appellate Body held, however, held this to be error:

"In our view, the Panel reached the correct conclusion. However, it did so on the basis of faulty reasoning. The issue in this case is when the subsidies for regional aircraft under PROEX should be considered to have been "granted" *for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the SCM Agreement*. The issue is *not* whether or when there is a "financial contribution", or whether and when the subsidy "exists", within the meaning of Article 1.1 of that Agreement."(emphasis in original).¹⁹

The Appellate Body further explained that:

"[T]he issue before the Panel under the heading 'Has Brazil increased the level of its export subsidies?' was simply this: given that the export subsidies in this case were already deemed to 'exist', when were they 'granted'? At issue was the interpretation and application of Article 27.4, *not* of Article 1 ... [F]or the purposes of Article 27.4, we see the issue of the *existence* of a subsidy and the issue of the point at which that subsidy is *granted* as two legally distinct issues (emphasis in original). Only one of those issues is raised here and, therefore, must be addressed".²⁰

6.14 We recognize that the distinction made by the Appellate Body was between the existence of a subsidy and when a subsidy is granted related to when a subsidy is granted *for the purposes of Article 27.4* of the *SCM Agreement*, and not when it was granted *for the purposes of Article 3.2*. As a matter of logic, however, we cannot perceive - nor has Brazil identified - any basis for us to conclude that, while the existence of a subsidy is a legally distinct issue from when it is granted for the purposes of Article 27.4, it is *not* a legally distinct issue from when it is granted for the purposes of Article 3.2. In other words, if the issue of when a subsidy is "granted" *for the purposes of Article 27.4* is legally distinct from when it "exists" for the purposes of Article 1, then it follows that the issue of when a subsidy is granted *for the purposes of Article 3.2* is also legally distinct from the issue when it exists for the purposes of Article 1. Accordingly, we decline Brazil's invitation to consider when the subsidy "exists" within the meaning of Article 1 when examining when the subsidy is "granted" for the purpose of Article 3.2.²¹

6.15 Brazil contends that requiring Brazil to cease issuing NTN-I bonds pursuant to commitments made prior to 18 November 1999 amounts to a retroactive remedy.

¹⁹ Ibid., para. 154.

²⁰ Ibid., para. 156.

²¹ Brazil argues that a finding that a subsidy within the meaning of Article 1 of the *SCM Agreement* does not exist until NTN-I bonds are issued would render provisions of Part III of the Agreement ineffective. Because our finding regarding when PROEX subsidies are "granted" within the meaning of Article 3.2 does not imply a view as to when PROEX subsidies "exist", we need not further address the issue raised by Brazil.

We cannot agree. In our view, the obligation to cease performing illegal acts in the future is a fundamentally prospective remedy.²²

6.16 Nor are we convinced that a different interpretation is required because Brazil asserts that it has a contractual obligation to issue PROEX bonds pursuant to commitments already entered into, and that it would be liable to damages for breach of contract if it failed to do so. Assuming that Brazil is correct in this regard,²³ the implication of this view would be that Members could contract to grant prohibited subsidies for years into the future and be insulated from any meaningful remedy under the WTO dispute settlement system. Nor is this a purely hypothetical situation. If Canada's figures are correct - and Brazil has not disputed their overall accuracy - Brazil has outstanding commitments to issue NTN-I bonds pursuant to PROEX as it existed before modification in respect of nearly 900 regional aircraft that have yet to be exported. Letters of commitment in respect of some 300 regional aircraft were issued after the Panel Report in the original dispute was circulated to Members on 14 April 1999. By Brazil's reasoning, it should be allowed to continue issuing bonds upon the exportation of these aircraft for years to come.

6.17 For all of the reasons set forth above, we conclude that the continued issuance of NTN-I bonds pursuant to letters of commitment issued prior to 18 November 1999 represents the granting of subsidies contingent upon export performance within the meaning of Article 3.2 of the *SCM Agreement*. Accordingly, we conclude that in this respect Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

C. *Are Payments Pursuant to the PROEX Scheme as Modified by Brazil Consistent with the SCM Agreement?*

6.18 In the first section of this Report, we addressed the *existence* of measures taken to comply with the recommendation of the DSB in respect of payments on

²² Cf., *Vienna Convention on the Law of Treaties*, Article 28. This provision, entitled "Non-Retroactivity of Treaties", provides that, unless a different intention appears from the treaty, its provisions do not bind a party "in relation to any act or fact that took place or situation which ceased to exist" before the date of entry into force of the treaty for that party. By negative implication, it would not be retroactive application to bind a party with respect to acts that took place after a treaty entered into force. Although this article addresses the temporal application of treaties, and not of DSB recommendations, it nevertheless provides some guidance in respect of the meaning of the concept of retroactivity in public international law.

²³ A resolution of the question whether Brazil would be liable to damages for breach of contract for failure to issue NTN-I bonds in respect of existing commitments would require consideration not only of Brazilian administrative and contract law, but also of the role of the *WTO Agreement* in Brazil's domestic legal system. See Response of Brazil to Question 12 of the Panel. Although a Panel may examine municipal law in order to determine whether a Member has complied with the *WTO Agreement*, (See, e.g., Report of the Appellate Body, *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("India - Patents (US)"), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, para. 66), we are reluctant to enter into such an examination here, as the issues are complex, not fully briefed, and ultimately not essential to our resolution of the case at hand. In any event, we recall that, under Article 27 of the *Vienna Convention on the Law of Treaties*, a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

exports of regional aircraft pursuant to letters of commitment issued under PROEX prior to its modification by Brazil. In this section, we address the *consistency* with the *SCM Agreement* of measures taken by Brazil to comply with the recommendation of the DSB in respect of payments on exports of regional aircraft pursuant to letters of commitment issued under PROEX after its modification by Brazil.

1. *Steps Taken by Brazil to Comply with the Recommendation of the DSB*

6.19 The basic language authorising PROEX interest rate equalisation, found in Provisional Measure 1892-33, has not changed since the date of establishment of the original panel in this dispute.²⁴ Brazil however argues that it has implemented the DSB's recommendation in this dispute through Resolution 2667 of 19 November 1999.²⁵ Article 1 of the Resolution repeats the basic standard of Provisional Measure 1892-33 that the National Treasury may grant equalisation sufficient "to ensure that the relevant financial charges are consistent with standard practices on the international market." Article 1 further provides that:

"Paragraph 1. In the financing of aircraft exports for regional aviation markets, equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices.

Paragraph 2. The equalisation rate shall be limited to the percentages established by the Central Bank of Brazil, and shall remain fixed throughout the period in question."

6.20 As discussed in paras. 6.75-6.77, *infra*, Brazil considers that, as a result of this Resolution, PROEX payments are no longer used to secure a material advantage in the field of export credit terms and are hence "permitted" by the first paragraph of item (k) of the Illustrative List.

²⁴ Provisional Measure 1892-33 of 23 November 1999 and Provisional Measure 1700-15 of 30 June 1998 both provide in Article 2 that, "[i]n operations to finance the export of domestic goods and services not covered by the preceding article and in financing for the production of goods for export, the National Treasury may grant the financing entity equalisation funding sufficient to make the financing charges consistent with practices on the international market."

²⁵ Canada Documentary Annex 5, Exhibit Bra-1. Brazil informed the DSB that it had implemented its recommendation through two pieces of "implementing legislation", Resolution 2667 and Circular Letter 2881 of 19 November 1999 published by the Central Bank of Brazil. Circular Letter 2881 establishes "the maximum percentages that may be applied under tax rate equalisation systems used for PROEX operations." These maximum percentages cover financing for up to ten years, with the highest interest rate equalisation rate set at 2.5 per cent for financing of "over 9 years and up to 10 years", down from 3.8 per cent previously. In the First Submission of Brazil, however, Brazil indicated that Circular Letter 2881 represents "an additional action that does not directly affect the question before this Panel". From this we conclude that Brazil does not assert that Circular Letter 2881 is relevant to our consideration whether PROEX as modified is consistent with the *SCM Agreement*.

2. Assessment of the Panel

6.21 In the original dispute, we found that Brazil had failed to comply with certain conditions of Article 27.4 of the *SCM Agreement*, and that the prohibition of Article 3.1(a) of the *SCM Agreement* was therefore applicable to Brazil.²⁶ The Appellate Body sustained this finding on appeal.²⁷ Brazil has not suggested before this Article 21.5 Panel that this situation has changed in any respect. Accordingly, we conclude that Article 3.1(a) continues to apply to Brazil. We further found, and Brazil did not dispute, that PROEX payments are subsidies within the meaning of Article 1 of the *SCM Agreement* that are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. This finding was not appealed, nor has Brazil suggested that Resolution 2667 in any way affects the status of PROEX payments as export subsidies.

6.22 Brazil does however assert that PROEX payments are "payments" within the meaning of the first paragraph of item (k) of the Illustrative List which are not "used to secure a material advantage in the field of export credit terms" and which are therefore "permitted". Thus, Brazil's defence in this dispute depends upon the proposition that the first paragraph of item (k) may be used to establish that an export subsidy within the meaning of item (k) is "permitted" by the *SCM Agreement*. It further depends upon Brazil establishing that (a) PROEX payments are "payments" within the meaning of item (k); and (b) PROEX payments are not "used to secure a material advantage in the field of export credit terms". Further, Brazil has acknowledged that it is asserting an affirmative defence, and that the burden of establishing entitlement to it is thus on Brazil.²⁸

6.23 We note that, in the original dispute, this Panel restricted itself to a finding that PROEX payments *were* used to secure a material advantage in the field of export credit terms. We did not address the two other elements necessary to Brazil's defence, *i.e.*, whether the first paragraph of item (k) can be used to establish that an export subsidy is "permitted", and whether PROEX payments are "payments" within the meaning of item (k). Nor did the Appellate Body make findings on these issues. In this Article 21.5 dispute, however, we have decided to address all three elements of Brazil's defence. In our view, this more comprehensive approach will provide a greater degree of clarity and guidance to the parties in respect of implementation. It also facilitates a better understanding of the relevant provisions in the context of the broader operation of the *SCM Agreement*.

(a) May the First Paragraph of Item (k) be Used to Establish that an Export Subsidy is "Permitted"?

6.24 The first paragraph of item (k) of the Illustrative List identifies as an export subsidy:

"The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they

²⁶ Original panel report, *supra*, *Brazil - Aircraft*, footnote 1, para. 8.1.

²⁷ Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 13, para. 164.

²⁸ Original Panel Report, *supra*, footnote 1, para. 7.17.

borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), *or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.*" (emphasis added).

6.25 As noted above, Brazil's "material advantage" defence is predicated on the proposition that payments within the meaning of the first paragraph of item (k) that are *not* "used to secure a material advantage in the field of export credit terms" are "permitted" by the *SCM Agreement*.²⁹ Accordingly, we will first consider whether, as a matter of law, the first paragraph of item (k) can be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted", or whether, as argued by Canada, the first paragraph of item (k) cannot be used in this manner.

(i) Has this Issue Already Been Addressed by the Appellate Body?

6.26 In considering this question, we first observe that this issue has *not* been decided, either by the Panel or by the Appellate Body, in the original dispute. To the contrary, both the Panel and the Appellate Body specifically declined to rule on this issue. In the words of the Appellate Body:

"Nor do we opine on whether a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage in the field of export credit terms' is, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. The Panel did not rule on these issues, and the lack of Panel findings on these issues was not appealed."³⁰

6.27 Nor do we accept Brazil's contention that we should infer some implicit finding on this issue by the Appellate Body. The fact that the Appellate Body considered and decided the issue of whether PROEX payments are used to "secure a material advantage in the field of export credit terms" does not mean that the Appellate Body accepted (nor, for that matter, that it rejected) Brazil's view that the first paragraph of item (k) can be used to establish that an export subsidy is "permitted". We decline to speculate about how the Appellate Body might have resolved this issue had it been before it. Rather, we will make our finding on this issue on the basis of the *SCM Agreement* as interpreted in accordance with customary rules of public international law.

²⁹ First Submission of Brazil, para. 4 ("The Appellate Body, noted, however, that Members are permitted to obtain an 'advantage' in the field of export credit terms, provided that advantage is not material").

³⁰ Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 13, para. 187.

(ii) The Relationship between Article 3.1(a) and the Illustrative List of Export Subsidies

6.28 In examining whether the first paragraph of item (k) can be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted", our starting point is of course the text of the *SCM Agreement*. In this respect, and turning first to the text of Article 3.1(a), we note that that Article states that:

"Except as provided in the Agreement on Agriculture, the following subsidies within the meaning of Article 1, shall be prohibited:

(a) Subsidies contingent [footnote omitted], in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁵;

.....
⁵ Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

6.29 Leaving aside for the moment the issue of the role of footnote 5 - an issue to which we will return shortly - we consider that two conclusions can be derived from the text of Article 3.1(a).

6.30 *First*, Annex I is purely illustrative, *i.e.*, it does not purport to be an exhaustive list of export subsidies. In other words, it contains examples of prohibited export subsidies. It is clear, however, that it is legally possible - and, as a matter of fact, highly likely - that there are prohibited export subsidies within the meaning of Article 3.1(a) that do not fall within the scope of Annex I. Should there be any doubt on this score - and neither the parties nor the third parties have expressed any such doubt - this conclusion is borne out by the title given to Annex I, to wit, "Illustrative List of Export Subsidies".

6.31 *Second*, a measure that falls within the scope of the Illustrative List is *deemed* to be a prohibited export subsidy. In other words, a Member may establish that a measure is a prohibited export subsidy by going directly to the Illustrative List, without first demonstrating that a measure falls within the scope of Article 3.1(a). This is confirmed from the words "subsidies contingent ... upon export performance, *including* those illustrated in Annex I" (emphasis added), which in their ordinary meaning tell us that measures identified in the Annex are *ipso facto* "subsidies contingent upon export performance".

6.32 There is however a third conclusion that we cannot draw from the text of Article 3.1(a). Canada argues that a finding that the Illustrative List could be used *a contrario* to establish that measures were "permitted", would turn the Illustrative List into an exhaustive list. We do not agree. Rather, another possible interpretation is that offered by Brazil but perhaps expressed most clearly by the United States as third party:

"The Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of

footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned."³¹

Without necessarily agreeing with the US interpretation of the role of the Illustrative List - as our subsequent discussion will clearly demonstrate - we do not consider that we can conclude, based on the mere fact that the Illustrative List is "illustrative", that the List cannot be used *a contrario*.

(iii) The Role of Footnote 5 to the SCM Agreement

6.33 How thus may we resolve the question whether and under what conditions the Illustrative List can be used to demonstrate that a subsidy which is contingent upon export performance is *not* prohibited, *i.e.*, that it is "permitted"? One possibility would be to resort to general interpretive techniques. Thus, it could be argued that the Panel should interpret the Illustrative List *a contrario sensu*, a term defined as meaning "on the other hand; in the opposite sense",³² or should apply the principle of *lex specialis*. For the reasons discussed below, however, we need not rely on such general principles in this case.

6.34 The drafters of the *SCM Agreement* must have recognized that the insertion of the Illustrative List of Export Subsidies - which was imported with only minor modifications from the Tokyo Round *Subsidies Code* - into an Agreement that contained for the first time definitions of "subsidy" and "export subsidy" would create interpretive difficulties, as the *SCM Agreement* provides us with a specific textual basis to resolve this question. This textual basis is footnote 5 to the *SCM Agreement*.³³

Footnote 5 provides that:

"Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement".

6.35 Brazil contends that payments within the meaning of the first paragraph of item (k) that are not used to secure a material advantage in the field of export credit terms fall within the scope of this footnote. We disagree.

6.36 In its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy. Thus, one example of a measure that clearly falls within the scope of footnote 5 involves export credit practices that are in conformity with the interest rate provisions of the *Arrangement on Guidelines for Officially Supported Export Credits* ("Arrangement"). The second paragraph of item

³¹ Oral Statement of the United States at the third-party session, para. 15.

³² *Black's Law Dictionary*, Seventh Edition, West Group, 1999 at 23.

³³ The *SCM Agreement* also includes a provision governing the relationship between certain elements of the Illustrative List and Article 1 of the Agreement. Footnote 1 to the Agreement provides that, "[i]n accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties and taxes in amounts not in excess of those which have accrued, shall not be deemed to be a *subsidy*." (emphasis added). This footnote, of course, is not applicable to the situation at hand, as PROEX payments are unrelated to the exemption of an exported product from duties or taxes.

(k) provides that such measures "shall not be considered an export subsidy prohibited by this Agreement". Arguably, footnote 5 in its ordinary meaning could extend more broadly to cover cases where the Illustrative List contains some other form of *affirmative* statement that a measure is not subject to the Article 3.1(a) prohibition, that it is *not* prohibited, or that it is allowed, such as, for example, the first and last sentences of footnote 5³⁴ and the proviso clauses of items (h)³⁵ and (i)³⁶ of the Illustrative List.³⁷

6.37 The first paragraph of item (k), however, does not contain any affirmative statement that a measure is *not* an export subsidy nor that measures not satisfying the conditions of that item are *not* prohibited. To the contrary, the first paragraph of item (k) on its face simply identifies measures that *are* prohibited export subsidies. Thus, the first paragraph of item (k) on its face does not in our view fall within the scope of footnote 5 read in conformity with its ordinary meaning.

6.38 We recall the view of Brazil and the United States that "the Illustrative List does not deal with all possible financial contributions, but for those it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned."³⁸ In other words, we understand them to argue that, with respect to financial contributions dealt with by the Illustrative List, the List provides the sole basis to determine whether the measure is prohibited or permitted. While we agree that an illustrative list could in principle operate in such a manner, we do not consider that such an interpretation is readily supported by the text of footnote 5 itself. To the contrary, if the drafters had intended the meaning which the United States attributes to footnote 5, they could certainly have found appropriate language to do so.

6.39 The United States advances arguments based on the negotiating history of footnote 5 in support of its broad interpretation of that footnote to apply to the first paragraph of item (k). In this respect, it points out that in a Chairman's text of the *SCM Agreement* known as *Cartland III*, footnote 5 provided as follows:

"Measures *expressly* referred to as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." (emphasis added).³⁹

³⁴ The first sentence of footnote 59 provides that "Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected." The last sentence states that "[p]aragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

³⁵ "... provided, however, that prior-stage cumulative indirect taxes *may be* exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product" (emphasis added).

³⁶ "... provided, however, that in particular cases a firm *may use* a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them ..."

³⁷ In any event, such measures may well fall within the scope of footnote 1, and thus not represent subsidies at all, whether prohibited or otherwise.

³⁸ Oral Statement of the United States at the third-party session, para. 15.

³⁹ Draft Text by the Chairman, MTN/GNG/NG10/W/38/Rev.2, 2 November 1990.

As the United States correctly observes, a new Chairman's text (known as "Cartland IV") was released just a few days later.⁴⁰ In that new text, the word "expressly" was dropped from the footnote, which took its present form. In the view of the United States, this change demonstrates that the drafters "intended to expand, rather than restrict" the scope of footnote 5, and that "they did not intend the sort of narrow construction of footnote 5 advanced by Canada and the EC."⁴¹

6.40 We agree with the United States that the deletion of the term "expressly" appears to have broadened the scope of footnote 5 in *Cartland IV* beyond its scope in *Cartland III*. We do not agree, however, that it served to broaden footnote 5 to the extent suggested by the United States. As we discussed above, the Illustrative List contains - and already contained at the time of *Cartland III* and *IV* - a number of provisions that include affirmative statements that arguably represent authorizations to use certain measures. The language of *Cartland III* ("expressly referred to") could have precluded asserting that footnote 5 applied to any of these provisions, and it may be that the purpose of the modification was to rectify this situation. If on the other hand the intention of the drafters in changing footnote 5 had been to extend the scope of that footnote to cover situations where the Illustrative List merely referred to things that *were* export subsidies, they might have been expected to modify the structure of the second part of the footnote, and not merely delete the word "expressly". At the very least, we conclude that the implications of the negotiating history referred to by the United States are inconclusive and cannot lead us to disregard the ordinary meaning of the footnote.

6.41 Of course, it could be argued that, based on an *a contrario* argument, the Illustrative List permits admitted export subsidies *even where those subsidies do not fall within the scope of footnote 5*. As we have already indicated, however, the drafters have provided us with a specific textual provision that addresses the issue when the Illustrative List can be used to demonstrate that a measure is not a prohibited export subsidy. The fact that this footnote was adjusted on at least one occasion suggests that the drafters gave this issue consideration and provided the answer to this question.⁴² If we were to conclude that the Illustrative List by implication gave rise to "permitted" measures beyond those allowed by footnote, we would be calling into serious question the *raison d'être* of footnote 5.

⁴⁰ Draft Text by the Chairman, MTN/GNG/NG10/W/38/Rev.3, 6 November 1990.

⁴¹ Oral Statement of the United States at the third-party session, para. 12.

⁴² The Illustrative List was imported with only modest changes from the Tokyo Round *Agreement on Interpretation and Application of Article VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("Subsidies Code")*. The Subsidies Code prohibited Signatories (other than developing country Signatories) from granting export subsidies on products other than certain primary products and included a list of practices that were "illustrative of export subsidies". See Articles 9 and 14.2. The *Subsidies Code* defined neither the term "subsidy" nor the term "export subsidy", and the drafters must have been aware that the importation of the List into a new agreement with groundbreaking new definitions would give rise to a need for textual clarification.

(iv) The Material Advantage Clause and the Principle of Effective Treaty Interpretation

6.42 Brazil, and the United States as third party, contend that a finding that the first paragraph of item (k) cannot be used *a contrario* to permit export credits and payments that are *not* used to secure a material advantage would render the "material advantage" clause ineffective.⁴³ We do not agree. In our view, the primary role of the Illustrative List is not to provide guidance as to when measures are *not* prohibited export subsidies - although footnote 5 allows it to be used for this purpose in certain cases - but rather to provide clarity that certain measures *are* prohibited export subsidies. Thus, it would be possible to demonstrate that a measure falls within the scope of an item of the Illustrative List and was thus prohibited without being required to demonstrate that Article 3, and thus Article 1, was satisfied. To borrow a concept from the field of competition law, the Illustrative List could be seen as analogous to a list of *per se* violations. Seen in this light, the material advantage clause is not "ineffective", in the sense that it is reduced to redundancy or inutility, by a finding that the first paragraph of item (k) cannot be used *a contrario* to establish that a measure is permitted. To the contrary, the material advantage nevertheless continues to serve an important role by narrowing the range of measures that would otherwise be subject to the "*per se*" violation set forth in the first paragraph of item (k), as discussed below.

6.43 Let us consider the first situation envisioned by the first paragraph of item (k), the grant by governments of export credits at rates below their cost of funds. It may generally be assumed that in such circumstances there will be a benefit to the recipient and thus a subsidy. This is however not always the case. Whenever a government's cost of funds is higher than that of the borrower, a loan at below the government's cost of funds may nevertheless fail to confer a benefit on the recipient. For example, Brazil argues in this dispute that its cost of funds is in excess of 13 per cent. By contrast, it is likely that many purchasers of Brazilian exports could obtain private export credit financing, not benefiting from government intervention of any kind, at an interest rate significantly lower than 13 per cent. Thus, direct financing by Brazil in these circumstances could well entail a cost to the government but provide no advantage, material or otherwise, to the recipient. Under these circumstances, and in the absence of the material advantage clause, Brazil would be prohibited from providing export credits at an interest rate lower than 13 per cent⁴⁴, even if the export credits provided no advantage whatsoever.⁴⁵ The role of the material advantage clause in this situation is to narrow the scope of the *per se* prohibition in such cases.

⁴³ The principle of effectiveness in the interpretation of treaties has been recognised in the WTO dispute settlement system. As the Appellate Body explained in *US - Gasoline*, "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paras. of a treaty to redundancy or inutility" (Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* ("*US - Gasoline*"), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, footnote 10, at 21).

⁴⁴ Except to the extent it successfully invoked the second para. of item (k).

⁴⁵ We are assuming that the material advantage clause applies with respect to both forms of government activity referred to in the first para. of item (k), *i.e.*, direct export credit financing and payments. If it does not, then the ability of a developing country not exempted from the export subsidy prohibition to provide direct export credit financing could in practice be limited to situations where it could invoke the second para. of item (k).

6.44 A similar situation could arise in cases of payments under the first paragraph of item (k). Without the material advantage clause, a complainant could demonstrate the existence of a prohibited subsidy merely by demonstrating the existence of a payment within the meaning of item (k). However, a financial institution in a developing country may have a higher cost of funds than financial institutions in developed countries, and thus be unable to provide export credits on terms competitive with those of foreign financial institutions. A payment by Brazil that allowed a Brazilian financial institution to provide export credits to an overseas customer on precisely the same terms as that customer could have obtained in international financial markets could, absent the material advantage clause, constitute a prohibited export subsidy, even though the borrower - and hence the exporter - was no better off than it would have been but for the payment.⁴⁶ The material advantage clause narrows the scope of the "*per se*" violation in the first paragraph of item (k) and precludes this result.⁴⁷

6.45 In light of the foregoing, we consider that the "material advantage" clause would not be rendered "ineffective" by a finding that the first paragraph of item (k) cannot serve as a basis to establish that a measure is "permitted".

(v) Developing Countries and the Object and Purpose of the SCM Agreement

6.46 Finally, we recall Brazil's view that the first paragraph of item (k) must be read to "permit" payments that are not used to secure a material advantage - and that for this reason footnote 5 must be read broadly to apply to the first paragraph of item (k) - in order to ensure that developing country Members are not placed at a "permanent, structural disadvantage" in the field of export credit terms. Because this argument appears to us to be at the core of Brazil's defence, we consider that we must address it in some detail.

6.47 We agree with Brazil that the *SCM Agreement* should not be interpreted in a manner that provides special and *less* favourable treatment for developing country Members in the field of export credit terms if the text of the Agreement permits of an alternative interpretation. In particular, an interpretation of the *SCM Agreement* that allowed developed country Members to consistently offer export credit terms more favourable than those that could in practice be offered by developing country Members - at least as of the date the export subsidy prohibition applies to any given developing country Member⁴⁸ - would be at odds with one of the objects and purposes of the *WTO Agreement* generally and the *SCM Agreement* specifically.⁴⁹

⁴⁶ In such a case, there would be a benefit and thus a subsidy, but it would be a subsidy to a service provider, the financial institution.

⁴⁷ In fact, Brazil made a similar argument regarding the need for PROEX payments due to "Brazil risk" in the original dispute in this case. In the case of PROEX payments, however, the aircraft purchaser is free to seek the best export credit terms available in the market, whether from a Brazilian or foreign bank, and then receive a reduction in that interest rate in the amount of the payments. Thus, PROEX payments by definition allow a purchaser/borrower to obtain export credits at interest rates lower than it could obtain in the market with respect to the transaction in question.

⁴⁸ In this respect, we recall that the prohibition on export subsidies does not apply to least-developed country Members, nor to Members listed in Annex VII until their GNP *per capita* reaches

6.48 We consider however that the broad reading of footnote 5 urged by Brazil is not necessary in order to ensure equitable treatment for developing country Members. To the contrary, we fear that a broad interpretation of footnote 5 would have the opposite effect, and we consider that the natural reading of the footnote discussed above is more in keeping with this important object and purpose of the *WTO Agreement*.

6.49 The essence of Brazil's argument in this Article 21.5 dispute, and in the original dispute which gave rise to the recommendation the implementation of which we are considering here, is that items (j) and (k) of the Illustrative List permit developed country Members to provide, consistent with the *WTO Agreement* and the *Arrangement*, export credit terms that a developing country would not be able to meet. Brazil further considers that the only way in practice to rectify this imbalance is to interpret the first paragraph of item (k) to permit Members to provide payments in so far as they are *not* used to secure a material advantage and to interpret that clause in a sufficiently broad manner so as to allow developing countries to meet developed country export credit terms.⁵⁰

6.50 In the original dispute, Brazil's developing country argument focused on the second paragraph of item (k). We will therefore first address the implications of that paragraph for developing countries.

6.51 The second paragraph of item (k) creates a safe harbour for export credit practices that are in conformity with the interest rate provisions of the *Arrangement*.⁵¹ The *Arrangement* is a plurilateral "gentlemen's" agreement, negotiated in the context of the Organization for Economic Cooperation and Development. The pur-

US\$1,000 per annum. Further, the prohibition does not apply to other developing country Members pursuant to Article 27 during an eight-year transition period (*i.e.*, until 1 January 2003) unless and until another Member demonstrates that a developing country Member has not complied with at least one of the elements set forth in Article 27.4. It will be recalled that Brazil is subject to the prohibition because it failed to abide by certain of these elements (Para 6.20, *supra*).

⁴⁹ The preamble to the *WTO Agreement* recognises

"that there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development."

This overarching concern of the *WTO Agreement* finds ample reflection in the *SCM Agreement*. Article 27 of that Agreement recognizes that "subsidies may play an important role in economic development programmes of developing country Members" and provides substantial special and differential treatment for developing countries, including in respect of export subsidies.

⁵⁰ Due to the nature of Brazil's defence in this case, we are required either to address the meaning of a number of provisions not directly invoked by Brazil, or to leave Brazil's fundamental object and purpose argument unanswered. Accordingly, and because, in our view, it is difficult to interpret the provisions invoked by Brazil without examining the broader context of other provisions of the *SCM Agreement* relating to export credit practices, we have chosen the latter course.

⁵¹ The text of the second para. of item (k) in fact refers to "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members)". We note that several "Sector Understandings" (relating to ships, nuclear power plants, and civil aircraft) are annexed to the *Arrangement*, and that for some products - not including regional aircraft - a minimum interest rate different from the CIRR applies. We assume - but need not here decide - that an export credit practice in conformity with the interest rate provisions of these Sector Understandings would also be entitled to the safe harbour of the second para. of item (k).

pose of the *Arrangement*, as stated in its Introduction, is to "provide a framework for the orderly use of officially supported export credits" and to "encourage competition among exporters from the OECD-exporting countries based on quality and price of goods and services rather than on the most favourable officially supported terms". The *Arrangement* sets forth certain guidelines with respect to the terms and conditions of officially supported export credits with repayment terms of two years or more, including minimum interest rates for export credits benefiting from official financing support⁵² based on Commercial Interest Reference Rates, or CIRRs. There is a CIRR for the currency of each Participant to the *Arrangement*, which is constructed based upon long-term bond yields for that Participant plus a fixed margin (which for most currencies is 100 basis points, *i.e.*, one percentage point).

6.52 Brazil does not dispute that any Member, whether or not a Participant to the *Arrangement*, can invoke the second paragraph of item (k) in respect of its export credit practices which are in conformity with interest rate provisions of the *Arrangement*. Thus, in the case at hand, Brazil could provide dollar-denominated export credits in respect of Brazilian regional aircraft on terms that might otherwise be prohibited by Article 3.1(a) of the *SCM Agreement*, provided those export credits conformed to the interest rate provisions of the *Arrangement*.

6.53 Brazil argued, however, that developing countries could not afford to provide direct export credit financing at the CIRR rate, because of their high cost of funds, and thus could not in practice use the safe harbour created by the second paragraph of item (k). In order to avoid the high cost of direct financing, developing countries such as Brazil had to use a system of payments in support of export credits provided through commercial banks. Because commercial lenders in many cases have a lower cost of borrowing than the governments of developing countries, those governments could afford to "buy down" interest rates provided by commercial lenders at much lower cost than if they offered direct export credit financing itself.⁵³ Thus, developing countries needed to be able to use the first paragraph of item (k) as a safe harbour for payments that were equivalent in effect to the direct financing provided pursuant to the safe harbour in the second paragraph of item (k) by developed countries. This would only be possible if the first paragraph of item (k) could be used to establish that "payments" under the first paragraph of item (k) were "permitted" under certain circumstances.

6.54 Brazil's argument in the original dispute was not well-founded. Under the *Arrangement*, minimum interest rates in the form of CIRRs apply with respect to "official financing support", which includes "interest rate support". Thus, there is no

⁵² As discussed *infra* at footnote, "official support" is a broader concept than "official financing support".

⁵³ To take a hypothetical and highly simplified example, imagine that the yield on the relevant US Government bonds (and thus the US Government's cost of borrowing) is 5 per cent, Brazil's cost of borrowing is 10 per cent and the interest rate on commercial export credits is 8 per cent. Because it is constructed based on the relevant US Government bond yields plus 1 percentage point, the US dollar CIRR would be 6 per cent. While developed countries could afford to borrow at 5 per cent and provide export credits at 6 per cent, Brazil could only do so by providing direct export financing at 4 percentage points below its own cost of borrowing, an expensive proposition. It would be much less costly for Brazil to allow a commercial lender to provide the export credits, and pay the lender 2 percentage points in the form of interest rate support.

reason why a developing country could not invoke the second paragraph of item (k) in respect of a payment scheme such as PROEX, provided that it is "in conformity with the interest rate provisions" of the *Arrangement*. In short, Brazil's argument that developing country Members needed to be able to use the first paragraph of item (k) as a safe harbour for their export credit interest buy-down schemes (and that footnote 5 thus had to be interpreted to apply in respect of the first paragraph of item (k)) because they could not in practice benefit from the safe harbour in the second paragraph was, in our view, simply incorrect.⁵⁴

6.55 In this implementation dispute, Brazil continues to argue that it must be allowed to use the first paragraph of item (k) to establish that an admitted export subsidy is "permitted" so that it can ensure the availability of WTO-consistent export credit financing for Brazilian products on terms equivalent to those that Canada is allowed to provide by the *SCM Agreement* and the *Arrangement*. Specifically, Brazil argues that Canada is allowed by the *Arrangement* and the *SCM Agreement* to provide or support below-CIRR export credits which, in the absence of the legal interpretations of the first paragraph of item (k) advanced by Brazil, cannot be met by Brazil as a practical matter without violating its WTO obligations.

6.56 In our view, however, the rules of the *SCM Agreement* as properly interpreted do not give rise to what Brazil refers to as a "permanent, structural disadvantage" in the field of export credit terms. We consider, however, that an unduly broad interpretation of footnote 5 to mean that measures not prohibited by an item of the Illustrative List are *permitted* would place developing country Members at a systematic disadvantage in respect of export credits.⁵⁵

6.57 To understand why this is so, we will first consider the implications in respect of direct export credit financing if the Panel were to find that footnote 5 should be interpreted to provide that measures not prohibited by the first paragraph of item (k) were "permitted". Under the first paragraph of item (k),

"[t]he grant by governments ... of export credits at rates below those which they actually have to pay for the funds so employed ... in so far as they are used to secure a material advantage in the field of export credit terms"

is an export subsidy prohibited by the *SCM Agreement*. The two conditions for the grant of export credits to fall within the scope of this paragraph - that (a) they are at rates below the government's cost of funds, and (b) they are used to secure a "material advantage" - are cumulative, *i.e.* they must both be satisfied in order for an export credit to fall within the scope of the paragraph. Thus, if we were to find that this paragraph could be used not only to establish that a measure is prohibited, but also to

⁵⁴ We found in our original Report that "a developing country Member could under the second para. of item (k) provide interest rate support to reduce the interest rates on export credits to the levels allowed by the OECD Arrangement if it considered that direct financing at those rates was too expensive." There is no indication in the Appellate Body Report that Brazil challenged this conclusion on appeal, nor did the Appellate Body find to the contrary.

⁵⁵ Of course, the *SCM Agreement* cannot *remove* competitive disadvantages arising from structural differences between WTO Members; it should not however be interpreted in such a manner that the rules *themselves* place developing country Members at a disadvantage *vis-à-vis* developed country Members.

establish that certain measures are "permitted", it would follow that a WTO Member benefited from a safe harbour and provided a "permitted" export subsidy whenever it provided an export credit at above its own cost of funds (whether or not that export credit was used to secure a material advantage in the field of export credit terms).

6.58 As Brazil itself has so forcefully argued before the Panel, developing countries' costs of borrowing are almost inevitably higher than those of developed countries⁵⁶. Accordingly, if we adopted the interpretation advocated by Brazil, the first paragraph of item (k) would "permit" developed countries to provide export credits at an interest rate - the developed countries' own cost of funds - which developing countries would almost never be able to meet without falling afoul of the *SCM Agreement*. Thus, not only is a broad interpretation of footnote 5 not necessary in order to prevent placing developing countries at a "permanent, structural disadvantage" in the field of export credit terms but, to the contrary, such a broad interpretation of footnote 5 would in fact place developing countries at precisely the type of disadvantage in the field of export credit terms feared by Brazil.

6.59 The same situation exists in respect of item (j) of the Illustrative List. Brazil argues that its interpretation of the first paragraph of item (k) is necessary to allow it to meet export credit terms provided by developed country Members through export credit guarantees.⁵⁷ If footnote 5 is interpreted broadly to encompass the first paragraph of item (k), however, it presumably would also apply to item (j) and thus "permit" export credit guarantees at premium rates adequate to cover long-term operating costs and losses, even where the guarantees constituted a subsidy contingent upon export performance within the meaning of Article 3.1(a).⁵⁸ As Canada points out, however, in the case of a government guarantee, a lending bank establishes financing terms in light of the risk of the guarantor government, not the borrower.⁵⁹ Developed countries generally present a lower risk of default than developing countries, and a developing country may often be perceived as posing a higher risk than even the borrower to whom a guarantee might be extended. As a result, while developing countries in theory could utilise any "safe harbour" under item (j) to provide loan guarantees at the same premium rates as developed countries, the effect of guarantees by developing country Members on the interest rate of the guaranteed export

⁵⁶ According to Brazil - and Canada has not challenged Brazil's assertion - Brazil's cost of borrowing as of 1 February 2000, based on 10-year bond yields - was more than twice that of Canada.

⁵⁷ As Brazil explained in its first submission (para. 11), when presenting evidence of an export credit transaction supported by loan guarantees, "export credit guarantee programs are permitted by item (j) of Annex I to the *SCM Agreement*, provided they are at premium rates that are adequate to cover the long-term operating costs and losses of the program".

⁵⁸ Brazil in fact so argues. See Oral Statement of Brazil at the Meeting of the Panel, para. 34 ("There is nothing in the text of either item (j) or (k) to support the conclusion that an *a contrario* argument is permitted in one but not the other"). Canada does not disagree; rather, it takes the view that item (j), like item (k) first para., cannot be used *a contrario* to establish that export credit guarantees at premium rates that are adequate to cover long-term operating costs and losses are "permitted". Canada points out that, if this were the case, then item (j), which operates on a cost-to-government basis, would be manifestly at odds with Article 14, which sets out a market-based benchmark for determining whether there is a benefit from a loan guarantee. In the Second Submission of Canada, para. 23.

⁵⁹ In the Second Submission of Canada, para. 36.

credits would be minimal or non-existent in most cases. In other words, a broad reading of footnote 5 would, in respect of item (j), allow developed countries to support export credits at interest rates that would be consistently lower than those of export credits supported by developing countries.

6.60 If, on the other hand, we interpret footnote 5 in accordance with its ordinary meaning, and conclude that it does not apply to items such as the first paragraph of item (k) and item (j), then all WTO Members are faced with a common set of rules in respect of export credit practices.⁶⁰ *First*, they can ensure that those practices do not confer a benefit within the meaning of Article 1 and are therefore not subsidies.⁶¹ Because the existence of benefit is determined based on the existence of a benefit to a recipient, and without regard to whether there is a cost to the government,⁶² all Members compete on a level playing field in respect of this assessment, *i.e.*, a measure which constitutes an export subsidy when provided by Brazil *ipso facto* will also constitute a subsidy when provided by Canada, and vice versa.

6.61 *Second*, they can establish that a measure that is a subsidy contingent on export performance is nevertheless permitted because it benefits from the safe harbour provided by the second paragraph of item (k) for export credit practices that are in conformity with the interest rate provisions of the *Arrangement*. As noted earlier in this Report (para. 6.52, *supra*), the export credit practice of a Member which is not a Participant to the *Arrangement* but which "in practice applies the interest rate provisions" of the *Arrangement* benefits from the safe harbour of the second paragraph of item (k) provided that the practice is "in conformity with those [*i.e.*, the interest-rate] provisions."

6.62 We have already seen that, even if a developing country Member cannot in practice afford to provide direct export credit financing at the CIRR rate, it can take advantage of the safe harbour in the second paragraph of item (k) by providing interest rate support in order to bring export credits provided by commercial lenders down to the CIRR rate.⁶³ The question remains whether the second paragraph of item (k) would otherwise permit developed country Members to provide or support export credits which developing countries could meet only through the *a contrario* invocation of the first paragraph of item (k) argued by Brazil.

6.63 In this respect, Brazil first refers to the issue of "market windows". According to Brazil, some Participants to the *Arrangement*, including Canada, take the view that export credits provided by their export credit agencies are not "official support" and thus not subject to the terms of the *Arrangement* if they are provided at rates equal to or above their cost of funds.⁶⁴ According to Brazil, "this means that developed countries that are able to borrow US dollars at a rate below the CIRR rate are able to lend

⁶⁰ Except, of course, to the extent that the *SCM Agreement* provides special and differential treatment for particular Members, as provided for in Articles 27 and 29 of that Agreement.

⁶¹ Assuming that their export credit practices are not *per se* violations under item (j) or item (k) first para. of the Illustrative List.

⁶² Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DSB70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 156.

⁶³ Provided, as discussed below, they respect the other provisions of the *Arrangement* which affect interest rates.

⁶⁴ First Submission of Brazil, para. 19.

at that below-CIRR rate in conformity with the *Arrangement* as presently interpreted".⁶⁵ In other words, Brazil seems to be arguing that developed countries are permitted by the *Arrangement*, and thus by the *WTO Agreement*, to provide such below-CIRR export credits. Because developing countries have a higher cost of funds than do developed countries, their minimum interest rate under the second paragraph would be CIRR, and they would be unable to meet developed countries' market window operations. Thus, Brazil argues, developing countries must be "permitted" by operation of the first paragraph of item (k) to make payments resulting in export credits on equivalent terms.

6.64 Canada responds that Brazil confuses Canada's position on market windows. In Canada's view, the term "market windows" refers to circumstances where an export credit agency offers direct financing on terms comparable to those the recipient may receive in the market. In such circumstances, the agency is operating similarly to a private commercial bank, rather than as an *official* export credit agency. Thus, Canada argues that, for example, the Canadian Export Development Corporation, when operating under its Corporate Account, does not in any event confer a benefit and accordingly does not provide a subsidy within the meaning of Article 1 of the *SCM Agreement*.⁶⁶

6.65 We understand that the "market windows" debate, which is an ongoing one among the Participants, relates to whether or not certain export credit practices are "official support" and thus *subject* to the *Arrangement*. An export credit practice is not however "*in conformity with*" the "interest rate provisions" of the *Arrangement* within the meaning of the second paragraph of item (k) of the *SCM Agreement* merely because it is not *subject to the Arrangement*. To the contrary, we consider that the "interest rate provisions" to which the second paragraph of item (k) refers are those provisions that establish minimum interest rates.⁶⁷ At present, the only generally applicable minimum interest rate under the *Arrangement* is the CIRR. Thus, an export credit which is provided through "market windows" at an interest rate below CIRR cannot be said to be "in conformity with" the interest rate provisions of the *Arrangement* and thus cannot benefit from the safe harbour provided for in that paragraph.⁶⁸ Accordingly - and in light of our understanding of the ordinary meaning of

⁶⁵ First Submission of Brazil, para. 24.

⁶⁶ Second Submission of Canada, para. 48. The disagreement between Brazil and Canada regarding what export credit practices qualify as "market window" operations appears to reflect that Canada's position on this question has evolved in the relatively recent past.

⁶⁷ This does not mean, however, that a Member may demonstrate that its export credit practice is in conformity with the interest rate provisions of the *Arrangement* merely by demonstrating that it has respected the minimum interest rates, irrespective of the other terms and conditions of the export credit in question. In our view, it would not be possible to make a meaningful assessment as to whether a Member has respected minimum interest rates without verifying as well that it has respected those provisions of the *Arrangement* which affect interest rates.

⁶⁸ Our reasoning would apply equally to any other situation where the *Arrangement's* minimum interest rates do not or may not apply. Thus, export credit guarantees, although "official support" subject to the *Arrangement*, are not "official financing support" and thus are not subject to minimum interest rates. While guaranteed export credits thus may be provided at below-CIRR interest rates without violating the *Arrangement*, they cannot be considered to be "in conformity with" the interest rate provisions of the *Arrangement*. Similarly, there is no consensus among Participants about the treatment of official financing support for export credits at floating interest rates. While Canada

footnote 5 - whether an export credit practice involving below-CIRR interest rates is or is not prohibited by the *SCM Agreement* will depend solely upon whether or not it falls within the scope of Article 3.1(a), and in particular whether it confers a benefit and therefore represents a subsidy within the meaning of Article 1.⁶⁹

6.66 In short, an interpretation of footnote 5 which accords with its ordinary meaning and does not allow the first paragraph of item (k) to be read in an *a contrario* manner to "permit" certain measures not only does not generate a "permanent, structural disadvantage" for developing country Members in the field of export credit terms but, to the contrary, prevents developed country Members from obtaining, through the *a contrario* invocation of the Illustrative List, a consistent advantage over developing countries in the field of export credit terms. Accordingly, we do not agree with Brazil that the object and purpose of the *SCM Agreement* requires us to read footnote 5 more broadly than its ordinary meaning would suggest.

(vi) Conclusion

6.67 For the foregoing reasons, we conclude that the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is "permitted".⁷⁰

(b) Are Payments under PROEX "Payments" within the Meaning of the First Paragraph of Item (k) which are "Used to Secure a Material Advantage in the Field of Export Credit Terms"?

6.68 As discussed above, we do not consider that the first paragraph of item (k) can be used to establish that a measure which is a subsidy contingent upon export performance within the meaning of Article 3.1(a) is nevertheless "permitted". Nevertheless, we consider that we should resolve the issue whether payments under the "new" PROEX are used to secure a material advantage in the field of export credit terms because such findings should facilitate Brazil's task in implementing the DSB's recommendations.

considers that such export credits need not comply with the CIRR - given that the CIRR logically is relevant only to export credits at fixed interest rates - floating rate export credits provided at an interest rate below CIRR cannot be considered to be "in conformity with" the interest rate provisions of the *Arrangement*. Finally, while the *Arrangement* authorizes Participants to "match" export credit terms and conditions offered by Participants or non-Participants that do not conform to the *Arrangement*, it cannot be said that an export credit benefiting from official financing support that derogates from the minimum interest rate provisions of the *Arrangement* is "in conformity with" the interest rate provisions of the *Arrangement*.

⁶⁹ We recall in this respect our view that the first para. of item (k) does not "permit" the grant of export credits that are at or above a government's cost of borrowing. See para. 6.43, *supra*.

⁷⁰ Of course, we do not preclude that, in appropriate circumstances, an item of the Illustrative List might represent context relevant to an interpretation of Article 1 (or vice versa), although in this regard substantial caution would certainly be appropriate given that, on its face, the Illustrative List focuses on whether a measure is a *prohibited export* subsidy, not on whether it is a *subsidy*. See generally Appellate Body Report, *United States - Tax Treatment for "Foreign Sales Corporations"* ("US - FSC"), WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619, para. 92.

- (i) Are Payments under PROEX "Payments" within the Meaning of the First Paragraph of Item (k)?

6.69 Brazil argues that PROEX payments constitute the payment by Brazil of all or part of the costs incurred by Embraer or financial institutions in obtaining credits within the meaning of the first paragraph of item (k). As explained in our original Panel Report,⁷¹ Brazil's argument appears to be two-fold. *First*, Brazil contends that financial institutions must borrow funds in order to finance their lending, that the export credits so funded are provided at below their cost of borrowing, and that PROEX payments are provided to compensate the lenders for this difference. The difference between the lender's cost of borrowing and the rate it charges on the export credits represents a "cost incurred by ... financial institutions in obtaining credits". *Second*, Brazil asserts that, although Embraer does not itself extend export credits to its customers, it incurs certain costs in relation to the provision of export credits by financial institutions. Brazil's arguments are linked to the principle that both Embraer and Brazilian financial institutions have high costs of borrowing as a result of "Brazil risk", *i.e.*, the Government of Brazil has a high cost of borrowing and Brazilian entities cannot borrow on terms more favourable than those of their government.

6.70 Canada agrees with the basic thrust of Brazil's interpretation of the notion of payments. In Canada's view, a payment exists within the meaning of the first paragraph of item (k) where an exporter or financial institution obtains credits at an interest rate higher than the rate at which it would provide export credits to a buyer and incurs a cost as a result, and the government pays for all or part of this difference. In Canada's view, however, PROEX payments are not "payments" in this sense. In this regard, it emphasises that Embraer does not itself provide export financing to its purchasers. Further, Canada asserts that PROEX payments are in practice paid when non-Brazilian purchasers finance their purchases through non-Brazilian financial institutions. Thus, Brazil risk is not relevant. Accordingly, Canada considers that PROEX payments are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases.

6.71 It will be recalled that item (k) refers to the payment by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". In interpreting this provision, we must of course start with its ordinary meaning. In this respect, we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.

6.72 Read in light of the foregoing considerations, we do not believe that PROEX payments can be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining export credits". Brazil's argument equates the cost for a financial institution of raising capital with the cost of "obtaining [export] credits". While the financial institutions involved in financing PROEX-supported transactions certainly *provide* export credits, they cannot be seen as *obtaining* such credits. Further, if the drafters had intended to refer to

⁷¹ Original panel report, *supra*, footnote 1, footnote 198, p. 80.

payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so. In short, we do not agree that payments to a lender that amount to interest rate support can reasonably be understood to be payments of all or part of the costs of obtaining export credits.

6.73 Even if we did agree that the provision of export credits at below a financial institution's cost of borrowing entailed a "cost incurred by ... financial institutions in obtaining credits", we are unconvinced that PROEX payments necessarily serve to reimburse such below-cost-of-borrowing export credits. In this respect, we note that Brazil's argument focused on the fact that Embraer and Brazilian financial institutions had a high cost of borrowing as a result of "Brazil risk". As Canada points out, however, Embraer does not itself provide export credit financing, and the financial institutions receiving PROEX payments are not necessarily Brazilian financial institutions. Rather, they are in many cases leading international financial institutions unhampered by "Brazil risk". Thus, there is no basis for us to conclude, nor even to hypothesise, that the financial institutions in question are providing export credits at below their cost of funds.

(ii) Are PROEX Payments "Used to Secure a Material Advantage in the Field of Export Credit Terms"?

6.74 The third and final element of Brazil's material advantage defence is that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

6.75 Brazil considers that it has modified PROEX in respect of regional aircraft such that PROEX payments are no longer used to secure a material advantage in the field of export credit terms. Specifically, Brazil argues that Resolution 2667

"means, effectively ... that no application for PROEX interest rate equalisation support for regional aircraft will be favorably considered unless it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ("T-Bill") plus 0.2 percent per annum. While the use of the T-Bill as the benchmark is preferred, the authorities retain the authority to utilise LIBOR as an alternative reference point in appropriate market circumstances."⁷²

Brazil requests the Panel to find that, "by requiring the net interest rate for any transaction supported by PROEX to equal or exceed an appropriate market benchmark - with the preferred benchmark being the T-Bill plus 20 basis points - Brazil has withdrawn the prohibited aspects of the PROEX programme."⁷³

6.76 In order to determine whether Brazil is correct in its view that payments pursuant to the PROEX scheme no longer are used to secure a material advantage in the field of export credit terms, we must first seek to resolve certain differences of view among the parties regarding the meaning of the "material advantage" clause as interpreted by the Appellate Body, and in particular the role of the CIRR in determining

⁷² First Submission of Brazil, para. 6.

⁷³ Second Submission of Brazil, para. 40.

whether payments are or are not used to secure a material advantage in the field of export credit terms.

6.77 In Brazil's view, the Appellate Body found that PROEX was flawed because it lacked a benchmark based on the marketplace. According to Brazil, the Appellate Body found that Members are permitted to obtain an "advantage" in the field of export credit terms provided that advantage is not "material". It also made clear that the appropriate benchmark for determining whether a material advantage is secured is the marketplace and not a specific transaction.⁷⁴ Put another way, Brazil argues that the "primary flaw" in PROEX identified by the Appellate Body was "the absence of a floor net interest rate based on a cognizable benchmark rate in the commercial marketplace."⁷⁵ In the view of Brazil, while the Appellate Body identified the CIRR as 'one example' of an appropriate benchmark, Brazil chose a point of reference other than CIRR for PROEX based on evidence that, in the case of aircraft, the marketplace in fact supports lower interest rates.⁷⁶

6.78 Canada sees no basis in the rulings of the Appellate Body for Brazil's claim to a benchmark below CIRR even if Brazil could demonstrate that interest rates in the marketplace were below CIRR at some given moment. In the view of Canada, the Appellate Body used the second paragraph of item (k), and therefore the *Arrangement*, as useful context for arriving at the appropriate benchmark to be used in the first paragraph of item (k). The Appellate Body found that the CIRR constituted the *minimum* commercial interest rate for the purposes of the *Arrangement*. It determined accordingly that a net interest rate below the relevant CIRR was a positive indication that material advantage was being secured. There was no suggestion at all by the Appellate Body that any other, lower benchmark could appropriately be used instead of CIRR for item (k).

6.79 From the above, it is evident that Canada and Brazil have fundamentally different views about the legal significance of the CIRR as a benchmark for determining whether or not a payment is used to secure a material advantage. Canada considers that a payment that results in a net interest rate below CIRR *ipso facto* secures a material advantage. Brazil considers that a lower benchmark for determining whether a payment is used to secure a material advantage would be appropriate if it could be established that the "marketplace" in fact supports lower rates.

6.80 As noted above, Resolution 2667 sets what Brazil characterises as a minimum net interest rate for export credits supported by PROEX payments based on US 10-year Treasury Bonds plus 0.2 per cent (20 "basis points"). Canada argues, and Brazil does not dispute, that such a minimum interest rate is below CIRR.⁷⁷ Accordingly, if Canada is correct in its view that a payment that results in a net interest rate below

⁷⁴ First Submission of Brazil, para. 4.

⁷⁵ Second Submission of Brazil, para. 30.

⁷⁶ First Submission of Brazil, para. 9.

⁷⁷ Second Submission of Canada, footnote 33; Response of Brazil to Question 1 of the Panel ("Brazil agrees that a net interest rate of 20 basis points above the 10-year US T-Bill normally is below the CIRR"). The United States as third party indicated that a review of data for the period 1970-99 showed that at no point during the period did the long-term CIRR go below the monthly average 10-year Treasury Bond plus 20 basis points, and that on average the long-term CIRR was 73 basis points above that benchmark (Response of the United States to Question 1 of the Panel to Brazil).

the CIRR is *ipso facto* used to secure a material advantage, then PROEX payments are used to secure a material advantage. On the other hand, if Brazil is correct that an interest rate below CIRR does not imply a material advantage if the marketplace supports such a lower interest rate, then we must examine the evidence submitted by the parties in respect of the interest rates in the marketplace for regional aircraft.

6.81 In considering this issue, we have carefully reviewed the Report of the Appellate Body in the original dispute. The Appellate Body had before it the conclusion of the Panel that a payment is used to secure a material advantage where the payment "has resulted in the availability of export credit on terms which are more favourable than the terms that would otherwise have been available to the purchaser in the marketplace with respect to the transaction in question".⁷⁸ The Appellate Body rejected the Panel's interpretation for two reasons. First, the Appellate Body found that the Panel had omitted the term "material" from its test, thus reading that term out of item (k). Second, the Appellate Body found that the Panel had interpreted the material advantage clause as equivalent to the term "benefit" in Article 1.1(b) of the *SCM Agreement*, thereby rendering that clause meaningless.

6.82 The Appellate Body then explained how the "material advantage" clause should properly be interpreted. Because the resolution of this dispute depends upon achieving a proper understanding of this clause as interpreted by the Appellate Body, we will quote *in extenso* from the Appellate Body's findings:

180. We note that there are two paragraphs in item (k), and that the "material advantage" clause appears in the first paragraph. Furthermore, the second paragraph is a proviso to the first paragraph. The second paragraph applies when a Member is "a party to an international undertaking on official export credits" which satisfies the conditions of the proviso, or when a Member "applies the interest rates provisions of the relevant undertaking". In such circumstances, an "export credit practice" which is in conformity with the provisions of "an international undertaking on official export credits" shall not be considered an export subsidy prohibited by the *SCM Agreement*. The *OECD Arrangement* is an "international undertaking on official export credits" that satisfies the requirements of the proviso in the second paragraph in item (k). However, Brazil did not invoke the proviso in the second paragraph of item (k) in its defence. Brazil argued before the Panel that it "has concluded that conformity to the OECD provisions is too expensive." [footnote omitted].

181. Thus, this case falls under the first paragraph, and not under the proviso of the second paragraph, of item (k) of the Illustrative List. Consequently, the issue here is whether the export subsidies for regional aircraft under PROEX "are used to secure" for Brazil "a material advantage in the field of export credit terms". Nevertheless, we see the second paragraph of item (k) as useful context for interpreting the "material advantage" clause in the text of the first paragraph. The *OECD Arrangement* establishes minimum interest rate guidelines for

⁷⁸ Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 13, para. 7.33.

export credits supported by its participants ("officially-supported export credits"). Article 15 of the *Arrangement* defines the minimum interest rates applicable to officially-supported export credits as the Commercial Interest Reference Rates ("CIRRs"). Article 16 provides a methodology by which a CIRR, for the currency of each participant, may be determined for this purpose. We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are "used to secure a material advantage in the field of export credit terms". Therefore, in our view, the appropriate comparison to be made in determining whether a payment is "used to secure a material advantage", within the meaning of item (k), is between the actual interest rate applicable in a particular export sales transaction after deduction of the government payment (the "*net* interest rate") and the relevant CIRR.

182. It should be noted that the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity as well as the creditworthiness of the borrower. Thus, a potential borrower is not faced with a single commercial interest rate, but rather with a range of rates. Under the *OECD Arrangement*, a CIRR is the *minimum* commercial rate available in that range for a particular currency. In any given case, whether or not a government payment is used to secure a "*material* advantage", as opposed to an "advantage" that is not "*material*", may well depend on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available. The fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been "used to secure a material advantage in the field of export credit terms".

183. Brazil has conceded that it has the burden of proving an alleged "affirmative defence" under item (k). In light of our analysis, it was for Brazil to establish a *prima facie* case that the export subsidies for regional aircraft under PROEX do not result in net interest rates below the relevant CIRR. We note, however, that Brazil did not provide *any information* to the Panel on this point. We also note that Brazil declined to provide this information, even when specifically requested to do so by the Panel.[footnote omitted]. Because Brazil provided *no information* on the net interest rates paid by purchasers of Embraer aircraft in actual export sales transactions, we have no basis on which to compare the net interest rates resulting from the interest rate equalisation payments made under PROEX with the relevant CIRR.

184. Accordingly, we find that Brazil has failed to meet its burden of proving that export subsidies for regional aircraft under PROEX are not "used to secure a material advantage in the field of export credit terms" within the meaning of item (k) of the Illustrative List.

185. We are aware that the *OECD Arrangement* allows a government to "match", under certain conditions, officially-supported export credit terms provided by another government. In a particular case, this could result in net interest rates below the relevant CIRR. We are persuaded that "matching" in the sense of the *OECD Arrangement* is not applicable in this case. Before the Panel, Brazil argued for an interpretation of the clause "in the field of export credit terms" that would include as an "export credit term" the price at which a product is sold, and maintained that, therefore, Brazil was entitled to "offset" *all the subsidies* provided to Bombardier by the Government of Canada. The Panel rejected Brazil's argument, finding instead that "[w]e see nothing in the ordinary meaning of the phrase to suggest that 'the field of export credit terms' generally encompasses the price at which a product is sold." We note that this finding was *not* appealed by either Brazil or Canada. Even if we were to assume that the "matching" provisions of the *OECD Arrangement* apply in this case (an argument Brazil did not make), those provisions clearly do not allow a comparison to be made between the net interest rates applied as a consequence of subsidies granted by a particular Member and the total amount of subsidies provided by another Member. We also note that under PROEX, the interest rate equalisation subsidies for regional aircraft are provided at an "across-the-board" rate of 3.8 per cent for *all* export sales transactions.[footnote omitted] That rate is fixed, and does not vary depending on the total amount of subsidies provided by another Member to its regional aircraft manufacturers. Thus, we cannot accept Brazil's argument that the export subsidies for regional aircraft under PROEX should be "permitted" because they "match" the total subsidies provided to Bombardier by the Government of Canada.

6.83 The text of the Appellate Body decision reveals elements that support the view of Canada in respect of the role of the CIRR. The language used by the Appellate Body in several places suggests that the CIRR is the sole and immutable benchmark against which material advantage is to be assessed. In particular, the Appellate Body's statement, in paragraph 182 of its Report, that "the appropriate comparison to be made in determining whether a payment is "used to secure a material advantage", within the meaning of item (k), is between the actual interest rate applicable in a particular export sales transaction after deduction of the government payment (the "*net* interest rate") and the relevant CIRR", is on its face absolute and would not allow of another benchmark. Similarly, in paragraph 183 the Appellate Body Report states, somewhat categorically, that, "[i]n light of our analysis, it was for Brazil to establish a *prima facie* case that the export subsidies for regional aircraft under PROEX do not result in net interest rates below the relevant CIRR."

6.84 In our view, however, a careful reading of the Report leads to the conclusion that the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases. In this regard, we note in particular certain more nuanced language in paragraph 182 of the Report. Thus, the Appellate Body states that whether a payment is used to secure a *material* advantage "*may well depend*" on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available. In the very next sentence, the Appellate

Body states that the fact that a particular *net* interest rate is below the relevant CIRR is "*a positive indication*" that the government payment in that case has been "used to secure a material advantage in the field of export credit terms". The choice of the words "positive indication" strongly suggests that, while an interest rate below CIRR might be strong evidence that a payment was used to secure a material advantage, there could be circumstances where an interest rate below CIRR nevertheless was *not* used to secure a material advantage in the field of export credit terms.⁷⁹

6.85 Although we believe that the Appellate Body did not intend that a payment that resulted in a net interest rate below CIRR would *ipso facto* be deemed to secure a material advantage, we are not sure under exactly what circumstances this would not be the case. There are a number of possible readings of the Appellate Body Report, each of which would suggest a different approach to determining under what circumstances a payment resulting in a net interest rate below CIRR might not be considered to have been used to secure a material advantage in the field of export credit terms.

6.86 One interpretation would be that the Appellate Body simply considered that a payment would not be used to secure a material advantage in the field of export credit terms if it resulted in an export credit on terms and conditions that would be protected by the safe harbour of the second paragraph as being in conformity with the interest rate provisions of the *Arrangement*. If this were the case, then our examination would focus on whether Brazil's below-CIRR benchmark could have been justified as being equivalent to the terms and conditions of export credits that other Members could provide or support, or perhaps were actually providing or supporting, pursuant to the safe harbour of the second paragraph. The Appellate Body's reference to matching in the sense of the *Arrangement*, although by no means amounting to a finding that Brazil would not be securing a material advantage in the field of export credit terms if it were merely matching another Member's export credit terms, might be seen as implying such an approach.⁸⁰

6.87 We do not believe, however, that the Appellate Body report should be understood in this manner. As we have seen, all WTO Members, whether or not Participants to the *Arrangement*, are entitled to take advantage of the safe harbour in the second paragraph of item (k) to the extent their export credit practices are in conformity with the interest rate provisions of the *Arrangement*. Further, we have seen that, contrary to Brazil's assertions, the export credit practices which may benefit from this safe harbour include interest rate support. Thus, even if a measure not prohibited by the first paragraph of item (k) were "permitted", there is no obvious reason why the test in the second paragraph of item (k), *i.e.*, conformity with the interest rate provisions of the *Arrangement*, should be simply duplicated in the first paragraph, as this

⁷⁹ Brazil also refers to the statement of the Appellate Body that "the *OECD Arrangement* can be appropriately viewed as *one example* of an international undertaking providing a specific market benchmark" by which to assess whether payments are used to secure a material advantage (emphasis added). Given that the Appellate Body referred to "one example" of an undertaking, and not "one example" of a benchmark, we are unsure how much weight should be placed on this element.

⁸⁰ For the reasons explained in paras. 6.62-6.65, *supra*, of this Report, however, we do not believe that an interest rate below CIRR could in fact ever be deemed to be "in conformity with" the interest rate provisions of the *Arrangement*.

would be re-creating in the first paragraph the very safe harbour already provided for by the second paragraph. In addition, the fact that the Appellate Body does not incorporate *Arrangement* requirements in respect of terms and conditions other than interest rates in its material advantage test, such as minimum premiums for sovereign and country credit risk⁸¹ and maximum repayment periods, strongly suggests that it did not intend to equate the concept of material advantage in the field of export credit terms with conformity with the interest rate provisions of the *Arrangement*.

6.88 Another possible interpretation is that suggested by Canada. Although Canada does not say so explicitly, its view seems to be that the Appellate Body did not overrule the Panel's finding that the concept of "material advantage" was comparable to the question whether there was a benefit to the recipient.⁸² Rather, the Appellate Body merely found that such an advantage had to be "material" and, if the net interest rate was below CIRR, this was irrebutable evidence that the advantage was in fact "material".⁸³ Under this reading of the Appellate Body Report, if we understand it correctly, a PROEX payment resulting in an export credit at an interest rate above CIRR would still be used to secure a "material" advantage if it resulted in an export credit on "materially" better terms than the terms that would otherwise have been available in the marketplace *to the borrower in question*.⁸⁴ Given Canada's references in this context to purely commercial transactions - *i.e.*, transactions not benefiting from official support - we assume that Canada defines the "marketplace" to mean the purely commercial marketplace. Consistent with this interpretation, and in support of its position that the advantage conferred by PROEX payments is "material", Canada submitted affidavits from airlines indicating that a reduction in interest rates of as little as 25 basis points could have a material impact on their choice of aircraft.

6.89 We cannot however interpret the Appellate Body Report in this manner. If the Appellate Body meant what Canada now suggests it meant, there would have been no need for it to have referred to the CIRR in order to establish that the advantage in question was "material". In this respect, we recall that, under PROEX, a borrower negotiates the best interest rate it can obtain in international financial markets, and

⁸¹ Which, in the case of direct credits/financing and refinancing, must be charged on top of the CIRR. *See the Arrangement*, Article 15.

⁸² *I.e.*, a payment is used to secure a material advantage where the payment has resulted in the availability of an export credit on terms that are materially more favourable than the terms that would otherwise have been available in the marketplace *to the purchaser with respect to the transaction in question*.

⁸³ Thus, Canada asserts that, "in the unlikely event that PROEX results in a net interest rate that is above CIRR, such a rate still secures a 'material advantage' By its design, PROEX secures a material advantage". Response of Canada to Question 7 of the Panel.

⁸⁴ *See* Oral Statement of Canada at the Meeting of the Panel, paras. 97-98 ("[I]f a net interest rate is below the relevant CIRR, the 'payment' in question must be considered to have secured a material advantage. If, however, a net interest rate is above the CIRR, a party that claims the benefit of an *a contrario* exception, if such an exception existed, would have the burden of establishing that it does not secure a material advantage as compared to the prevailing market rate ... This is because an interest rate buy-down of 2.5 percentage points may well not bring the net interest rate in a transaction below the relevant CIRR in cases *where the credit of the borrower is particularly bad*. But, it would be untenable to argue that such a massive subsidisation would not, at the same time, secure a material advantage."(emphasis added).

then benefits from a buy-down of that interest rate of 2.5 percentage points (3.8 percentage points under PROEX as it existed at the time of the original Panel Report). There was information in the record indicating that this interest rate buy-down reduced the total cost of an aircraft to a borrower by several million dollars⁸⁵, and in any event there could be little doubt that a 3.8 percentage point reduction in the interest rate on a long-term export credit would secure a "material" advantage in the field of export credit terms, *if* the point of comparison were in fact the terms otherwise available to that borrower in the commercial marketplace. Thus, the Appellate Body could have noted the failure of the Panel to consistently state that an advantage had to be "material", but concluded on the basis of the record that the amount of the PROEX payments could not but be used to secure a material advantage. The fact that the Appellate Body did not indicate to us that they considered the Panel's basic approach to be incorrect.

6.90 Brazil, by contrast, argues that "the appropriate reference for determining whether a material advantage is secured is the 'marketplace' and not a specific transaction".⁸⁶ In referring to the "marketplace", Brazil apparently means that a payment does not secure a material advantage if the net interest rate on the export credits is no lower than that which is available to purchasers of competing regional aircraft. In light of the "evidence" cited by Brazil (*See* paras. 6.94 and 6.97, *infra*) regarding interest rates in respect of regional aircraft, we conclude that Brazil would not distinguish between commercial and non-commercial benchmarks in determining what interest rates prevailed in the "marketplace". Put simply, Brazil's position seems to be that its payments do not secure a material advantage provided that the resulting net interest rate is no lower than the interest rates available in respect of export credits for competing regional aircraft, irrespective of whether those interest rates are the result of market forces or government intervention.

6.91 In our view, however, Brazil's approach is also inconsistent with the choice of CIRR as benchmark by the Appellate Body. The Appellate Body seems to have identified the CIRR as a relevant benchmark under the material advantage clause because it represents the "*minimum* commercial interest rate" faced by a potential borrower in respect of a particular currency. In this respect, we note that, under the *Arrangement*, the CIRR is established according to a number of principles, including that the CIRR should represent final commercial lending interest rates in the domestic market of the currency concerned, that it should closely correspond to the rate for first-class domestic borrowers and to a rate available to first-class foreign borrowers and that it should not distort domestic competitive conditions.⁸⁷ In other words, the CIRR is intended in principle to approximate the interest rate that first-class borrowers would pay "commercially", *i.e.*, in private transactions not benefiting from official support. The reasoning of the Appellate Body in choosing the CIRR seems to have been that a payment would be used to secure a *material* advantage, as opposed to an advantage that was not material, if it resulted in an interest rate that was below

⁸⁵ A report by Ernst and Young estimated that the net present value of the equalisation payments would total \$2,454,162 per aircraft (Exhibit 23 to First Submission of Canada in the original dispute).

⁸⁶ First Submission of Brazil, para. 4.

⁸⁷ *OECD Arrangement*, Article 15.

the lowest *commercial* interest rates available to the best borrowers in respect of a particular currency, irrespective of whether that rate would have been available to the borrower in question.

6.92 For the foregoing reasons, we consider that a Member may under the first paragraph of item (k) as interpreted by the Appellate Body establish that a payment was not used to secure a material advantage in the field of export credit terms, even if it resulted in a below-CIRR interest rate, if it could establish that the net interest rate resulting from the payment was not lower than the minimum *commercial* interest rate in respect of that currency.⁸⁸

6.93 That being the case, the next question we must address is whether Brazil has demonstrated that the benchmark it has chosen as the floor net interest rate for export credits supported by PROEX payments is in fact equal to or higher than the "minimum commercial interest rate" available in the marketplace. In considering this question, we recall that Brazil is seeking to use the first paragraph of item (k) as an affirmative defence and that it therefore bears the burden of establishing entitlement to it.⁸⁹ At the same time, and conscious that Canada might have access to relevant information not in the possession of Brazil, we have exercised our authority to seek certain information from Canada,⁹⁰ and we have taken the responses of Canada into account when examining this issue.

6.94 The first piece of evidence relied on by Brazil in support of the view that there are commercial interest rates below CIRR is documentation relating to the terms of an export financing transaction at a floating interest rate for large civil aircraft supported by export credit guarantees from the United States Export-Import Bank. Brazil compared the interest rate on this transaction (LIBOR plus 3 basis points) plus an amount to reflect a one-time guarantee fee it estimated to have been charged by the Export-Import Bank, to the "minimum" net interest rate for export credits benefiting from PROEX payments (10-year US Treasury Bonds plus 20 basis points) and concluded that the "minimum" net interest rate for PROEX-supported export credits was higher than that of the Export-Import Bank-supported transaction. Brazil further argued that this transaction appeared to involve a Chinese purchaser, and that the guarantee fee in respect of airline borrowers from developed countries such as Switzerland would be lower. In Brazil's view, this example demonstrates that the marketplace supports interest rates below the "minimum" net interest rate for

⁸⁸ We note that it would make little sense to compare the interest rate on a floating rate loan with the CIRR when determining whether an export credit or payment was "used to secure a material advantage in the field of export credit terms". We assume that in such circumstances the issue of material advantage would be assessed on the basis of the minimum commercial interest rate for comparable floating-interest rate export credits.

⁸⁹ Original Panel Report, *supra*, footnote 1, para. 7.17. Of course, we have determined that the first para. of item (k) cannot be used to establish that a measure is "permitted" (para. 6.67, *supra*). If a complainant sought to use the first para. of item (k) to establish that a measure was *prohibited*, the complainant would, as in all cases, bear the initial burden of presenting evidence and argument sufficient to establish a *prima facie* case of violation. See Appellate Body Report, *EC - Measures Concerning Meat And Meat Products (Hormones)* ("EC - Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 December 1998, DSR 1998:I, 135, para. 98.

⁹⁰ See Responses of Canada to Questions 4 and 5 of the Panel.

export credits supported by PROEX payments, and that PROEX payments therefore are not used to secure a material advantage in the field of export credit terms.

6.95 Canada challenges the relevance and comparability of the transaction referred to by Brazil. First, it argues that this transaction involves a loan guarantee, rather than direct financing. It considers that , because the first phrase of the first paragraph of item (k) refers to direct export credit financing, it would be incongruous if "the field of export credit terms" in the second clause of that paragraph included loan guarantees. In other words, Canada seems to be arguing that, in determining whether a payment is used to secure a material advantage in the field of export credit terms, export credits supported by government guarantees cannot be taken into account. We agree with Canada, but not for the reasons it has expressed in this dispute. It seems clear to us that the fact the export credit terms in question here are the result of a guarantee is of little relevance.⁹¹ On the other hand, the fact that these terms are the result of a *government* guarantee is highly relevant, if we are correct that, in order to justify a benchmark below CIRR, Brazil must demonstrate that the *commercial* marketplace supports interest rates as low as the rate for 10-year US Treasury Bonds plus 20 basis points. Clearly, Brazil has not demonstrated that the interest rate on this financing transaction, which is the direct result of a government guarantee, is a commercial or market rate of interest.

6.96 In any event, the financing transaction relied upon by Brazil is a floating-rate transaction, while the "minimum" net interest rate set by Brazil in respect of export credits supported by PROEX payments relates to transactions at fixed interest rates.⁹² In response to a question from the Panel as to how Brazil's benchmark rate would be applied in the case of floating interest rate transactions, Brazil explained that there are no records that PROEX transactions for aircraft have involved floating interest rates, nor are such transactions anticipated. Brazil further stated that it has not determined what "floor" rate it would apply if it provided PROEX payments in support of floating interest rate transactions, although it would have to be compatible with market rates.⁹³ Under these circumstances, it is hard to understand what relevance the terms of a floating interest rate transaction might have for the case at hand.

6.97 The second piece of "evidence" cited by Brazil involves a legal issue related to the application of the *Arrangement* known as "market windows". As noted earlier in this Report, the gist of the market windows argument is the view of Canada that an export credit agency, such as the Export Development Corporation, under certain circumstances is not providing "official support", and is therefore not subject to the *Arrangement*. It may therefore under certain circumstances provide export credits on terms more favourable than those envisioned by the *Arrangement* (e.g., at an interest rate below CIRR). Brazil relies on this fact as evidence that Canada may provide export credits for regional aircraft at rates which are below the CIRR, and argues that

⁹¹ For example, a parent company might guarantee an export credit of a subsidiary, thereby allowing the subsidiary to borrow at a lower interest rate.

⁹² Because a fixed interest rate locks in the lender for the duration of the export credit, lenders typically charge higher interest on a fixed interest rate loan than on a floating interest rate loan. Thus, it makes little sense to compare fixed interest rates to floating interest rates.

⁹³ Response of Brazil to question 8 of the Panel.

under these circumstances Brazil as well should be entitled to support through PROEX payments export credits at a net interest rate below CIRR.

6.98 Based on our understanding of the Appellate Body's Report, the fact that Canada considers itself entitled to provide through its Export Development Corporation export credits on terms that are more favourable than those allowed by the *Arrangement* is not in itself a reason to conclude that Brazilian payments resulting in net interest rates comparable to those offered by Canada were not used to secure a material advantage in the field of export credit terms. After all, and for the reasons set forth in para. 6.65 of this Report, any export credits provided by the EDC in respect of regional aircraft at an interest rate below CIRR are not protected by the safe harbour of the second paragraph of item (k). Accordingly - and in light of our view that Members cannot use the first paragraph of item (k) to establish that a subsidy is "permitted" - Brazil would be free to challenge any such export credits to the extent that they were subsidies within the meaning of Article 1 that are contingent upon export performance within the meaning of Article 3.1(a), just as Canada could challenge any export credits on the same basis.

6.99 We were, however, struck by Canada's assertion that export credits provided by EDC through the "market window", even at interest rates below CIRR, were nevertheless "commercial" export credits that did not confer a benefit within the meaning of Article 1. Assuming this were the case, then, applying the Appellate Body's reasoning as we understand it, the existence of these "commercial" interest rates at below CIRR would mean that Brazil could itself provide PROEX payments resulting in below-CIRR net interest rates without securing a material advantage and therefore not fall within the scope of the *per se* prohibition.⁹⁴ Accordingly, and in light of the fact that information regarding the terms of EDC export credits was in the sole control of Canada, the Panel asked Canada to indicate whether any Canadian government agency, including EDC, had provided export credits in respect of regional aircraft at an interest rate below CIRR since 1 January 1998 and, if so, to indicate the interest rates at which such export credits were provided.

6.100 Canada responded that it has since 1 January 1998 provided export credits in respect of regional aircraft at interest rates below CIRR.⁹⁵ Although it does not identify the aircraft financed, the borrowers or the precise terms and conditions of these transactions, it does provide certain information in respect of them. In particular, we know that these transactions involved direct financing (as opposed to guarantees) and that they involved fixed interest rates.

6.101 Canada informs us that one of these transactions was a Canada Account transaction which involved "matching". Although Canada asserts that this transaction

⁹⁴ Canada asserts that in *Canada - Aircraft* the Panel and Appellate Body found that, in providing direct financing under its Corporate Account, the EDC operates on the basis of commercial principles and does not provide an advantage above and beyond the market. In fact, the Appellate Body upheld a finding by the Panel that Brazil "had not established a *prima facie* case" that the debt financing activities of the EDC in support of the Canadian regional aircraft industry confer a 'benefit' within the meaning of Article 1.1(b) of the *SCM Agreement*. Appellate Body Report, *Canada - Aircraft, supra*, footnote 62, para. 220. This falls far short of an affirmative finding that the financing in question did *not* confer a benefit.

⁹⁵ Response of Canada to Question 4 of the Panel.

"was implemented in full compliance with the *Arrangement*", it does *not* assert that this transaction was in any sense a market-based transaction.

6.102 Canada further confirms that "there were instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed." Canada does not specify the number of such below-CIRR transactions, nor the share of EDC's regional aircraft transactions made at below-CIRR interest rates. It does however insist that these transactions were "market-based and commensurate with the risk associated with the particular borrower, and said transactions included customary collateral security protection". Canada explains in some detail that the situation of below-CIRR market rates can arise because the CIRR lags behind the market. Thus, in cases where interest rates are falling, the market rate at the time a transaction is closed can be lower than the CIRR, which is constructed on the basis of bond rates in an earlier period. For example, the CIRR applicable to transactions closing during the period 15 September - 15 October would be constructed using the average of the 7-year Treasury for the month of August, plus 100 basis points. Accordingly, Canada concludes, "[t]o an entity that operates on the basis of market principles, the calculation of the CIRR is such that it would not be considered a reliable reflection of current market conditions." Finally, Canada categorically asserts that, with the exception of the Canada Account transaction, the interest rate "in every case has been well above Brazil's preferred PROEX rate of 10-year Treasury plus 20 basis points."

6.103 We are not in a position to perform an independent assessment as to whether the below-CIRR export credits provided by Canada in respect of regional aircraft were or were not at commercial rates, as Canada has not provided us with any details concerning the specific terms and conditions of the transactions in question. Nevertheless, in light of Canada's clear admission not only that there can be commercial interest rates below CIRR but also that Canada itself has provided export credits in respect of regional aircraft at such below-CIRR "commercial" interest rates, we conclude that payments in respect of export credit financing for regional aircraft at below-CIRR interest rates are not necessarily used to secure a material advantage in the field of export credit terms as that term has been interpreted by the Appellate Body.

6.104 That said, the ultimate question in this dispute is not whether *any* below-CIRR commercial interest rates in respect of regional aircraft financing may be said to involve a material advantage, but whether Brazil has demonstrated that PROEX payments aimed at achieving the benchmark rate set by Brazil - a net interest rate on fixed interest rate export credits based on the 10-year US Treasury Bond plus 20 basis points - are not used to secure a material advantage in the field of export credit terms. We recall that the benchmark established by Brazil in respect of export credits supported by PROEX payments is below the relevant CIRR, and we note in addition that Brazil has presented *no* evidence that export credits at fixed interest rates in respect of regional aircraft⁹⁶ are being provided in the *commercial* market to any borrower at the benchmark rate of 10 year US Treasury bonds plus 20 basis points es-

⁹⁶ Or, for that matter, any aircraft. As noted in paras. 6.92 - 6.95 of this Report, the only evidence presented by Brazil relevant to the interest rates in respect of export credits for aircraft involved non-commercial, floating interest rates.

tablished by Brazil. We recall that, because Brazil is seeking to assert an "affirmative" defence, and that it bears the burden of demonstrating entitlement to that defence. We further note that, in respect of access to information regarding commercial interest rates - and with the exception of information regarding export credits provided by EDC at rates alleged by Canada to be "commercial" - such information is equally accessible to Brazil and Canada.

6.105 In respect of that information which is in the exclusive possession of Canada, Canada has categorically stated that, with the exception of one Canada Account transaction which clearly is *not* commercial, all fixed interest rate export credit financing provided by Canadian government agencies, including EDC export credits at rates below CIRR, has been at rates "well above" the Brazilian benchmark. We cannot assume bad faith on the part of Canada and therefore must accept the veracity of these statements.⁹⁷

6.106 For the foregoing reasons, we find that Brazil has failed to demonstrate that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

(c) Conclusions and Closing Remarks

In this section of our Panel Report, we have found that:

- (i) PROEX payments in respect of regional aircraft pursuant to the PROEX scheme as modified are subsidies contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*;
- (ii) Brazil has failed to demonstrate, both as a matter of law and as a matter of fact, that PROEX subsidies are "permitted" by the first paragraph of item (k). In this respect, we recall our finding that the first paragraph of item (k) cannot be used to demonstrate that a subsidy contingent upon export performance within the meaning of Article 3.1(a) is "permitted". We further recall our findings that Brazil has failed to establish (a) that PROEX payments are "payments" within the meaning of the first paragraph of item (k); and (b) that PROEX payments are not "used to secure a material advantage in the field of export credit terms".

Therefore, we conclude that PROEX payments in respect of regional aircraft under the PROEX scheme as modified by Brazil are export subsidies prohibited by Article 3 of the *SCM Agreement*. Accordingly, we conclude that in this respect Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

6.107 We note that Brazil's effort to defend PROEX payments as "permitted" under the first paragraph of item (k) of the Illustrative List centred on the notion that a developing country Member had to be "permitted" by that paragraph to provide otherwise prohibited export subsidies in order to meet WTO-consistent competition from developed country Members in the field of export credit terms. In our view, however,

⁹⁷ Cf. Appellate Body Report, *Chile - Taxes on Alcoholic Beverages* ("Chile - Alcoholic Beverages"), WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281, para. 74.

the *SCM Agreement* as properly interpreted establishes a level playing field for all Members in respect of export credit practices (except, of course, to the extent that a Member is exempted from the export subsidy prohibition by reason of special and differential treatment). Under these circumstances, if a developing country Member (or indeed any Member) encounters an export credit that has been provided on terms that it cannot meet consistent with the *SCM Agreement*, the proper response is to challenge that export credit in WTO dispute settlement.⁹⁸

VII. CONCLUSION

7.1 For the reasons set forth in this Report, we conclude that Brazil's measures to comply with the Panel's recommendation either do not exist or are not consistent with the *SCM Agreement*. Accordingly, we conclude that Brazil has failed to implement the DSB's 20 August 1999 recommendation that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

7.2 Canada requests that we suggest, pursuant to Article 19.1 of the *DSU*, that the parties develop mechanisms that would allow Canada to verify compliance with the original recommendation of the DSB. Canada notes that Brazil has a reciprocal interest in verifying Canada's compliance in a parallel dispute, *Canada - Aircraft*.⁹⁹ Canada emphasises that it is *not* seeking a continuing role for the Panel in proposing such verification procedures, nor is it requesting that we impose such procedures. Brazil responds that, although it does not in principle oppose an agreement with Canada on reciprocal transparency, it does not consider that it is an appropriate matter for a suggestion under Article 19.1 of the *DSU*, but is better left to be agreed by the parties. Brazil notes that any such agreement would have to involve balanced and truly reciprocal offers of transparency.

7.3 We note that Article 19.1 provides that "the panel ... may suggest ways in which the Member concerned could implement the recommendation". In our view, Article 19.1 appears to envision suggestions regarding what could be done to a measure to bring it into conformity or, in case of a recommendation under Article 4.7 of the *SCM Agreement*, what could be done to "withdraw" the prohibited subsidy. It is not clear if Article 19.1 also addresses issues of surveillance of those steps. That

⁹⁸ In this regard, we recall the statement of the Appellate Body in *Canada - Aircraft* that:
"we do not intend to suggest that Brazil is precluded from pursuing another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the *DSU*, concerning the consistency of certain of the EDC's financing measures with the provisions of the *SCM Agreement*."

⁹⁹ First Submission of Canada, para. 45.

said, any agreement that WTO Members might reach among themselves to improve transparency regarding the implementation of WTO obligations can only be encouraged.

ANNEX 1-1

FIRST SUBMISSION OF CANADA
(23 December 1999)

TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	4138
II. MEASURES TAKEN BY BRAZIL TO COMPLY WITH THE PANEL AND APPELLATE BODY REPORTS.....	4140
A. Factual Findings of the Panel and the Appellate Body in Respect of the Operation of the PROEX Export Subsidy Programme	4140
B. Substantive Findings of the Panel and the Appellate Body in Respect of Brazil's Obligations	4141
C. Measures Taken by Brazil	4143
1. Export subsidies on regional aircraft exported after 18 November 1999 pursuant to commitments made before that date	4143
2. Revisions to PROEX in respect of new commitments	4145
(a) The Resolution.....	4145
(b) The Newsletter.....	4145
D. Brazil's Measures do not Change Other Elements of PROEX	4146
III. APPLICABLE LAW.....	4146
A. Jurisdiction of the Panel under Article 21.5	4146
B. The Requirement to Withdraw Prohibited Subsidies under Article 4.7.....	4146
IV. BRAZIL HAS NOT WITHDRAWN THE PROEX EXPORT SUBSIDY.....	4148
A. Commitments Made before 18 November 1999	4148
B. Measures Taken to Comply in Respect of Future Commitments	4148
V. TRANSPARENCY	4150
VI. RELIEF REQUESTED	4151
LIST OF ANNEXES.....	4152

I. INTRODUCTION

1. In this proceeding under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU), Canada contends that the measures taken by Brazil in respect of the *Programa de Financiamento às Exporta-*

ções (PROEX) and export subsidies on sales of Brazilian regional aircraft, neither withdraw the export subsidies nor otherwise comply with the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement) and the findings and the recommendations of the Panel, as modified by the Appellate Body, in *Brazil - Export Financing Programme for Aircraft (PROEX)*.¹

2. The Panel found that interest equalization payments made under PROEX for the benefit of purchasers of exported Brazilian regional aircraft were subsidies contingent upon export performance. The Panel further found that these subsidies were not covered by any exceptions or affirmative defences under the SCM Agreement and were therefore prohibited in accordance with Article 3 of that Agreement. The Panel recommended that Brazil withdraw these prohibited export subsidies within ninety days of the adoption of its report by the DSB, that is, by 18 November 1999. Brazil has not done so.

3. Brazil has failed to meet its obligation to modify the PROEX export subsidy programme in two senses, each of which constitutes a failure to withdraw its export subsidies under Article 4,² and thereby to bring its measures into conformity with the SCM Agreement. First, in respect of regional aircraft that have been or will be delivered after 18 November 1999 Brazil has not ceased granting export subsidies pursuant to conditional commitments made before that date. Contrary to Article 4.7 and Article 3.2, Brazil is thus continuing to grant export subsidies by issuing NTN-I bonds to buy down purchasers' financing costs under conditions that the DSB found to constitute illegal export subsidies.

4. Second, Brazil has not modified the PROEX export subsidy programme for new financing commitments by the Government of Brazil respecting future sales or leases of regional aircraft in a way that withdraws the illegal export subsidies or otherwise brings the programme into conformity with the SCM Agreement. Brazil has announced certain measures that it claims would bring the PROEX export subsidy programme into compliance with the recommendations and rulings of the DSB and with its obligations under the SCM Agreement. Those measures call for PROEX interest rate buy-down subsidies to aim to achieve an effective interest rate for a transaction equivalent to US 10-year Treasury Bonds plus 20 basis points. Canada submits that such payments would continue to be subsidies contingent upon export performance that do not benefit from any exceptions or affirmative defences under the SCM Agreement.

5. Accordingly, Canada requests that the Panel find that:
in respect of PROEX export subsidies committed on exports of regional aircraft but not yet granted as of 18 November 1999: Brazil continues to pay subsidies found to have been illegal and is therefore not in compliance with the recommendations and rulings of the DSB and Articles 4.7 and 3.2 of the SCM Agreement; and

¹ Report of the Panel, *Brazil - Export Financing Programme for Aircraft ("Brazil - Aircraft")*, WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1121 and Report of the Appellate Body, *Brazil - Export Financing Programme for Aircraft ("Brazil - Aircraft")*, WT/DS46/AB/R, DSR 1999:III, 1161.

² Unless otherwise indicated, all references to Article numbers are references to Articles of the SCM Agreement.

in respect of post-November 18 conditional commitments to pay PROEX subsidies on the export of Brazilian regional aircraft: Brazil has failed to implement measures that would bring the PROEX export subsidy programme into compliance with the recommendations and rulings of the DSB and Articles 4.7 and 3.2 of the SCM Agreement.

II. MEASURES TAKEN BY BRAZIL TO COMPLY WITH THE PANEL AND APPELLATE BODY REPORTS

A. Factual Findings of the Panel and the Appellate Body in Respect of the Operation of the PROEX Export Subsidy Programme

6. At paragraphs 2.2 to 2.6 of its Report, the Panel made the following findings of fact in respect of the operation of the PROEX export subsidy programme that are relevant to an assessment of Brazil's implementation measures (footnotes omitted from quotations):

"2.2 ...With interest equalization, underlying legal instruments provide that the 'National Treasury grant[s] to the financing party an equalization payment to cover, at most, the difference between the interest charges contracted with the buyer and the cost to the financing party of raising the required funds."

"2.3 The financing terms for which interest rate equalization payments are made are set by Ministerial Decrees. The terms, determined by the product to be exported, vary normally from one year to ten years. In the case of regional aircraft, however, this term has been extended to 15 years. The length of the financing term, in turn, determines the spread to be equalized: the payment ranges from 2 percentage points per annum, up to 3.8 percentage points per annum for a term of nine years or more. The spread is fixed and does not vary depending on the lender's actual cost of funds.

"2.4 PROEX is administered by the Comitê de Crédito as Exportações ("Committee"), a 13-agency group, with the Ministry of Finance serving as its executive. Day-to-day operations of PROEX are conducted by the Banco do Brasil. For applications for financing transactions not exceeding US\$5 million, whose terms otherwise fall within PROEX guidelines, Banco do Brasil has pre-approved authority to provide PROEX support without requesting the approval of the Committee. All other applications are referred to the Committee, which has the authority to waive some of the published PROEX guidelines. In the case of regional jet aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.

"2.5 PROEX involvement in aircraft financing transactions begins when the manufacturer requests a letter of approval from the Committee prior to conclusion of a formal agreement with the buyer. This request sets forth the terms and conditions of the proposed transaction. If the Committee approves, it issues a letter of commitment to the manufacturer. This letter commits PROEX to providing support as

specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into within a specified period of time, usually 90 days. If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.

"2.6 PROEX interest equalization payments, pursuant to the commitment, begin after the aircraft is exported and paid for by the purchaser. PROEX payments are made to the lending financial institution in the form of non-interest bearing National Treasury Bonds (Notas do Tesouro Nacional - Série I) referred to as NTN-I bonds. These are denominated in Brazilian Reais indexed to the United States dollar. The bonds are issued by the Brazilian National Treasury to its agent bank, Banco do Brasil, which then passes them on to the lending banks financing the transaction. The bonds are issued in the name of the lending bank which can decide to redeem them on a semi-annual basis for the duration of the financing or discount them for a lump sum in the market. PROEX resembles a series of zero coupon bonds which mature at six months intervals over the course of the financing period. The bonds can only be redeemed in Brazil and only in Brazilian currency at the exchange rate prevailing at the time of payment. If the lending bank is outside of Brazil, it may appoint a Brazilian bank as its agent to receive the semi-annual payments on its behalf."

7. The Appellate Body made the following relevant finding of fact:

"4. For sales of regional aircraft, PROEX interest rate equalization subsidies amount to 3.8 percentage points of the actual interest rate on any particular transaction. The lending bank charges its normal interest rate for the transaction, and receives a payment from two sources: the purchaser, and the Government of Brazil. Of the total interest payments, the Government of Brazil pays 3.8 percentage points, and the purchaser pays the rest. In this way, PROEX reduces the financing costs of the purchaser and, thus, reduces the overall cost to the purchaser of purchasing an Embraer aircraft.³

B. Substantive Findings of the Panel and the Appellate Body in Respect of Brazil's Obligations

8. Canada's challenge to the PROEX export subsidy programme was concerned with both the application in practice of the programme to specific exports of regional aircraft and, more broadly, the nature and operation of the interest equalization scheme.⁴

³ Report of the Appellate Body, *op. cit.*, at para. 4.

⁴ At para. 7.2 of its Report, *op. cit.*, the Panel observed:

"We do not understand Canada to be alleging that the interest rate equalization component of the PROEX programme *per se* is the prohibited measure, because Canada does not seek a finding or recommendation with respect to the programme itself. In fact, it limits itself to challenging PROEX payments relating to the particular sector of regional aircraft. On the other hand, neither is Canada

9. The Panel found that "PROEX payments on exports of Brazilian regional aircraft are subsidies within the meaning of Article 1 of the SCM Agreement and are contingent upon exportation within the meaning of Article 3.1(a) of that Agreement."⁵

10. According to the Panel, this followed from the very design of PROEX and the manner in which PROEX export subsidy scheme operated:

"As characterized by Brazil, the purpose of the payments is to improve the terms of export credit financing that would otherwise be available to purchasers of Brazilian regional aircraft and other Brazilian products by offsetting "Brazil risk". Thus, under the PROEX interest rate equalization scheme, Embraer and its export customers are free to negotiate the best credit terms they may obtain in the market, irrespective of whether the lender is a Brazilian or a foreign financial institution The [PROEX] payments may be used to improve the export credit terms in one of several ways. For example, the availability of the payments may be used to negotiate lower interest rates for the export credits in question than would otherwise be available for the transaction. In the alternative, the lending bank may agree to discount the bonds and to pass the sum along to the purchaser/borrower as a cash discount. In any event, we consider that, as a matter of logic, the payments will as a natural consequence allow Embraer and the purchaser to negotiate more favourable export credit terms than they could otherwise achieve in the marketplace."⁶

11. The Panel noted Brazil's admission that purchasers of its regional aircraft would not be interested in PROEX payments if the payments did not offer them an advantage relative to what they could obtain in the market:

"PROEX presumably would always be more favourable to the purchaser than the terms it could obtain on its own; otherwise, the purchaser would have no interest in PROEX. If the PROEX-supported export credit term is compared merely to the credit terms a particular buyer could obtain on its own, PROEX could never provide assistance and always would be at a disadvantage vis-à-vis competitors sup-

restricting its challenge to a particular specified payment or payments already made pursuant to the interest rate equalization component of PROEX. To the contrary, although Canada identifies specific transactions with respect to which it considers that PROEX payments have been or will be made, Canada is arguing that all PROEX payments, to the extent they relate to exported Brazilian regional aircraft, *including payments to be made in the future pursuant to the PROEX interest rate equalization scheme*, are prohibited subsidies. Thus, we understand Canada to be challenging not only specific payments, *but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft (which we will hereafter refer to as 'PROEX payments')*. In order to analyse this contention, we are required to go beyond an examination of individual PROEX payments that have been identified and look more generally at the nature and operation of the PROEX interest rate equalization scheme which governs the payment of the alleged export subsidies." (footnotes omitted; underline added).

⁵ Ibid., at paras. 7.13 and 7.14.

⁶ Ibid.

ported by an export credit agency, whether that agency's programmes were or were not consistent with WTO obligations.⁷

12. Accordingly, the Panel found that Brazil had failed to demonstrate that the PROEX payments did not secure a "material advantage" in the field of export credit terms within the meaning of Item (k) of the Illustrative List of Export Subsidies (Annex I to the SCM Agreement). The Appellate Body considered the relevant Commercial Interest Reference Rate (CIRR) an appropriate point of comparison in determining whether a material advantage was secured and to that extent modified the Panel's findings. The Appellate Body nevertheless upheld the findings of the Panel, because Brazil had failed also to demonstrate a relationship between actual interest rates in financing transactions involving exported Brazilian regional aircraft that benefited from PROEX subsidies and the relevant CIRR.

13. The Panel and the Appellate Body then made a number of additional findings with respect to Brazil's rights and obligations under Article 27 of the SCM Agreement. In particular, they found that:

- (a) PROEX export subsidies are granted, for the purposes of Article 27.4, at the time when NTN-I bonds are issued upon the exportation of regional aircraft⁸;
- (b) Brazil had increased its level of export subsidies⁹; and
- (c) Brazil had failed to phase-out its export subsidies, as conditional commitments it had made lasted well past the end of the transitional period provided for in Article 27.¹⁰

14. Having found that Brazil had failed to meet the conditions of Article 27, the Panel further found that "payments on exports of regional aircraft under the PROEX interest rate equalization scheme are export subsidies inconsistent with Article 3 of the SCM Agreement".¹¹

15. The Panel recommended that Brazil withdraw its subsidies within 90 days of the adoption of the reports by the DSB.¹² The Appellate Body confirmed the Panel's recommendation.¹³ The DSB adopted the reports of the Panel and the Appellate Body on 20 August 1999.

C. *Measures Taken by Brazil*

1. *Export Subsidies on Regional Aircraft Exported after 18 November 1999 Pursuant to Commitments Made Before that Date*

16. With respect to the export of regional aircraft after 18 November 1999 under commitments made before that date, Brazil has taken no action to terminate the PROEX export subsidies found to be inconsistent with Brazil's obligations under Article 3 of the SCM Agreement. Not only has Brazil presented no evidence of any

⁷ Ibid., at para. 7.35.

⁸ Ibid., at para. 7.72; Report of the Appellate Body, *op. cit.*, at para. 159.

⁹ Report of the Panel, *Ibid.*, at para. 7.76; Report of the Appellate Body, *Ibid.*, at para. 164.

¹⁰ Report of the Panel, *Ibid.*, at para. 7.84.

¹¹ *Ibid.*, at para. 8.2.

¹² *Ibid.*, at para. 8.4.

¹³ Report of the Appellate Body, *op. cit.*, at para. 194.

cessation of such illegal export subsidies, but the Brazilian Government also orally informed Canada that it did not have any intention of withdrawing PROEX export subsidies with respect to such exports. Indeed, ten days after the end of the implementation period, Mr. Valdemar Carneiro Leao, Director-General of the Economic Department of Brazil's Ministry of Foreign Affairs, noted that to resolve this dispute the parties should let "bygones be bygones" and affirmed that:

"From the very beginning of the dispute Brazil has consistently declared it will honour its commitments. A commitment is a commitment and it would make no sense for the country or for the company not to meet them. It would mean a breach of contract, which can incur hefty penalties."¹⁴

17. Apparently to allay fears by Embraer's customers that they might no longer benefit from export subsidies found to have been prohibited by this Panel, Mauricio Botelho, the President of Embraer, has consistently and publicly stated that such subsidies will continue to be paid on aircraft to be delivered after 18 November 1999.¹⁵ Publicly available information such as the US Security and Exchange Commission filings by purchasers of Embraer aircraft does not even suggest that any changes to prior PROEX commitments have occurred. One such company, Skywest, in materials filed on 3 November 1999, simply noted that it had no reason to believe subsidies it receives from Brazil would be discontinued.¹⁶ Had changes, such as those required by the recommendations of the DSB occurred, they should have been notified as material changes of circumstances under the rules of the SEC.¹⁷ Brazil thus continues to grant PROEX prohibited export subsidies, contrary to its obligation to withdraw such subsidies in respect of commitments made before 18 November 1999.

¹⁴ Mara Lemos, "Brazil, Canada Trapped in Past Aircraft Row", Dow Jones International News, 11/29/99. Documentary Annex 1.

¹⁵ *Folha de Sao Paulo*, 25 November 1999 (3 December 1999). Documentary Annex 2. This public affirmation has, at no point, been contradicted by officials of the Government of Brazil.

¹⁶ See, e.g., Form 10-Q filing of Skywest Airlines before the US Securities and Exchange Commission for the quarter ending on September 30, 1999, online: Securities and Exchange Commission (SEC), <http://www.sec.gov/Archives/edgar/data/793733/0000950149-99-001424.txt> (date accessed 19 December 1999). The Skywest 10-Q filing states that:

"While the Company has no reason to believe, based on information currently available, that the Company will not continue to receive these subsidy payments from the Federative Republic of Brazil in the future, there can be no assurance that such a default will not occur."

This statement was made after the date of the adoption by the DSB of the rulings in this case. Documentary Annex 3.

¹⁷ SEC rules (Rule 12b-20) require that 10-Q filings describe any "further material information" needed to ensure that the information that is specifically required by the SEC to be included in the 10-Q is not misleading. Skywest has viewed the Brazilian subsidies as "material" and included these in its 10-Q filings; a development that increased the risk that Skywest would not continue to receive those subsidies would also be considered as "material."

2. *Revisions to PROEX in Respect of New Commitments*

18. The PROEX programme continues to exist by virtue of provisional measures issued on a monthly basis by the Government of Brazil.¹⁸ Brazil has notified the DSB that it has adopted the following measures to comply with the recommendations and rulings of the DSB:

- (a) Resolution No. 2.667 (19 December 1999) of the National Monetary Board (Resolution) (amending Resolution No. 2.576 of 17 December 1998).¹⁹ The Resolution establishes requirements for interest rate equalization transactions under PROEX; and
- (b) Newsletter No. 2.881 (Newsletter), in which the Central Bank of Brazil indicated the maximum percentages that may be applied under the PROEX interest rate equalization scheme.²⁰

(a) The Resolution

19. The Resolution amended Articles 1, 8 and 9 of Resolution 2.576. The key changes are found in the amendments to Article 1 of Resolution 2.576. Translated, the amendments read as follows:

"Article 1: In export financing operations covering goods and services including computer software programmes as set out in Law No. 9.609 of 19 February 1998, the National Treasury may grant to the financing or refinancing agency, as the case may be, sufficient equalization credits to ensure that the relevant financial charges are consistent with standard practices on the international market.

"Paragraph 1: In the financing of aircraft exports for regional aviation markets, equalization rates shall be established on a *case by case* basis and at levels which may be differential, *preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2 per cent per annum*, to be reviewed periodically in accordance with market practices.

"Paragraph 2: The equalization rate shall be limited to the percentages established by the Banco Central do Brasil, and shall remain fixed throughout the period in question." (emphasis added)

(b) The Newsletter

20. The Newsletter sets out new maximum interest rate reductions for the PROEX export subsidy payments. The maximum reduction available is 2.5 percentage points for financing equalization periods of over 9 years and up to 10 years. The Newsletter does not specify a maximum interest rate reduction percentage for financing terms in excess of ten years.

¹⁸ The PROEX programme is currently being maintained by Provisional Measure No. 1892-33 of 23 November 1999. Documentary Annex 4.

¹⁹ Documentary Annex 5.

²⁰ Documentary Annex 6.

D. Brazil's Measures do not Change Other Elements of PROEX

21. The Resolution and the Newsletter apply only to future commitments. They do not apply to or in any way modify PROEX export subsidies in respect of regional aircraft that have been or will be exported after 18 November 1999 pursuant to commitments made before that date. For commitments made after 18 November 1999, except for a reduction of the interest rate buy-down subsidy from 3.8 to 2.5 percentage points (for certain transactions), and the concept that the payments would "preferably" result in a net interest rate 20 basis points above the noted US Treasury Bond rate, the basic elements of the PROEX programme found by the Panel remain the same:

- (a) PROEX interest equalization payments are grants from the Brazilian National Treasury to buy down commercial interest rates freely negotiated by the borrower, as found by the Panel and the Appellate Body;
- (b) the programme is still administered by the Committee and the Committee retains the authority to waive the published PROEX guidelines including the term of the payments; and
- (c) the interest rate equalization payments made under the programme are still being provided at the time of export of the aircraft in the form of non-interest-bearing bonds.

22. The PROEX programme, as modified, continues to be an export subsidy scheme prohibited under Article 3 of the SCM Agreement.

III. APPLICABLE LAW

A. Jurisdiction of the Panel under Article 21.5

23. Under Article 21.5 of the DSU²¹ the Panel must determine whether a measure taken to comply with the recommendations and rulings of the DSB is consistent with a covered agreement.

24. In the context of this dispute, the Panel must determine whether Brazil's implementation measures are consistent with its obligations under Article 4.7 of the SCM Agreement to withdraw the prohibited export subsidies and under Article 3.2 of the Agreement to neither grant nor maintain such subsidies. As demonstrated below, Brazil's implementing measures do not comply with these obligations.

B. The Requirement to Withdraw Prohibited Subsidies under Article 4.7

25. Article 4.7 provides that:

"4.7 If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the

²¹ Article 21.5 states, in relevant part:

"Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement proceedings, including, wherever possible, resort to the original panel...".

subsidy without delay. In this regard, the panel shall specify in its recommendation the time period within which the measure must be withdrawn.²²

26. The Concise Oxford Dictionary defines "withdraw" to mean "discontinue, cancel, retract (*withdrew my support; the promise was later withdrawn*)."²³ Thus the plain meaning of withdraw conveys as a minimum the notion of cessation (discontinuance) of the illegal subsidy.

27. This plain meaning of withdraw should be interpreted in the light of the context and object and purpose of the relevant provisions of the WTO Agreements. Article 19.1 of the DSU provides that "[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." Withdrawal of the illegal subsidies, under Article 4.7 implies certainly no lesser obligation than to "bring into conformity" under Article 19.1 of the DSU.

28. A related contextual point is Article 3.2, which provides that: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1." Withdrawal of a subsidy must therefore entail, at a minimum, ceasing to grant or maintain subsidies found to have been prohibited in accordance with the Article 3.1.

29. Accordingly, in the case at hand, Brazil's withdrawal of prohibited PROEX export subsidies must include, at a minimum, two actions:

first, it must cease to grant subsidies found to have been prohibited, in respect of commitments made before the date of compliance for regional aircraft exported after that date; and

second, Brazil must make the necessary modifications to the programme to eliminate export subsidies in respect of *future* commitments.

30. The obligation to withdraw without delay illegal export subsidies would be largely nullified if the rule did not apply to all exports after the date for compliance, including aircraft that had been contracted for under pre-existing government commitments. Such an outcome would result in possible prohibited export subsidies being granted in respect of some 700 Embraer regional aircraft²⁴ (undelivered firm orders and options) covered by commitments made by the Brazilian government prior to 18 November 1999.

31. The two actions referred to in paragraph 29 above constitute the only means by which Brazil could be found to have discontinued the granting of PROEX prohibited export subsidies and, accordingly, found to have withdrawn such subsidies in accordance with its obligation to implement the recommendations and rulings of the DSB.

²² Article 4.7 is a special or additional rule and procedure under Appendix 2 of the DSU.

²³ *The Concise Oxford Dictionary*, Ninth Edition, Della Thompson, ed. (Oxford: Clarendon Press, 1995), at 1609.

²⁴ Mara Lemos, "Brazil, Canada Trapped in Past Aircraft row", *op. cit.*

IV. BRAZIL HAS NOT WITHDRAWN THE PROEX EXPORT SUBSIDY

32. In claiming to have implemented the DSB recommendations in this dispute, Brazil has cited as evidence three documents.²⁵

- (a) Provisional Measure 1892-32 of 22 October 1999;
- (b) Resolution 2.667 of 19 December 1999, which amends Resolution 2.576 of December 1998; and
- (c) Newsletter 2.881 of 19 November 1999 (the Newsletter).

The Provisional Measure of 22 October 1999 is the continuation of the chain of such measures that have maintained PROEX since July 1998. These measures do not bring the PROEX export subsidy programme into conformity with the SCM Agreement.

A. *Commitments Made before 18 November 1999*

33. None of these documents appears on its face to apply to exports of undelivered regional aircraft pursuant to commitments made prior to 18 November 1999. Brazil has not claimed that it will not continue to grant the subsidies that were found illegal by issuing NTN-I bonds. Indeed, as stated above, Brazil has informed Canada that it has no intention of withdrawing PROEX export subsidies committed but not yet granted. It has not, therefore, withdrawn such subsidies found by the Panel to be prohibited under Article 3.1 of the SCM Agreement.

B. *Measures Taken to Comply in Respect of Future Commitments*

34. With respect to future commitments of the Government of Brazil, the Resolution and the Newsletter make two apparent modifications to the measures previously in effect. First, the Newsletter establishes a 2.5 percentage point interest rate buy-down for ten-year financing as opposed to an interest rate buy-down of 3.8 percentage points for financing periods that, in practice, were as long as fifteen years under the previous programme. Almost all regional aircraft financing is for terms of fifteen years or more. Accordingly the limit of 2.5 percentage points for ten-year terms does not appear, in practice, to be relevant for transactions involving regional aircraft. As under the previous programme, the Brazilian implementation measures enable the Committee to waive any of the conditions of the programme with respect to both the interest rate and the financing term. The sole effect of the Newsletter is to replace the former applied ceiling of 3.8 percentage point interest reduction subsidy with an apparent ceiling of 2.5 percentage points.²⁶ The Newsletter does nothing else.

²⁵ Letter to the Chairman of the Dispute Settlement Body announcing Brazil's implementation. Sent by the Permanent Representation of Brazil to the United Nation, dated 19 November 1999. Documentary Annex 7.

²⁶ In its question 13 to the Parties the Panel asked: "Please explain the basis on which Brazil decided that the level of interest rate equalization pursuant to PROEX should be 3.8 percentage points." In its Reply, dated 4 December 1998, Brazil noted that the level had been established in 1995 "in response to representations of financial institutions concerning the level of Brazil risk." It noted that although a number of meetings had been held to determine whether the subsidy should be reduced, following the world financing crisis of 1997, "there was no need to alter the level of

35. Second, Resolution 2.667 modifies Resolution 2.576 to provide that, for exports of regional aircraft, "equalization rates shall be established on a case by case basis and at levels which may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2 per cent per annum." The Resolution calls for equalization rates to be set at a level aimed at achieving (but apparently not required to achieve) a net interest rate of 0.2 per cent (20 basis points) over the US Treasury Bond rate. This preferred rate is consistent neither with CIRR nor with the market.

36. The Provisional Measure and the new Resolution also refer to rates "compatible with ... the international market " or "in accordance with market practices". These references do not represent a change . Essentially the same concepts have been part of the governing rules and regulations of the previous PROEX programme.²⁷ Even the possibility that different subsidies will be granted for different transactions does not represent a change given that the Committee maintains its discretionary authority to waive the published conditions.

37. Thus, Brazil's modifications to the PROEX programme with respect to future commitments and aircraft deliveries that would benefit from subsidies granted under those commitments do not bring the programme into compliance with the SCM Agreement. Payments by the Brazilian National Treasury for the purpose of reducing the interest paid by a purchaser by 2.5 percentage points are financial contributions that confer a benefit and are, accordingly, subsidies within the meaning of Article 1 of the SCM Agreement.²⁸ As they are paid only upon the exportation of regional

PROEX assistance from its current level of 3.8 percentage points." Brazil clearly identified the 3.8 percentage point buy-down as the level of assistance applicable to regional aircraft.

The Panel found in para. 2.3 of its Report: "The spread is fixed and does not vary depending on the lender's actual cost of funds."

²⁷ The Panel examined Provisional Measure 1700/15 of 30 June 1998 (Report of the Panel, *op. cit.*, at para. 2.1 and footnote 6). It states at Article 1 that:

"In financing operations using funds from the Special Public Credit Operations programme for the export of domestic goods and services, the National Treasury may establish financing charges that are the *consistent with practices on the international market*. ..."

It further states, at Article 2, that:

"In operations to finance the export of domestic goods and services not covered by the preceding article and in financing for the production of goods for export, the National Treasury may grant the financing entity *equalization funding sufficient to make the financing charges consistent with practices on the international market*." (emphasis added)

²⁸ A grant by the National Treasury, by definition, is a financial contribution that, also by definition, is not available in the marketplace and therefore confers a benefit. See in particular Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 157:

"We also believe that the word 'benefit', as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no benefit to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred' , because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a ' financial contribution' on terms more favourable than those available to the recipient in the market."

aircraft, these subsidies are contingent upon export performance and therefore continue to be prohibited under Article 3.1 of the SCM Agreement.

38. PROEX payments under the revised PROEX programme continue to be prohibited under Article 3.1 of the SCM Agreement and must be withdrawn in accordance with the recommendations of the DSB. Any granting of such subsidies by Brazil is a violation of Article 3.2 of the SCM Agreement and, therefore, would be inconsistent with Brazil's obligation under Article 4.7 of the Agreement.

V. TRANSPARENCY

39. To facilitate a definitive resolution of this dispute, Canada proposes the establishment of transparency provisions in respect of measures taken by Brazil to immediately bring its subsidies into compliance with the SCM Agreement in accordance with the original recommendations and rulings of the DSB. In this respect, Canada recalls Articles 3.3, 3.4 and 19 of the DSU.

40. According to Article 3:

"3. The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.

"4. Recommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations under this Understanding and under the covered agreement."

41. Article 19.1 further provides that the Panel may suggest ways in which the Member concerned could implement the Panel's recommendations to bring its measures into conformity with the covered agreements.

42. In its submissions before the Panel in this case, Brazil claimed that the application of PROEX in the regional aerospace sector was designed to and did offset the alleged higher cost of financing Brazilian aircraft exports by bringing these costs into line with financing costs for regional aircraft in international financial markets. The Panel did not find this claim persuasive.

43. Resolution No. 2.667 of 19 December 1999, which Brazil claims to effect compliance with the Panel's recommendation to withdraw the subsidy, states that the National Treasury "may grant ...sufficient equalization credits to ensure that the relevant financial charges are consistent with standard practices on the international market." The same resolution then directs, however, that in the regional aerospace sector such "equalization rates" shall preferably be based on a rate - 10-year US Treasury Bonds plus 20 basis points - that is demonstrably not consistent with international market rates.

Since grants are not available in the marketplace, by definition they confer a benefit and constitute a subsidy when made by governments.

44. In the light of Brazil's previous and current characterization of PROEX's purpose and effect, a finding by this panel that Brazil is not in compliance and that it must withdraw its prohibited export subsidies immediately will be meaningful only if procedures are established that enable the verification of Brazil's withdrawal of the prohibited subsidies.

45. Canada also notes that Brazil has a reciprocal interest in verifying Canada's compliance in the parallel dispute, *Canada - Measures Affecting the Export of Civilian Aircraft*. For this reason, in consultations with Brazil on 16 and 19 November concerning implementation of the Panels' recommendations and rulings in the two cases, Canada proposed that the Parties establish transparency procedures that would enable each government to verify the compliance of the other with respect to specific transactions under the pertinent measures as revised in order to bring that Party into consistency with the SCM Agreement.

46. Canada remains ready to develop and implement such verification procedures on a reciprocal basis. Canada believes that it would be useful if the Panel were to suggest that the Parties develop such procedures, consistent with its authority under Article 19.1 of the DSU.

VI. RELIEF REQUESTED

47. In the light of the above considerations, Canada requests that the Panel find that Brazil has failed to withdraw its export subsidies with effect from 18 November 1999, with respect to all regional aircraft exported after that date whether PROEX interest equalization subsidies were committed on, after or before that date.

48. Canada further notes that a process for verification of compliance will be useful in order to avoid recurrent recourse to the DSU, including under Article 21.5. Accordingly Canada requests that the Panel suggest, in accordance with Article 19.1, that the Parties develop verification procedures so as to permit verification that future Brazilian financing of exported regional aircraft conforms with the SCM Agreement without the need for further recourse to the DSU.

LIST OF ANNEXES

- Documentary Annex 1 Mara Lemos, "Brazil, Canada Trapped in Past Aircraft Row", Dow Jones International News, 11/29/99.
- Documentary Annex 2 *Folha de Sao Paulo*, 25 November 1999 (3 December 1999).
- Documentary Annex 3 Form 10-Q filing of Skywest Airlines before the US Securities and Exchange Commission for the quarter ending on 30 September 1999.
- Documentary Annex 4 Provisional Measure No. 1892-33 of 23 November 1999.
- Documentary Annex 5 Resolution No. 2.667 (19 December 1999)
- Documentary Annex 6 Newsletter No. 2.881 (Newsletter)
- Documentary Annex 7 Letter to the Chairman of the Dispute Settlement Body announcing Brazil's implementation. Sent by the Permanent Representation of Brazil to the United Nation, dated 19 November 1999.

ANNEX 1-2

REBUTTAL SUBMISSION OF CANADA
(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4154
II. BRAZIL MISSTATES THE FINDINGS OF THE APPELLATE BODY	4155
III. BRAZIL HAS NOT WITHDRAWN ITS EXPORT SUBSIDIES	4157
A. Brazil Must Withdraw PROEX Export Subsidies	4157
B. Brazil's Conditional Commitments Given Prior to 18 November 1999	4158
C. PROEX Payments under the Modified Programme Continue to be Export Subsidies	4158
D. Brazil's "Modification" of PROEX does not Bring it within an Exception	4158
1. Burden of Proof	4158
2. PROEX Payments do not Benefit from an Exception under the First Paragraph of Item (k)	4159
(a) The First Paragraph of Item (k) does not Give Rise to an a Contrario Exception	4159
(b) PROEX Export Subsidies are not "Payments" of the Kind Referred to in the First Paragraph of Item (k)	4160
(c) The PROEX Programme Secures a Material Advantage	4161
E. Brazil's Arguments about Loan Guarantees and "Market Window" are Irrelevant and without any Merit	4162
1. Loan Guarantees	4163
2. The Market Window	4164
(a) Market Window and the OECD Arrangement	4164
(b) Brazil Confuses Canada's Position on Market Window Transactions	4165
(c) Brazil's Arguments with Respect to "Market Window" Transactions Are Irrelevant and Incorrect	4165
3. Brazil's Examples are Without Merit and do not Establish its Affirmative Defence	4166
IV. REQUESTED FINDINGS AND RECOMMENDATIONS	4166
LIST OF ANNEXES	4168

I. INTRODUCTION

1. In its First Article 21.5 Written Submission, Canada establishes that Brazil has failed to "withdraw" PROEX export subsidies by 18 November 1999, as required by the Reports of the Panel and the Appellate Body¹ in two ways. First, Brazil has not exhibited any intention, and indeed has confirmed that it has no intention, of ceasing to grant export subsidies pursuant to commitments made before 18 November 1999 in respect of regional aircraft delivered after that date. Second, it has not reformed the PROEX export subsidy programme in a manner that complies with the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). The PROEX programme, as applied to exports of Brazilian regional aircraft, continues to provide subsidies that are contingent upon export performance. The measures taken by Brazil do not bring PROEX into conformity with the SCM Agreement, and they do not amount to a "withdrawal" of the subsidies that the Panel and the Appellate Body determined were prohibited.

2. Brazil's submission addresses only some of Canada's arguments and refutes none of the evidence adduced by Canada. Most tellingly, Brazil says nothing at all with respect to subsidies on future deliveries of regional aircraft pursuant to commitments issued before 18 November 1999. Nor does Brazil deny that PROEX, as reformulated, continues to grant subsidies that are contingent upon export performance.

3. Instead of refuting Canada's submissions, Brazil implicitly admits them by resurrecting its defence of PROEX export subsidies on the basis of a purported *a contrario* exception in the first paragraph of Item (k) of Annex I of the SCM Agreement. It argues, but does not establish, that "PROEX as modified is not used to secure a material advantage in the field of export credit terms". On this basis, Brazil concludes that it has implemented the rulings and recommendations of the DSB in this case and brought the PROEX export subsidy programme, as applied to exports of Brazilian regional aircraft, into conformity with the SCM Agreement. Brazil makes this assertion without any attempt to establish the other two elements that must be demonstrated under the first paragraph of Item (k), as found by the Panel and confirmed by the Appellate Body. As the party advancing an affirmative defence, Brazil also bears the burden of demonstrating that the first paragraph of Item (k) gives rise to an *a contrario* exception, and that PROEX export subsidies are "payments" of the kind mentioned in that paragraph.

4. Brazil's submission is also silent on Canada's request for the establishment of transparency procedures to facilitate verification and implementation.

5. In the light of Brazil's failure to withdraw PROEX export subsidies, its adoption of measures that amount to less than full and good faith implementation of the rulings and recommendations of the DSB, and its failure to ensure that the matter is finally resolved, Canada requests that the Panel find that Brazil's measures are not in compliance with the recommendations and rulings of the DSB in that:

- **first**, Brazil continues to pay export subsidies committed on exports of regional aircraft but not yet granted as of 18 November 1999 ; and

¹ The Dispute Settlement Body (DSB) adopted these Reports on 20 August 1999.

- **second**, Brazil has failed to implement measures that would bring the PROEX export subsidy programme into conformity with the SCM Agreement because:
 - (a) PROEX payments continue to constitute prohibited export subsidies,
 - (b) the first paragraph of Item (k) does not give rise to an *a contrario* exception, and
 - (c) even if Item (k) were considered to give rise to an *a contrario* exception:
 - (i) PROEX export subsidies are not "payments" of the kind referred to in the first paragraph of Item (k); and
 - (ii) PROEX export subsidies under the revised programme will continue to "secure a material advantage" in the field of export credit terms.
6. Canada further requests that the Panel suggest that the Parties develop verification procedures so as to permit verification that future Brazilian financing of exported regional aircraft conforms with the SCM Agreement without the need for further recourse to the DSU.

II. BRAZIL MIS-STATES THE FINDINGS OF THE APPELLATE BODY

7. In its submission Brazil makes a number of assertions and draws certain conclusions about the findings of the Appellate Body that are either incorrect or misleading.

8. Brazil states, for example, that the Appellate Body noted that "Members are *permitted* to obtain an 'advantage' in the field of export credit terms, provided that advantage is not 'material'.² [emphasis added] It asserts that the "Appellate Body made clear that the 'marketplace' should provide the benchmark for determining whether PROEX is used to secure a material advantage.³ Brazil also argues that, according to the Appellate Body, "the appropriate reference for determining whether a material advantage is secured is the 'marketplace' and not a specific transaction.⁴ None of these statements is accurate.

9. First, the Appellate Body noted that:

"... we do not rule on whether the export subsidies for regional aircraft under PROEX are 'the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits'. Nor do we opine on whether a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage within the field of export credit terms' is, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement."

² Brazil's Article 21.5 First Submission (Brazil's Submission), at para 4.

³ *Ibid.*, at para 25.

⁴ *Ibid.*, at para 4.

10. The Appellate Body did not, therefore, in any way suggest what would be permitted by the first paragraph of Item (k). It merely determined what would be prohibited. And it made no finding about whether PROEX export subsidies even qualify as "payments" within the meaning of the first paragraph such that they could benefit from an exception if one existed.

11. Second, Brazil's description of the Appellate Body's benchmark for "material advantage"⁵ confuses the Panel's findings with that of the Appellate Body. The Appellate Body did not make "clear that the appropriate reference for determining whether a material advantage is secured is the 'marketplace' and not a specific transaction." Rather, in the paragraph cited by Brazil (para. 178) the Appellate Body was referring to the *Panel's* findings and not its own.

12. In contrast to what Brazil asserts, the Appellate Body determined that the "market" test of "benefit" in Article 1, and "material advantage in the field of export credit terms" in Item (k) should be given different meanings. To do so, the Appellate Body turned to the second paragraph of Item (k):

"... we see the second paragraph of item (k) as useful context for interpreting the 'material advantage' clause in the text of the first paragraph. The *OECD Arrangement* establishes minimum interest rate guidelines for export credits supported by its participants ('officially-supported export credits'). Article 15 of the Arrangement defines the minimum interest rates applicable to officially-supported export credits as the Commercial Interest Reference Rates ('CIRRs'). ... We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are 'used to secure a material advantage in the field of export credit terms'. Therefore, in our view, the appropriate comparison to be made in determining whether a payment is 'used to secure a material advantage', within the meaning of item (k), is between the actual interest rate applicable in a particular export sales transaction after deduction of the government payment (the '*net* interest rate') and the relevant CIRR.

"It should be noted that the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity as well as the creditworthiness of the borrower. Thus, a potential borrower is not faced with a single commercial interest rate, but rather with a range of rates. Under the *OECD Arrangement*, a CIRR is the *minimum* commercial rate available in that range for a particular currency. In any given case, whether or not a government payment is used to secure a '*material* advantage', as opposed to an 'advantage' that is not '*material*', may well depend on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available. The fact that a particular *net* interest rate is below the relevant CIRR is a positive indication

⁵ Ibid.

that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms'.⁶

13. The Appellate Body did not, therefore, establish the "marketplace" as a legal benchmark against which it may be determined whether a particular payment or financing transaction "secures a material advantage". The Appellate Body recognized that "[i]n any given case, whether or not a government payment is used to secure a 'material advantage', as opposed to an 'advantage' that is not 'material', may well depend on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available.⁷ It found that as a matter of evidence, a net interest rate below the applicable CIRR is a positive indication that material advantage has been secured.

14. Canada will demonstrate below that the evidence produced by Brazil fails to establish that PROEX export subsidies do not secure such a material advantage.

III. BRAZIL HAS NOT WITHDRAWN ITS EXPORT SUBSIDIES

A. *Brazil Must Withdraw PROEX Export Subsidies*

15. Canada argued in its First Article 21.5 Written Submission that Brazil's withdrawal of prohibited PROEX export subsidies must include, at a minimum, two actions:

first, Brazil must cease to grant subsidies found to have been prohibited, in respect of commitments made before 18 November 1999 for regional aircraft exported after that date; and

second, Brazil must make the necessary modifications to the PROEX programme to eliminate export subsidies in respect of commitments made after 18 November 1999.

16. Canada further observed that the obligation to "withdraw without delay" illegal export subsidies would be largely nullified if the rule did not apply to all exports after 18 November 1999, including aircraft that had been contracted for under pre-existing government commitments. Accordingly, the two actions referred to above constitute the only means by which Brazil could be found to have discontinued the granting of PROEX prohibited export subsidies and found to have withdrawn such subsidies in accordance with its obligation to implement the recommendations and rulings of the DSB and thereby bring itself into compliance with the SCM Agreement.

17. Brazil has not challenged Canada's interpretation of what constitutes "withdrawal" of an illegal export subsidy.

⁶ Report of the Appellate Body, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 181-2.

⁷ *Ibid.*, at para. 182.

B. Brazil's Conditional Commitments Given Prior to 18 November 1999

18. In its First Article 21.5 Written Submission, Canada demonstrates that Brazil has not "withdrawn" PROEX export subsidies found to have been illegal by the Panel. Brazil has chosen not to respond to Canada's arguments in this regard. Brazil does not deny that it has no intention of withdrawing PROEX subsidies with respect to the exports of regional aircraft that have been or will be delivered after 18 November 1999 pursuant to commitments made before that date. It does not rebut Canada's evidence that deliveries under existing commitments continue to take place and that PROEX subsidies continue to be granted. And Brazil does not attempt to explain how it can continue to pay such export subsidies and be in compliance with the rulings and recommendations of the DSB.

19. As Canada pointed out⁸ the conditional commitments made by Brazil prior to 18 November 1999 cover a significant number of Embraer regional aircraft that would continue to benefit from illegal PROEX export subsidies in the absence of a clear finding on this issue.⁹

C. PROEX Payments under the Modified Programme Continue to be Export Subsidies

20. Nothing that Brazil has done changes the basic elements of PROEX. Except for a reduction of the interest rate buy-down subsidy from 3.8 to 2.5 percentage points (for certain transactions), and the concept that payments would "preferably" result in a net interest rate 20 basis points above the 10-year US Treasury Bond rate, the elements remain the same. The payments are still grants to buy down commercial interest rates freely negotiated by the borrower. The programme is still administered by the Committee, which retains authority to waive all guidelines. PROEX payments are still being provided in the form of NTN-I bonds. The payments are made to reduce the interest paid by a purchaser. Such payments continue to be financial contributions that confer a benefit. As these subsidies are available only for exported products, they are export subsidies prohibited by Article 3.

D. Brazil's "Modification" of PROEX does not Bring it within an Exception

1. Burden of Proof

21. As a party advancing an affirmative defence Brazil has the burden of establishing its case. This is uncontroversial. Brazil accepted that it had this burden in the course of the original proceedings. Without conceding that the first paragraph of Item (k) is capable of giving rise to an affirmative defence, Canada underlines that Brazil

⁸ Canada's First Article 21.5 Written Submission, at para. 30.

⁹ Based on information reported in a newspaper article, Canada stated in its first Article 21.5 submission that the commitments prior to 18 November 1999 cover some 700 aircraft that have been or will be delivered after 18 November 1999. However, data from Back Information Services/Lundkvist Aviation Research indicate that, in fact, such commitments cover 969 aircraft. This data is set out in Exhibit CDN-8.

continues to bear the burden of establishing such a defence. In this respect, Canada recalls the findings of the Panel in paragraph 7.17 of the Report:

"In reviewing Brazil's item (k) defense, we note that in order for this Panel to rule in favour of Brazil we must find for Brazil on all of the following points. First, we must find that PROEX payments are the 'payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits' within the meaning of item (k). Second, we must find that PROEX payments are not 'used to secure a material advantage in the field of export credit terms' within the meaning of item (k). Finally, we must find that a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage in the field of export credit terms' is 'permitted' by the SCM Agreement even though it is a subsidy within the meaning of Article 1 of the SCM Agreement which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. If we were to find against Brazil on any of these points, Brazil's item (k) defense would fail. Finally, we note Brazil's explicit acknowledgement that 'its view of the "material advantage" clause is that it constitutes an affirmative defense and, therefore, the burden of establishing entitlement to it is on the challenged party.'"

22. These findings establish that Brazil has the burden of establishing its Item (k) defence. This defence has three elements, all of which must be established in favour of Brazil. Brazil did not appeal these findings, and the Appellate Body did not rule on them. The Appellate Body agreed that Brazil had the burden (as Brazil had conceded) of proving that PROEX export subsidies are not used to secure a material advantage and that it had not met its burden. Nothing in these proceedings relieves Brazil of this burden where, as in this case, Canada has put forward a *prima facie* case of non-compliance with the covered agreements.

2. *PROEX Payments do not Benefit from an Exception under the First Paragraph of Item (k)*

(a) The First Paragraph of Item (k) does not Give Rise to an a Contrario Exception

23. Brazil makes assertions and draws certain conclusions about the findings of the Appellate Body that are either incorrect or misleading. It states that the Appellate Body noted that "Members are *permitted* to obtain an 'advantage' in the field of export credit terms, provided that advantage is not 'material'.¹⁰ [emphasis added]

24. This statement is incorrect. In fact, the Appellate Body stated that:

"... we do not rule on whether the export subsidies for regional aircraft under PROEX are 'the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits'. Nor do we opine on whether a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage within the

¹⁰ Brazil's Submission, at para 4.

field of export credit terms' is, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement."

25. Contrary to Brazil's assertion, the Appellate Body did not in any way suggest what would be permitted by the first paragraph of Item (k). It merely determined what would be prohibited. And it made no finding one way or another about whether PROEX export subsidies are indeed "payments" within the meaning of the first paragraph, even if such an exception existed therein. Both of these issues have yet to be determined by the Panel.

26. Canada has consistently argued that there is no *a contrario* exception in the first paragraph of Item (k). Item (k) is part of an "illustrative" list of export subsidies. Each specific item sets out a particular practice that, by its very nature, is considered an export subsidy and therefore prohibited by Article 3. Footnote 5 to Article 3 creates a limited exception for certain practices identified in the Annex as not constituting export subsidies. Neither the wording of footnote 5, nor the position of the Illustrative List suggests, let alone establishes, that an Item can give rise to an *a contrario* exception. Where a practice does not fit squarely within a specific Item, it simply means that a complainant must go through the process of establishing that Articles 1 and 3 apply. It does not mean that the practice in question is, by virtue of an *a contrario* implication, *permitted*. Canada also refers the Panel to its arguments on this issue that were presented in the original proceedings, which arguments continue to be relevant in all material respects.¹¹ Brazil has the burden of establishing its claim to an exception. It has not done so.

(b) PROEX Export Subsidies are not "Payments" of the Kind Referred to in the First Paragraph of Item (k)

27. Even if the Panel finds that Item (k) does give rise to an *a contrario* exception, Brazil must establish two other elements under the first paragraph. One of these is whether PROEX export subsidies fit within the terms of that paragraph. Canada has consistently argued that PROEX export subsidies do not constitute "payments" within the meaning of Item (k). PROEX export subsidies are available to purchasers, even when they finance their purchases outside Brazil and through non-Brazilian banks. In such instances, any "payments" by Brazil are not the coverage of the costs incurred by a financing institution or an exporter in "obtaining credits". Canada established in the original case that even where financing is offered by Brazilian financial institutions, PROEX payments are made to reduce interest rates below market rates, rather than to reimburse an exporter or a financing institution for costs incurred in "obtaining credits". Canada also refers the Panel to its arguments on this issue that were presented in the original proceedings, which arguments continue to be relevant in all material respects.¹² Brazil has the burden of establishing its claim to an exception. It has not done so.

¹¹ Canada's Second Written Submission, *Brazil - Aircraft*, at paras. 38-60.

¹² *Ibid.*, at para. 31 and Appendix III, and Canada's First Oral Submission, at paras. 75-77.

(c) The PROEX Programme Secures a Material Advantage

28. Even if Brazil demonstrates that the first paragraph of Item (k) can give rise to an *a contrario* exception and that PROEX export subsidies are "payments" within the meaning of the first paragraph of Item (k), it must still establish that such payments do not secure a material advantage in the field of export credit terms. It has not done so.

29. **First**, nothing on the face of Brazil's measures would enable the revised PROEX programme to qualify for an exception, where the programme as challenged by Canada was found not to qualify. The Newsletter of 19 November 1999 establishes a 2.5 percentage point buy-down for ten-year financing as opposed to a previous interest rate buy-down of 3.8 percentage points for financing periods that, in practice, were as long as fifteen years. Even assuming that the 2.5 percentage point buy-down for ten-year transactions would be applicable to longer term financing transactions, a 2.5 percentage point interest rate buy-down that is contingent upon exportation is, at best, a smaller export subsidy than one of 3.8 percentage points. Such an export subsidy would still secure a material advantage in the field of export credit terms.

30. **Second**, Brazil's establishment of a preference for a net interest rate of 0.2 per cent [20 basis points] above the US 10-year Treasury Bond rate (which, even at that rate, is *preferable* only¹³ on its face demonstrates that PROEX export subsidies secure a material advantage in the field of export credit terms.

31. The Appellate Body found that, in any given case, whether or not a government payment is used to secure a "material advantage"¹⁴ may well depend on where the net interest rate applicable to a particular transaction at issue stands in relation to the range of commercial interest rates available.¹⁵ So as to avoid conflating "benefit" in Article 1 and "material advantage", the Appellate Body interpreted the phrase "field of export credit terms" in the first paragraph of Item (k) in the light of the provisions of the second paragraph. It recognized that the *OECD Arrangement* can be viewed as one example of an international undertaking of the type mentioned in the second paragraph of Item (k). The Appellate Body pointed out that the OECD's Commercial Interest Reference Rate (CIRR)¹⁶ is, under the *OECD Arrangement*, the minimum commercial rate available in a range of available rates for a particular currency.¹⁷ Accordingly, the Appellate Body used the CIRR as a reference benchmark by which to assess whether payments by governments are used to secure a material advantage. The Appellate Body concluded that, as an evidentiary matter, a net interest rate below the relevant CIRR "is a positive indication that the government payment ... [at issue] has been 'used to secure a material advantage in the field of export credit terms'".¹⁸

¹³ Resolution No. 2.667 (19 December 1999) of the National Monetary Board.

¹⁴ As opposed to an "advantage" that is not material.

¹⁵ Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 6, para. 182.

¹⁶ *Ibid.*, at paras. 181-2.

¹⁷ *Ibid.*

¹⁸ *Ibid.*, at para. 182.

32. Under the new PROEX programme, the Resolution establishes that PROEX export subsidies should result in financing "*preferably*" at a rate considerably below the applicable CIRR.¹⁹ It does not set a floor, contrary to Brazil's assertion "that *no* application for PROEX interest equalization support for regional aircraft *will be favourably considered unless* it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ("*T-Bill*") plus 0.2 per cent per annum."²⁰ [emphasis added] Rather, it simply calls for a payment aimed at achieving - but not at all required to achieve - a net interest rate of 10-year US Treasury Bonds + 20 basis points.

33. A net interest rate of 20 basis points above the US 10-year Treasury Bond rate is well below CIRR.²¹ By establishing a preference for a rate below the applicable CIRR, Brazil has demonstrated a preference for securing advantage in the field of export credit terms. Indeed, the "preference" is not a floor as such for the desired interest rate and is therefore in no sense a limit on the amount of the export subsidy that may be granted under PROEX.

34. Thus, even if the first paragraph of Item (k) were considered to constitute an *a contrario* exception and even if PROEX export subsidies are considered "payments" within the meaning of that paragraph - points with which Canada does not agree - Brazil has not demonstrated that its revised system would meet the terms of that exception. In establishing a *preference* for financing resulting in a rate considerably below the CIRR, Brazil is flagrantly providing for continued use of export subsidies to secure a "material advantage" by any standard.

E. Brazil's Arguments about Loan Guarantees and "Market Window" are Irrelevant and without any Merit

35. In its submission, Brazil presents two grounds to defend the PROEX subsidies. First, it compares the subsidies to loan guarantees offered by the United States Export Import (Ex-Im) Bank to China. Second, it makes a vague reference to "market window" operations of agencies such as Canada's Export Development Corporation (EDC). Neither ground has merit.

¹⁹ US\$ CIRR for regional aircraft transactions would be the 7-year US Treasury Bond +100 bps. See "Commercial Interest Reference Rates" and "About CIRR Rates", <http://www.exim.gov/country/cntcirrc.html>, accessed 16 January 2000, Exhibit CDN-9. Brazil uses the 10-year Treasury Bond as its reference benchmark. While there is no simple formula to allow for the concordance of 7-year and 10-year Treasury Bond Rates, historically (at least since 1970), 10-year Treasury Bond rates have been between 3 bps to 30 bps above 7-year Treasury Bond rates. Thus, a preference for 10-year Treasury Bond+20 bps indicates a preference for a rate (7-year Treasury Bond+23-50 bps) that would be between 77 and 50 bps below the prevailing CIRR. See in particular *Federal Reserve Statistical Release H15 - Historical Data*, <http://www.federalreserve.gov/Releases/H15/data.htm>, accessed 16 January 2000, Exhibit CDN-10.

²⁰ Brazil's Submission, at para. 6.

²¹ Commercial Interest Reference Rates (CIRRs) which, for most Consensus Participants are set at a fixed margin of 100 basis points above their respective base rates. See in particular *supra*, note 19.

1. Loan Guarantees

36. The transaction cited by Brazil is a simple US Ex-Im Bank loan guarantee under which the Government of the United States extends its own Sovereign credit risk to cover a percentage of the amount financed. In such circumstances, the lending bank establishes financing terms in the light of the risk of the US Government, not the borrower. Loan guarantees such as that transaction are fundamentally different from the direct export subsidies paid in the form of interest rate buy-downs under the PROEX programme.

37. **First**, Canada recalls the Panel's finding that "in its ordinary meaning, the field of export credit terms would refer to items directly related to export credits, such as interest rates, grace periods, transaction costs, maturities and the like."²² Although the Appellate Body modified the Panel's use of the market as the appropriate reference benchmark, the Appellate Body did not disagree with the Panel's definition of the term.

38. **Second**, Canada notes that Item (j) of Annex I sets out an example of a loan guarantee that would *ipso facto* be considered an export subsidy.²³ Although loan guarantees generally can be considered a form of export credit, for the specific purposes of the SCM Agreement, and in particular first paragraph of Item (k) and Item (j), loan guarantees are to be treated separately from direct financing. Indeed, the term "export credit" in the first phrase of the first paragraph of Item (k) *must* refer only to direct financing, given that loan guarantees are already covered in the previous Item. It would be incongruous if "export credit" in the first phrase of the first paragraph referred only to direct financing, but "export credit terms" in the same paragraph included loan guarantees.

39. Brazil's use of loan guarantees by US Ex-Im Bank indicates that the essence of its defence has changed little from the original proceedings. There, Brazil argued that PROEX export subsidies should be compared to domestic and other export subsidies allegedly offered by Canada. Now it argues that PROEX export subsidies to reduce interest rates for direct financing should be compared with a loan guarantee by the US Ex-Im Bank to China. The Panel rejected the first comparison as without any basis in logic or law. Canada submits that the Panel should reject this latest claim as well, for want of logic or of foundation in law.

40. **Third**, Brazil's comparison, even if it made sense in principle, is fundamentally flawed factually. Brazil's calculations and conversions are incorrect. A proper methodology would, for example, take into account, *inter alia*, the fact that LIBOR is a floating rate benchmark, while US Treasury Bonds are fixed rate reference benchmarks (to each of which, then, must be added a proper risk premium and transaction costs). Such a methodology would also take into account the fact that the 3 basis point spread above LIBOR in this instant is taken from a large aircraft transaction. In such transactions, spreads of less than 10 basis points are common, while spreads of

²² Panel Report, *Brazil – Export Financing Programme for Aircraft* ("Brazil – Aircraft"), WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221, para. 7.28.

²³ Canada, needless to say, does not in any way agree with Brazil's assertion that it *permits* loan guarantees that do not meet its terms. Indeed, if that were so, Item (j), which operates on cost to government basis, and Article 14, which sets out a market-based benchmark for determining whether there is a benefit in a loan guarantee, would be manifestly at odds with one another.

less than 20-30 bps for regional aircraft would be unlikely. Indeed, proper calculation indicates that the preferred PROEX rate (10-year US Treasury Bonds+20 bps) would be well below the rate obtained *after* US Government guarantees are taken into account.²⁴ An export subsidy that brings down the interest paid by any purchaser to one below that would be paid by the Government of the United States in a specific transaction would "secure" a material advantage in the field of export credit terms.

41. Brazil's "loan guarantee" defence must, therefore, fail.

2. *The Market Window*

42. Brazil's second ground for justifying PROEX export subsidies under the alleged exception in the first paragraph of Item (k) is a vague reference to the "market window" operations of export credit agencies.

(a) Market Window and the OECD Arrangement

43. "Market window" generally refers to circumstances where an export credit agency offers a recipient direct financing at terms comparable to those that the recipient would be able to obtain in the market. An export credit agency that steps through this "window" is operating similar to a private commercial bank, rather than as an *official* export credit agency.

44. Market window transactions are undertaken at prevailing market levels in the sense both of interest rate and of terms and conditions offered to the recipient. In this light, Brazil's reference to market window solely in the context of the cost of funds is misleading. As well, Brazil's implied reference to market window as indicating a range of possible rates against which PROEX export subsidized rates could be measured is incorrect. For the purposes of market window transactions, the appropriate reference is to terms available to a recipient in the market with respect to a particular transaction.

45. To the extent relevant, Brazil's letter from the Director General of the OECD establishes no more than the simple fact that market window operations are not inconsistent with the *OECD Arrangement*.

²⁴ Without complete details on the transaction in question, it is not possible for Canada to provide a definitive analysis of the transaction cited by Brazil. However, it is clear that Brazil's position that the net interest rate for the PROEX transaction is above the Ex-Im transaction (Brazil's Submission, at para. 7) is unsustainable.

First, Brazil converts the Ex-Im guarantee fee of 3.54 per cent into 30 basis points. The proper conversion yields is in the range of 75 basis points.

Second, the LIBOR rate of interest is a floating rate of interest. To compare this to a US Treasury Bond, which has a fixed interest rate, a "swap spread" currently in the range of 75-80 basis points must be added. (See attached Bloomberg Financial chart, dated 12 January 2000, Exhibit CDN-11.) Brazil did not account for this necessary conversion in its calculation.

Using these figures, the Table presented at para. 17 of Brazil's Submission would show a total interest rate for the Ex-Im transaction of 7.71 per cent compared to the PROEX transaction at 6.59. Moreover, if the low 3 basis point spread for large aircraft transactions is replaced with a proper 20-30 basis point spread for regional aircraft, the total interest rate for the Ex-Im transaction would be 7.88-7.98 per cent. In other words, the PROEX transaction is well *below* the Ex-Im rate.

(b) Brazil Confuses Canada's Position on Market Window Transactions

46. Brazil confuses several aspects of Canada's position before the panel in *Canada - Measures Affecting the Export of Civilian Aircraft*. In that case, Canada argued that in providing direct financing under its Corporate Account, the EDC "operates on the basis of commercial principles, and does not provide an advantage above and beyond the market."²⁵ The panel so found. That finding was upheld on appeal.

47. The EDC does not lend at below its cost of funds. The EDC does not make the payments referred to in the first paragraph of Item (k) of the SCM Agreement. The first paragraph of Item (k) is therefore not relevant to the market window operations of the EDC. For this reason, even if Canada had thought this paragraph provided an *a contrario* exception, it would not have, in the *Canada - Aircraft* case, sought the protection of such an exception.

48. The EDC does not provide a subsidy under its Corporate Account, in the sense that in entering into financing transactions, it does not confer a benefit in accordance with the terms of Article 1 of the SCM Agreement.

(c) Brazil's Arguments with Respect to "Market Window" Transactions are Irrelevant and Incorrect

49. Canada recalls the Panel's finding in paragraph 7.26 of its Report: "Brazil's approach to 'material advantage' boils down to an argument that an admitted export subsidy should not be deemed to be prohibited if it can be demonstrated merely to offset some advantage or advantages available to the competing product of another Member. ... The Brazilian approach to item (k), however, would effectively allow a Member to raise the provision of export subsidies - or indeed of any subsidy - by the complaining Member as a defense justifying its own provision of export subsidies."

50. In this instance, Brazil seeks to raise not the provision of subsidies, but the simple operation of the market (direct financing at market rates by export credit agencies, through the market window) as a justification for the granting of an admitted export subsidy. This argument is not tenable.

51. Canada notes that a rate of 10-year Treasury Bonds+20 bps is, under no circumstance, available to the purchasers of regional aircraft in direct financing offered at market rates.²⁶ It is telling that although Brazil relies on this ostensible benchmark,

²⁵ Canada's First Written Submission, *Canada - Measures Affecting the Export of Civilian Aircraft*, at para. 163.

²⁶ For example, British Airways, which is the best rated non-Sovereign airline, obtains rates of LIBOR + 30 to 40 bps for large aircraft deals (an additional 20-30 bps should be added for regional aircraft, even for clients with British Airways' credit rating). This translates (see *supra* note 24) to T+105-120 (+125-150 for regional aircraft). See Chart obtained from Captial DATA Loanware, Exhibit CDN-12. Indeed, AAA-rated industrials (and there are no airlines with this rating) cannot obtain credit at T + 20; AAA's tend to pay a spread of approximately 70 bps. See Bloomberg Professional industrial sector chart, accessed 14 and 16 December 1999, Exhibit CDN-13.

It would appear that the only borrower that could obtain rates at or below the PROEX preferred rate is the US Government, which pays, naturally, simply the Treasury rate.

and although it has the burden of establishing its claim, it adduces no data in support of its position.

3. *Brazil's Examples are without Merit and do not Establish its Affirmative Defence*

52. Where a Member lends at below its cost of funds, at rates below the CIRR, there is positive indication that a "material advantage" is being secured. Where a Member makes payments of the kind referred to in the first paragraph of Item (k) that would, in turn, bring down interest rates below the CIRR, there is positive indication that "material advantage" is being secured. Canada reiterates its view that PROEX export subsidies are not, in fact, "payments" of the kind referred to in the first paragraph of Item (k). The preferred interest rates of the PROEX export subsidy programme are well below CIRR. If, therefore, PROEX export subsidies were "payments" of the kind referred to in the first paragraph of Item (k), there is positive indication that such payments secure a material advantage in the field of export credit terms.

53. Brazil has not demonstrated the relevance of either of its two examples in the light of the findings of the Appellate Body. It has not shown that any interest rates derived from those examples would be appropriate benchmarks for the purposes of comparison with PROEX export subsidies. Brazil's data and calculations are incorrect in respect of one example and non-existent with respect to the other. Brazil, which has the burden of establishing its entitlement to an affirmative defence, has failed to demonstrate that PROEX export subsidies do not secure a material advantage in the field of export credit terms.

IV. REQUESTED FINDINGS AND RECOMMENDATIONS

54. In the light of Brazil's failure to withdraw PROEX export subsidies and its adoption of measures that amount to less than full and good faith implementation of the rulings and recommendations of the DSB, Canada requests that the Panel find that Brazil's measures are not in compliance with the recommendations and rulings of the DSB in that:

- **first**, Brazil continues to pay export subsidies committed on exports of regional aircraft not yet granted as of November 18, 1999 ; and;
- **second**, Brazil has failed to implement measures that would bring the PROEX export subsidy programme into conformity with the SCM Agreement because:
 - (a) PROEX payments continue to constitute prohibited export subsidies,
 - (b) the first paragraph of Item (k) does not give rise to an *a contrario* exception,
 - (c) even if Item (k) were considered to give rise to an *a contrario* exception:
 - (i) PROEX export subsidies are not "payments" of the kind referred to in the first paragraph of Item (k); and

- (ii) PROEX export subsidies under the revised programme will continue to "secure a material advantage" in the field of export credit terms.

55. Canada also requests that, so as to ensure that the matter is finally resolved, the Panel make a finding in respect of each of the elements of Brazil's purported Item (k) defence.

56. Canada further requests that the Panel suggest that the Parties develop verification procedures so as to permit verification that future Brazilian financing of exported regional aircraft conforms with the SCM Agreement without the need for further recourse to the DSU.

LIST OF ANNEXES

- Exhibit CDN-8 Back Information Services/Lundkvist Aviation Research
- Exhibit CDN-9 "Commercial Interest Reference Rates" and "About CIRR Rates"

http://www.exim.gov/country/cntcirrc.html,
accessed 16 January 2000
- Exhibit CDN-10 *Federal Reserve Statistical Release H15 - Historical Data*
http://www.federalreserve.gov/Releases/H15/data.htm,
accessed 16 January 2000
- Exhibit CDN-11 Bloomberg Financial chart, dated 12 January 2000
- Exhibit CDN-12 British Airways borrowing rate, chart obtained from Captial
DATA Loanware
- Exhibit CDN-13 Bloomberg Professional industrial sector chart, accessed 14
and 16 December 1999.

ANNEX 1-3

ORAL STATEMENT OF CANADA
(3 February 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4169
II. BRAZIL MUST CEASE GRANTING PROEX EXPORT SUBSIDIES CONDITIONALLY COMMITTED PRIOR TO 18 NOVEMBER 1999	4171
A. Brazil Must Cease Granting Illegal Proex Export Subsidies	4171
B. The Issue of Whether a Subsidy "Exists" is Legally Distinct from the Issue of when a Subsidy is "Granted"	4172
C. PROEX is Granted at the Moment the NTN-I Bonds are Issued... ..	4173
D. Brazil Proposes to Continue Granting Illegal PROEX Export Subsidies under Letters of Commitment Issued before 18 November 1999	4174
E. The Obligation to Cease Granting NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999 does not Result in the Imposition of a Retroactive Remedy.....	4174
III. BRAZIL HAS NOT BROUGHT PROEX INTO CONFORMITY WITH THE SCM AGREEMENT	4175
A. Brazil's a Contrario Defence has no Merit.....	4177
B. PROEX Export Subsidies do Indeed Secure a Material Advantage in the Field of Export Credit Terms.....	4179
1. The Findings of the Panel and the Appellate Body.....	4179
2. What are Brazil's "Measures to Comply".....	4180
3. The Claim of an Item (k) First Paragraph Exception	4180
(a) Brazil's Erroneous Claims and Assertions	4181
(b) Brazil has not Established its Claim to the Benefit of an a Contrario Exception	4183
(c) PROEX Export Subsidies do, in Fact, Secure a Material Advantage.....	4183
IV. RELIEF REQUESTED	4185

I. INTRODUCTION

[Mr. Hankey]

1. Mr. Chairman, distinguished Members of the Panel, distinguished members of the delegation of Brazil, it is an honour to appear before you in this proceeding under Article 21.5 of the DSU. On behalf of Canada, I want to express our apprecia-

tion for the time and attention that you continue to devote to the resolution of this dispute.

2. At issue in this proceeding is whether Brazil has complied with Articles 3.2 and 4.7 of the SCM Agreement and the recommendations of the DSB to withdraw its illegal PROEX export subsidies by 18 November 1999.

3. Canada respectfully submits that Brazil has not done so. It is continuing to grant interest equalization payments under PROEX in respect of regional aircraft that have been or will be delivered after 18 November 1999, pursuant to commitments made *before* that date. It has also failed to modify the PROEX programme in a way that withdraws the illegal subsidies promised *after* 18 November 1999. In fact, Brazil has indicated that it will continue to grant illegal PROEX export subsidies whenever Embraer regional aircraft are exported.

4. Because Brazil appears intent on rearguing issues that were decided by this Panel and the Appellate Body in the original proceedings, I want to underscore at the outset what this proceeding is *not* about. The Panel will recall its findings that PROEX interest equalization payments are subsidies within the meaning of Article 1 of the SCM Agreement that are contingent upon export performance within the meaning of Article 3.1(a). The Panel further found that the subsidies were not covered by any exceptions or affirmative defences under the SCM Agreement and that they were accordingly prohibited in accordance with Article 3. The Appellate Body upheld the appealed findings of the Panel.

5. The issue in this proceeding, therefore, is not whether PROEX interest equalization payments are subsidies under Article 1 and export subsidies under Article 3. The only issue is whether Brazil has complied with the recommendations and rulings of the DSB by withdrawing its illegal export subsidies.

6. Before turning to the specific legal issues and Brazil's contentions, I want to stress how crucial this proceeding under Article 21.5 of the DSU is, not only to the resolution of this dispute, but also to the operation of the WTO dispute settlement system more broadly. Canada believes that the dispute settlement system will live up to its promise only if it leads Members to bring their programmes and practices into conformity with their obligations without endless recourse to litigation before panels and the Appellate Body. We believe that the legal interpretations of the SCM Agreement provisions in the prior proceedings in this dispute have already substantially clarified the kinds of steps Brazil might take that would constitute withdrawal of its illegal subsidies. Canada now hopes that this Article 21.5 proceeding will lead to a definitive determination that Brazil has not complied with its obligations.

7. Finally, we note that to that same end of avoiding continuing resort to dispute settlement, Canada has proposed reciprocal transparency provisions to enable each Party - in this case and in the counter case brought by Brazil against Canada - to verify compliance of the other with regard to the specific applications of its measures. Canada is fully cognisant that panels and the Appellate Body may not add to or diminish rights and obligations provided in the WTO agreements. Hence in proposing these verification procedures, Canada does not in any way seek a continuing role or responsibility for the Panel; nor, certainly, does it seek to have the Panel impose transparency requirements. Rather, in purely practical terms, Canada sees reciprocal transparency as a means of bilateral compliance oversight that might obviate continued recourse to the DSU. In that context, Canada continues to hope that the Panel

will endorse its transparency proposal as a potentially helpful incentive for adherence to WTO obligations.

8. Mr. Chairman, I will now turn to Brazil's failure to withdraw its illegal PROEX subsidies in respect of the export of regional aircraft exported after 18 November 1999 pursuant to letters of commitment issued *before* that date, and to Brazil's arguments in that regard. My colleague, Mr. Rambod Behboodi, will then address the failure of Brazil's revised measures to bring the PROEX programme into conformity with the SCM Agreement and the recommendations of the DSB.

II. BRAZIL MUST CEASE GRANTING PROEX EXPORT SUBSIDIES CONDITIONALLY COMMITTED PRIOR TO 18 NOVEMBER 1999

9. Mr. Chairman, distinguished Members of the Panel, Canada respectfully submits that Brazil has failed to "withdraw" PROEX under commitments issued before 18 November 1999 because it continues to grant NTN-I bonds on newly delivered aircraft in accordance with the terms of those commitments. My argument in support of this position can be summarized in the following five points:

- first**, Brazil must cease granting illegal PROEX export subsidies;
- second**, the issue of whether a subsidy is deemed to "exist" under Article 1 of the SCM Agreement is legally distinct from the issue of when a subsidy is "granted" under Article 3.2;
- third**, illegal PROEX export subsidies are "granted" when the NTN-I bonds are issued;
- fourth**, Brazil proposes to continue granting illegal PROEX export subsidies under letters of commitment issued before November 18, 1999; and
- fifth**, the requirement to cease granting PROEX does not amount to a retroactive remedy.

A. *Brazil Must Cease Granting Illegal Proex Export Subsidies*

10. Mr. Chairman, my first point is simply that Brazil must cease granting illegal PROEX export subsidies in order to comply with the recommendations and rulings of the DSB. The Panel and the Appellate Body have already determined that PROEX constitutes a subsidy within the meaning of Article 1 of the SCM Agreement. The Panel and the Appellate Body have also determined that PROEX is a prohibited subsidy within the meaning of Article 3.1(a). The DSB recommended and ruled, in accordance with Article 4.7, that Brazil must withdraw the illegal PROEX export subsidies by 18 November 1999.

11. At a minimum, to comply with the recommendation to "withdraw" the illegal PROEX export subsidies in accordance with Article 4.7 of the SCM Agreement, Brazil must abide by the prohibition set out in Article 3.2. The purpose of Article 4.7 is to ensure that the subsidizing member brings itself into compliance with the prohibition in Article 3.2.

12. Article 3.2 prohibits the granting or maintaining of export contingent subsidies in language that is quite clear: "[a] Member shall neither grant nor maintain subsidies referred to in paragraph 1." To comply with the prohibition in Article 3.2, Brazil must cease granting the illegal PROEX export subsidies.

13. The language of Articles 4.7 and 3.2 of the SCM Agreement does not leave any room for debate. The DSB recommended that Brazil withdraw the illegal PROEX export subsidies by November 18, 1999. To comply with the DSB's recommendation, Brazil must cease granting the illegal PROEX export subsidies after that date.

B. The Issue of Whether a Subsidy "Exists" is Legally Distinct from the Issue of when a Subsidy is "Granted"

14. Mr. Chairman, my second point addresses the relationship between Articles 1 and 3.2 of the SCM Agreement. Brazil appears to take the position that it has already complied with the DSB's recommendation in respect of the illegal PROEX export subsidies because there is nothing left to "withdraw". The illegal PROEX export subsidies already "exist" and, therefore, cannot be "withdrawn" on a prospective basis. In support of its position, Brazil provided an exhaustive analysis of Article 1 in its second written submission to this Panel.

15. Article 1 is important. It sets forth the test to determine whether a subsidy is deemed to "exist", and, thereby, sets the stage for a determination whether the subsidy is prohibited under Article 3.1(a). However, the Article 1 analysis is not relevant to these proceedings.

16. As I stated earlier, the issue before this Panel is not whether PROEX is deemed to be a subsidy in accordance with Article 1, or whether PROEX is export contingent under Article 3.1(a). Illegal PROEX export subsidies "exist" within the meaning of Article 1 of the Agreement. They are prohibited because they are contingent upon export within the meaning of Article 3.1(a) of the SCM Agreement.

17. The only issue is whether Brazil has withdrawn its illegal PROEX export subsidies by ceasing to "grant" such subsidies pursuant to its obligation under Article 3.2. In its review of this Panel's finding that the illegal PROEX export subsidies were granted at the moment the NTN-I bonds were issued, the Appellate Body stressed that the issue of the "existence" of a subsidy, and the issue of the time at which the subsidy is "granted" are two legally distinct issues. The Appellate Body certainly agreed with the Panel that, for the purpose of Article 27.4, PROEX is granted when the NTN-I bonds are issued. However, it also stressed that the Article 1 issues of "financial contribution" and "benefit" are to be taken together to determine *whether* a subsidy "exists", not *when* a subsidy is granted.²⁷

18. In its second written submission in these proceedings, Brazil correctly observed that the Appellate Body had found that PROEX is granted when "all legal conditions have been fulfilled that entitled the beneficiary to receive the subsidies." Not surprisingly, Brazil failed to note that the Appellate Body also shared "the Panel's view that such unconditional legal right exists when the NTN-I bonds are issued", not before.²⁸ Brazil skirts this finding because it has chosen to reargue the position it advanced before the Appellate Body on the issue of when the illegal PROEX export subsidies are granted. Brazil's arguments that the illegal PROEX export subsidies are granted when the letters of commitment are issued failed before the

²⁷ Report of the Appellate Body, *supra*, footnote 6, para. 157.

²⁸ *Ibid.*, at para. 158.

Appellate Body. Brazil's arguments about the moment when the illegal PROEX export subsidies are granted should also fail in these proceedings.

C. PROEX is Granted at the Moment the NTN-I Bonds are Issued

19. This brings me to my third point, Mr. Chairman, which is that PROEX is granted for the purposes of Article 3.2 when the NTN-I bonds are issued. The Panel and the Appellate Body have already determined that, for the purpose of Article 27.4, PROEX is granted when the NTN-I bonds are issued. Brazil has suggested no logical, legal or factual basis for the assertion that this issue should be analysed differently for the purposes of Articles 3.2 and 27.4. Indeed, there is no basis for Brazil's assertion. The finding of the Appellate Body should be applied to the analysis of when a subsidy is granted for the purposes of Article 3.2.

20. Articles 3.2 and 27.4 both deal with the prohibition of export subsidies. Both establish a time frame for the withdrawal of prohibited export subsidies. Article 3.2 requires a Member to cease granting prohibited export subsidies immediately. In recognition of the important role that subsidies play in the economic development programmes of developing country Members, Article 27.4 provides that a developing country Member must phase-out the grant of prohibited export subsidies and cease granting such subsidies by the end of the phase-out period. If those conditions are met, the prohibition in Article 3.2 does not apply.

21. Brazil ceased to benefit from the special treatment afforded by Article 27.4 because it was determined that it had increased the level of the export subsidies that it had granted during the phase-out period. In order to make that determination, the Panel and the Appellate Body first had to determine when illegal PROEX export subsidies are granted.

22. Both Articles 3.2 and 27.4 of the SCM invite a determination of when a prohibited export subsidy is granted. The word "grant" is not used in Article 27.4, but two derivatives thereof, "granting" and "granted", are used in footnote 55 to Article 27.4. Footnote 55 reads as follows: "For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986." Article 3.2 provides that a Member shall not "grant" prohibited export subsidies. The only way to determine whether a Member is in compliance with its obligations under Article 27.4 or Article 3 is to first determine when the prohibited export subsidy is granted.

23. The term "grant" should be interpreted in the same manner for both Article 27.4 and 3.2. There is nothing in the analysis of the Appellate Body that would indicate that the time when a subsidy is granted for the purposes of Article 27.4 should be different for the purpose of Article 3.2. There is nothing in the spirit or context of the SCM Agreement that would indicate that the term "grant" should be interpreted differently for the two Articles. On the contrary, the term "grant" is used in the same manner in similar types of provisions in the same agreement. It should, therefore, be interpreted and applied to the same set of facts in the same way.

24. Since PROEX is granted when the NTN-I bonds are issued, in order to comply with the prohibition in Article 3.2 of the SCM Agreement, Brazil must cease issuing NTN-I bonds on the export of regional aircraft pursuant to letters of commitment issued before 18 November 1999.

D. Brazil Proposes to Continue Granting Illegal PROEX Export Subsidies under Letters of Commitment Issued before 18 November 1999

25. Mr. Chairman, Brazil has not done so. Brazil has taken no measures to withdraw illegal PROEX export subsidies committed before 18 November 1999 on exports of regional aircraft scheduled for delivery after that date. On the contrary, Brazil has indicated that it intends to continue granting illegal PROEX export subsidies on each regional aircraft this is exported so long as the letter of commitment was issued before 18 November 1999.

26. Far from complying with the recommendations and rulings of the DSB, Brazil consistently declares that it will honour its obligations under the letters of commitment issued before 18 November 1999, and continue issuing NTN-I bonds after that date.

27. Canada first requested consultations in accordance with Article 4.1 of the SCM Agreement on 18 June 1996. During the consultations and negotiations that took place in the following two years - that is, before this Panel was established - Brazil issued letters of commitment to provide illegal PROEX export subsidies in respect of approximately 298 orders for Embraer aircraft that have yet to be delivered or exported.

28. This Panel was established to determine whether PROEX interest rate equalization was prohibited under Article 3 on 23 July 1998. During the proceedings before this Panel and up to the date that the Panel issued its report, Brazil issued letters of commitment to provide illegal PROEX export subsidies in respect of approximately 259 additional orders for Embraer aircraft that have yet to be delivered or exported.

29. This Panel found that PROEX interest rate equalization was prohibited under Article 3 of the SCM Agreement in its report circulated on 14 April 1999. Since that date - and before the deadline by which the DSB recommended that Brazil withdraw the illegal PROEX export subsidies - Brazil has issued letters of commitment to provide illegal PROEX export subsidies in respect of approximately 312 more orders for Embraer aircraft that have yet to be delivered or exported.

30. Our numbers are estimates. But the actual numbers of Embraer aircraft that are yet to be exported under letters of commitment issued prior to 18 November 1999 is irrelevant to the determination that Brazil is not in compliance with its obligations under Article 3.2 of the SCM Agreement. Whether a single Embraer aircraft or 869 Embraer aircraft are exported, Brazil is prohibited under Article 3.2 from granting NTN-I bonds after November 18, 1999 pursuant to letters of commitment issued prior to that date.

E. The Obligation to Cease Granting NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999 does not Result in the Imposition of a Retroactive Remedy

31. Mr. Chairman, I now turn to Brazil's arguments concerning retroactivity. Whether retroactive remedies are prohibited under the SCM Agreement is not before this Panel because the finding requested by Canada does not result in the imposition of a retroactive remedy. Brazil's assertions about a retroactive remedy are based entirely on its confusion about the issues of whether a subsidy "exists" and when a sub-

sidy is "granted". Canada is not requesting that Brazil terminate its obligations in respect of any of the NTN-I bonds issued prior to 18 November 1999. Canada is requesting only that Brazil cease issuing NTN-I bonds on a prospective basis, that is, after 18 November 1999.

32. Brazil argues that it must be allowed to meet its commitments to issue the NTN-I bonds pursuant to letters of commitment issued on or before 18 November 1999. As emotionally engaging as Brazil's arguments about its liability for damages may be, Brazil cannot be allowed to contract out of its international obligations. No one can have legitimate expectations regarding subsidies that are prohibited by the SCM Agreement. In its third-party written submission to this Panel, the United States correctly points out that it is the rare case when the economic position of private parties is *not* disrupted by the recommendations and rulings of the DSB that a prohibited export subsidy be withdrawn. As recognized by Appellate Body Member Beeby in *Indonesia - Certain Measures Affecting the Automobile Industry*, "[i]n virtually every case in which a measure has been found to be inconsistent with a Member's obligations under the GATT 1994 or any other covered agreement, and therefore, must be brought into conformity with that agreement, some degree of adjustment by the domestic industry of the Member concerned will be necessary."²⁹

33. If the position put forward by Brazil were accepted, it would eviscerate the WTO dispute settlement system as a vehicle for sanctioning prohibited export subsidies. A subsidizing Member could simply grant contingent legal rights to receive prohibited export subsidies, as Brazil has done. In the event of a challenge, the subsidizing Member could then argue that the prohibited export subsidies had already been granted: i.e., the prohibited export subsidies were "granted" at the moment the subsidizing Member conditionally obligated itself to grant the prohibited export subsidies, not when the prohibited export subsidies were actually granted.

34. Canada respectfully submits, therefore, that the Panel reject Brazil's argument that it be allowed to continue to issue NTN-I bonds in respect of letters of commitment issued before 18 November 1999. Mr. Chairman, members of the Panel, WTO Members cannot be allowed to contract out of their WTO obligations. To rule otherwise would render the prohibition on export subsidies in Part II of the SCM Agreement a nullity.

35. That completes my statement this morning. With your submission, Sirs, I will ask Mr. Behboodi to continue this presentation on behalf of Canada.

III. BRAZIL HAS NOT BROUGHT PROEX INTO CONFORMITY WITH THE SCM AGREEMENT

[Mr. Behboodi]

36. Mr. Chairman, Members of the Panel, it is indeed an honour to appear before you again.

²⁹ Award of the Arbitrator, *Indonesia – Certain Measures Affecting the Automobile Industry - Arbitration under Article 21.3(c) of the DSU ("Indonesia – Autos")*, WT/DS54/15, WT/DS55/14, WT/DS59/13, WT/DS/64/12, 7 December 1998, DSR 1998:IX, 4029, para. 25.

37. The second issue before you today is whether Brazil has complied with the rulings and recommendations of the DSB in respect of letters of commitment to be issued after 18 November 1999.

38. But before I discuss the legal questions involved in this aspect of the dispute, we wish to underline the enormous economic impact that Brazil's continued illegal subsidization has on the regional aircraft market. We note, in particular, a report issued only last Friday about Embraer's fourth largest sale of regional aircraft, potentially worth about US\$1.7 billion, to Mesa Airline.³⁰

39. Mesa Airline, you will recall, was a major beneficiary of PROEX export subsidies under the old regime.³¹ It is our understanding that all sales by Embraer, including this one to Mesa Airline, continue to benefit from PROEX subsidies. The Panel may wish to inform itself further about the particulars of this deal.

40. Mr. Chairman, while Canada is here again challenging PROEX, Embraer is busy making subsidized sales to its old subsidized customers. We are here to ask you to put a stop to this patent flouting of the international law of trade, to ensure that lawlessness will not win the day.

41. I now turn to the legal issues.

42. Brazil claims to have met its obligation to "withdraw" PROEX export subsidies. It argues that certain administrative steps will cause PROEX payments under future commitments to fall within the terms of what Brazil assumes to be an *a contrario* exception in the first paragraph of Item (k) of the Illustrative List of Export Subsidies.

43. Brazil does not deny that PROEX payments under the reformulated programme will continue to constitute subsidies within the meaning of Article 1 of the SCM Agreement. It does not deny that these subsidies will continue to be contingent upon export performance within the meaning of Article 3 of the SCM Agreement.

44. Brazil argues, however, that PROEX payments now "preferably" will result in a net interest rate equal to 10-year US Treasury Bonds plus 20 basis points for a purchaser of Brazilian aircraft. It asserts that because of this "preferred" rate, PROEX export subsidies do not "secure a material advantage in the field of export credit terms." Brazil rests its claim on the example of a loan guarantee to China by the US Export-Import Bank, and also on the "market window" export credit practices of participants in the *OECD Arrangement*.

45. Brazil then asserts that PROEX export subsidies with this resulting net interest are "permitted" under the first paragraph of Item (k) of the Illustrative List of Export Subsidies.

46. Brazil's defence, Mr. Chairman, has no merit. The measures Brazil has taken - that is, the Resolution 2667 and Newsletter 2881 - do not bring the PROEX export subsidy programme into compliance with the SCM Agreement.

47. Brazil seeks refuge in an exception that does not exist and whose terms Brazil would not have met if it did exist. As this Panel noted when Brazil claimed in the original proceeding an *a contrario* exception under the first paragraph of item K,

³⁰ *Folha de São Paulo*, 28 January 2000.

³¹ Canada's First Written Submission, at para. 56.

Brazil would have to demonstrate each of three elements in order to succeed with such as defence:

first, Brazil must show that the first paragraph of Item (k) of the Illustrative List creates an *a contrario* exception, notwithstanding that this is an illustrative list;

second, even if there were an exception by *a contrario* implication, Brazil must show that PROEX export subsidies are "export credits" or "payments" of the kind referred to in the first paragraph; and

third, even if Brazil were able to show each of the first two elements, Brazil would bear the burden of demonstrating that the payments do not secure a material advantage in the field of export credit terms.

48. Brazil bears the burden of proving each of these elements of a claimed affirmative defence. Brazil has not even attempted to demonstrate the first two elements. And the steps it has taken with respect to the third are manifestly insufficient according to the findings of the Panel, as modified by the Appellate Body.

A. *Brazil's a Contrario Defence has no Merit*

49. You will recall that in the original proceedings, Canada extensively argued the first two points; we do not propose to retread this familiar ground here. Instead we refer the Panel to arguments set out in Canada's Second Written Submission and the Panel's own comments in footnotes 197 and 198 of its Report.

50. I should, however, like to make three observations in this respect.

51. The first is to bring to your attention to Brazil's erroneous statement about the findings of the Appellate Body in respect of the first paragraph of Item (k), and Brazil's generally incorrect conclusions about Annex I. In paragraph 4 of its First Article 21.5 Written Submission, Brazil states, "The Appellate Body, noted, however that Members are permitted to obtain an 'advantage' in the field of export credit terms, provided that advantage is not 'material'."

52. The Appellate Body did not note, or even suggest, any such thing. The Appellate Body simply stated that "item (k) does not *refer* simply to 'advantage'. The word 'advantage' is qualified by the adjective 'material'."³² These are the words of the Appellate Body. They noted a *reference* in Item (k), not a *permission*.

53. In fact, contrary to what Brazil alleges, in paragraph 187 of its Report the Appellate Body unambiguously declined to rule on this issue.³³ Brazil is thus wrong to assert that the Appellate Body found Item (k) to permit the securing of an advantage that is not material.

54. This leads me to the second observation: Brazil has ignored your findings that each of three elements must be established before an *a contrario* defence under Item

³² Appellate Body Report, *Brazil - Aircraft*, *supra*, footnote 6, para 177.

³³ As the Appellate Body stated:

"Nor do we opine on whether a 'payment' within the meaning of item (k) which is not 'used to secure a material advantage within the field of export credit terms' is, *a contrario*, 'permitted' by the *SCM Agreement*, even though it is a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of that Agreement."

(k) first paragraph prevails. Your determination was manifestly correct and Brazil did not appeal it.³⁴

55. Nevertheless, Brazil ignores that it has the burden of establishing its claim to this defence. It has the burden of proving that PROEX export subsidies are "payments" of the kind referred to in Item (k) first paragraph. It must convince you that Item (k) first paragraph gives rise to an *a contrario* exception.

56. Mr. Chairman, Members of the Panel, you have already indicated your scepticism about both points. You determined, nevertheless, that it was not necessary to decide whether Brazil could meet either of the first two elements required for its defence.

57. The Panel could again find that it does not need to rule on the first two elements because Brazil does not meet the third element (material advantage). But, in the interests of resolving this issue, Canada respectfully asks you to make a finding in respect of all of these issues. Otherwise, instead of reforming PROEX to bring it within the disciplines of the SCM Agreement, Brazil will continue to grant illegal export subsidies with small adjustments based on the claim that there is an *a contrario* exception to be found somewhere in the first paragraph of Item (k).

58. My third observation has to do with the scope of any "exception" the Panel might find *a contrario* in Item (k) first paragraph. For, it is not any and all export subsidies that would benefit from any such exception. The first paragraph of Item (k) specifically relates to only two types of practices to which the so-called "material advantage" clause would apply:

- first**, export credits provided by governments below their own cost of funds;
- second**, payments made to cover "the costs incurred by exporters or financial institutions in obtaining credits".

59. Thus, if there is an exception under the first paragraph of Item (k), it does not apply to interest rate buy-down export subsidies. It does not apply to subsidies that cover the cost of loan guarantees, residual value guarantees, "opportunity costs" related to money placed in escrow, or other such costs. And, self-evidently, PROEX export subsidies do not pay the costs of financial institutions or exporters in obtaining credits.

60. The reason, Mr. Chairman, can be found in the very structure of the Item (k) in which Brazil seeks to find an *a contrario* exception. Canada submits that the "payments" referred to in the second part of the first paragraph must be viewed in the light of the first part. That is, both cases relate to granting export credits at below the lender's cost of funds. The first part describes the situation in which a government incurs a cost by granting export credits at rates below its own borrowing cost; the second, where the government covers the same costs incurred by a financial institution or an exporter.

61. If, therefore, the Panel considers that Item (k) first paragraph gives rise to an *a contrario* exception, the Panel should also recognize that any such exception is narrow. Only those subsidies that fit within the specific circumstances described in the first two parts of the first paragraph could benefit from such an exception, if they did not secure a material advantage. And PROEX export subsidies do not fit within

³⁴ Ibid., at para. 187.

this exception. We ask that the Panel also find that PROEX payments are not "payments" of the type that would fit within the first paragraph of Item (k), even if they did not secure a material advantage.

62. Before turning to material advantage we note that Brazil's failure to establish - even argue - the other elements of its claim to an exception ought to be conclusive in Canada's favour. Indeed, a Panel finding that Brazil is not entitled to an exception under the first paragraph of Item (k) would considerably clarify Brazil's rights and obligations under the SCM Agreement and, in Canada's submission, be an important step towards finally settling this dispute.

63. Mr. Chairman, in concluding this section of our presentation, I should like to assure you that the Panel's scepticism about the validity of Brazil's reliance on Item (k) was and continues to be well-justified.

64. Last summer, in the midst of the appellate process, Brazil offered PROEX subsidies on the sale of Embraer regional aircraft to Crossair, a subsidiary of Swiss Air, Alitalia, and KLM Excell, a subsidiary of Royal Dutch Airlines. It strains credulity to argue that some of the most profitable airlines in the world, operating out of some of the richest countries in the world and major centres of international financing, needed half-a billion dollars to "equalize" their borrowing rates.

65. No amount of linguistic agility would fit such a subsidy into an *a contrario* exception in the first paragraph of Item (k).

B. *PROEX Export Subsidies do Indeed Secure a Material Advantage in the Field of Export Credit Terms*

66. Even if Brazil did not fail the required elements of a defence that Brazil simply and wrongly assumes in these proceedings, Brazil's defence would still fail because PROEX subsidies are designed systematically to secure a material advantage in the field of export credit terms. Although it is not required to do so as it does not bear the burden of proof, Canada will establish that PROEX export subsidies do in fact secure a material advantage in the field of export credit terms within the meaning of the first paragraph of Item (k).). Thus, Brazil's affirmative defence would still fail even if Brazil had established that it met the first two requirements of Item (k).

1. *The Findings of the Panel and the Appellate Body*

67. I propose first to briefly discuss the findings of the Appellate Body and the Panel in the original proceedings. The most salient features of the PROEX export subsidy programme as challenged by Canada were the following.

first, for sales of regional aircraft, PROEX interest rate equalization subsidies amounted to 3.8 percentage points of the actual interest rate on any particular transaction;

second, the lending bank charged its normal interest rate for the transaction, and received a payment from two sources: the purchaser, and the Government of Brazil;

third, of the total interest payments, the Government of Brazil paid 3.8 percentage points, and the purchaser paid the rest;

fourth, in this way, PROEX subsidies reduced the financing costs of the purchaser and, thus, reduced the overall cost to the purchaser of purchasing an Embraer aircraft; and

fifth, the subsidies were available to purchasers that obtained their financing at prevailing international commercial rates, even where the lender was a non-Brazilian financial institution, even where the financing was guaranteed by large non-Brazilian manufacturers.

68. The Panel determined that such payments constituted subsidies contingent upon export performance. The Appellate Body confirmed this finding. The Panel and the Appellate Body also found, although on different grounds, that these export subsidies secured a material advantage in the field of export credit terms. The Panel considered that the benchmark was the marketplace: whether the purchaser benefited relative to what it could otherwise have obtained on the market in respect of the specific transaction. PROEX export subsidies did not meet that test. The Appellate Body modified that finding and considered that:

"the fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms'."³⁵

2. *What are Brazil's "Measures to Comply"*

69. I now turn to the measures that Brazil claims constitute "compliance" on the theory that they do not obtain a "material advantage in the field of export credit terms." Under Resolution 2667,

"no application for PROEX interest equalization support for regional aircraft will be favorably considered unless it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ("T-bill") plus 0.2 percent per annum. ... While the use of the T-bill as the benchmark is preferred, the authorities retain the authority to utilize LIBOR as an alternative reference point in appropriate market circumstances".

70. Canada has pointed out and Brazil has not contested that the impact of PROEX may well be to drive the net interest rate below the "preferred" rate. In **Chart 1**, we have taken the "preferred rate" and compared it with the prevailing CIRR over the last ten year. You will notice that the "preferred rate" would have been consistently below the prevailing CIRR. Based on this historical information, we could project that the "preferred rate" will, in the future, be below the prevailing CIRR.

3. *The Claim of an Item (k) First Paragraph Exception*

71. Brazil does not claim that PROEX is not an export subsidy. Rather, it claims the benefit of an exception to the prohibition in Article 3. It argues that PROEX ex-

³⁵ Para. 182.

port subsidies amounting to an interest buy-down of 2.5 percentage points for the benefit of the purchaser do not secure a material advantage in the field of export credit terms.

72. Even if it had disposed of its other burdens as noted above, Brazil has the burden of establishing this defence. That is, it must establish that the impact of PROEX export subsidies is not to reduce the *net* interest paid by a recipient in a financing transaction below an applicable benchmark. This much is not controversial.

(a) Brazil's Erroneous Claims and Assertions

73. While acknowledging that there must be a benchmark, Brazil misstates or simply ignored the Appellate Body's findings and determinations in respect of the applicable benchmark.

74. **First**, Brazil asserts that the Appellate Body "also made clear that the appropriate reference for determining whether a material advantage is secured is the 'marketplace' and not a specific transaction." Brazil refers in its footnotes to paragraph 178 of the Report of the Appellate Body. Brazil is wrong. In paragraph 178 the Appellate Body was referring to what the Panel had found, a finding that the Appellate Body expressly modified.

75. **Second**, Brazil asserts that the Appellate Body found that the CIRR provides only "one example" of an appropriate benchmark.³⁶ Brazil does not cite where in the Report the Appellate Body might have made such an observation. This is not surprising, for this is not at all what the Appellate Body said. Rather, the Appellate Body found that the *Arrangement* was one example of an agreement referred to in the second paragraph of Item (k).³⁷ In fact, as a practical matter, the *OECD Arrangement* is and has been the *only* example of an agreement that meets the criteria of the second paragraph of Item (k).

76. The Appellate Body, in an analysis that Brazil completely ignored, used the second paragraph, and therefore the *Arrangement*, as useful context for arriving at the appropriate benchmark to be used in the *first paragraph*. The Appellate Body found that the CIRR constituted the *minimum* commercial rate for the purposes of the *Arrangement*. It determined, accordingly, that a net interest rate below the relevant CIRR was a positive indication that material advantage was being secured. There was no suggestion at all by the Appellate Body that any other, lower, benchmark could appropriately be used instead of CIRR.³⁸

³⁶ At para. 9, it states:

"The Appellate Body noted that the Commercial Interest Reference Rate ('CIRR') of the *Arrangement on Guidelines for Officially Supported Export Credits* ('OECD Arrangement' or 'Arrangement') of the Organization for Economic Cooperation and Development ('OECD') provided one example of an appropriate benchmark ..."

³⁷ At para. 181, the Appellate Body found that:

"We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are 'used to secure a material advantage in the field of export credit terms'."

³⁸ At *ibid.*, the Appellate Body went on to find that,

"Therefore, in our view, the appropriate comparison to be made in determining whether a payment is 'used to secure a material advantage', within the meaning of item (k), is between

77. **Third**, Brazil purports to recall a statement made by Canada in footnote 17 to its First Written Submission that: "In aircraft financing transactions (which are mostly US dollar-denominated) the benchmark used is US Treasury."³⁹ Brazil does not, however, quote the passage to which the footnote refers. There Canada noted:

"For example, the credit quality of the airline is an important variable in determining the 'spread' that would be demanded by the financier over the market benchmarks of LIBOR (for floating-rate transactions) and US Treasuries (for fixed rate transactions in US dollars)."⁴⁰

78. This does not mean, as Brazil incorrectly suggests in its Rebuttal Submission, that by simply using LIBOR or US Treasury Bond rates as a *base* an interest rate would be consistent with the market. Canada at no point argued or even implied that the US 10-year Treasury Bond rate, without any spread or with an inadequate spread, is the appropriate benchmark for an Item (k) determination.

79. In fact, before the Appellate Body made its finding that CIRR is the appropriate minimum benchmark, Canada had repeatedly and emphatically pointed out that the benchmark for determining material advantage in the regional aircraft sector was US Treasury Bonds *plus a credit risk premium* for fixed rate transactions. This is so because in financing transactions, the credit risk premium is as important a constituent element of the final interest rate paid by a purchaser as the base to which the premium would be added.

80. **Fourth**, in its Rebuttal Submission, Brazil states that:

"Canada asserts, without any elaboration, that the preferred benchmark rate of T-bill plus 20 bps is 'consistent neither with CIRR nor with the market.' By this statement, Canada acknowledges implicitly that Brazil must be deemed to have brought PROEX into conformity to the extent that the benchmark rate of T-bill plus 20 bps is found to be 'consistent' with 'CIRR []or with the market'."⁴¹

81. Mr. Chairman, Canada did not say and does not agree that PROEX could be brought into conformity with the SCM Agreement if the net interest rate, after PROEX subsidies are applied, were at or above either the relevant CIRR or "the market". Canada does not consider Item (k) first paragraph to give rise to an *a contrario* exception. And even if it did, PROEX subsidies would not fit within its express terms. Further, Canada was not establishing or endorsing an alternative benchmark, but merely pointing out that Brazil could not even meet the alternative it had contrived for itself. Finally, as Chart 1 demonstrates, the "preferred" rate of US Treasury Bond+20 bps is on its face below the relevant CIRR.

the actual interest rate applicable in a particular export sales transaction after deduction of the government payment (the '*net* interest rate') and the relevant CIRR."

³⁹ At para. 7.

⁴⁰ At para. 24.

⁴¹ At 32.

(b) Brazil has not Established its Claim to the Benefit of an *a Contrario* Exception

82. I should now like to address Brazil's claimed exception. After misquoting and misinterpreting the Report of the Appellate Body to conjure up a "market" benchmark, Brazil makes two further errors. First, Brazil relies on erroneous calculations of the impact of loan guarantees on net interest rates to claim that the rate of T-Bonds+20 bps is somehow consistent with its market standard. Second, to justify such a rate notwithstanding that it is below CIRR, Brazil relies on the unremarkable observation that in some instances in the regional aircraft market, rates and terms offered to purchasers may be different from those provided for in the *OECD Arrangement*. This point, we note, was already on the record considered by the Panel and the Appellate Body.

83. In respect of the loan guarantee example, Canada established, in its Rebuttal Submission that:

first, the example was irrelevant to an Item (k) first paragraph determination;

second, Brazil simply reargued its case in the original proceedings by trying to include disparate elements in the phrase "export credit", even though its defence had already been rejected; and

third, Brazil's calculations were simply wrong.

84. In the interest of time, I do not propose to go through the numbers. But, we will of course be more than happy to provide you with additional clarification if needed.

85. In respect of the market window question, Brazil argues that "the 'market' for aircraft supported rates that may be lower than the CIRR rate (which was just 'one example' of an appropriate benchmark)." Brazil goes on to claim that "T-bill plus 20 bps benchmark rate was fully 'consistent' with the market and provided no advantage, material or otherwise, to borrowers in PROEX-backed transactions."⁴²

86. It is an unremarkable observation that market rates could, on rare occasions, be below the prevailing CIRR in certain circumstances, or that market terms could be longer than those provided for in the *OECD Arrangement*. But Brazil has not furnished a scintilla of evidence in support of its contention that the T-bill rate+20 bps is remotely consistent with the market. On this basis alone, its claim to the defence would fail, even if it could meet all other elements.

(c) PROEX Export Subsidies do, in Fact, Secure a Material Advantage

87. In the ordinary course of dispute settlement, Canada should prevail because Brazil has failed to support its claim to the benefit of an exception.

88. But, we want to ensure that the Panel is seized of all the facts and arguments necessary for making a complete determination. For this reason, Canada provided evidence and argument in respect of both the CIRR and the market in its Rebuttal Submission. I will not go through these submissions in detail. Rather, in the remaining minutes I propose to focus on three salient points.

⁴² Rebuttal at 35.

89. **First**, the Appellate Body found that a net interest rate below the prevailing CIRR is a *positive* indication that material advantage has been secured. The PROEX programme provides for a preferred rate that is manifestly below the prevailing CIRR. This positive indication that the PROEX programme secures a material advantage.

90. The finding of the Appellate Body does not, however, exclude that a net interest rate *above* the prevailing CIRR could also be found to secure a material advantage.

91. Brazil proposes, however, that there are other benchmarks *below* the CIRR against which a net interest may be compared. In the light of the findings of the Appellate Body, this argument is not tenable. Such an argument would effectively eviscerate the finding of the Appellate Body that a net interest rate below the prevailing CIRR is a *positive* indication of material advantage. In Canada's view, it is not appropriate for Brazil to ask you, Mr. Chairman, Members of the Panel, to modify what the Appellate Body has found. We therefore request that the Panel dismiss arguments by Brazil inviting the Panel to question or modify the findings of the Appellate Body on this issue.

92. In respect, we note that in paragraph of its Second Submission, Brazil argues that using the CIRR as a benchmark would place developing countries "at a permanent structural disadvantage in the field of export credit terms." The Panel should reject Brazil's renewed attempt to turn the discussion of Item (k) first paragraph into a developing versus developed country question. The Appellate Body had ample evidence and argument before it concerning the impact of various interpretative approaches on the interests of developing and developed countries. The Appellate Body could not be said to have ignored developing country interests. Indeed, weakening the export subsidy rules to accommodate Brazilian practices does no favour to developing countries that are more often the victims of subsidized competition from wealthier competitors.

93. **Second**, as Canada demonstrated in its Rebuttal Submission, and as the Chart clearly shows, the preferred rate established under Brazil's Resolution is indeed below the prevailing CIRR.⁴³

94. The CIRR, of course, is not a raw interest rate. The CIRR for each currency is a rate based strictly on the terms set out in the *OECD Arrangement*. In the regional aircraft sector, the prevailing US\$ CIRR is based on seven-year US Treasury Bond rates for terms not exceeding ten years and is applicable to fixed-rate transactions. Thus, applying a ten-year CIRR for terms of over ten years or for floating rate transactions would amount to effectively going below the reference level and "securing a material advantage." In this respect, Canada refers the Panel to Exhibit 15 and **Chart 2**. Canada notes that extending the term results in an increase in the applicable credit risk premium.

⁴³ Canada acknowledges that the comparison is not exact, because in the regional aircraft field, the prevailing CIRR is based on the seven-year US Treasury Bond rate, while the preferred PROEX rate is based on a ten-year Bond.

95. **Third**, the preferred PROEX rate is also considerably below what the market would provide. For fixed rate transactions, the benchmark is US Treasury Rates, to which also a risk premium must be added.

96. The "market" is important for the purposes of the first paragraph of Item (k), but not for the reasons Brazil asserts.

97. Simply put, for the purposes of Item (k) first paragraph, if a net interest rate is below the relevant CIRR, the "payment" in question must be considered to have secured a material advantage. If, however, a net interest rate is above the CIRR, a party that claims the benefit of an *a contrario* exception, if such an exception existed, would have the burden of establishing that it does not secure a material advantage as compared with prevailing market rate.

98. This is because an interest rate buy down of 2.5 percentage points may well not bring the net interest rate in a transaction below the relevant CIRR. But, it would be untenable to argue that such a massive subsidization would not, at the same time, secure a material advantage. To illustrate this point better, we have prepared two charts for your examination.

99. In **Chart 3** we compare the PROEX preferred rate to actual interest rates offered in the market. You will notice that the preferred rate is significantly below the rates offered in the market even to the best credit risk in the airline business.

100. In **Chart 4**, we set out the impact of reducing interest rates by a few basis points. While a 5 basis point interest reduction translates to less than one half of one percent of the cost of an aircraft, the impact of higher rates of subsidization does amount to an advantage substantial enough to persuade a purchaser to choose one product over another. Such an advantage, Canada submits, should be considered material for the purposes of the first paragraph of Item (k).

101. For these reasons, Mr. Chairman, Members of the Panel, PROEX export subsidies do not benefit from an exception in the first paragraph of Item (k), were one to be found by *a contrario* implication.

IV. RELIEF REQUESTED

102. Canada respectfully requests that the Panel find that Brazil has failed to withdraw its export subsidies with effect from 18 November 1999, with respect to all regional aircraft exported after that date whether PROEX interest equalization subsidies were committed on, after or before that date.

103. I thank you Mr. Chairman and Members of the panel for your patience. This concludes Canada's presentation this morning. We will make a concluding statement at the close of these statement.

ANNEX 1-4

RESPONSES BY CANADA TO QUESTIONS OF THE PANEL
(3 February 2000)

TABLE OF CONTENTS

	Page
I. CANADA'S RESPONSES TO THE PANEL'S QUESTIONS POSED ON 3 FEBRUARY 2000	4186
II. CANADA'S RESPONSES TO PANEL'S FURTHER QUESTION POSED ON 7 FEBRUARY 2000	4196
III. CANADA'S RESPONSES TO BRAZIL'S QUESTIONS POSED ON 7 FEBRUARY 2000	4197
I. CANADA'S RESPONSES TO THE PANEL'S QUESTIONS POSED ON 3 FEBRUARY 2000	

For Canada

Question 1

Please state your views about whether, under the "material advantage" clause as interpreted by the Appellate Body, the CIRR is the exclusive benchmark for determining whether a material advantage has been secured, or whether, as argued by Brazil, a different benchmark might prevail if it could be demonstrated that interest rates in the marketplace were lower than the CIRR.

Reply

The Appellate Body found that the CIRR was the appropriate benchmark against which a net interest rate had to be compared to determine whether "material advantage" had been secured. The Appellate Body derived this benchmark after rejecting the benchmarks suggested by the Panel on grounds that it made the concept of material advantage redundant of the measure for benefit, and after considering the useful context of the second paragraph of item (k).

We see no basis in the rulings of the Appellate Body for Brazil's claim to a benchmark below CIRR even if Brazil could demonstrate that interest rates in the marketplace were below CIRR at some given moment. Brazil is already asking the Panel to agree that item (k) creates an *a contrario* exception, which would enable Brazil to make cash buy-down payments or to lend below Brazil's cost of funds so long as no "material advantage" is secured. In suggesting now a "market" benchmark for measuring material advantage, Brazil is asking the Panel to loosen the standards for this exception and disregard the Appellate Body rulings.

As the Appellate Body noted, the second paragraph of item (k) provides context for interpreting the first paragraph of item (k). The second paragraph provides an exception to the application of Article 3 for export credit practices that apply the

"interest rates provisions" of the *OECD Arrangement*. Those provisions include provisions relating to CIRR and to the repayment term of the support being extended. Thus, if a Member applies the "interest rates provisions" of the Arrangement, an export credit practice that is in conformity with these provisions will not be considered an export subsidy prohibited under Article 3.

If the first paragraph of item (k) were interpreted to provide an *a contrario* exception, as paragraph two provides by its terms, the standards that must be met for claiming each exception should not be so dissimilar as to reward those who do not adhere to *OECD Arrangement* standards and claim an exception under paragraph one. A discrepancy that permitted governments claiming the benefit of paragraph one to lend (or pay others' credit costs) at interest rates lower than the "minimum commercial rate available" under the *OECD Arrangement* would give an advantage to those governments claiming the paragraph one exception and penalize those providing officially supported export credits under the terms of the Arrangement. Those adhering to the Arrangement would then have no choice but to exercise their right to match, as provided for under the Arrangement and paragraph two, the more favourable terms being offered by others.

Question 2

Brazil argues that PROEX interest rate equalization which results in a net interest rate equal to or higher than the 10-year US Treasury rate plus 20 basis points is not used to secure a "material advantage" because developed country Members can provide export credits for regional aircraft below the CIRR rate through "market window" operations. In the view of Canada, could support provided through the "market window" result in export credits being extended at interest rates that are below the CIRR rate? Please explain your answer.

"Market window" financing may result in the provision of export credits at net interest rates that are below the prevailing CIRR. However, whether "market window" financing results in net interest rates that are below CIRR does not depend on the identity of the lender or the lender's cost of funds.

The term "market window" is used to describe the provision of financing on terms that are consistent with those that are available in the market place to a particular borrower in a particular transaction. When an export credit agency provides "market window" financing, it is providing financing on terms and conditions consistent with those available from commercial banks and lenders. In that sense, the borrower obtains a net interest rate that is consistent with the market. Since the borrower could go out on the market and obtain a competitive rate in respect of the transaction from a commercial bank or lender, no benefit is conferred within the meaning of Article 1 of the SCM Agreement and, therefore, no subsidy exists.

Unlike "market window" financing, PROEX interest rate equalization provides financing on terms that are better than those available to a particular borrower in a particular transaction. PROEX interest rate equalization payments "buy-down" the rate negotiated in the market by a particular borrower in a particular transaction. As such, PROEX always results in a net interest rate that is better than the rate otherwise available to the borrower. A "buy-down" from the interest rate secured by a

particular borrower in the market always results in a net interest rate that is below market.

Question 3

Please state whether, in the view of Canada, Participants to the Arrangement are required to respect the CIRR (a) in respect of "pure cover" and (b) in respect of floating interest rate transactions.

The CIRR as constructed in accordance with Article 16 is a fixed interest rate. Therefore, it is not applicable for the purpose of floating rate transactions or pure cover transactions involving a floating rate undertaken under the *OECD Arrangement*.

However, it is Canada's view that pure cover and floating rate transactions should respect the relevant principles for minimum interest rates of Article 15, and should not, therefore, be undertaken at rates below internationally recognized market standards, such as LIBOR. The transactions would also have to respect all the other relevant interest rate provisions of the Arrangement including, in particular, the requirement for a risk-based premium and the limitations on maximum repayment terms (i.e., ten years for regional aircraft).

Question 4(a)

Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional aircraft, (a) provided fixed interest-rate export credits at interest rates below CIRR?

Yes. Due to the time delay in the construction of CIRR (as discussed below), there were instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed. However, the interest rates charged by EDC for such transactions were market-based and commensurate with the risk associated with the particular borrower, and said transactions included customary collateral security protection. There was also one instance of matching in respect of a Canada Account financing transaction that was implemented in full compliance with the *OECD Arrangement*, and this transaction also benefited from collateral security.

A meaningful comparison of market transactions to CIRR is difficult due to the fact that the CIRR is a constructed rate, while commercial aircraft transactions are priced at commercial rates available at the time of the specific transaction. To recall, the CIRR is determined by taking the average of the 7-year Treasury rate (in the case of deals with repayment terms up to 10 years) for the previous month and adding 100 bps. For example, the CIRR for the period 15 September-15 October would be constructed using the average of the 7-year Treasury for the month of August, plus 100 bps. Carrying on with the example, the result of this calculation is that the CIRR applicable to transactions closing during the period from 15 September through 15 October would close using a rate that was calculated using the average of the applicable Treasury rate during August, i.e. up to two months earlier. To an entity that operates on the basis of commercial principles, the calculation of the CIRR is such that it would not be considered a reliable reflection of current market conditions.

We have attached hereto as Exhibit CDN-16 a chart that compares the 7-year Treasury rate and the 10-year Treasury rate to the applicable CIRR during the period January 1998 through December 1999. (Please note that the seven and 10-year Treasury rates provide a base to which the risk premiums appropriate for a particular borrower must be added.) The attached Exhibit CDN-16 demonstrates clearly the lagging aspect of the CIRR due to the method of its calculation. One good example of this is the period September - October 1998, when the market rates decreased considerably while the CIRR lagged behind. At certain times during this period, the CIRR was more than 200 bps above the then applicable 7-year Treasury rate.

As a result, during this September-October 1998 period, a commercial lender could have made a loan at a rate of interest equal to the 7-year Treasury plus 200 bps, and the rate of interest still would have been below the applicable CIRR. As the graph in Exhibit CDN-16 demonstrates, during the period September - October 1998, the 7-year Treasury and the 10-year Treasury were trading at about the same level, which suggests that a 10-year Treasury rate + 200 bps would also have been below the applicable CIRR.

The same issue of the appropriateness of the CIRR applies when interest rates are increasing. If one looks again at Exhibit CDN-16, during the period May-June 1999, it is again apparent that the CIRR lags behind the market. As a result, during this period, there are times when commercial interest rates in the range of the 7-year Treasury rate + 15 to 20 bps and the 10-year Treasury + 25 to 30 bps (which Canada has previously indicated would not be reflective of commercial market pricing) would have been above the applicable CIRR.

While the examples provided above are only relevant for the time periods covered therein, they nonetheless illustrate the shortcomings of comparing a constructed rate such as a CIRR to commercial market pricing.

With the exception of the one Canada Account transaction referenced above, we can confirm that the interest rate charged in respect of regional aircraft has been market-based, that it has been commensurate with the risk associated with the particular borrower and that in every case it has been well above Brazil's preferred PROEX rate of 10-year Treasury plus 20 bps.

Question 4(b)

Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional aircraft, (b) provided guarantees in respect of fixed interest-rate export credits extended at interest rates below CIRR?

Reply

No,

Question 5(a)

Canada states (second submission, footnote 24) that, in order to compare a floating interest rate expressed in LIBOR to a US Treasury Bond, a "swap spread" must be added. Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional

aircraft (a) provided floating interest-rate export credits the initial interest rate of which was below the CIRR applicable as of the date of the transaction, less the relevant swap spread prevailing as of that date?

Reply

No.

Question 5(b)

Canada states (second submission, footnote 24) that, in order to compare a floating interest rate expressed in LIBOR to a US Treasury Bond, a "swap spread" must be added. Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional aircraft (b) provided guarantees in respect of floating interest-rate export credits the initial interest rate of which was below the CIRR as of the date of the transaction, less the relevant swap spread prevailing as of that date?

Reply

No.

Question 6

Canadian Exhibit CDN-11 appears to establish a "swap spread" between the floating interest rates and 7-year fixed interest rates. Canada, however, uses this swap spread to compare a floating interest rate to a 10-year US Treasury Bond rate. Please explain.

Reply

In the normal course, when swapping a fixed interest rate to a floating interest rate, the swap spread relating to the average life of the loan in question is used. In the case of a loan requiring equal, semi-annual payments of principal and interest, the average life of the loan is determined by reference to the time in the life of the loan when 50 percent of the principal amount of the loan has been repaid.

In the transaction submitted by Brazil, which was based on a twelve-year loan, the average life of a twelve-year loan with equal semi-annual payments (i.e., six years) would be closer to seven years than it would be to ten. We therefore took the conservative route and selected the seven-year swap rate. Had we selected the ten-year swap rate for the same period, it would in fact have been marginally higher, i.e., 80 to 85 basis points.

Question 7

The Appellate Body has stated that "the appropriate comparison to be made in determining whether a payment is 'used to secure a material advantage', within the meaning of item (k), is between the actual interest rate applicable in a particular export transaction after deduction of the government payment (the 'net interest rate') and the relevant CIRR." (WT/DS46/AB/R, para. 54). It could be argued that whether PROEX interest rate equalization results in

a net interest rate below CIRR will depend upon the initial, pre-equalization interest rate, and PROEX interest rate equalization does not necessarily result in a below-CIRR net interest rate in any given transaction. Please comment.

Reply

Yes, it could be argued that whether PROEX results in a net interest rate below CIRR depends upon the initial pre-equalization interest rate in a given transaction. However, the situation in which PROEX interest rate equalization produces a net interest that is higher than CIRR arises only where the credit standing of the borrower is particularly poor. In such a case, the interest rate spread payable by the borrower may be in excess of 350 basis points; and, in that case, PROEX interest rate equalization effectively puts the borrower in a position that is similar to that of a borrower with a much better credit rating.

In the unlikely event that PROEX results in a net interest rate that is above CIRR, such a rate still secures a "material advantage". Canada has provided evidence that, in the regional aircraft market, an interest rate advantage on the order of as little as 25 basis points is substantial enough to persuade a purchaser to choose one product over another.

By its design, PROEX secures a material advantage. Brazil has provided no evidence to the contrary.

Question 8

To what extent do you consider the OECD Arrangement is legally binding on Canada?

Reply

As a matter of WTO law, the interest rate provisions of the *OECD Arrangement* are binding in the sense that compliance with those provisions is a condition of benefiting from the exception in paragraph two of item (k).

In addition to the legal status of the *OECD Arrangement* in the context of the WTO, Canada considers that, as a participant in the Arrangement, Canada is bound to follow its terms in the same way as all other participants. Notwithstanding the somewhat ambiguous and certainly archaic use of the term "gentlemen's agreement" in OECD documents and the lack of apparent dispute settlement terms within the Arrangement, participants have treated the Arrangement as a serious multilateral commitment, and recognized that discipline on export credit competition through adherence to the Arrangement is in their individual and mutual self-interest.

Question 9

Canada states (second submission, para. 24) that the 3.54 per cent guarantee fee in respect of the US Export-Import Bank transaction cited by Brazil is equivalent to 75 bps, rather than the 30 bps cited by Brazil. Please explain the basis for your statement.

Reply

Brazil uses a methodology in determining the amount one would need to add to the annual interest rate spread of a loan to achieve a return equivalent to the up-front Ex-Im Bank fee that simply divides the fee by the number of years the loan is outstanding. This is not the appropriate formulation to determine this figure. In calculating our estimate of this amount we utilised EDC's standard "yield model" which determines the yield of such an up-front fee essentially by determining the cash-flow required over the term of the loan to produce the equivalent of the up-front fee. The assumptions made in terms of a range of elements of a particular loan, including interest rate, disbursement schedule and repayment profile, will have a bearing on this calculation. The yield is determined as the transaction's internal rate of return (IRR). The IRR is the discount rate at which the net present value (NPV) of all cash outflows (i.e. loan disbursements) equals the NPV of all cash inflows (i.e. principal repayment, interest and all fees). The NPV is taken as of the date of the first disbursement.

We have included two attachments that demonstrate this calculation as Exhibit CDN-17 and Exhibit CDN-18. The first of these attachments highlights the calculation of the IRR using a set of assumptions, including a guarantee fee of 3.54 per cent as included in Brazil's example. Our determination of the 75 bps is included at the bottom of Exhibit CDN-17. Exhibit CDN-18 simply demonstrates that increasing the interest rate margin by 75 bps results in the same IRR.

Brazil has noted that Canada and the EU came up with different figures for the appropriate number (the EU suggested 60 basis points, Canada suggested in the range of 75 basis points). The differences in these two calculations could result from differences in a range of assumptions regarding the characteristics of the loan that, as referred to above, can have a bearing on the calculation of this figure. The important point is that Canada and the EU agree that the Brazilian methodology is incorrect, and that the appropriate number is well above the 30 basis points put forward by Brazil.

Question 10

Canada states (second submission, para. 51) that "a rate of 10-year Treasury Bonds + 20 bps is, under no circumstance, available to purchasers of regional aircraft in direct financing at market rates." Is such a rate available to the purchasers of regional aircraft through modalities other than direct financing, e.g., through loan guarantees? Please support your answer.

Reply

Canada's assertion that a "rate of 10 year Treasury Bonds + 20 bps is, under no circumstance, available to the purchasers of regional aircraft in direct financing at market rates" is equally true for loan guarantees and direct financing.

Canada knows of no transaction in the regional aircraft sector, or in any other sector, where a loan guarantee - or any other financing modality - has led to rates of 10-year Treasury bonds + 20 bps. Brazil has not adduced any evidence to the contrary. In Exhibit CDN-15, the rates for a range of credit ratings were provided, and these demonstrate that even for the highest rated borrowers (AAA), interest rate

spreads of 20 bps are not attainable. In fact, as shown in the same exhibit for a 10-year transaction, the borrowers with the highest credit ratings were borrowing on an unsecured basis at interest rates of 10-year Treasury plus 82-97 bps. While the interest rates paid by borrowers fluctuates over time as market conditions vary, our research indicates that the average yield spread for AAA credits for the last nine years has been approximately the 10-year Treasury Bond + 43 bps.

Question 11

Please provide further information regarding the interest rates you identify in respect of transactions regarding AMR, NW and US Air, sufficient to establish the basis on which they were calculated and the comparability of the transactions including, *inter alia*, the nature of the aircraft financed.

Reply

Canada is pleased to provide further information in respect of the transactions regarding American Airlines, Northwest Airlines and US Air, referred to in Chart 2, which was produced during Canada's oral statement.

First, with respect to the method of calculation, Canada notes that, in all three cases, a weighted average of the series of *tranches* and their accompanying interest rates was calculated. In the American Airlines and US Air deals, structuring fees were excluded, though we estimate they would constitute an additional five to ten basis points. We have attached hereto as Exhibit CDN-19 the specific information regarding *tranches* and corresponding spreads relating to the US Air and AMR cases provided by Morgan Stanley Dean Witter. With respect to the Northwest transaction, the weighted average was calculated on the basis of the spreads provided below:

<i>Class</i>	<i>Coupon</i>	<i>Amt</i>	<i>LTV</i>	<i>Term</i>	<i>Avg Life</i>	<i>Rating</i>	<i>Offer Spread</i>	<i>Current Pricing</i>
G*	7.93%	\$150	44%	4/19	12	Aaa/AAA	170	160
B	9.48%	\$58	61%	4/15	9	Baa2/BBB	325	310
C	9.15%	\$32	69%	4/10	5	Baa3/BBB-	300	285

*It is important to note that the G *tranche* of the above-noted transaction is "credit wrapped" by a financial guarantee provided by MBIA, a world-wide financial insurance company. The "credit wrap" obligates MBIA (a AAA-rated company) to ensure timely payment of interest and ultimate payment of principal by the legal final maturity date. MBIA is paid a one-time up-front premium by the airline which represents an additional estimated 30 bps to the guaranteed *tranche*, i.e., raising the guaranteed *tranche* from 170 bps to 200 bps. The wrap enhances the rating of the *tranche*, thus lowering the yield required by investors, as demonstrated in Exhibit CDN-20, attached hereto.

Second, with respect to the issue of comparability, Canada notes that these are all North American transactions, and that all are secured by the aircraft. They are fully comparable. The fact that they are North American transactions is noteworthy for the following reason: for US major airlines, S&P makes a two-notch upwards rating adjustment (e.g., BB+ to BBB flat, skipping over BBB) from the airline's sen-

ior unsecured rating for being secured with "good" aircraft (a viable product with significant market demand) at a non-aggressive loan-to-value ratio and with Section 1110 legal protection. The Section 1110 protection obligates the defaulting airline, within 60 days of default, to either continue the financing (or lease) and make all payments current, or give the aircraft to the lender / lessor in a repossession.

As for the type of aircraft purchased, the Northwest Airlines transaction involved the purchase of regional aircraft: 14 Avro RJ85 aircraft from British Aerospace.

The American Airline and US Air examples involved the purchase of large aircraft.

Specifically, in the case of US Air, the acquisition was for thirteen Airbus 319-100s, five Airbus A320-200s and two Airbus A330-300s, as shown in Exhibit CDN-21.

In the American Airlines' transaction, the financing was for two Boeing 777-200s, three 767-300s and ten 737-800s.

The above establishes without doubt that 20 bps above US Treasury Bills is well below rates which prevail in the marketplace.

The most recent evidence of this was made available after Canada submitted its oral arguments earlier this month. Just last week, Bloomberg announced that Brazil's BNDES sold \$190 million in asset-backed bonds that were backed by the receivables from the sale of 42 Embraer ERJs to AMR. Bloomberg states, "BNDES provided the export financing to support the sale of the Embraer jets. The bonds were sold to yield 7.79 percent, representing a difference of 115 to 135 basis points above equivalent US Treasury bonds." The relevant Offering Memorandum states at page 1 that, "[f]rom February 27, 1998 to November 16, 1999, FINAME, the Brazilian state owned export-import agency, provided debt financing to American Eagle for the purchase by American Eagle of 42 new Embraer EMB-145LR regional jet aircraft." Canada has attached the Bloomberg newswire and relevant Salomon Smith Barney Summary Offering Memorandum hereto as Exhibit CDN-22.

This most recent information provides evidence of two other unassailable facts:

- (i) Contrary to Brazil's claims in its oral submission that, due to the prohibitive cost, Brazil "has been forced to reject [direct financing]," Brazil can provide, and, indeed, has provided, direct financing.
- (ii) Embraer aircraft can easily be financed on the private market.

This last fact was proven long ago with the purchase of 9 ERJ-145s by Continental Airlines in 1997. Canada refers here to the prospectus supplement by Morgan Stanley Dean Witter that is attached hereto as Exhibit CDN-23. The Continental pass-through had a weighted average cost of some 93 bps. The Continental weighted average spread was unusually low because conditions were extremely tight at that date.

Canada submits that all of the above demonstrates that, by definition, PROEX interest rate equalization results in a below-market rate that yields a material advantage. PROEX interest rate equalization always "buys-down" the prevailing market rates by up to 250 bps, and, thereby, provides a rate that, except in rare circumstances, falls in the range of 100 to 350 bps above US Treasury rates.

Question 12

The Appellate Body refers to the CIRR as a minimum commercial rate, and it could be argued that it was for that reason that it chose the CIRR as reference point for evaluating material advantage. Canada has stated that commercial rates below CIRR are possible. Does this not suggest that, to the extent that a commercial rate below CIRR exists, that commercial rate should represent the reference point for evaluating material advantage?

Reply

No. The Appellate Body correctly observed that CIRR is "the minimum commercial rate available under the *OECD Arrangement*". The Arrangement applies to officially supported export credits. Paragraph 1 of item (k) concerns the provision by governments of export credits provided at rates below the government's cost of funds, or government payments to cover similar costs incurred by exporters or financial institutions. The relevant benchmark against which a net interest rate must be compared to determine whether a material advantage has been secured under paragraph 1 is CIRR. Commercial market rates that are below CIRR would occur only in the context of market window transactions that do not require either paragraph of item (k). Such a reference point, therefore, would not be relevant to any item (k) analysis.

For Both Parties**Question 1**

The Appellate Body has referred to the CIRR as "a minimum commercial interest rate". The US dollar CIRR is however constructed on the basis of US Treasury bond yields. Further, Canada has stated (second submission, para. 40) that US Treasury Bonds are fixed rate reference benchmarks, while LIBOR is a floating rate benchmark. That being the case, to what extent can CIRR rates be considered relevant to establishing a "minimum commercial interest rate" in respect of floating rate transactions?

Reply

The CIRR is a constructed rate that is calculated monthly on the basis of the applicable US Treasury rate plus 100 basis points. The swap market provides a current indication of the cost at any given time of taking a stream of floating interest rate cash-flows and converting them to fixed interest rate cash-flows. The US Treasury rates and the swap spreads are dynamic and subject to constant fluctuation and adjustment due to current economic, financial and market conditions. While we have demonstrated that it is possible to convert a floating rate of interest to a fixed rate of interest, we do not believe that the CIRR would be relevant in establishing a minimum floating rate of interest because the CIRR is a constructed rate that is adjusted only on a monthly basis.

Question 2

Resolution 2667 states, inter alia, that "equalization rates shall be established on a case by case basis and at levels that may be differential." What relevance, if any, does this language have to the issues now before the Panel?

Reply

The language in Resolution 2667 to which the Panel's question refers is not germane to the issue whether Brazil has withdrawn its illegal PROEX export subsidies.

By design, PROEX always results in a net interest rate that is below CIRR or that is materially below the market, as we have explained in our response to question 7 to Canada, above.

The language identified in this question must be understood in the context of the revised PROEX programme. The market-based interest rates secured by a borrower prior to the application of a PROEX interest rate buy-down to that interest rate will vary depending on several factors, such as the creditworthiness of the borrower and the structure and terms of the transaction. Because the market-based interest rates will always vary from borrower to borrower and transaction to transaction, the "gap" or "spread" between that interest rate and the Preferred PROEX rate (which could, theoretically, go below T + 20 bps as a result of the discretionary authority of the Committee) will also vary.

Accordingly, PROEX interest rate equalization will have to be "established on a case by case basis", and the levels of equalization to different borrowers "may be differential". However, the net interest rate will invariably secure a "material advantage", whether it is below or above CIRR because it is still an interest rate buy-down of up to 250 bps that will influence the outcome of the transaction.

II. CANADA'S RESPONSES TO PANEL'S FURTHER QUESTION POSED ON 7 FEBRUARY 2000

Question 1

Canada stated at the meeting with the Panel on 4 February 2000 that, if the Export Development Corporation provides financing at rates equal to or higher than its borrowing costs, but below the CIRR, that practice may still not constitute a subsidy because no benefit is conferred. That would mean that there may exist a market benchmark lower than the CIRR. Does Canada agree that if Brazil, for instance, used that same benchmark, which is lower than the CIRR, no subsidy would exist as per the Canadian argument because no benefit is conferred.

Reply

No. Canada does not agree. As discussed in response to questions 1 and 12, above, Brazil, having claimed an *a contrario* exception under paragraph one of item

(k), must comply with the CIRR benchmark for material advantage. If it gains a material advantage through its payments, by buying down rates to levels below

CIRR, then it is by definition, under item (k), granting an illegal export subsidy. Item (k) does not apply to EDC when it engages in market transactions; in such cases, EDC is free to lend at market rates and would not require recourse to item (k) for an exception.

III. CANADA'S RESPONSES TO BRAZIL'S QUESTIONS POSED ON 7 FEBRUARY 2000

Question 1(a)

At the meeting of the Panel, Canada stated that the concept of "market window" was applied whenever financing was provided at a commercial rate.

- a. **Please explain how Canada determines for each transaction whether or not it needs to resort to the concept of "market window".**

Reply

Canada did not make the statement referred to by Brazil. Canada indicated that the "market window" is used to provide financing on terms and conditions consistent with those available from commercial banks or lenders to a particular borrower. When the terms and conditions available from commercial banks or lenders for a specific transaction are outside the terms and conditions under the *OECD Arrangement*, the "market window" is used.

Question 1(b)

- b. **How does Canada determine whether the interest rate for any such transaction is consistent with the marketplace?**

Reply

Canada has already answered this question, as well as questions 2(a), 2(b) and 2(c), in the context of the original proceeding in *Canada - Measures Affecting the Export of Civilian Aircraft*. At paragraphs 57 and 58 of its second written submission to the Panel in that proceeding, Canada explained as follows in respect of EDC's Corporate Account:

"The EDC operates on commercial principles. This means that in providing financing in sales transactions, the terms it offers to prospective purchasers are "priced" commercially. The EDC provides financing at market rates by setting its interest margins to reflect credit risk in accordance with market principles. The EDC's interest rates reflect commercial benchmarks and interest rate margins that are in accordance with commercial credit ratings provided by rating agencies such as Moody's or Standard & Poor. Where commercial credit ratings are not available from rating agencies, the EDC uses internal credit ratings determined in accordance with prudent commercial practices. Like several other international financial institutions,

the EDC's internal credit ratings are based upon the result of analyses using a sophisticated computer program, *LA Encore*. This program is employed for the same purpose by other major financial institutions, such as Lloyd's Bank and Barclays Bank in the United Kingdom.

In terms of the pricing process, the EDC's transportation group has a committee that reviews and approves the pricing on all transactions in the civil aircraft sector. In setting this pricing, EDC compares what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. The EDC then prices according to that benchmark. In the absence of this benchmark, the EDC compares the relevant borrower to borrowers of comparable credit standing in the civil aviation sector for whom a similar credit history exists; the EDC then prices according to this alternative benchmark."

Question 2(a)

At the meeting of the Panel, Canada stated that the "market window" concept permits financing transactions at rates below the CIRR. Canada also stated that in such cases no benefit is conferred within the meaning of Article 1 of the SCM Agreement because financing is provided on commercial terms.

- a. **How does Canada determine in such cases that financing is provided on commercial terms otherwise available in the marketplace?**

Reply

See response to Question 1(b), above.

Question 2(b)

- b. **What criteria or benchmarks are used other than financing provided by Canada itself?**

Reply

See response to Question 1(b), above.

Question 2(c)

- c. **What are the sources of information Canada uses to determine what the commercial rates available in the marketplace are?**

Reply

See response to Question 1(b), above.

Question 2(d)

- d. **What are the public sources of information that Brazil or other governments could use to determine what are the commercial rates available in the marketplace?**

Reply

The various public sources of information include published information memoranda and prospectuses from completed transactions, deal and market summaries published by many financial institutions as well as a number of on-line services (i.e. Reuters, Bloomberg) which publish both deal specific and general information as well as market trends and the current trading levels of many airline transactions.

Question 3

At the meeting of the Panel, Canada stated that when it "steps through the market window," it operates on commercial terms and, therefore, the issue of its cost of funds is irrelevant. Does this mean that Canada would be justified in lending below its cost of funds under the "market window" concept?

Reply

Canada put forward during the Panel meeting that determining the appropriate terms and conditions for a specific transaction was done on the basis of what would be available to the specific borrower from commercial banks or lenders for the type of transaction in question. The issue is therefore not whether a lender would be justified in lending below its cost of funds, but whether any lender that operates on the basis of commercial principles would consider a transaction where meeting the terms available in the market would require it to lend at below its cost of funds, and we believe the answer to this question is no.

Question 4

Does Canada comply with the "matching" provisions of the OECD Arrangement (Article 29) when it applies or resorts to the concept of the "market window" under the OECD Arrangement?

Reply

"Market window" transactions are different from "official support" transactions. Although the OECD Participants continue to discuss "market window", both with the objective of ensuring transparency on all of the participating governments' export credit practices (whether involving official support or not) and more formally defining the appropriate borderline between "official support" and "market window", the disciplines of the *OECD Arrangement* are simply not applicable to "market window" transactions. In international trade law, "market window" transactions are legitimate because they do not involve the granting of a subsidy; they do not need the protection of the "safe haven" of the second paragraph of item (k).

In the *OECD Arrangement* context, "matching" refers only to the matching of "official support" offered by another government on non-compliant terms and conditions through the provision of "official support" by the matching Participant. This has nothing to do with the operation of a "market window".

Question 5

Canada stated at the meeting of the Panel that it has not applied the "matching provisions" of Article 29 of the OECD Arrangement. Please confirm.

See our response to Question 4 above. Canada did not make the statement referred to by Brazil. Rather, Canada indicated that it does not apply the matching provisions of the *OECD Arrangement* in the case of "market window" because they are simply not applicable. "Market window" is not "official support", and the "matching" and other provisions of the *OECD Arrangement* are pertinent only to "official support".

Question 6

At the meeting of the Panel, Canada seemed to say that when it resorts to the "market window" concept it "matches" the commercial rate available in the marketplace, while the "matching" provisions of Article 29 permit Canada to provide the financing below the market rate if another government does so. Please confirm and explain.

Reply

See our responses to Questions 4 and 5, above.

Canada did not make the statement suggested by Brazil. Rather, it indicated that "market window" transactions are entered into on terms and conditions that are consistent with those that are otherwise available to a borrower in the marketplace.

Question 7

In its First Submission dated January 10, 2000 (paras. 12-18 and Ex. Bra-2), Brazil provided information regarding an Ex-Im Bank loan guarantee for the financing of two Boeing aircraft sold to China. In Canada's view, do the terms and conditions of this transaction represent the commercial rates available in the marketplace for financing of large jet aircraft?

Reply

No. The Ex-Im Bank transaction is exceptional and would simply not occur "in the marketplace". There is no commercial bank that could provide such rates without the benefit of an Ex-Im Bank guarantee. This transaction is influenced by and clearly reflects particular US-China policy issues; therefore, it does not "represent the commercial rates available in the marketplace for financing of large jet aircraft".

In other words, the financing terms in this transaction are an isolated example that cannot be used as a comparison to a financing transaction in the commercial market.

Question 8

Please assume that the transaction described above was for an actual sale of regional jet aircraft rather than of large jet aircraft. In such circumstances,

would Canada consider the terms of this transaction to represent the "market" for regional jet aircraft?

Reply

No. For the reasons cited in Canada's response to Question 7, the transaction does not represent the "market" for large jet financing; nor could it represent the "market" for regional jet financing. The Ex-Im Bank transaction is made within the applicable conditions of the *OECD Arrangement* applicable to large aircraft financing. It was for a term of 12 years. And it is completely irrelevant to the market conditions applicable to the commercial market financing of regional aircraft, which has terms that are recognized as being for 15 to 18 years .

Question 9

Repeating the hypothetical situation described in the previous question, would the provision of financing under these terms constitute a violation of either the OECD Arrangement or the SCM Agreement?

Reply

No. Canada understands that the Ex-Im Bank loan guarantee is fully compliant with the Arrangement. Therefore, the transaction enjoys the protection of the "safe haven" of item (k), which also makes it compliant with the SCM Agreement.

Question 10

Again repeating the hypothetical situation described in the previous two questions, in such circumstances, would Canada be entitled to "step through the market window" and provide the same terms and conditions to finance or guarantee the sale of Canadian regional jet aircraft?

Reply

Brazil's question combines two separate and distinct concepts, "pure cover guarantees" and "market window". They cannot be combined.

Recognising that the Ex-Im Bank transaction referred to by Brazil was a pure cover *OECD Arrangement* transaction, if Canada were to deliver a similar transaction, it would also do so in accordance with the *OECD Arrangement*.

ANNEX 1-5

CANADA'S COMMENTS ON BRAZIL'S RESPONSES TO QUESTIONS OF THE PANEL

(17 February 2000)

FOR BRAZIL

Question 1

1. Brazil correctly responds that a net interest rate equal to the 10-year US Treasury Bond rate plus 20 basis points is below CIRR. Brazil is wrong in asserting, first, that such a rate is "consistent with the market for regional aircraft transactions" and, second, that Canada agrees.

2. Canada does not agree that a 10-year US Treasury Bond rate plus 20 basis points is consistent with the market for regional aircraft. Canada stated, at paragraph 51 of its Rebuttal Submission (17 January 2000), that a 10-year US Treasury Bond rate plus 20 basis points is under no circumstance available to purchasers of regional aircraft in direct financing offered at market rates. Canada's Exhibit 15 and the Charts adduced as evidence in the course of Canada's Oral Statement demonstrate that the preferred PROEX net interest rate is significantly below the current rates offered in the market to a number of major US airlines. Canada addressed this point again in its response to Question 10 to Canada, posed by the Panel on 3 February 2000. The evidence adduced by Canada has never been questioned or contradicted by Brazil.

3. Canada has also argued that the first paragraph of item (k) does not provide an *a contrario* exception to the prohibition on export contingent subsidies in Article 3 of the SCM Agreement. But, even if it did, Brazil has admitted, and this Panel and the Appellate Body have already found, that Brazil has the burden of establishing that PROEX export subsidies do not "secure a material advantage in the field of export credit terms." Apart from misstating Canada's views with respect to the net interest rates available in the regional aircraft sector, Brazil has adduced no evidence that would allow this Panel to find that the preferred PROEX net interest rate would satisfy the requirements of paragraph one of item (k). PROEX secures a material advantage. It results in a net interest rate that is below the market rates available in the regional aircraft sector, and, most importantly, below CIRR.

Question 3

4. Brazil attempts to support its interpretation of "maintain" in Article 3.2 by relying on alleged Canadian "subsidy" programmes as notified to the WTO under Article 25. Canada recalls that under Article 25.7, notification of a programme to the WTO does not prejudge whether those practices are subsidies. *A fortiori*, such notification has little relevance in the interpretation and application of an obligation solely related to subsidies prohibited under Article 3, and required by the DSB to be withdrawn. The Panel in *Canada - Aircraft* rejected Brazil's reliance on Canada's notification for the establishment of a *prima facie* case against the Canadian programmes (at 9.256).

5. At issue are Brazilian export subsidies found to have been prohibited by the DSB and whether Brazil continues to "grant" such subsidies under Article 3.2. Canadian programmes that, according to Brazil itself, no longer exist and that may or may not constitute subsidies, let alone subsidies contingent upon export performance, have no relevance to this case.
6. Finally, Canada notes Brazil's statement that,
"a financial contribution is made and a benefit is conferred within the meaning of Article 1 of the SCM Agreement, *and a subsidy is thereby granted within the meaning of Article 3.2 of the SCM Agreement*, when contracts are signed pursuant to the letters of commitment."
(emphasis added)
7. Brazil provides no rationale for interpreting "grant" differently in the case of Articles 3 and 27 of the SCM Agreement. It does not in any way explain what the word "grant" might mean in Article 3. Instead, it challenges an argument not made by Canada in respect of Article 1 of the SCM Agreement that is not pertinent to the question before the Panel in this instance, based impermissibly on notifications in respect of programmes that no longer exist. Having done so, it baldly conflates the point at which a subsidy comes into "existence" under Article 1 and when it might be "granted" for the purposes of the prohibition in Article 3, without any analysis, logic or explanation.
8. Brazil must withdraw subsidies found by the DSB to have been prohibited and granted at the time of the issuance of NTN-I bonds. Brazil must, accordingly, cease granting such subsidies in accordance with Article 3, by no longer issuing NTN-I bonds upon the delivery of aircraft after 18 November 1999.

Question 6

9. Brazil's response confirms that Brazil will provide PROEX payments for terms longer than 10 years, and apparently up to 18 years, on the same basis as for 10-year financing. Canada notes that PROEX payments are provided to reduce the borrower's costs after the borrower has already obtained what are presumably the best possible combination of interest rates and terms available on the market for that borrower. Brazil's response in effect means that the PROEX subsidies that Canada has already shown to be inconsistent with the SCM Agreement will indeed be applied in the case of regional aircraft for an even longer tenure than that provided "normally" under the PROEX programme.

Question 9

10. In its response to Question 9 to Brazil, Brazil asserts that, "PROEX's spread of 20 bps above the 10-year T-bill falls within the range for regional jet aircraft transactions suggested by Canada." On this point, Canada refers to its comments under Question 1, above. A 10-year US Treasury Bond rate plus 20 basis points is under no circumstance available to purchasers of regional aircraft in direct financing offered at market rates. For the last nine years, the average yield spread for AAA credits has been approximately the 10-year Treasury Bond rate plus 43 basis points; and *no* airline enjoys such a rating.

11. Canada has already demonstrated that in December 1999, a representative sample of airline companies operating in the US market obtained financing at T+110

to 250 basis points (based on a weighted average of the different *tranches* of the financing transaction). It has also noted that the net interest rate payable by a borrower with a particularly poor credit rating may be in excess of T+350 basis points. Of course, neither of these examples establishes a hard limit for the international aircraft financing market. Prevailing market conditions, different payment profiles, or terms, or other conditions negotiated between a lender and a borrower could affect the final interest rate, resulting in higher or lower rates than those set out in Chart 1. However, a rate of T+20 bps is under no circumstance available in the international financing market to even the highest-rated airline, regardless of the other terms and conditions of the transaction.

Question 11

12. A commercial lender operating in the market does not "distort" that market. An export credit agency, acting as a commercial lender and on the basis of commercial principles does not "distort" the market, or the field of export credit terms. Brazil's allegation that commercial lending by export credit agencies acting in the so-called market window somehow distorts the market is simply wrong.

13. The term market window merely describes the provision of financing on terms that are consistent with those that a commercial bank or lender would provide to a particular borrower in a particular transaction. An export credit agency lending through the market window is simply acting as a commercial lender would. In such circumstances, there is no "benefit" to the recipient because the recipient does not receive terms and conditions that are more favourable than those that it could obtain from a commercial lender. Accordingly, there is no more "distortion" in the market from the market window operations of an export credit agency than from the involvement of any other commercial lender in the market.

14. Finally, Brazil again asserts that the "T-bill plus 20 bps rate does not provide a material advantage vis-à-vis [EDC's 'market window' operations]". Canada refers to its comments to Questions 1 and 9, above, and repeats, a 10-year US Treasury Bond rate plus 20 basis points is not available to purchasers of regional aircraft in direct financing offered at market rates.

15. PROEX export subsidies buy down interest rates negotiated freely in the market between a purchaser and financial institutions, many of which are non-Brazilian financing institutions. Such interest rate buy-down subsidies by definition result in a net interest rate that is better than the rate otherwise available to the borrower. Where the resulting net interest rate is below the prevailing CIRR, PROEX export subsidies *ipso facto* secure a material advantage. Even where the resulting interest rate is above the prevailing CIRR, by providing a buy-down of 250 basis points, as Canada has demonstrated, PROEX export subsidies secure a material advantage.

Question 12(a)

16. With respect to Brazil's statement that "the letter of commitment temporarily creates a binding legal obligation, which becomes final when the contracts are signed before the letter of commitments expires", Canada notes that the Panel found that:

" ... at the time the letter of commitment is issued, no PROEX payments have been made, nor has the beneficiary earned the unconditional right to receive PROEX payments. Rather, the issuance of the

letter of commitment means only that, if an export transaction is closed within a certain period of time, and if the product in question actually is exported, a right to receive PROEX payments will arise" (para. 7.71).

17. The Appellate Body has not modified this finding. Clearly, Brazil is not legally obligated to provide PROEX equalization payments at the time a letter of commitment is issued. As the Panel found and the Appellate Body confirmed, that obligation arises only when the aircraft are actually exported, i.e., when Brazil issues NTN-I bonds.

Question 12(b)

18. Without questioning Brazil's statement of Brazilian law, Canada considers it important to make three brief points in this regard. First, as provided in Article 27 of the *Vienna Convention on the Law of Treaties*, "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty." Thus, the fact that the Government of Brazil might be liable for damages if it ceased to issue NTN-I bonds on regional aircraft exported after 18 November 1999 pursuant to letters of commitment issued prior to that date cannot excuse its failure to act in conformity with Articles 3.2 and 4.7 of the SCM Agreement and the recommendations and rulings of the DSB. See also Canada's Oral Statement to the Panel at paragraphs 32 and 33.

19. Second, Canada notes that - even if Brazil's plea for relief from its WTO obligations were legitimate, and it is not - whether or the extent to which the Government of Brazil might in fact face damages claims is entirely speculative. Brazil has not provided copies of the letters or contracts as evidence to permit a factual assessment of their contents (including, for example, whether they contain, or have been renegotiated to incorporate, clauses protecting the Government of Brazil against liability in these circumstances, or provide it defences against damages claims), or even to permit a factual conclusion regarding whether the contracts - many of which involved non-Brazilian financial institutions - are subject to Brazilian or foreign law. (Brazil provided only two sample letters of commitment, in the original proceeding, and the legal opinion submitted by Brazil was based only on those samples.)

20. As Canada noted in its oral statement to the Panel, Brazil has been on notice since at least June 1996 that Canada considered PROEX interest equalization payments to be prohibited export subsidies. It has known since April 1999 that this Panel agreed. During the consultations and Panel proceedings, Brazil issued letters of commitment to provide illegal PROEX export subsidies in respect of orders for some 557 Embraer aircraft not yet exported and on which, therefore, the subsidies have yet to be granted. After the Panel Report, that number grew to approximately 869 aircraft. The notion that a government would have taken no steps to avoid future legal liabilities in these circumstances strains credulity.

21. Third, from the perspective of the integrity of the WTO Agreements (which, as Brazil explains, are incorporated in Brazilian law), the only appropriate solution is for Brazil to cease granting illegal PROEX export subsidies under pre-18 November 1999 commitments and defend in court as necessary claims for damages if indeed it is subject to them and any materialize. (Canada notes, but does not address here, that the payment of damages in lieu of illegal subsidies may itself constitute a continuing

failure to conform to WTO obligations.) If Brazil does not follow that course, it will simply pay twice - once in illegal subsidies, and again in compensation or retaliation pursuant to the DSU.

ANNEX 2-1

FIRST SUBMISSION OF BRAZIL
(10 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4207
II. PROEX AS MODIFIED IS NOT USED TO SECURE A MATERIAL ADVANTAGE IN THE FIELD OF EXPORT CREDIT TERMS.....	4207
A. PROEX Before the Panel.	4207
B. The Legal Standard Established by the Appellate Body.....	4209
C. The Action Taken by Brazil.....	4209
D. Brazil's Action Meets the Appellate Body's Test.....	4210
1. Loan Guarantees	4210
2. The "Market Window"	4212
III. CONCLUSION	4213
LIST OF EXHIBITS	4214

I. INTRODUCTION

1. On 18 November 1999, Brazil informed the Dispute Settlement Body of the action it had taken to withdraw the prohibited export subsidy in the Programa de Financiamento às Exportações ("PROEX") in conformity with the Report of the Panel in *Brazil - Export Financing Programme for Aircraft*, adopted as modified by the Appellate Body on 20 August 1999. Canada disagrees with Brazil's conclusion that the action Brazil has taken complies with the recommendations and rulings of the Panel and the Appellate Body. In this submission, Brazil will demonstrate that the steps it has taken are fully consistent with its obligations under the Agreement on Subsidies and Countervailing Measures ("SCM Agreement" or "Agreement"), as elaborated upon in the adopted reports.

II. PROEX AS MODIFIED IS NOT USED TO SECURE A MATERIAL ADVANTAGE IN THE FIELD OF EXPORT CREDIT TERMS.*A. PROEX Before the Panel.*

2. Brazil argued before the Panel that, even though PROEX was a subsidy conditioned on export, it was not prohibited because it did not confer a "material advantage" within the meaning of item (k) of Annex I of the SCM Agreement. Canada, however, argued that the fundamental flaw with PROEX was the absence of a floor below which the interest rate to a borrower could not go. Canada argued that PROEX either did or potentially could bring the interest rate to the borrower well below recognized and accepted international benchmarks and thereby confer a material advantage. For example, in its Second Written Submission, Canada made reference to

financing that carried a margin of 10 to 15 basis points (0.10 to 0.15 per cent) above LIBOR, the London Inter Bank Offer Rate. This "lending rate," Canada said, "is consonant with normal business practices in the regional aircraft market and does not exhibit the influence of any 'Brazil cost.'¹ In its Second Oral Submission, Canada told the Panel that if "PROEX simply reduced the interest rate offered to an airline to one that is above LIBOR or OECD rates, Canada would not have brought this case."² In its response to Question 36 from the Panel, Canada said:

It is Canada's position that material advantage should be assessed with respect to the international financing market. The international financing market is defined by the benchmarks that have been discussed by Canada (LIBOR or US Treasuries plus a spread that reflects the credit risk of [the] transaction - see footnotes 15 to 17 of Canada's First Written Submission).

3. The footnotes in its First Written Submission referred to by Canada in its response to the Panel's Question 36 are lengthy, but are very much on point and merit full quotation:

15. London Inter Bank Offer Rate: this is the rate of interest at which banks offer to lend money to one another in the "wholesale" money markets in the City of London. Although LIBOR figures are available for the major currencies, the US dollar tends to be the currency of choice in international financing activities related to aircraft. They tend to quote interest rates they would charge as "basis points (or bps) above LIBOR". These "basis points above LIBOR" are what is known as the "spread" charged by a lender - the additional charge that reflects the credit risk of the transaction. This credit risk is based on the credit quality of the borrower and incorporates other criteria determined by the lender to be relevant to the transaction, such as the value of any asset being financed, any security interests in the assets of the borrower, or any third-party guarantees. If three-month LIBOR were (for example) six per cent, a bank may choose to lend to a purchaser at (for example) seven and a quarter per cent, or 125 basis points (bps) above three-month LIBOR. (Citation omitted).

16. In a floating rate transaction the lender sets an interest rate that will be moved up or down in relation to general movements in interest rates in the wider economy. In floating-rate aircraft transactions, the benchmark used (to reflect the "general movements of interest rates") is the three-month or the six-month LIBOR.

17. In fixed-rate transactions, the borrower's interest payments are set at the outset of the transaction and are not subject to variation in the underlying interest rate. *In aircraft financing transactions (which are mostly US dollar-denominated) the benchmark used is US Treasury.* (Emphasis added).

¹ Brazil - Export Financing Programme for Aircraft, Second Written Submission of Canada, Appendix IV, note 6 (4 December 1998).

² Brazil - Export Financing Programme for Aircraft, Canada's Second Oral Submission, para. 109.

B. The Legal Standard Established by the Appellate Body

4. The Appellate Body agreed with Canada that PROEX was flawed because it lacked a benchmark based in the marketplace.³ The Appellate Body, noted, however that Members are permitted to obtain an "advantage" in the field of export credit terms, provided that advantage is not "material."⁴ It also made clear that the appropriate reference for determining whether a material advantage is secured is the "market-place" and not a specific transaction.⁵

C. The Action Taken by Brazil

5. On 22 November 1999, the Central Bank of Brazil published in the Diário Oficial Resolution No. 2667 of 19 November 1999, which amended Resolution No. 2576 of 17 December 1998.⁶ These Resolutions define the criteria applicable to the operations related to the equalization programme of interest rates under the PROEX. Article 1, paragraph 1 of Resolution No. 2576 of 17 December 1998, was amended by Resolution No. 2667 of 19 November 1999, to read in relevant part:

In financing of aircraft exports for regional aviation, the equalization will be established on an operation-by-operation basis, at levels that may be differentiated, preferably having as a reference the United States 10-year "Treasury Bonds," plus a "spread" of 0.2 per cent per annum, to be reviewed periodically depending on market practices.

6. What this means, effectively, is that no application for PROEX interest equalization support for regional aircraft will be favorably considered unless it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ("T-bill") plus 0.2 per cent per annum. The 0.2 per cent per annum spread also may be referred to as "20 basis points" or "20 bps." While the use of the T-bill as the benchmark is preferred, the authorities retain the authority to utilize LIBOR as an alternative reference point in appropriate market circumstances.

7. Brazil recalls the statement made by Canada in footnote 17 to its First Written Submission, quoted in full above, that, "In aircraft financing transactions (which are mostly US dollar-denominated) the benchmark used is US Treasury." This is precisely what Brazil has used, with an additional 20 bps spread.

8. In an additional action that does not directly affect the question before this Panel, Brazil also reduced the maximum PROEX interest equalization payment available from 3.8 per cent to 2.5 per cent per annum.⁷ No payment may be greater. The practical effect of this will be to reduce the overall amount of interest equalization available and, in all likelihood, an increase in the number of instances in which

³ Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 178.

⁴ *Id.* para. 177.

⁵ *Id.* para. 178.

⁶ Exhibit Bra-1 contains the original Portuguese and English translated versions of the Resolution, together with the original and translated versions of Circular Letter No. 00281 referred to in para. 8 below.

⁷ Exhibit Bra-1 contains an original and translated versions of Circular Letter No. 002881 of the Central Bank of Brazil effecting this change.

the Brazilian exporter will not be able to offer competitive financing even with PROEX support.

D. Brazil's Action Meets the Appellate Body's Test

9. The Appellate Body held, as Brazil has noted above, that the appropriate reference for determining whether a material advantage is secured by PROEX interest equalization payments for aircraft is the "marketplace" for export financing. The Appellate Body noted that the Commercial Interest Reference Rate ("CIRR") of the *Arrangement on Guidelines for Officially Supported Export Credits* ("OECD Arrangement" or "Arrangement") of the Organization for Economic Cooperation and Development ("OECD") provided one example of an appropriate benchmark, and explained the potential operations of that example at some length. However, as the Appellate Body noted, the OECD CIRR rate is only "one example."

10. Brazil chose a point of reference other than CIRR for PROEX based on evidence that, in the case of aircraft, the marketplace in fact supports lower interest rates. These lower rates are the result of at least two factors: loan guarantees and the operations of "market windows."

1. Loan Guarantees

11. With a loan guarantee, a government effectively can make its credit rating available to borrowers that otherwise would face higher financing costs. Export credit guarantee programmes are permitted by item (j) of Annex I to the SCM Agreement, provided they are at premium rates that are adequate to cover the long-term operating costs and losses of the programme.

12. Attached as Exhibit Bra-2, is a "Term Sheet," which is an example of a loan guarantee provided by the Export-Import Bank of the United States ("Ex-Im Bank") for the financing of two Boeing aircraft, together with two spare engines and spare parts.⁸ While the country of the loan recipient is not identified on the first page of the Term Sheet, the first paragraph of the "Special Conditions" refers to a "Chinese Guarantor" which suggests, quite strongly in Brazil's view, that the ultimate user of the aircraft is a Chinese airline.

13. The interest rate listed on the Term Sheet is "LIBOR plus 3 bps."

14. While a guarantee adds to the borrower's net cost, this additional increment is comparatively small. Ex-Im's charge is based upon its calculation of "transaction risk." Exhibit Bra-3 is an Ex-Im Bank "exposure fee calculation" for China taken from Ex-Im's web site.⁹ In the case of China, the nominal amount runs from 2.63 per cent to 4.46 per cent.¹⁰ However, Ex-Im's web site notes that the amounts shown are non-binding approximations and that actual fees are determined upon approval by the

⁸ Term Sheet Ex-Im Bank Guaranteed Loan, Ex-Im Bank Final Commitment No. APO73516. The identity of the end-user of the aircraft, the type of aircraft, and the amounts were deleted before the document was made available to Brazil.

⁹ Visited 31 December 1999

¹⁰ The 5th example shown on the Ex-Im web site would not print. The amount on the web site, as indicated in the text, was 4.46 per cent. While the web page indicates page 1 of 2, no text appears on page 2 which is, therefore, omitted.

Bank of a completed application. Thus, they would be higher or lower than the displayed amounts.

15. Assuming a transaction risk assessment of two, the Ex-Im calculator indicates a one-time guarantee fee of 3.54 per cent. For a 12-year loan, this would add about 30 bps to the loan's cost ($3.54 \div 12$). For a 15-year loan, the added amount would be 23.6 bps. China, however, is not necessarily the best credit risk according to the criteria of international markets and the US Ex-Im Bank. In the same transaction for Taiwan, a transaction risk assessment of two would indicate a one-time guarantee fee of 1.75 per cent. For a 12-year loan, this would add less than 15 bps ($1.75 \div 12$). For a 15-year loan, the amount would be less than 12 bps.¹¹

16. Even more to the point is a comparison involving Switzerland, the headquarters of Embraer's largest European customer, Crossair. Again, assuming a transaction risk assessment of two, the Ex-Im calculator indicates a one-time guarantee fee of 1.00 per cent.¹² For a 12-year loan, this would add about 8.3 bps to the loan's cost ($1.00 \div 12$). For a 15-year loan, the added amount would be a mere 6.6 bps ($1.00 \div 15$).

17. As Canada noted, both the T-bill and LIBOR are used as reference points in the financing of aircraft. The rates are comparable. On 28 December 1999, the reported T-bill yield was 6.39 per cent while six month LIBOR was quoted at 6 5/32 or 6.16 per cent.¹³ A comparison of the PROEX reference of T-bill plus 20 bps to these rates makes clear that, even for a transaction involving China, PROEX does not provide a material advantage, as that term was interpreted by the Appellate Body:

<i>PROEX</i>		<i>Ex-Im Transaction</i>	
T-bill:	6.39	LIBOR	6.16
Spread	.20	Spread	.03
		Guarantee Fee	.30
<u>Total</u>	<u>6.59</u>	<u>Total</u>	<u>6.49</u>

18. Thus, in comparison with the Ex-Im guaranteed 12-year loan involving an airline in China, PROEX with a reference benchmark of T-bill plus 20 bps provides no advantage whatsoever, material or otherwise. In the case of Taiwan, the difference between T-bill plus 20 bps and an Ex-Im guaranteed transaction is even greater: 6.59 *versus* 6.34 ($6.16 \text{ plus } .03 \text{ plus } .15$). In the case of Switzerland, the difference is 6.59 *versus* 6.27 ($6.16 \text{ plus } .03 \text{ plus } .08$). PROEX offers no advantage here, material or otherwise.

¹¹ Exhibit Bra-4. Again, the 5th example shown on the Ex-Im web site would not print. The amount on the web site, as indicated in the text, was 2.20 per cent. While the web page indicates page 1 of 2, no text appears on page 2 which is, therefore, omitted.

¹² Exhibit Bra-5. Again, the 5th example shown on the Ex-Im web site would not print. The amount on the web site, as indicated in the text, was 1.26 per cent. While the web page indicates page 1 of 2, no text appears on page 2 which is, therefore, omitted.

¹³ *Financial Times*, 28 December 1999, pp. 14, 15.

2. *The "Market Window"*

19. The OECD Arrangement applies to "official support" for exports.¹⁴ The term "official support" is not defined in the Arrangement. Some Participants in the Arrangement take the position that "official support" consists only of the provision of support at rates below the government's cost of funds. Support at rates equal to or above the government's cost of funds, in the view of these Participants, is so-called "market window" support. In the view of these Participants, so long as support is provided above the government's cost of funds - through the "market window" - it may be provided at rates below CIRR rates and remain consistent with the requirements of the Arrangement. Among those Participants who take this position is Canada, which Canada described its market window operation to the Panel in *Canada - Measures Affecting the Export of Civilian Aircraft*. Its Export Development Corporation, or EDC, according to Canada, always lends above its cost of funds, and does not incur a net cost on its financing activities. It operates on the basis of commercial principles, and does not provide an advantage above and beyond the market. Canada told the Panel that EDC financing, therefore, is not a subsidy.¹⁵ Canada did not tell the Panel, however, that EDC's loans were at CIRR rates.

20. The operation of "market windows" and the definition of "official support" have been ongoing issues in the OECD for several years. Article 86 of the Arrangement provides:

The Participants undertake to investigate further both the issue of transparency and the definition of market window operations in order to prevent distortion of competition.

21. Article 88 of the Arrangement provides:

It has not proved possible to reach total agreement on the definition of official support in the light of differences between long-established national export credit systems. It is understood that efforts will be made to resolve differences of interpretation as a matter of urgency. Until agreement is reached, the current wording in the Arrangement does not prejudice present interpretations.

22. In an effort to clarify the requirements of the Arrangement, the Foreign Minister of Brazil, on 6 May 1999, wrote to the Director General of the OECD asking for information. The Director General of the OECD responded on 4 June 1999.¹⁶

23. The reply of the OECD Director General established, *inter alia*, that the Participants in the Arrangement had not reached a conclusion regarding the issue of market windows or of the definition of official support. The Director General referred to a meeting of the Participants scheduled for October 1999 where the matters

¹⁴ Art. 2: "The Arrangement shall apply to all official support for exports of goods and/or services, or to financial leases, which have repayment terms (as defined in Article 8) of two years or more. This is regardless of whether the official support for export credits is given by means of direct credits/financing, refinancing, interest rate support, guarantee or insurance. The Arrangement shall also apply to official support in the form of tied aid."

¹⁵ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, para. 9.145.

¹⁶ This correspondence is attached as Exhibit Bra-6.

would be considered further. Brazil has been informed, however, that the October meeting did not result in a resolution of either question.

24. Market windows, accordingly, are not inconsistent with obligations under the OECD Arrangement in the view of the OECD. This means that developed countries that are able to borrow US dollars at a rate below the CIRR rate are able to lend at that below-CIRR rate in conformity with the Arrangement as presently interpreted. The actions of OECD Arrangement Participants in their "market window" operations are an objective part of the marketplace, providing a benchmark below CIRR against which "material advantage" must be measured.

III. CONCLUSION

25. The Appellate Body made clear that the "marketplace" should provide the benchmark for determining whether PROEX is used to secure a material advantage. Appropriate market benchmarks may include the CIRR rate, as the Appellate Body noted, and also include rates on loans that are guaranteed by government export credit agencies, and rates on loans that are made pursuant to "market window" operations. Because aircraft are financed primarily in dollars, the most appropriate benchmark is a dollar-based rate. The floor established by Brazil, the 10-year United States Treasury Bond plus a spread of 20 basis points, is clearly consistent with an established benchmark in the marketplace. This floor does not secure a material advantage in the field of export credit terms in comparison to either guaranteed loans or loans made through the "market window." Accordingly, Brazil has withdrawn the prohibited subsidy found to exist by the Panel and the Appellate Body, and is in full conformity with all of its obligations under the SCM Agreement.

LIST OF EXHIBITS

- Exhibit Bra-1: Official and Translated Versions of Central Bank of Brazil Resolution No. 2667 and Circular Letter No. 002881.
- Exhibit Bra-2: Term Sheet for Ex-Im Bank Guaranteed Loan.
- Exhibit Bra-3: Ex-Im Bank "Exposure Fee" Calculation (China).
- Exhibit Bra-4: Ex-Im Bank "Exposure Fee" Calculation (Taiwan).
- Exhibit Bra-5: Ex-Im Bank "Exposure Fee" Calculation (Switzerland).
- Exhibit Bra-6: Correspondence Regarding "Market Windows."

ANNEX 2-2

REBUTTAL SUBMISSION OF BRAZIL
(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4215
II. BRAZIL MAY CONTINUE TO PROVIDE PROEX SUPPORT TO AIRCRAFT SUBJECT TO PRIOR COMMITMENTS	4216
A. The Appellate Body's Decision	4216
B. The Language of Article 1	4217
C. The Rules of Interpretation of Public International Law	4217
D. The Consequences of Finding that PROEX Exists Only when Aircraft are Exported	4218
E. PROEX Commitments are Legally Binding on Brazil	4220
III. BRAZIL'S ACTIONS TO AMEND PROEX FULLY IMPLEMENT THE APPELLATE BODY'S DECISION.....	4220
IV. TRANSPARENCY	4224
V. CONCLUSION	4224
LIST OF EXHIBITS	4225

I. INTRODUCTION

1. In its submission of 23 December 1999, Canada argues that the measures taken by Brazil to withdraw the prohibited export subsidy in the Programa de Financiamento às Exportações ("PROEX") in conformity with the Report of the Panel in *Brazil - Export Financing Programme for Aircraft*, adopted as modified by the Appellate Body on 20 August 1999, were inadequate for two reasons. First, Canada argues that Brazil must cease to make PROEX payments with respect to letters of commitment previously entered into for regional aircraft that may be delivered after 18 November 1999. Second, Canada argues that Brazil has not modified the PROEX programme sufficiently to bring it into conformity with the findings of the Appellate Body with respect to future commitments.

2. Brazil disagrees with Canada that Brazil is required to amend its conduct with respect to legally binding letters of commitment issued before the date of implementation of the findings and recommendations in the adopted report. Moreover, the actions taken to amend PROEX have brought that programme fully into compliance with the requirements of the SCM Agreement as interpreted by the Panel and the Appellate Body.

II. BRAZIL MAY CONTINUE TO PROVIDE PROEX SUPPORT TO AIRCRAFT SUBJECT TO PRIOR COMMITMENTS

3. Canada's first claim is that Brazil is required to cease providing PROEX support with regard to aircraft delivered after 18 November 1999 pursuant to commitments made prior to that date. In Canada's view, by continuing to honour its prior commitments to provide PROEX support, Brazil is continuing to subsidize aircraft exports contrary to the requirements of the SCM Agreement. Canada is incorrect; its position is tantamount to a retroactive remedy, calling upon Brazil to dishonour its commitments. In simply fulfilling its legal obligations under those prior commitments, Brazil is not creating new subsidies and is not acting in a manner inconsistent with its obligations.

4. Canada's argument confuses a determination the Appellate Body made with regard to Article 27 with a determination it explicitly did not make with regard to Article 1. Canada's argument fails to address the sound reasons why the Appellate Body made a distinction between when a subsidy comes into existence for purposes of Article 1 of the Agreement, and when it is granted for purposes of Article 27.

A. *The Appellate Body's Decision*

5. The only issue before the Panel with regard to the "timing" of the subsidy, the Appellate Body held, was the issue of when it is granted for purposes of Article 27.4: "[G]iven that export subsidies in this case were already deemed to 'exist,'" the Appellate Body asked, "when were they 'granted'?"¹ The Appellate Body affirmed the finding of the Panel that, for purposes of Article 27.4, PROEX is granted when "all the legal conditions have been fulfilled that entitle the beneficiary to receive the subsidies."²

6. But this conclusion did not, as Canada argues it did, mean that PROEX comes into existence for purposes of Article 1 only when aircraft are exported. To the contrary, "We wish to underscore especially," the Appellate Body wrote, "that we find that it is not relevant, for purposes of calculating the level of Brazil's export subsidies under Article 27.4, for the Panel to decide whether the 'financial contribution' for PROEX subsidies involved a 'direct transfer of funds' or a 'potential direct transfer of funds' under Article 1.1 of the *SCM Agreement*."³

7. There were sound reasons why the Appellate Body should have made the distinction it made between the question of when a subsidy is granted for Article 27.4 purposes, and when it comes into existence for purposes of Article 1. These reasons include the language of Article 1; the principles of treaty interpretation; the consequences of not treating the legally-binding commitment of the Government of Brazil to provide PROEX support as the subsidizing event; and the fact that PROEX commitments are legally binding on Brazil.

¹ Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 156.

² *Ibid.* para. 158.

³ *Ibid.* para. 159.

B. The Language of Article 1

8. Article 1 provides that "a subsidy shall be deemed to exist" when "there is a financial contribution by a government" and "a benefit is thereby conferred."⁴ The Appellate Body made clear that "financial contribution" and "benefit" are "two separate legal elements in Article 1.1 of the *SCM Agreement*, which *together* determine whether a subsidy *exists*, and not whether it is *granted* for the purpose of calculating the level of a developing country Member's export subsidies under Article 27.4 of that Agreement."⁵

9. Basic logic and the wording of Article 1 make clear that the financial contribution must either precede or coincide with the benefit. The benefit conferred by a financial contribution cannot, in logic, precede the contribution itself. The benefit is the effect; the financial contribution is the cause. As Article 1.1(a)(1) states, a subsidy exists when "there is a financial contribution" and, moving to Article 1.1(b), "a benefit is *thereby* conferred."⁶

10. The economic beneficiary of PROEX interest equalization payments for aircraft is the Brazilian producer, Embraer - not the financial institution that receives the payments, not the airline whose cost of financing is reduced. The entire purpose of PROEX interest equalization payments for aircraft is to permit Embraer to offer customers financing that is competitive with the financing offered by other, non-Brazilian, suppliers. Embraer receives this benefit when Brazil makes a legally-binding commitment to provide PROEX support. It is this action by Brazil that assists Embraer in its sales effort and that confers the benefit on Embraer.

11. This benefit must be preceded by or coincide with a financial contribution, as that term is defined in Article 1 of the Agreement. The financial contribution is not, at this point, "a direct transfer of funds," within the meaning of Article 1.1(a)(1)(i). It is, rather, a "potential direct transfer of funds" within the meaning of that provision. To say that it is not is to say that there is no benefit to Embraer by the commitment, and to say this is to say that Part III of the Agreement is a nullity, contrary to the customary rules of interpretation of public international law.

C. The Rules of Interpretation of Public International Law

12. The Appellate Body held, in its very first decision, that, "interpretation must give meaning and effect to all the terms of a treaty. An interpreter," it said, "is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."⁷ A reading of Article 1 that would result in the conclusion that PROEX comes into existence when aircraft are exported rather than when the letter of commitment is issued would reduce whole clauses and paragraphs of Part III of the SCM Agreement to inutility. It would effectively read them out of the Agreement altogether.

⁴ SCM Agreement Article 1.1(a)(1) and (b).

⁵ Para. 157 (emphasis in the original).

⁶ Emphasis added.

⁷ Appellate Body Report, *United States - Standards for Reformulated and Conventional Gasoline* ("*US - Gasoline*"), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, at 21.

D. The Consequences of Finding that PROEX Exists Only when Aircraft are Exported

13. Article 1 defines the term "subsidy" not only for purposes of Part II of the Agreement, dealing with prohibited subsidies, but also for purposes of Part III, dealing with actionable subsidies. Article 5 of the Agreement, the first article in Part III, begins: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members ..."

14. Canada has pointed out that Brazil is required to "make the necessary modifications to the programme to eliminate export subsidies in respect of future commitments."⁸ One of Brazil's options is to modify PROEX by removing the export requirement for interest equalization payments for aircraft. This simple action would turn PROEX from a prohibited export subsidy to an actionable subsidy. A Member challenging such a modified PROEX would be required to show not only the existence of a subsidy, but also adverse effects to its interests caused by that subsidy.

15. One of three means by which a Member may demonstrate adverse effects is by showing injury to its domestic industry within the meaning of Part V of the Agreement, dealing with countervailing measures.⁹ The requirements for a determination of injury under Part V are set forth in Article 15. Paragraph 5 of Article 15 specifies that, for an affirmative determination of injury, "[i]t must be demonstrated that the subsidized imports are, through the effects of the subsidies, causing injury within the meaning of this Agreement."¹⁰

16. If the subsidy does not come into existence until an aircraft is exported, then "the effects of the subsidies" could not be felt until that time, since the effect can only follow the cause. Thus, no determination of injury could be made prior to export. This result defies the economic realities of the aircraft industry, and would reduce the injury provision of Article 5 to inutility.

17. This consequence can be made clear from a consideration of how aircraft normally are bought and sold. An airline decides that it wishes to acquire aircraft and makes that fact known to potential suppliers. The suppliers offer not only their aircraft, but also a financing arrangement. This financing package would include whatever government support is available. In the case of Brazil, this is when PROEX is offered.

18. If Embraer, benefiting from PROEX, is successful in obtaining the order, the impact, if any, on the domestic industry of another Member would be immediate. It is possible that workers would lose their jobs, that factories would shut down, that a company's ability to raise capital could be jeopardized. All of these adverse effects could result from the loss of a significant order.

19. Yet, if in these circumstances a Member were to initiate dispute settlement proceedings under Canada's proposed standard, claiming adverse effects based on injury to its domestic industry "through the effects of subsidies," it would be met with the question: What subsidies? At the time the contract was awarded, no aero-

⁸ Brazil - Export Financing Programme for Aircraft, First Submission of Canada (23 December 1999) para. 29 ("Canada Submission").

⁹ SCM Agreement Art. 5(a).

¹⁰ A footnote referring to the economic factors to be examined is omitted.

planes would have been exported. Export would occur only months, perhaps even years, in the future. An order for a large number of aircraft is likely to call for delivery of only one or two aircraft per month over a period of years, with the first delivery not occurring for several months or even a year or more after the contract is awarded.

20. Moreover, even an injury proceeding brought after the first aircraft were exported would be limited. The causal connection between exports of a few aircraft and injury would be far less than the causal connection between the entire number of aircraft ordered and the alleged injury.

21. In this regard, it is instructive to note that, in applying its own antidumping and countervailing duty laws, Canada rejects the timing standard it proposes here. Section 2 of Canada's Special Import Measures Act ("SIMA") defines the term "sale" to include leasing and renting, an agreement to sell, lease or rent, and an irrevocable tender. The SIMA Handbook explains:

The definition is significant because it establishes the category of transactions considered as a sale. For example, the definition covers an irrevocable offer to sell, e.g. bids accompanied by a bond. This is particularly relevant where large capital equipment is involved. In such cases, the purchaser's decision to buy is usually made on the basis of irrevocable tenders. *The market for large capital equipment is characterized by long time gaps between the irrevocable tender and the actual delivery of goods. In such cases, the injury occurs not only at the time of acceptance of the tender but as early as when the bid is offered.*¹¹

22. It is clear that, were Canada to initiate countervailing duty proceedings, under Part V of the Agreement, against imports of aircraft from Brazil based on PROEX, it would consider the question of injury "as early as when the bid is offered." If PROEX has been committed for a transaction, the bid from Embraer reflects that fact. In considering the question of injury, Canada would deem the letter of commitment to be the subsidy. If it did not, it could not impose countervailing duties because, as noted above, those duties require a demonstration that the subsidized imports are, "through the effects of the subsidies, causing injury."¹² The definition of "subsidy" used by a Member for purposes of countervailing duty proceedings under Part V of the Agreement is the same definition that applies to Parts II and III. It is the definition in Article 1, which begins, "For purposes of this Agreement, a subsidy shall be deemed to exist if ..."

23. Finally, it should be noted that a "threat of injury" determination would not support a complainant in these circumstances. By definition, in this example, the injury has occurred at the time of the order. It is present, not anticipated or threatened injury, when workers are already unemployed. To be sure, there may be a real "threat" of a subsidy in the future, but threat of *subsidy* will not support an affirmative determination under Article 15; only a "threat of injury" from an already existing subsidy will do that.

¹¹ Canada SIMA Handbook Inserts (emphasis added) (Exhibit Bra-7).

¹² SCM Agreement Art. 15.5.

E. PROEX Commitments are Legally Binding on Brazil

24. In honouring binding commitments it made prior to the date of implementation of the adopted report, Brazil is not bringing new subsidies into existence. The subsidies on which these payments are based came into existence with the letters of commitment, prior to Brazil's obligation, pursuant to the Report, to cease creating new subsidies. Brazil is legally obligated to honour those commitments. It cannot take them back; it cannot, with impunity, inform the institutions and parties that have acted in reliance on those commitments that Brazil will not honour them. If Brazil does not provide the PROEX payments to which it has already committed, Brazil will be required to provide payments for damage resulting from breach of contract.

25. No useful purpose would be served by a determination that Brazil must dishonour its financial commitments in order to comply with WTO requirements. Payment must be made, if not as PROEX, then, as noted above, as damages for breach of contract. If this should occur, Brazil's reputation for reliability will be unfairly damaged in the international financial community. Perhaps even more important, the wisdom, if not the sanity, of a WTO dispute settlement system that requires such a result, would be questioned seriously.

26. Such a result, which amounts to a retroactive remedy, not only is not necessary, it is not permitted. PROEX comes into existence, for the reasons given above, when Brazil issues a letter of commitment. The Panel should so conclude.

III. BRAZIL'S ACTIONS TO AMEND PROEX FULLY IMPLEMENT THE APPELLATE BODY'S DECISION

27. In its First Submission of 10 January 2000, Brazil explained that it had amended PROEX to ensure that no application for PROEX interest equalization support would be considered favorably unless the transaction was based on a net interest rate to the borrower equal to or greater than an appropriate benchmark rate used in the commercial marketplace. Under the amended PROEX regulation, the preferred benchmark rate is the 10-year United States Treasury Bond (the "T-bill") plus a spread of 0.20 per cent ("20 basis points" or "20 bps") per annum. Brazil also explained that the adoption of this benchmark rate fulfilled Brazil's obligation to withdraw the aspect of the PROEX programme found to be a prohibited subsidy by the Appellate Body.

28. In its First Submission of 23 December 1999, Canada argued that these amendments do not bring the programme into compliance with the SCM Agreement. Canada quotes the dictionary definition of the word "withdraw" and argues that withdrawal requires cessation of a subsidy found to have been prohibited.¹³ As Canada notes, however, the word "withdraw" must be interpreted in the light of the context and object and purpose of the relevant WTO Agreements and their provisions¹⁴ In the end Canada concludes, and Brazil agrees, that, in this proceeding, this means that Brazil is required to make the modifications necessary in PROEX to eliminate export subsidies with respect to future commitments. Brazil has done exactly that.

¹³ Canada Submission para. 26.

¹⁴ *Id.* para. 27.

29. Canada's arguments that Brazil has failed to withdraw the prohibited aspects of PROEX are unavailing.¹⁵ First, Canada argues that the action of the Central Bank of Brazil to amend the maximum amount of PROEX assistance payable on a given transaction, taken under Circular Letter No. 002881, does not constitute withdrawal of the prohibited subsidy. Brazil has never claimed that it does.

30. Circular Letter No. 002881 simply amends the PROEX programme to reduce the *maximum* interest equalization payment available from 3.8 per cent to 2.5 per cent. Contrary to Canada's arguments, as explained in Brazil's First Submission, the imposition of this new ceiling on PROEX payments is not directly relevant to the question before the Panel. This is because reducing the maximum payment under PROEX did not directly address the primary flaw in PROEX identified by the Appellate Body - the absence of a floor net interest rate based on a cognisable benchmark rate in the commercial marketplace. Nevertheless, the reduction of the amount of funds available for PROEX transactions will necessarily mean that in practice, Brazil will be able to equalize net interest rates on regional aircraft transactions to commercial marketplace rates in many fewer transactions, since a payment of 2.5 per cent will reduce an interest rate less than a payment of 3.8 per cent.

31. Second, Canada claims that the new requirement of Resolution 2667 requiring that net interest rates be compatible with international market rates "do[es] not represent a change" in PROEX. Canada states that essentially the same concepts have been part of previous PROEX programmes. Canada is mistaken. The absence of any such benchmark was precisely the flaw found in PROEX by the Appellate Body. In fact, Canada acknowledges that Resolution 2667 "calls for equalization rates to be set at a level aimed at achieving ... a net interest rate of 0.2 per cent ... over the US Treasury Bond rate." Thus, contrary to Canada's protestations, Brazil's actions to implement have rectified the defect found in PROEX by imposing the discipline of a commercial marketplace benchmark below which the net interest rate may not fall.

32. Canada asserts, without any elaboration, that the preferred benchmark rate of T-bill plus 20 bps is "consistent neither with CIRR nor with the market."¹⁶ By this statement, Canada acknowledges implicitly that Brazil must be deemed to have brought PROEX into conformity to the extent that the benchmark rate of T-bill plus 20 bps is found to be "consistent" with "CIRR [or] with the market."

33. In these circumstances, Canada's failure to explain why it believes that this benchmark is not "consistent" with CIRR or the "market" is somewhat surprising. As explained in Brazil's First Submission, Canada has previously stated to the Panel that "In aircraft financing transactions (which are mostly US dollar-denominated) *the benchmark used is US Treasury*."¹⁷ The Panel has already noted Canada's position:

¹⁵ Brazil described the measures it had taken to bring PROEX into conformity in its communication to the Dispute Settlement Body on 18 November 1999, and in paras. 5-8 of its 10 January 2000 submission to this Panel. The documents amending PROEX were attached as Exhibit Bra-1 to the 10 January 2000 submission.

¹⁶ "CIRR" is the Commercial Interest Reference Rate established under the Organization for Economic Cooperation and Development's (the "OECD's") *Arrangement on Guidelines for Officially Supported Export Credits* (the "OECD Arrangement").

¹⁷ Brazil - Export Financing Programme for Aircraft, First Submission of Brazil (10 January 2000) para. 3.

Canada submits in that connection that the relevant rates to be considered in the international market are the London Inter Bank Offer Rate (LIBOR) or the United States (US) Treasuries rate plus a spread that reflects the credit risk of the transaction.¹⁸

34. By Canada's own admission, therefore, the new benchmark rate used in PROEX is totally "consistent" with the market, and, therefore, meets the standard announced by the Appellate Body.

35. Brazil provided in its First Submission a detailed explanation of why the new PROEX benchmark is consistent with the marketplace. Brazil explained how the "market" for aircraft supported rates that may be lower than the CIRR rate (which was just "one example" of an appropriate benchmark). Moreover, Brazil explained how the T-bill plus 20 bps benchmark rate was fully "consistent" with the market and provided no advantage, material or otherwise, to borrowers in PROEX-backed transactions.

36. Canada's failure to explain how the T-bill plus 20 bps rate is not consistent with the market may be explained by Canada's own position on the provision of official support for exports. As Brazil explained in its First Submission, many members of the OECD, including Canada, take the position that the OECD Arrangement permits support for exports at rates equal to or above the government's own cost of funds. The OECD has not disapproved of this interpretation. Thus, members of the OECD may provide assistance at rates below the CIRR rates, consistent with their obligations under the Arrangement, provided they do so at, or above, their cost of funds. Indeed, as Canada told the Appellate Body in the case involving its own programmes, "[I]t is nonsensical to argue that the *OECD Arrangement* is a better indicator of the market than the practice of commercial banks, because, in many instances, the market is more generous than the *OECD Arrangement*."¹⁹ By Canada's standards, its practice of meeting the "more generous" market is consistent with its obligations. This is not a market for Canadian firms alone, however; it is a market for all firms. Consequently, rates supported by PROEX that are below the CIRR rate, but that are based on the T-bill or LIBOR, must be deemed to be consistent with this market.²⁰

37. If this were not the case, developing countries would be placed at a permanent, structural disadvantage in the field of export credit terms. Their borrowing costs are high. Therefore, in most, if not all, circumstances, their cost of funds will exceed the "market" rate established by export credit agencies from developed countries. In Canada's view, however, developing countries with high borrowing costs can make

¹⁸ Panel Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/R, adopted 20 August 1999, as modified by the Appellate Body Report, DSR 1999:III, 1221 para. 4.92. Similarly, as the Panel noted in para. 4.93 of its Report, "Canada confirms its view that the appropriate benchmark is either LIBOR or US Treasury rates ..." See also, Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/R adopted 20 August 1999, DSR 1999:IV, 1443, para. 6.69 and footnote 211.

¹⁹ Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 87.

²⁰ As we have seen, Canada has previously stated that the benchmark for aircraft financing is the US Treasury rate (not CIRR).

credits available at rates no lower than the CIRR rates, while developed countries with low borrowing costs may do so, provided they lend at or above their cost of funds. As Canada told the Panel examining its programmes:

In terms of the pricing process, according to Canada, the EDC's transportation group has a committee that reviews and approves the pricing on all transactions in the civil aircraft sector. Canada argues that in setting this pricing, EDC compares what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. The EDC then prices according to that benchmark. In the absence of this benchmark, the EDC compares the relevant borrower to borrowers of comparable credit standing in the civil aviation sector for whom a similar credit history exists; the EDC then prices according to this alternative benchmark.²¹

38. There is no mention of CIRR here. Indeed, in the immediately preceding paragraph, the Panel examining Canada's programmes noted, "Canada replied that it does not seek shelter in the 'safe haven' provided in the second paragraph of item k, with respect to EDC financing under its corporate account ...".²²

39. The Panel should not countenance any attempt by Canada to impose one standard of commercial behaviour on Brazil and other developing countries, while advocating or indeed practising a less rigorous standard of behaviour for itself. In determining whether Brazil's amendments bring PROEX into conformity, the Panel must examine the amendments, and Canada's challenge thereto, by reference to the "marketplace," in accordance with the decision of the Appellate Body. The "marketplace" must necessarily be based on rates available to other actors in the market. Brazil has demonstrated that the revised PROEX programme incorporates the most appropriate benchmark for aircraft transactions - the US Treasury T-bill - and is consistent with actual market transactions. The Panel should reject any attempt by Canada to require Brazil to meet benchmarks that do not actually prevail in the marketplace.²³

40. For these reasons, Brazil requests that the Panel find that by requiring the net interest rate for any transaction supported by PROEX to equal or exceed an appropriate market benchmark - with the preferred benchmark being the T-bill plus 20 bps - Brazil has withdrawn the prohibited aspects of the PROEX programme and has brought PROEX into conformity with the SCM Agreement.

²¹ Panel Report, *Canada - Aircraft, supra*, footnote 18, para. 6.70.

²² *Id.* para. 6.69.

²³ It should be noted that Brazil does not argue that it should be allowed to "match" credit terms offered by any other government as that term is used in Article 29 of the OECD Arrangement. These rates may well be subsidized in a manner inconsistent with both WTO and OECD requirements. Brazil is not alleging here that any of the market benchmarks to which it has referred - through the operations of loan guarantees or market windows - are in any way inconsistent with WTO or OECD requirements. Brazil is simply arguing that these are the marketplace, and that the Appellate Body's reference to market benchmarks must be interpreted with reference to actual marketplace practices.

IV. TRANSPARENCY

41. Canada proposes that the Panel suggest to the parties, pursuant to Article 19.1 of the DSU, that they establish a reciprocal arrangement for verifying their mutual compliance with their obligations under the Subsidies Agreement.²⁴ Brazil notes that the parties have been engaged for some time in negotiations concerning these disputes and have discussed, *inter alia*, the question of verification. Brazil also notes, however, that the issue of transparency thus far has had to do with Canada's programmes, not Brazil's.²⁵

42. While Brazil does not, in principle, oppose such an agreement, it considers that resolution of the matter in the context of dispute settlement is not clearly compatible with the spirit, if not the letter, of Article 19 of the DSU. Brazil also believes that such an arrangement is better agreed to by the parties in the course of bilateral discussions. It is, in particular, fundamentally necessary for Brazil that any such arrangement involves balanced and truly reciprocal offers of transparency, not only by Brazil, but also by Canada. Discussions between the parties in this regard are ongoing, but no agreement has been reached either on the specific Canadian and Brazilian programmes to be included and subjected to verification, or on the institutional framework for a potential monitoring mechanism.

V. CONCLUSION

43. Brazil requests that the Panel reject Canada's requests in their entirety, and that it find that Brazil is in full compliance with all of its obligations under the SCM Agreement, as interpreted by the Panel and the Appellate Body, with regard to PROEX interest equalization payments for aircraft.

²⁴ Canada Submission, paras. 44-46.

²⁵ Both the Panel and the Appellate Body noted Canada's failure to produce documents requested by the Panel in the original proceedings. Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 19, para. 199 ("Canada refused to provide the information requested by the Panel."). *See also* Panel Report, *Canada - Aircraft*, *supra*, footnote 18, paras. 6.80, 6.171, 6.203, 6.258, 6.259, 6.260, 6.279, 6.303, 6.304, 6.326, 6.327, 9.176, 9.188, 9.218, 9.244, 9.253, 9.272, 9.293, 9.294, 9.299, 9.303, 9.313, 9.314 (footnote 621), 9.327, 9.345, 9.347 (footnote 633).

LIST OF EXHIBITS

Exhibit Bra-7: Canada's SIMA Handbook Inserts

ANNEX 2-3

ORAL STATEMENT OF BRAZIL
(3-4 February 2000)

TABLE OF CONTENTS

	Page
1. The Background to PROEX.....	4227
2. The CIRR and the Market.....	4229
3. Canada's Arguments.....	4230
4. Market Windows.....	4234
5. Undelivered Aircraft.....	4236
6. Australia Leather.....	4236
7. Conclusion.....	4238
8. Concluding Remarks of Brazil.....	4239

Mr. Chairman and Members of the Panel, and members of the Canadian delegation:

1. I am Carlos Simas Magaães, Minister of the Permanent Mission of Brazil in Geneva. I have already introduced my colleague, Roberto Azevedo and the other members of the Brazilian delegation. Mr. Azevedo and I will present Brazil's statement jointly, and then we will all be available to answer questions.
2. Brazil appreciates this opportunity to present its views to the Panel regarding the action it has taken to comply with the requirements of the Panel's Report, adopted as modified by the Appellate Body, concerning Brazil's export credit support measure, the Programa de Financiamento às Exportações, known as PROEX.
3. PROEX, as you know, is an interest equalization mechanism for providing official support for export credits. The Panel concluded that PROEX was a prohibited export subsidy inconsistent with Brazil's obligations under the Agreement on Subsidies and Countervailing Measures. The Appellate Body affirmed, with some important modifications. Brazil has made the changes in the original PROEX that were required by the Panel and the Appellate Body with the result that, in its present form, PROEX is consistent with all of Brazil's obligations.
4. Canada, however, disagrees. Canada claims first, that the changes made in PROEX do not bring the measure into conformity for the present and the future, and, second, that Brazil is required to dishonour the legal commitments it has made to international financial institutions and to cease payments on aircraft, subject to prior commitments, but not yet exported. In its written submissions, Brazil has explained why PROEX, in its present form, is consistent with Brazil's WTO obligations and why Brazil should not be required to dishonour its commitments on undelivered aircraft. To the extent possible, I will avoid repeating those arguments, but I fear that some repetition is necessary in addressing the second submission of Canada and the submissions of the third parties.
5. In this statement, I will discuss the changes made to PROEX, and the question of the undelivered aircraft. I will also address the implications for this case of

the recently circulated Report of the Panel in the Article 21.5 proceeding in *Australia - Leather*. First, however, I want to explain to you the problems Brazil faces in the field of export credits and why it has elected to utilize a program like PROEX.

1. *The Background to PROEX*

6. In an ideal world, governments would not need to support export credits, but, unfortunately, we do not live in an ideal world.

7. After the Brazilian aircraft manufacturer, Embraer, developed its highly regarded and highly successful 50 seat regional jet, the ERJ-145, with its own funds, it entered the regional jet market in mid-1996. The Canadian producer, Bombardier, was already well established in the market for regional jet aircraft, having introduced its 50-seat aeroplane, the CRJ, in about 1993. Embraer was the first manufacturer from a developing country to compete in the world-wide market for passenger jet aircraft, and it remains the only developing country manufacturer to do so.

8. When it entered that market, Embraer was faced with a fact of this less than ideal world, that is, that success in the market did not depend only on having the best product at the best price. Success also depended on a manufacturer's ability to package its product with attractive export credit support from its government. This was the market established by the Canadian, United States, and European governments for their aircraft manufacturers long before Embraer came on the scene. If Embraer wanted to play in the game, it had to play by the rules already established by the developed countries.

9. The Subsidies Agreement recognizes that this world is imperfect, and that governments use export credit support to assist their exporters. Thus, while Article 3 of the Agreement would, by its terms, prohibit all forms of export credit support that met Article 1's definition of "subsidy," exceptions are made.

10. In actual practice, these exceptions apply for the most part to expensive capital goods, such as aircraft. From the perspective of a developing country like Brazil, this presents a problem. Export credit support programs for capital goods can be expensive for any government to maintain; they are inevitably expensive for developing countries to maintain. Consequently, the ability of developing countries to support their industries is limited, particularly in comparison with the ability of developed countries to do so.

11. There are several means by which governments may provide support for export credits. Article 2 of the *OECD Arrangement on Guidelines for Officially Supported Export Credits* mentions direct credits, which may take the form of financing or refinancing; guarantees or insurance; and interest rate support.

12. Direct financing requires the government to advance the entire proceeds of the loan - typically 85 percent of the cost of an aircraft. This is beyond the means of most, if not all, developing countries. A further problem with direct financing is that the government, as lender, bears the risk of default. Brazil has been forced to reject this alternative means of providing export credit support for financial reasons.

13. Guarantees are the least costly means of support for governments; indeed, they may have no cost at all. If the borrower does not default, the guarantor is never called upon to pay, and may even make a profit through the guarantee fees it receives. Unfortunately, as a practical matter, loan guarantees also are not available to developing countries. Let me explain why this is so.

14. The Panel will recall Exhibit 2 to Brazil's First Submission, which concerns a guarantee from the US Ex-Im Bank to the Chase Manhattan Bank in New York for the sale of aircraft to an airline located, it appears, in China. That Exhibit rather dramatically illustrates the impact a loan guarantee from a developed country government can have on a transaction.

15. With the security of a guarantee from the US Ex-Im Bank, Chase Manhattan is willing to finance aircraft to an airline in China for LIBOR plus three basis points - LIBOR plus, in other words, three one-hundredths of one percent. Through that guarantee, the Ex-Im bank effectively has transferred to an airline in China the credit rating of the United States Government.

16. No commercial bank in the world would lend at so low a rate to a Chinese borrower on the strength of a guarantee from Brazil or any other developing country. This is because the value of a guarantee depends upon the credit rating of the guarantor, and no developing country has the credit rating of developed countries like the United States, Canada, or the member States of the EC.

17. An indication of the magnitude of the problem Brazil would face in offering loan guarantees can be seen from a comparison of current yields on Brazilian, Canadian, and US bonds of comparable maturity. On February 1, Bloomberg reported that the yield on the 10-year US T-bill, upon which PROEX is based, was 6.64 percent. On the same day, Bloomberg also reported that the yield on the 10-year Canadian bond was 12 full basis points lower than the yield on the US bond - 6.52 percent. And also on the same day BB Securities reported the yield on the 10-year Brazilian bond at 13.53 percent, twice the yield on the Canadian bond. In practical terms, this means that Brazil must pay 13.53 percent for funds while Canada has to pay only 6.52 percent. This spread indicates the relative risks the market perceives in the two investments, Mr. Chairman, and suggests why loan guarantees are not a viable option for Brazil or other developing countries.

18. With direct lending too expensive and too risky, and with guarantees not viable commercially, Brazil settled upon interest equalization as its best option to support the financing of Embraer's aircraft. From a long-term perspective, interest rate support is not the most desirable option, indeed it may be the least desirable. After all, if a government has the resources to support direct financing, it is paid back with interest. And if it is able to offer commercially acceptable guarantees, it will make money on the premiums, as I have noted, provided defaults are not excessive. With interest equalization payments, however, there is no payback. It is all expense.

19. But Brazil and most developing countries have no choice other than to incur that expense. They cannot afford to finance exports of large capital goods directly, and markets do not readily accept their guarantees. Their exporters, however, face competition from developed country exporters who benefit from both direct financing and loan guarantees. Interest equalization is the only available alternative. In export financing, as in so many other areas, the rich seem to get richer, and the poor get poorer.

20. This, then, is the background as to why Brazil needs to use PROEX interest equalization payments to support export credits. I will now ask Mr. Azevedo to discuss the standard required by the Appellate Body and why PROEX, as revised, meets that standard.

2. *The CIRR and the Market*

21. Mr. Chairman and Members of the Panel, the central issue before the Panel, the Appellate Body, and again in this proceeding is whether PROEX interest equalization payments for aircraft are used by Brazil to secure a "material advantage" in the field of export credit terms as that term is used in the first paragraph of item (k) of Annex I to the Subsidies Agreement. The Panel found that they were; the Appellate Body agreed, and accordingly Brazil has made the changes necessary.

22. However, the Appellate Body also clarified an important aspect of the Panel's Report regarding the measurement of material advantage. At paragraph 178 of its Report, the Appellate Body makes clear that it is the "marketplace" and not "the terms that would have been available in the absence of a payment" that is the benchmark for determining whether PROEX is used to secure a material advantage within the meaning of the first paragraph of item (k).

23. This seems quite clear to Brazil, but Canada, at paragraph 11 of its Second Submission, disagrees. In paragraph 178, according to Canada, the Appellate Body was merely referring to the Panel's findings and not its own. Canada is mistaken.

24. In its written submission to the Appellate Body, Brazil had noted that the Panel appeared to use two different benchmarks for the term material advantage. Brazil cited paragraphs 7.23 and 7.37 of the Panel Report as suggesting that the benchmark was whether the payment resulted in the availability of export credit on terms more favorable than the terms that would otherwise have been available to the purchaser with respect to the transaction in question. In other words, Brazil argued to the Appellate Body, the Panel Report seemed to say that if a customer could obtain a rate of 9.8% from a lender to finance a Brazilian aircraft without PROEX, a material advantage would be secured if PROEX reduced the rate to 6%, regardless of the terms the customer could obtain in the marketplace from other suppliers.

25. However, Brazil noted that in paragraph 7.23 the Panel also stated "that an item (k) payment is 'used to secure a material advantage' where the payment has resulted in the availability of export credit on terms which are more favorable than the terms that would otherwise be available *in the marketplace* to the purchaser with respect to the transaction in question." Brazil then referred to several definitions of "marketplace," such as "a place or institution in which buyers and sellers of a good or asset meet." A "marketplace," Brazil concluded, is not a single transaction between a particular buyer and a particular seller, but the universe of transactions or offers for transactions among all potential buyers and sellers. This argument is reflected in paragraphs 171-177 of the Appellate Body's Report.

26. The Appellate Body resolved Brazil's confusion by assuming, at paragraph 178, that the Panel meant the latter definition, and proceeded in its analysis from there. After having made clear that it is the "marketplace" that is the benchmark, the Appellate Body discussed "one example" of a benchmark in the marketplace, the Commercial Interest Reference Rate of the OECD Arrangement, the CIRR, and concluded, however, that PROEX as it then was formulated, did not meet this or any other acceptable benchmark.

27. The only reasonable reading of the Appellate Body's extended discussion of the CIRR is that an interest equalization program like PROEX, based on the CIRR, would not provide a material advantage in the field of export credit terms, and would, therefore, be in conformity with the requirements of the Subsidies Agreement. Canada has noted the statement of the Appellate Body, at the end of paragraph

182, that the fact that a particular interest rate is below the relevant CIRR "is a positive indication" that the government payment in that case has been used to secure a material advantage in the field of export credit terms. But a "positive indication" is not conclusive proof; it is at most a rebuttable presumption. The Appellate Body did not say that CIRR was the measure of material advantage. It said the market was the measure, and that CIRR was "one example" of the market, one benchmark.

28. Canada itself has suggested other benchmarks, and has noted that its own export financing support is based on these benchmarks - LIBOR and the US T-bill. Canada asserts that its own program, based on these benchmarks, is consistent with its OECD and WTO obligations. Fair enough. In this proceeding, Brazil is not challenging those assertions. But if LIBOR and the T-bill are acceptable benchmarks for Canada, and constitute - as Canada has repeatedly said - the marketplace, they are acceptable benchmarks for Brazil as well.

29. Canada and the two developed country third parties all disagree, apparently believing that there is one benchmark for them and another for everyone else. Let me turn to their objections.

3. *Canada's Arguments*

30. Canada's argument hinges on its claim that, in paragraph 178 of its Report, the Appellate Body was referring to the Panel's findings and not to its own, which obviously, as I have noted, is not the case. That point basically responds to the bulk of Canada's arguments, but let me address each one briefly.

31. First, Canada argues that Brazil improperly uses an *a contrario* argument in connection with the first paragraph of item (k). However, an *a contrario* exception to the first paragraph of item (k) is necessitated by the very language of that paragraph. Moreover, item (k) is not the only paragraph of Annex I that requires an *a contrario* exception. Shortly I will be discussing loan guarantees in greater detail, so let us look at item (j) of Annex I in the context of Canada's argument that *a contrario* interpretations of Annex I are not permitted. Item (j) certainly provides context for the text of item (k). It provides that the following is an example of a prohibited export subsidy:

The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes ...
at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

32. If this text is read with an *a contrario* exception, it means that government loan guarantee programs, such as the Ex-Im Bank of the United States and Canada's Export Development Corporation, which presumably charge premium rates to cover their long term costs and losses, *are* permitted. (And I would add, parenthetically, that the Panel, at paragraph 6.98 of its April 1999 Report, noted that Canada's EDC provides loan guarantees).

33. But if there is no *a contrario* interpretation permitted, then all loan guarantee programs are prohibited subsidies, regardless of whether their premiums are adequate to cover long term costs and losses. That is because all of them provide a financial contribution in the form of potential direct transfers of funds, as the original Panel found, and because all of them confer a benefit. That is their *raison d'être*. I can assure you that LIBOR plus 3 basis points is an extremely beneficial rate for any airline, Chinese or otherwise.

34. Canada cannot have it both ways. Either *a contrario* exceptions to Annex I are permitted or they are not. There is nothing in the text of either item (j) or item (k) to support the conclusion that an *a contrario* exception is permitted in one but not the other. If an *a contrario* exception is not permitted in item (j), then EDC, Ex-Im Bank and a host of other government loan guarantors are providing prohibited subsidies.

35. Obviously, such a result is contrary to the clear text of item (j). And just as clearly, an *a contrario* exception is mandated by the text and context of the first paragraph of item (k). In both items, a *condition* or *requirement* for inclusion is given. In (j), it is inadequate premium rates; in (k), it is material advantage. Failure to employ an *a contrario* interpretation renders the conditional language of each item superfluous. Item (j) could just as well have read, "loan guarantees," and item (k) "payment of part or all of the costs incurred." Put differently, the conditional language of both items makes no sense *unless* an *a contrario* interpretation is adopted.

36. Canada's next point is that PROEX payments somehow are not "payments" as that term is used in item (k). Canada argues that because PROEX payments are available to purchasers who finance payments outside Brazil, they are not costs incurred by a financing institution or an exporter in "obtaining credits." Let me note first that this part of the argument, by its terms, applies only when the financing institution is outside Brazil. Further, Canada argues, when the financing institution is inside Brazil, the payments are made to reduce rates "below market rates," and accordingly, the argument runs, this is not a reimbursement for the cost of "obtaining credits."

37. Neither argument has merit. Item (k) speaks of "the payment ... of all or part of the costs incurred by exporters or financial institutions in obtaining credits." When the lending institution is outside Brazil, Embraer, the exporter, faces costs in obtaining for its customer a financial package that is competitive in the market. If it cannot obtain a competitive financial package for its customer, it would be forced to take other costly action such as paying for a commercially available loan guarantee at a high premium. When the lender is inside Brazil, it is the lender itself who must obtain the dollars on the market. Inevitably, for reasons that were thoroughly discussed in the original panel, this cost is higher than the rate that must be made available to the borrower. The lender, in effect, may be called upon to lend below its cost of funds, and PROEX is intended to compensate for this cost. Thus, whether the lender is outside or inside of Brazil, PROEX is payment of all or part of the costs incurred by exporters or financial institutions in obtaining credits.

38. At note 198 of its April 1999 Report, the Panel queried whether PROEX payments reflected the cost of "obtaining" credits or of "providing" credits. There is no functional difference. What has not been obtained cannot be provided. Embraer must provide competitive credits to its potential customers. Therefore, Embraer must obtain credits or work with a financial institution that obtains them. Both incur costs in obtaining the credits they provide, and it is these costs that are the object of PROEX.

39. Next, Canada argues that Brazil's use of a benchmark of T-bill plus 20 basis points "on its face demonstrates that PROEX export subsidies secure a material advantage in the field of export credit terms."

40. Before dealing with the inadequacies of this argument, let me note a statement Canada makes at paragraph 33 of its Second Submission. "By establishing a preference for a rate below the applicable CIRR," Canada states, "Brazil has demon-

strated a preference for securing advantage in the field of export credit terms." If Brazil may be permitted an *a contrario* interpretation of this statement, Canada appears to be saying that if Brazil *had* established a reference rate at the applicable CIRR, it would *not* be securing advantage in the field of export credit terms. Brazil agrees, and believes this is the only reasonable interpretation of the Appellate Body's language with regard to CIRR. Brazil also notes that by arguing here that CIRR is the market, Canada is contradicting its earlier arguments that the Appellate Body did not hold that the marketplace is the proper measurement for material advantage, as that term is used in item (k). Clearly, the Appellate Body did hold that the measure is the market.

41. But as I have noted, just because a CIRR reference point does not secure a material advantage does not mean that all other reference points of necessity do so. As the Appellate Body noted, CIRR is but "one example."

42. Canada itself, as I noted earlier, has furnished other examples: LIBOR and the T-bill. It was Canada that repeatedly told the original Panel, as well as the Panel examining Canada's programs, that the proper benchmarks were LIBOR or the T-bill. It was Canada that said, in its Second Oral Submission to the original Panel, "if PROEX simply reduced the interest rate offered to an airline to one that is above LIBOR or OECD rates, Canada would not have brought this case." Well, PROEX simply reduces the interest rate offered to an airline to one that is above LIBOR, so the question arises, why are we here? Canada, it seems to Brazil, keeps moving the goal posts.

43. The marketplace for aircraft financing includes both loan guarantees and market window operations. Canada disagrees. Let me turn now to those points.

44. Canada begins its loan guarantee argument, at paragraph 36 of its Second Submission, with a reference to the Ex-Im Bank loan guarantee documented in Exhibit 2 to Brazil's First Submission. According to Canada, "The transaction cited by Brazil is a simple US Ex-Im Bank loan guarantee under which the Government of the United States extends its own Sovereign credit risk to cover a percentage of the amount financed. In such circumstances," Canada continues, "the lending bank establishes financing terms in the light of the risk of the US government, not the borrower."

45. That is precisely the point. As Minister Magahes has explained, Governments can support export credits in several ways, with direct financing, with loan guarantees, and with interest rate support. From the point of view of the potential borrower, it makes little if any difference. The cost to the borrower is what makes all the difference.

46. To compete effectively with the LIBOR plus three basis points offered by Chase Manhattan with an Ex-Im guarantee, a government offering either direct financing or interest rate support would have to offer the borrower an equally low rate, allowing an add-on for the guarantee premium. The marketplace consists of all of the financing options available to the customer, not the mechanisms, such as guarantees, direct financing, or interest rate support, by which governments make those options available.

47. Canada's argument to the contrary is an argument of form over substance. While conceding at paragraph 38 of its Second Submission that "loan guarantees generally can be considered a form of export credit," Canada basically argues that because guarantees are treated in item (j) of Annex I while "export credit" is the

subject of item (k), the two "are to be treated separately." The fact that they are treated separately for purposes of the conditions that apply - premiums in one case, material advantage in the other - does not mean they are separate for purposes of their impact in the market. Both the Subsidies Agreement and the OECD Arrangement make clear that they both are forms of export financing support, and, as the quote confirms, Canada agrees.

48. Canada also argues that the particular example offered by Brazil does not justify the changes made in PROEX because LIBOR normally is used as a base in floating rate transactions while the US Treasury bonds are normally used as a base in fixed rate transactions. The first thing that should be noted about this argument is that it would be met completely by a PROEX based on LIBOR plus three basis points plus an appropriate amount for a guarantee fee. Thus, the only remaining question concerns the relevance of Brazil's LIBOR evidence to PROEX.

49. Canada's argument is based on the assumption that longer-term interest rates always are higher than shorter-term rates. While long term rates frequently are higher, this is not always the case. Interest rates fluctuate, and at times long-term rates are lower than short term. In fact, the *Financial Times*, for the January 29-30 weekend, reported that the one-year LIBOR rate was 6 13/16 - approximately 6.81 percent - while the yield on the one-year T-bill was only 6.22 percent. The 10-year T-bill, on which PROEX is based, yielded 6.65 percent while the 30-year US bond yielded less, only 6.44 percent. This is just the opposite of what Canada assumes is *always* the fact.

50. PROEX is not based on the assumption that lower long-term rates are a permanent condition, Mr. Chairman. Clearly they are not. As I said, interest rates fluctuate. But the point is, as Canada admits, both LIBOR and the T-bill are legitimate, competitive benchmarks, widely used in aircraft financing. Neither is inherently higher or lower than the other. Brazil prefers to use the 10-year T-bill which, I would note, was - at the time it was selected - the higher of the two. The 10-year T-bill is the benchmark that most closely corresponds to the usual financing period for aircraft. Brazil then added 20 basis points for good measure.

51. Now Canada argues, however, that Brazil's comparison of a rate based on LIBOR to a rate based on the T-bill is an improper comparison, despite the fact, as I have noted, that Canada itself treats both rates as appropriate, competitive benchmarks. I would agree that a comparison to a T-bill transaction would be preferable, but as Minister Magahes has noted, Mr. Chairman, we live in a less than ideal world. In this less than ideal world, information on specific transactions is not normally available to the public. Brazil was somewhat fortunate to obtain the example it did obtain.

52. However, if this is a problem there is a solution. Certainly Canada has supported fixed rate financing for aircraft. Certainly, as well, has the EC, which in its third party submission also criticises Brazil's use of LIBOR as a comparison. And certainly so has the United States, which was the guarantor in the transaction set out in Brazil's exhibit. Canada, the EC, and the US could quite easily make a fair and representative selection of their own fixed-rate financing for aircraft (including financing supported by guarantees) available to the Panel and to the parties. This would resolve the matter quickly. Until they do so, however, they should not be heard to complain of the inadequacy of Brazil's evidence on the point. After all, the parties - particularly Canada as the complaining party - have an affirmative obliga-

tion to be fully forthcoming in providing information to Panels. Unless and until they do so, the Panel is more than justified in concluding that a benchmark of T-bill plus 20 basis points does not provide a material advantage over a benchmark of LIBOR plus three basis points and a guarantee fee.

53. Finally on this point, Mr. Chairman, I would note that in calculating the amount of the total guarantee fee that should be attributed to each year of the guarantee, Brazil simply divided the total amount by the number of years the guarantee would be in effect. We understand that this is a perfectly acceptable methodology in the business world. Both Canada and the EC criticize this method, but do not disclose the methods they used. Moreover, they reach different results themselves. This would seem to demonstrate that there is no single correct way to make this calculation, and that Brazil's methodology is acceptable. In concluding this point, Mr. Chairman, I would simply note that in the transaction that is the subject of Brazil's Exhibit 2, even the guarantee fee itself is financed at the LIBOR plus three basis points rate applicable to the principal of the loan. This is typical, we understand. Even the guarantee fee is financed at a rate below CIRR.

4. *Market Windows*

54. Mr. Chairman and Members of the Panel, totally apart from the comparison with LIBOR plus three basis points, is the question of "market window" operations. We have read and pondered the submissions of Canada and the third parties on this subject, and have to admit to some confusion. This is an important subject, Mr. Chairman, because market windows are explicitly referred to in the OECD Arrangement and are relevant to its operations. The Arrangement, in turn, provides a "safe harbour" for export credit support in the second paragraph of item (k) and, as we have learned from the Appellate Body, it has relevance for the material advantage language in the first paragraph as well.

55. Consequently, it is important that market windows be fully understood, not only by the OECD participants, but by all WTO Members, most of whom are not members of the OECD and most of whom, like Brazil, might not appreciate all of the subtleties of the workings of that organization. We ask the Panel to take advantage of the fact that the complaining party in this proceeding and the third parties are all developed country members of the OECD and participants in its Arrangement. A complete explanation by them of the market window, and a thorough description of all of their operations under the market window, would be of benefit not only to this Panel, but to all Members of the WTO.

56. Let me begin with the facts as Brazil understands them. All participants in the Arrangement - and all Members of the WTO - may take advantage of the Arrangement's CIRR in supporting export credits. Thus, regardless of their cost of funds, all participants and all Members may make financing available at CIRR. This has nothing to do with the market window.

57. In addition, the Arrangement contains provisions that permit participants to match rates offered by others that are below the relevant CIRR. These provisions, too, have nothing to do with the market window.

58. But if all participants can lend at CIRR, and if all participants can match rates below CIRR, what is the market window and what is its function?

59. Canada has said, at paragraph 44 of its Second Submission, that, "For the purposes of market window transactions, the appropriate reference is to terms available to a recipient in the market with respect to a particular transaction." It is not clear to Brazil, Mr. Chairman, how this standard differs from the matching provisions of the OECD. We had thought that the purpose of the matching provisions was to permit official credits below the CIRR when, in a particular transaction, a potential borrower was being offered lower terms.

60. Brazil has told the Panel how it believes the market window operates and what Brazil believes its function to be. To summarize, Brazil's understanding is that certain participants in the OECD Arrangement consider that they are permitted by the Arrangement to support export credits *below* the relevant CIRR through the "market window." According to Brazil's information, these OECD participants define "official credits" as those made available below the participant's cost of funds. Credits made available at or above a participant's cost of funds, according to Brazil's information, are not considered to be "official credits" by these participants, and, therefore are not considered to be subject to the interest rates provisions of the Arrangement, including the CIRR. The OECD has not disapproved of this interpretation and this practice.

61. Now, Canada claims that Brazil confuses its market window position, but, Mr. Chairman, Canada never says what that position is. Canada states, at paragraph 48 of its Second Submission, that, "The EDC does not provide a subsidy under its Corporate Account, in the sense that in entering into financing transactions, it does not confer a benefit in accordance with the terms of Article 1 of the SCM Agreement." But this is all Canada says.

62. Mr. Chairman, I want to make clear that Brazil is not here accusing Canada's EDC, through its Corporate Account, of conferring a benefit within the terms of Article 1 of the Agreement. That is not the issue. The issue is whether Canada, through its EDC or any other agency, enters into financing transactions for aircraft in which the relevant interest rate is below CIRR. Specifically, the issue is whether it does so through so-called market window operations, and in so doing affected the market in which Embraer must operate, utilising PROEX, without securing a material advantage.

63. Canada simply has refused to address this question, arguing that Brazil is trying to raise the issue of Canada's subsidies as a justification for its own. While Brazil certainly made that argument before the original Panel, it is not doing so here. The question is not what are Canada's subsidies, but *what is the market, and what is the market window's contribution to that market?*

64. In this proceeding, Mr. Chairman, Brazil is not, to repeat, accusing Canada of conferring a benefit within the meaning of Article 1, but of operating through a market window at rates below CIRR, in a way that is perfectly legal and proper. Brazil is not challenging that action Mr. Chairman, Brazil just wants to participate, along with Canada and the third parties, in the market where loan guarantees and market windows permit operations below the CIRR.

65. In paragraph 43 of its Second Submission, Canada states, "'Market window' generally refers to circumstances where an export credit agency offers a recipient direct financing at terms comparable to those that the recipient would be able to obtain in the market." Of necessity, the market to which Canada refers is a market below the CIRR. PROEX at T-bill plus 20 is designed to permit Brazilian firms to par-

ticipate in that market along with firms from Canada and other Members. Minister Simas Magahes will present the remainder of Brazil's points.

5. *Undelivered Aircraft*

66. Let me turn briefly now to the question of the undelivered aircraft. The parties have argued this issue extensively, Mr. Chairman, and little new appears in the written submissions of Canada or the third parties that we need dwell on. Suffice it to say, as Brazil has pointed out in detail in its written submissions, that the Appellate Body made a sharp distinction between the granting of a subsidy for purposes of Article 27, and the coming into existence of a subsidy for purposes of Article 1. Neither Canada nor the third parties can contest that distinction.

67. We also note, with regret, that the EC has changed its position from the one it took before the original Panel and the Appellate Body, and now agrees with Canada that PROEX subsidies are provided when aircraft are exported, not when commitments are made. There are those in Brazil who are cynical enough to believe that this volte-face is related to the 9 December 1999 decision of the European Commission to authorize the Government of Germany and the State of Bavaria to guarantee a loan of \$350 million to Dornier Luftfahrt for the development of competing regional aircraft. But that is not a matter for this particular proceeding.

6. *Australia Leather*

68. Let me now turn to the question of the recent report of the Article 21.5 Panel in *Australia - Leather*. For reasons that I will discuss, Mr. Chairman, Brazil believes that *Australia - Leather* was wrongly decided, and its results should not be followed by this Panel. Nevertheless, even assuming that *Australia - Leather* was correctly decided, its results are not applicable to this case, which should be distinguished.

69. The Panel in *Australia - Leather* said, at paragraph 6.39 of its Report, that the term "withdraw the subsidy" in Article 4.7 of the Subsidies Agreement "may" encompass repayment of the subsidy. It went on, at paragraph 6.48, to say that "in the circumstances of this case, repayment is necessary in order to 'withdraw' the prohibited subsidies found to exist." The circumstances of the case before the Panel in *Australia - Leather* were very much *like* the circumstances before the original Panel in *Canada - Aircraft*, and very much *unlike* the circumstances before the original PROEX Panel and this Panel.

70. The circumstances that faced the Panel in *Australia - Leather* were those in which a subsidy was provided in a covert attempt to circumvent the rules, with un-notified subsidies that were in fact contingent upon export. These circumstances parallel in every relevant point those that faced the original Panel in *Canada - Aircraft*. In those circumstances, the Panel in *Australia - Leather* concluded that the term "withdraw the subsidy" in Article 4.7 of the Subsidies Agreement meant that Australia had to recoup the entire amount previously provided. This might have been an appropriate conclusion in a case involving a covert attempt to circumvent the rules, but that is not the case before this Panel.

71. PROEX did not involve a covert attempt to circumvent the rules, Mr. Chairman. PROEX was properly notified to the Subsidies Committee as an export subsidy. There was no attempt by Brazil to mislead anyone about anything.

72. Moreover, because of Article 27, Brazil was, at the time it notified PROEX, and for a considerable period thereafter, exempt from the prohibition of Article 3. While the Panel eventually found that Brazil was no longer eligible for Article 27, it concluded, in paragraph 7.57 of its Report, that "it is for the complaining Member to demonstrate that the developing country Member in question is not in compliance with" the conditions of Article 27. Until that proof is made, developing countries, as the Panel concluded, are presumed to be exempt from the prohibitions of Article 3.

73. This is also the answer to the point raised by the United States at paragraph 8 of its submission to the effect that private firms could have no legitimate expectation regarding prohibited subsidies. Totally apart from the right of any private party to expect that it is entitled to rely on its government's legal position with regard to the government's international legal obligations, is the undisputed fact that post-1995, the prohibition of Article 3 did not apply to developing countries by virtue of Article 27.

74. Thus, there are valid reasons for distinguishing this case from *Australia - Leather*, and we believe the Panel should do so. However, we also believe the Panel should consider not following *Australia - Leather* on the ground that it was wrongly decided.

75. The Panel in *Australia - Leather* decided an issue that the parties did not present to it. It is highly unusual in GATT/WTO jurisprudence for panels to decide issues the parties decline to present to them. To be sure, a panel, or the Appellate Body, may question a legal interpretation or assumption of the parties, but this has not been taken as license to decide issues that have not been submitted. More typical are the remarks of the Appellate Body in its first Report, *Reformulated and Conventional Gasoline*. There the parties had cited, with approval, the language of a GATT Panel interpreting the "relating to" language of Article XX(g) of GATT 1994 as meaning "primarily aimed at."

76. "All the participants and third participants in this appeal," the Appellate Body wrote, "accept the propriety and applicability of the view of the *Herring and Salmon* report and the Panel Report that a measure must be 'primarily aimed at' the conservation of exhaustible natural resources in order to fall within the scope of Article XX(g). Accordingly, we see no need to examine this point further, save, perhaps, to note that the phrase 'primarily aimed at' is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g)."

77. The Appellate Body in *Gasoline* thus decided the case that was presented by the parties, even though the parties and the Panel had adopted an interpretation of a relevant GATT 1994 Article that the Appellate Body clearly thought questionable. It signalled those doubts quite clearly, but it did not go beyond its mandate.

78. Brazil believes that the Panel in *Australia - Leather* went well beyond its mandate, and did so unnecessarily. Its radical conclusion that refund of all past amounts paid is necessary to withdraw a subsidy within the meaning of Article 4.7 certainly was not forced upon the Panel by the language of the Agreement. Consider, for example, the fact that the Panel used the second definition of "withdraw" from the Oxford Dictionary. That definition, as the Panel notes, includes the words "retract" and "pull back," which may lend some support to its conclusion. But the first definition, passed over by the Panel, includes the notion of "remove," as in "remove" something from its place or position. This definition does not support the Panel's conclusion; to the contrary, it suggests ending the offending practice rather than re-

funding past subsidies. To be sure, neither definition is conclusive one way or the other, but it seems unwise and unnecessary for the Panel to have moved past the first definition to reach one more supportive of its unusual conclusion. Prudence, I would submit, suggests a different approach.

79. Next, the Panel considered the context of Article 4.7, and said this context "supports the suggestion" that withdraw the subsidy requires repayment. But mere support of a suggestion is hardly a convincing argument for telling the parties to a dispute that they do not know what their dispute is about.

80. The Panel also noted the similarity of the language in Article 3.7 of the Dispute Settlement Understanding and acknowledged that this could support a conclusion contrary to the one it reached. However, the Panel then said that it did not believe Article 3.7 "requires" such an interpretation.

81. Perhaps, Mr. Chairman, Article 3.7 of the DSU does not "require" the interpretation that retroactive remedies are not called for by Article 4.7 of the Subsidies Agreement, but it certainly would "permit" such an interpretation. Such an interpretation would have been consistent with that of the parties, including the third party, and with half a century of GATT/WTO jurisprudence.

82. Brazil believes the Panel was in error to reach the conclusion that retroactive remedies "may" be permitted by Article 4.7. Brazil does not believe that such a conclusion was contemplated by the negotiators of the Subsidies Agreement; the language to which they agreed certainly does not compel such a conclusion. Accordingly, in Brazil's view, *Australia - Leather* was wrongly decided, and should not be followed by this Panel.

7. Conclusion

83. In conclusion, Mr. Chairman, Brazil requests that this Panel find that Brazil's amendments to PROEX comply fully with the recommendations and rulings of the DSB. For the reasons explained above and in Brazil's written submissions, Brazil requests that the Panel find that PROEX subsidies are granted at the time when binding letters of commitment are made.

84. In addition, Brazil requests that the Panel find that under the revised PROEX, Brazil has ensured that interest equalization is provided only insofar as necessary to meet a well-recognized marketplace benchmark.

85. Canada argues that Brazil should not be allowed to provide interest rate support below a single benchmark rate, the CIRR. But this does not reflect actual market practice. Canada asks you to interpret the Subsidies Agreement so as to deny Brazil, a developing country, the right to use export credit support to assist its exporter in the same manner and to the same degree as do Canada and other developed country Members. The language of the Subsidies Agreement makes plain that its drafters did not intend to produce such an inequitable result, and did not do so. They did not, as Canada claims, place developing countries at a stark disadvantage in the export credit marketplace. The Panel can and should interpret the Agreement so as to allow all WTO Members to operate fairly on an equal footing.

86. Thank you very much. We will be pleased to answer any questions you might have.

8. *Concluding remarks of Brazil*

87. Mr. Chairman and Members of the Panel:

This complex dispute involves many issues that most of us have never dealt with in our lifetimes, and probably are unlikely to deal with again. Issues of this nature require a special effort on the part of all who must become familiar with them, particularly those, like yourselves, who must decide them. Brazil therefore is particularly appreciative of the time and effort the Panel has invested in this matter. We know - from our own experience - that it has not been easy.

88. In my concluding remarks, I will be as brief as I can.

89. When all of the complex and obtuse details of the record in this case are boiled down, one central question remains: How can a producer in a developing country participate in global markets for capital goods like aircraft? Those markets are dominated by producers from developed countries, making it difficult for newcomers to compete. But Embraer has been notably successful commercially. Its problem is not its competition. Its problem is the government financing received by its competition.

90. It cannot be disputed that aircraft are sold with government financing support. It cannot be disputed that developed countries have more options in designing the support they can make available, than do developing countries. In our remarks yesterday, we explained why loan guarantees are not a realistic option for developing countries - our credit ratings are not strong enough. We explained why direct financing is not a realistic option - the initial cost is too high. That leaves interest rate support.

91. In yesterday's question and answer session, Mr. Chairman, Brazil posed two hypothetical questions to Canada. We think it is significant that Canada answered one question, but declined to answer the other on the claimed ground that it was hypothetical. After all, if you can answer one hypothetical, why not two?

92. The Panel will recall that Brazil asked what Canada would consider to be the date of the subsidy in a hypothetical countervailing duty investigation of PROEX in Canada. This hypothetical question was answered.

93. The unanswered hypothetical question related to Brazil's Exhibit 2, the US Ex-Im guarantee of a loan to a Chinese airline at LIBOR plus 3 basis points. Brazil asked what options would be available to Canada, if a foreign competitor of the Canadian aircraft manufacturer were able to offer such terms to a potential customer. I think I am accurate in recalling that Canada's first response was that there would be no options available because this transaction involved large aircraft made by Boeing, and the Canadian manufacturer did not compete in that sector of the market.

94. Brazil then clarified the question, and noted that it was asking Canada to assume that the aircraft involved were regional aircraft. Canada then responded that the question was hypothetical and that, if I recall correctly, "there have been and will not be any such transactions in the regional aircraft market."

95. Mr. Chairman, this was no answer. Totally apart from the unjustified certainty of Canada's answer - how can it be sure there will *never* be any such transactions? - the question certainly could be answered from the current legal point of view. Are options available consistent with the requirements of the OECD Arrangement and the Subsidies Agreement, or not? Brazil submits, Mr. Chairman, that Canada *could have* answered. It just did not *want* to answer.

96. Canada did not want to answer because an accurate answer would have been that, to meet the rate on the loan guaranteed by Ex-Im Bank - which is legitimately well below CIRR - a Member could have offered its own comparable guarantee. This is an option that would be available to Canada, but not to Brazil, for the reasons we explained yesterday. The only other options of which Brazil is aware would be direct financing and interest rate support that met this legitimate market rate, and therefore did not secure a material advantage within the meaning of the first paragraph of item (k).

97. Canada has admitted that there is a market below CIRR, served not only by loan guarantees, but also by the market window. And Canada has also admitted that it has participated in that market. But Canada argues that - by some double standard it cannot justify - Brazil is not permitted to participate in that market.

98. Canada tells us, Mr. Chairman, that when it "steps through the market window," it merely acts as a commercial bank or lender, providing financing consistent with the terms available to a borrower from commercial banks. But Mr. Chairman, what commercial banks offer loan guarantees that permit LIBOR plus 3 basis points financing? As Brazil's Exhibit showed, Mr. Chairman, commercial banks *receive* loan guarantees; they don't *provide* them.

99. Who other than Canada participates in this below-CIRR market? Canada's Exhibit 15, distributed yesterday, shows that even a Double-A rated corporations pay more than 100 basis points above T-bill for financing. Canada used that example to argue that Brazil's T-bill plus 20 basis points is inadequate.

100. But T-bill plus 100 is above CIRR, Mr. Chairman, so where is this "commercial market" *below* CIRR that Canada serves when it "steps through the market window"? Who are the other participants in this market? Certainly it is not those commercial entities whose activities form the basis of Canada's Exhibit 15.

101. That Exhibit represents the ideal world that would exist, Mr. Chairman, if governments were not involved in trying to improve upon it for the benefit of their exporters. That is a world in which Embraer could be highly successful if only its competitors played in that world.

102. But Embraer's competitors do not play in that world, Mr. Chairman. They benefit from financial support *below* CIRR from Canada, if not others. Just how much this support means can be appreciated by considering the fact that, according to Canada's Exhibit 15, a Triple-A rated borrower can pay as much as 97 points above T-bill for 10-year financing while a Chinese airline with a guarantee pays only LIBOR plus 3 points.

103. Mr. Chairman, Brazil submits that the "market" in which Canada participates when it "steps through the market window" is a market in which there are few, if any, participants other than Canada. Canada's circular, tautological, goal post-moving explanations and arguments make no sense. Of course, when Canada "steps through the market window" its terms are "market" terms. This is true by definition - they are the dominant, if not the only, terms in that so-called market. No one, that Brazil has ever heard of, is there other than Canada.

104. In the end, what it all comes down to is this: Canada is supporting exports at rates below CIRR, thereby creating a market below CIRR, albeit a market served essentially by Canada alone. It then justifies these rates, as it "steps through the market window," by asserting that they are merely market rates.

105. This conduct has not met with the disapproval of the OECD, as Brazil's Exhibit 6 to its First Written Submission shows. It is therefore a legitimate commercial market rate below CIRR. Brazil's PROEX benchmark of T-bill plus 20 does not provide a material advantage, within the meaning of item (k) when compared to this market.

106. Let me make several points as briefly as I can in conclusion. First, Canada has said that LIBOR and T-bill are only the starting points for a market rate. An appropriate amount for the risk of the borrower must be added. This is true, and Brazil has addressed this point in its First Written Submission, particularly in Exhibits 2 through 5 which set out the "exposure fee" chart of the Ex-Im Bank. In this regard, I would note that Embraer's largest customer in Europe is in Switzerland which enjoys an extremely low "exposure fee."

107. More importantly on this point, is the Ex-Im guarantee that has been so thoroughly discussed. The whole point of loan guarantees is to eliminate the risk, shifting it to the sovereign guarantor. As Canada said, in a loan guarantee, a government extends its own Sovereign credit risk to cover the risk presented by the buyer. The buyer's "risk premium," in other words, is absorbed by the guarantee.

108. I have already addressed Canada's Exhibit 15, submitted yesterday. Let me now comment on the other exhibits.

109. Canada handed out two charts. One purported to show the present value of savings as a result of reduction in interest rates. This chart would apply to *any* reduction in interest rates, including reductions that result when a government "steps through the market window."

110. Another chart purports to show that PROEX is still below the market. The chart compares PROEX to CIRR and to three airline transactions. It does not compare PROEX to the market window or to rates on loans that benefit from sovereign guarantees. It also does not appear to compare PROEX to any transactions supported by Canada. AMR, for example, is a customer of Embraer, among others. While AMR also has ordered 70 seat aircraft from Bombardier, these have not yet been delivered, and, therefore, presumably they are not part of the calculation. Northwest Airlines indeed is a customer of Bombardier, but Canada chose not to provide rates on that sale. Instead, Canada reports on a sale involving aircraft from British Aerospace.

111. Exhibit 16 is a series of "affidavits" from airline officials, all of which amount to legal *non sequiturs*. They assert the unsurprising proposition that "when comparing two equivalent aircraft offers," the officials prefer the one with the better financing. This is hardly surprising. What is surprising is that Canada, which declined to answer Brazil's question because it was hypothetical, is willing to ask the Panel to rely on such hypothetical documents.

112. The fact is that there never, never has been a competition for regional jet aircraft in which the aircraft were "equivalent." There are marked physical differences between the Bombardier and the Embraer regional jets, as the companies are only too eager to point out. More significantly, Mr. Chairman, this Exhibit confirms Brazil's position regarding T-bill plus 20. Consider:

- Canada has admitted that there is a market below CIRR.
- Canada is the major - if not the only - participant in that market.
- Brazil must be able to offer export credit support to its manufacturer sufficient to permit that manufacturer to compete in that market that is 50 or so basis points below CIRR.

113. Finally, there is Exhibit 14 which is an article from a São Paulo newspaper concerning the award of a contract to Embraer from Mesa Air. We are surprised that Canada had to go as far as São Paulo for this news.

114. According to a press report from Montreal, Bombardier said they lost the sale because their order backlog was so large they could not meet Mesa's delivery requirements. They lost business, in other words, because their business is so good. This has nothing to do with PROEX.

115. Thank you very much.

ANNEX 2-4**RESPONSES BY BRAZIL TO QUESTIONS OF THE PANEL**

(14 February 2000)

The following are Brazil's written responses to the questions received from the Panel on 7 February 2000.

Q1. Canada states in its rebuttal submission that "[a] net interest rate of 20 basis points above the 10-year Treasury Bond rate is well below CIRR" (para. 33). Brazil itself states in its first submission that "Brazil chose a point of reference other than CIRR for PROEX based on evidence that, in the case of aircraft, the marketplace in fact supports lower interest rates" (para. 10). Does Brazil acknowledge that a net interest rate of 20 basis points above the 10-year Treasury Bond rate is below CIRR? If not, please provide historical examples of periods where such a net interest rate was equal to or higher than the CIRR rate?

Reply

Brazil agrees that a net interest rate of 20 basis points above the 10-year US T-bill normally is below the CIRR. This rate is consistent with the market for regional aircraft transactions, as Brazil has shown and as Canada has acknowledged. Canada has not sustained its burden in this Article 21.5 proceeding of proving that the T-bill plus 20 bps rate does not conform with Brazil's obligations under the SCM Agreement as interpreted in the Appellate Body report as adopted by the DSB.

Q2. Canada considers that, consistent with Article 3.2 of the SCM Agreement, withdrawal of a subsidy under Article 4.7 of that Agreement entails, at a minimum, ceasing to grant or maintain subsidies found to be prohibited under Article 3.1 of the SCM Agreement. Do you agree? Please explain your answer.

Reply

Brazil considers that to "withdraw the subsidy," under Article 4.7, means that Brazil can make no new legal commitments under PROEX after 18 November 1999 that constitute prohibited export subsidies. Please also see the response to question 3 below.

Q3. The Appellate Body has ruled that, for the purposes of Article 27.4 of the SCM Agreement, export subsidies for regional aircraft under PROEX are "granted" when the NTN-I bonds are issued. WT/DS46/AB/R, para. 158. Article 3.2 of the SCM Agreement provides that a Member "shall neither grant nor maintain" export subsidies. Is it your view that export subsidies for regional aircraft under PROEX are "granted" at a different point in time for the purposes of Article 3.2 than for the purposes of Article 27.4? If so, please explain the basis for that view.

Reply

The Appellate Body envisaged the possibility of different interpretations of the term "grant" as it is used in different Articles of the Agreement. Otherwise, it would not have gone to such lengths to specify, expressly, that it was speaking solely to the meaning of the term "grant" for the purposes of Article 27.4. The Appellate Body explicitly stated: "The issue in this case is when the subsidies for regional aircraft under PROEX should be considered to have been 'granted' for the purposes of calculating the level of Brazil's export subsidies under Article 27.4 of the SCM Agreement."¹ It emphasized that at issue is "the interpretation and application of Article 27.4 not of Article 1."² Further, the Appellate Body distinguished between the existence of a subsidy and the point at which it is granted, and discussed the latter only in the context of Article 27.4. It disagreed with the manner in which the Panel expanded its discussion of the term "grant" and the point at which a subsidy is granted to include issues of interpretation of provisions of the SCM Agreement other than Article 27.4. It upheld the Panel's conclusion with respect to when the subsidies are granted but only "for the purposes of Article 27.4 of the SCM Agreement."³ It is thus quite clear that the Appellate Body deliberately and painstakingly avoided any possible interpretation of its ruling that would extend its conclusions relating to when a subsidy is "granted" beyond the scope of Article 27.4, and thereby made it abundantly clear that its discussion of the issue is relevant for the purposes of Article 27.4 only.

The requirement that a Member should not "maintain" subsidies found to be prohibited should be given its normal meaning that the prohibited subsidy should not continue in effect, certainly once it has been found to violate the SCM Agreement. The standard definition of the word "maintain" is to "go on with, continue."⁴ Similarly, the standard definition of the word "maintenir" (used in the French text of Article 3.2) is "conserver dans le même état."⁵ This also suggests that the injunction against maintaining a prohibited subsidy means that the subsidy cannot be continued in its prohibited state. Thus, Brazil has amended PROEX to ensure that the net interest rate to the borrower can be lower than the appropriate benchmark.

Brazil would note that Canada's position on this point appears to be contrary to its own practice. On 25 May 1999, the Committee on Subsidies and Countervailing Measures circulated Canada's 30 April 1999 notification of subsidies pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement.⁶ A number of the programmes notified have, according to the notification, been terminated yet payments based on prior commitments continue to be made. For example, the notification states that the Communications Technology R&D Incentive Programme was

¹ Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August, 1999, DSR: III, 1161, para. 154 (emphasis in original).

² *Id.* para. 156 (emphasis in original).

³ *Id.* para. 159.

⁴ The New Shorter Oxford English Dictionary on CD-ROM.

⁵ Robert, *Dictionnaire de la langue Française*.

⁶ Committee on Subsidies and Countervailing Measures, New and Full Notifications Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the Agreement on Subsidies and Countervailing Measures, Canada, G/SCM/N/38/CAN (25 May 1999).

terminated in February 1995. However, payments are listed for 1996/7.⁷ "No new financial commitments have been made since 1 March 1995" under the Defense Industry Productivity Programme (the predecessor of TPC), yet payments totaled \$1,732,102 in 1996/97.⁸ "The last date for governmental financial commitments was 30 June 1988" for the Industrial Regional Development Programme, yet payments were made in 1996/97. According to the notification, the payments noted were "from commitments made prior to June 1988."⁹ Additionally, the Sector Campaigns (Sector Competitiveness Initiatives), designed to "enhance the international competitiveness of Canadian industry in selected sectors" was terminated in February 1995, yet payments totalled nearly \$7 million in 1996/97.¹⁰ With regard to fulfilling commitments, therefore, Canada, it would appear, advocates one rule for itself and another rule for Brazil and everyone else.

For the reasons explained in detail in paragraphs 3-26 of Brazil's Second Submission, therefore, in the case of PROEX, a financial contribution is made and a benefit is conferred within the meaning of Article 1 of the SCM Agreement, and a subsidy is thereby granted within the meaning of Article 3.2 of the SCM Agreement, when contracts are signed pursuant to the letters of commitment. At this point, the beneficiary has been granted an unconditional legal right to receive PROEX interest equalization. Please see also the response to question 12 below.

Q4. Canada states (first submission, para 21) that Resolution 2667 and Newsletter 2881 "only apply to future commitments. They do not apply to or in any way modify PROEX export subsidies in respect of regional aircraft that have been or will be exported after 18 November 1999 pursuant to commitments made before that date." Please confirm whether this statement is correct and, if it is not, please provide an explanation as to the precise relevance of these legal instruments to payments pursuant to letters of commitment predating the effective date of these legal instruments.

Reply

Resolution 2667 and Newsletter 2881 do not modify pre-existing PROEX commitments pertaining to aircraft to be exported after 22 November 1999.

Q5. Article 2 of Resolution 2667 provides that it shall enter into force on its date of publication. Although the Resolution is dated 19 November 1999, Exhibit Bra-1 indicates that the Resolution was published on 22 November. Were any letters of commitment in respect of regional aircraft issued between 19 and 21 November inclusive? If so, were they issued pursuant to the terms laid down in Resolution 2667?

⁷ *Id.* para. VI.

⁸ *Id.* para. VII."

⁹ *Id.* para. X.

¹⁰ *Id.* para. XVI.

Reply

There were no letters of commitment issued with respect to regional aircraft between 19 and 21 November 1999, inclusive.

Q6. Central Bank of Brazil Circular Letter No. 2881 sets forth maximum percentages for PROEX interest rate equalization in respect of financing up to 10 years. Canada states in its first submission (para. 20) that this Circular Letter "does not specify a maximum interest rate reduction percentage for financing terms in excess of 10 years." Is PROEX interest rate equalization available in respect of financing for a period in excess of ten years? If so, please state whether and how the maximum interest rate equalization set forth in Circular Letter No. 2881 would apply in respect of such financing.

Reply

Brazil normally foresees a maximum period of 10 years for PROEX financing. This is why both the prior programme and the amended programme specify a 10-year maximum term. That maximum was waived, and continues to be waived, however, for regional jet aircraft only. This is because it is necessary for Brazil to provide regional aircraft financing on terms that are consistent with the market. When the Brazilian manufacturer entered the regional jet market, terms in excess of 10 years had already been established in that market by Canada. The *maximum* equalization payment under Circular Letter No. 2881 remains at 2.5 percentage points, however, even if the term of the loan is greater than 10 years.

Canada has confirmed that it is consistent with the market to provide tenure terms beyond those included in the OECD Arrangement. Before the Appellate Body in *Canada - Aircraft*, Canada argued that "a financing term for regional jet aircraft of more than 10 years, and even of up to 18 years, is entirely within the bounds of commercial practice." Brazil refers the Panel to paragraph 85 of the Appellate Body's Report in *Canada - Aircraft* for this discussion.

Q7. Has Brazil issued any letters of commitment to provide interest rate equalization in respect of regional aircraft since 19 November 1999? If the answer is yes:

- Please inform the Panel of the net interest rate (as defined by the Appellate Body in WT/DS46/AB/R, para. 181) applicable to each transaction.
- Please inform the Panel as to whether that interest rate is at or above the relevant 10-year US Treasury Bond plus 20 bps?

Reply

No, Brazil has not issued any letters of commitment to provide interest rate equalization in respect of regional aircraft since 19 November 1999.

Q8. Is PROEX interest rate equalization available in respect of export credits provided at floating interest rates? If your answer is yes, please state whether and how the "preferred" interest rate based on 10-year US Treasury Bonds plus 20 bps would be applied in respect of such floating interest rates. If this

"preferred" interest rate does not apply in the case of PROEX-supported export credits at floating interest rates, please explain what "floor" interest rate would be applicable in such a case.

Reply

PROEX as modified to implement the recommendations and rulings of the DSB is aimed at fixed-rate transactions. Floating rate transactions are not normally used to finance aircraft. There are no records that PROEX transactions for aircraft have involved floating rates. However, if an application were made for PROEX support for a floating rate transaction, it would be considered on its merits. As a practical matter, none is anticipated. Brazil has not determined what floor interest rate it would use in such a case. That decision would have to be based upon the circumstances prevailing at the time. Obviously, under the "new" PROEX such floor would have to be compatible with market rates. As a practical matter, Brazil has not addressed the problem in detail because it is so highly unlikely that such a proposal would occur.

Q9. Canada asserts (second submission, para. 40 and footnote 24) that, in the case of large aircraft, spreads of less than 10 bps are common, while for regional aircraft, spreads, of less than 20-30 bps would be uncommon. Please comment.

Reply

In Brazil's view, it is not the aircraft, but the airline and its credit rating that determine the amount of the credit spread. The main component of the spread is the risk of repayment by the purchaser. The degree of risk of repayment depends on the purchasing airline rather than the size of the aeroplane. For example, American Airlines, a customer of the Brazilian regional aircraft manufacturer, has an excellent credit rating. Its credit spread is, as a result, less than the spread of many airlines that purchase only large aircraft, but that happen to have poor credit ratings. In addition, the spread may be affected by the total amount of the transaction regardless of whether it is for large or for regional aircraft. Finally, it is worth noting that PROEX's spread of 20 bps above the 10-year T-bill falls within the range for regional jet aircraft transactions suggested by Canada. Again, Canada has failed to show that the T-bill plus 20 bps benchmark provides a material advantage in the market place.

Q10. Brazil states (first submission, para. 4) that the Appellate Body held that "Members are permitted to obtain an "advantage" in the field of export credit terms provided that advantage is not "material" (emphasis added)." The Appellate Body did not however address the issues of whether the first paragraph of item (k) can be used as an affirmative defence, nor whether PROEX payments are "payments" within the meaning of that item. Please comment.

Reply

Brazil believes that the Appellate Body effectively, and of necessity, did address the issue whether the first paragraph of item (k), in its *a contrario* form, can be used as an affirmative defence. The Appellate Body, at paragraph 177, noted that the word "advantage" is modified by the word "material". When it did so, it confirmed that the term "material advantage" carries significance and cannot be "read out" of the Agreement, consistent with the principles of interpretation of public international law.

Similarly, the Appellate Body's discussion of the acceptability of the CIRR as a benchmark for the first paragraph of item (k) of necessity implies the notion that PROEX payments consistent with the CIRR are payments within the meaning of that paragraph. Brazil does not believe that this can be disputed. Brazil also believes, as we have explained, that the CIRR is not the only acceptable benchmark, but that the Appellate Body instead used it as one indication of the *market*. It is the *market* that is the ultimate benchmark.

The Appellate Body's statement, in the last sentence of paragraph 187 of its Report, was that *as a jurisdictional matter only*, it could not rule on either of these issues in the abstract, since the Panel had not made any findings on either issue, and the lack of Panel findings was not appealed.

But the Appellate Body's decision on the issue that was clearly before it - "material advantage" in the first paragraph of item (k) - by necessity implies that an *a contrario* interpretation is required and that PROEX payments are "payments" within the meaning of that paragraph. Any other interpretation renders the Appellate Body's discussion of the question academic.

The Appellate Body also certainly disagrees with Canada's arguments that the Illustrative List is by definition superfluous because its only purpose is to illustrate the definition of a prohibited subsidy. Footnote 5 to the SCM Agreement makes clear that the List has a purpose other than pure illustration. The provisions of the Illustrative List must be interpreted in compliance with the rules of interpretation of public international law, which prohibit interpretations that render treaty language meaningless. This means that they must be given their ordinary meaning and full effect. The Appellate Body did so in interpreting the phrase "material advantage." Canada's denial of an *a contrario* interpretation to the material advantage clause would render that clause meaningless, and is therefore contrary to the rules of interpretation of public international law.

Canada's analysis ignores the fact that the material advantage clause was added to the language of an earlier version of item (k) and, therefore, must have had separate meaning to the negotiators who included the language.

The language of what now comprises item (k), without the material advantage clause, had its origins in rules adopted in 1958 by the Organization for European Economic Cooperation, the "OEEC," which was the predecessor of the OECD. These rules prohibited, among other practices:

- (g) The grant by governments (or special institutions controlled by governments of export credits at rates below those which they have to pay in order to obtain the funds so employed;

- (h) The government bearing all or part of the costs incurred by exporters in obtaining credit.¹¹

These provisions were included *verbatim* in a 1960 Report of a GATT Working Party on Subsidies as examples of export subsidies¹² Subsequently, they provided the basis for the Illustrative List that eventually was included in the Tokyo Round Code. It is significant, however, that in their first appearance in a GATT document, and for the next 18 years, these provisions had no material advantage clause.

When the Tokyo Round Code was concluded in 1979, the language that is now the second paragraph of item (k) was included to permit the Participants in the just-concluded OECD Arrangement to continue to take advantage of its provisions. Initially the Tokyo Round negotiators did not include a material advantage clause.

On 10 July 1978, an *Outline of an Arrangement* was circulated to the Sub-Group on Subsidies and Countervailing Measures of the Negotiating Group on Non-Tariff Barriers.¹³ This Sub-Group comprised the GATT negotiators whose efforts produced the Tokyo Round Code. The draft contained a description of an Annex A, which set forth an illustrative list of export subsidies:

A list of export subsidies illustrative of the obligations in GATT Article XVI:4, as supplemented by the Arrangement. In this connection, work should build upon the 1960 Illustrative List, taking into account other work on this subject in the GATT.¹⁴

This description explicitly takes into account the OECD Arrangement, but does not mention a material advantage clause which, as of that date, had not appeared in any previous version of the Illustrative List, either in the OECD or in GATT. The first appearance of the material advantage clause in a GATT document did not occur until 19 December 1978, some 20 years after the relevant language was included in the first Illustrative List of the OEEC. This document, also an Outline of an Arrangement, contained the language that was included in the Tokyo Round Code and eventually became item (k):

The grant by governments (or special institutions controlled by [and/or acting under the authority of] governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed, or the payment by them of all or part of the costs incurred by exporters or *financial institutions* in obtaining credit, *insofar as they are used to secure a material advantage in the field of export credit terms.*¹⁵

¹¹ John E. Ray, *Managing Official Export Credits* 35 (Washington, D.C., Institute for International Economics 1995).

¹² BISD 9S/185 9 (Report Adopted on 19 November 1960).

¹³ General Agreement on Tariffs and Trade, Multilateral Trade Negotiations Group " Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/168, 10 July 1978.

¹⁴ *Id.* page 23.

¹⁵ General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING

Thus, sometime after deciding to include the OECD safe-harbour clause, the GATT negotiators made two additional significant changes to the language contained in the 1960 Working Party report. First, they added the phrase "or financial institutions," and second, they added the clause, "insofar as they are used to secure a material advantage in the field of export credit terms." These additions were the last changes made in the language of item (k). They were made deliberately, and were intended by their drafters to have genuine meaning and effect. Canada's proposed interpretation of item (k) improperly treats these words as if the changes outlined here had never occurred.

Q11. The Appellate Body refers to the CIRR as a minimum commercial benchmark. Thus, it could be argued that any alternative benchmark in the marketplace for determining whether a payment is used to secure a material advantage must be undistorted by government intervention. Please comment.

Reply

The Appellate Body's statement that the CIRR is the "minimum commercial benchmark" was made in the context of its discussion of the OECD Arrangement. The CIRR is the lowest rate allowed for official credits under the interest rates provisions of that Agreement. The CIRR itself, however, is derived only in part from commercial transactions in the market. It is based on certain average rates paid for government debt securities with 100 basis points added to this average. It is, therefore, an agreement among governments to adopt a particular average rate with an arbitrary add-on. To this extent, at least, the CIRR itself is a distortion.

Moreover, the SCM Agreement itself explicitly permits government distortions - such as government loan guarantees. These permitted actions, in addition to the "market window" operations of some Participants in the OECD Arrangement, and indeed the CIRR itself, contribute to - and "distort" - the market for export credits for aircraft.

Brazil would emphasize that it has shown and Canada has acknowledged that there is a commercial market for aircraft financing at rates below the CIRR. This is the market in which Canada's EDC programme operates. Brazil's T-bill plus 20 bps rate does not provide a material advantage vis-à-vis this below-CIRR market rate, which is undistorted by government intervention.

Q12. Brazil argues (second submission, paras. 24-26) that if it does not issue bonds pursuant to letters of commitment issued before 18 November 1999, it can be sued for breach of contract.

- (a) **In this respect, please explain to whom Brazil owes an alleged contractual obligation under the letter of commitment.**
- (b) **In the original dispute in this case, Brazil submitted a legal opinion (exhibit Bra-17) stating that letters of commitment could not**

MEASURES, Outline of an Arrangement, MTN/NTM/W/210, 19 December 1978, page 26 (emphasis added).

be annulled because they were "a perfect legal act, absolutely licit and practised based on legal provisions." In document G/ADP/W/281-G/SCM/W/291 dated 2 February 1996, Brazil stated that "[h]aving been incorporated into the Brazilian legal system by means of a Presidential decree (Decree No. 1355, dated 30 December 1994), the WTO Agreements have the same hierarchical level as laws, and are subordinate only to the Federal Constitution." Please comment.

Reply

- (a) Brazil issues a letter of commitment that offers PROEX support for transactions specified in that letter of commitment if and when the contracts are completed within the time specified in the letter of commitment (usually 90 days).¹⁶ The letter of commitment constitutes an irrevocable conditional offer that is accepted when the contracts are signed within the period specified in the letter of commitment. The letter of commitment temporarily creates a binding legal obligation, which becomes final when the contracts are signed before the letter of commitment expires. Pursuant to the letter of commitment, therefore, when the contract of sale is signed, the Brazilian government is legally obligated to provide PROEX equalization to the financial institution. At that point, the financial institution has an unconditional legal right to receive PROEX equalization payments.¹⁷ If a default occurs, the institution or any other party affected by the default could sue the Brazilian government for damages.
- (b) WTO Agreements are incorporated into Brazilian law and, therefore, could affect pre-existing legislation in the event of a conflict. However, Panel and Appellate Body Reports are not incorporated into Brazilian law. Accordingly, the question of whether a conflict exists and, if so, what is necessary to avoid it, would be determined by Brazilian judicial authorities.

Even if a conflict were found to exist by the Brazilian judiciary, previous legal commitments would not be affected. The PROEX letter of commitment is, under Brazilian law, a *legal act* ("*ato jurídico*") which produces immediate and binding effects.. When the parties enter into a contract that is the subject of a PROEX commitment, pursuant to the terms of that commitment, they acquire rights. At that point, the financial institution, the exporter and third parties become protected by the rules regarding pre-contractual liability and the principles of good faith, along with other provisions of law regarding affirmations and promises made during negotiations.

¹⁶ See, e.g., Brazil's Second Submission to the Panel, dated 4 December 1998, at paras. 46-48.

¹⁷ During this proceeding Brazil has, for the sake of convenience, used the term "letter of commitment" to refer to this entire process. As a practical matter the date of the letter of commitment and the date the contract is signed are extremely close. Brazil's legal liability begins with its letter of commitment which, as noted, is a time-limited, binding offer. If it were revoked prior to the stated time, Brazil would be liable for any damages caused by that action. Once the parties comply with the terms of the commitment by entering into a contract, then all of the legal conditions have been fulfilled.

The Brazilian Supreme Court has held that the Administration may not annul its own acts if that annulment interferes with acquired rights. This is consistent with Article 5 of the Brazilian Federal Constitution, which provides that a law may not impair acquired rights, the perfect legal act, and *res judicata*. Consistent with Article 5 of the Constitution, Article 6 of the Introduction to the Brazilian Civil Code provides that retroactivity in the law is not possible or permitted, and that a law may not impair acquired rights and a perfect legal act. The previously signed letters of commitment, therefore, being perfect legal acts that have generated acquired rights, may not be revoked by the Government of Brazil without liability for damages.

Questions for Both Parties

Q1. The Appellate Body has referred to the CIRR as "a minimum commercial interest rate." The US dollar CIRR is however constructed on the basis of US Treasury bond yields. Further, Canada has stated (second submission, para 40) that US Treasury Bonds are fixed rate reference benchmarks, while LIBOR is a floating rate benchmark. That being the case, to what extent can CIRR rates be considered relevant to establishing a "minimum commercial interest rate" in respect of floating interest rates?

Reply

Brazil agrees that the CIRR, which is, as we have noted, itself a government-constituted rate, might not be the most appropriate benchmark for floating-rate transactions. This is simply a further illustration of why the CIRR is not the only benchmark against which PROEX or indeed any other export credit programme should be measured.

Q2. Resolution 2667 states, inter alia, that "equalization rates shall be established on a case by case basis and at levels that may be differential." What relevance, if any, does this language have to the issues now before the Panel?

Reply

Resolution 2667 states that equalization rates shall be established on a case-by-case basis and at levels that may be differentiated simply to reflect that each transaction is different, and that different levels of support may be required or permitted in different cases. Thus, Brazil will provide PROEX support only up to an amount that will reduce the net interest rate to the level of the appropriate benchmark. Moreover, Brazil will only provide PROEX support up to the maximum of 2.5 percentage points specified in the regulations. The language quoted in the Panel's question is relevant because it establishes that while the actual amount of equalization is not fixed for every transaction, PROEX support may never result in a net interest rate below the appropriate benchmark.

Further Questions

Q1. Does Brazil incorporate by reference its arguments in the original panel proceedings with respect to (i) whether item (k) of the Illustrative List may be

used to make an a contrario argument and (ii) whether PROEX payments constitute payments within the meaning of item (k)?

Reply

Brazil does incorporate by reference its arguments in the original panel proceedings with respect to both issues. Brazil considers its arguments in the Article 21.5 proceeding to be consistent with the arguments Brazil presented to the original Panel proceedings and the Appellate Body. While Brazil is not aware of any, to the extent that the Panel might consider that there are any inconsistencies in the arguments made by Brazil with respect to the issues relating to item (k) of the Illustrative List, the arguments made in the later submissions in these Article 21.5 proceedings should prevail.

ANNEX 2-5

**BRAZIL'S COMMENTS ON CANADA'S RESPONSES
TO QUESTIONS OF THE PANEL AND BRAZIL**

(17 February 2000)

TABLE OF CONTENTS

	Page
I. CANADA'S RESPONSES TO THE PANEL'S 3 FEBRUARY QUESTIONS.....	4254
II. FOR BOTH PARTIES	4257
III. CANADA'S RESPONSES TO THE PANEL'S 7 FEBRUARY QUESTION.....	4258
IV. CANADA'S RESPONSES TO QUESTIONS FROM BRAZIL.....	4258

Brazil would like to make several comments on the responses of Canada to the questions presented by the Panel and Brazil. In the interests of brevity, we will not comment on every response. This should not be taken as an indication of Brazil's agreement with the responses of Canada.

**I. CANADA'S RESPONSES TO THE PANEL'S 3 FEBRUARY
QUESTIONS**

For Canada

Question 1

Brazil has addressed this point in its submissions.

Question 2

As Brazil will point out in its comment on Canada's response to Question 11, below, Canada has not proved that "PROEX interest rate equalization provides financing on terms that are better than those available to a particular borrower in a particular transaction."

Question 3

Brazil would point out that Canada's statement that transactions consistent with CIRR require adherence to the *OECD Arrangement's* 10-year maximum repayment term for regional aircraft is an example of how Canada interprets the rules to provide a double standard between Canada and Brazil. It is uncontradicted that, despite the requirements of the *OECD Arrangement*, Canada established a repayment period of 15 to 18 years for regional jet aircraft long before Brazil ever entered the market. Canada's view that Brazil must adhere to CIRR, and that CIRR means a 10-year maximum, would mean that Brazil would be at a permanent, and unjustified disadvantage.

Question 4(a)

Canada admits that a market below CIRR exists for fixed interest-rate export credits, and that it participates in that market. Canada's reference to the "shortcomings of comparing a constructed rate such as the CIRR to commercial market pricing" implicitly acknowledges that there are more appropriate benchmarks than CIRR. Canada's view is thus that the CIRR may not always be the appropriate benchmark for Canada, but it should be the only appropriate benchmark for Brazil, "even if Brazil could demonstrate that interest rates in the marketplace were below CIRR at some given moment." (*Canada's Response to Question 1*).

Canada's excuse is the complexity of CIRR.

Brazil also would point out that (1) the CIRR's complexity applies to Brazil as well as to Canada, and (2) Canada, as a member of the OECD shares responsibility for that complexity; Brazil, as a non-member, does not.

Question 4(b)

No comments.

Question 5(a)

No comments.

Question 5(b)

No comments.

Question 6

Canada's assumption is that a floating rate is always lower than a fixed rate. Recent events demonstrate that this is not the case, as Brazil noted at paragraph 49 of its Oral Statement to the Panel on 3 February 2000.

Question 7

The assumption underlying Canada's response is erroneous. Canada assumes that PROEX is used to compensate the *borrower* for its cost of funds. This is not the case. It is used to compensate the financial institution or the exporter for the cost of obtaining credits to provide to the borrower. *See* in this regard Brazil's comment on Canada's response to Question 11. PROEX was not used in that transaction to support American Airlines, which, as Canada noted, was subject to a rate of 7.79 per cent.

Canada's statement that PROEX support with an interest rate above CIRR confers a material advantage is contradicted by the determination of the Appellate Body.

Question 8

Brazil has no comments.

Question 9

Canada disputes Brazil's calculation of the guarantee fee in the example cited by Brazil on the basis of "EDC's standard 'yield model'" as if there were something

sacrosanct about EDC and its model. Brazil does not agree. That there is more than one way to calculate the annual cost of the guarantee fee is demonstrated by the fact that the EC, the only other party or third party to calculate the amount, reached a result different from both Brazil and Canada. Brazil would also note that the example used was a "worst case" example, involving a sale to an airline apparently in China. Brazil noted that its largest European customer is in Switzerland, and the US Export-Import Bank premium for Swiss transactions is considerably lower than for Chinese transactions.

Question 10

Canada's unsupported assertion is contradicted by Brazil's evidence. With a loan guarantee, an airline apparently located in China was able to obtain, from a commercial bank, a rate of LIBOR plus 3 basis points.

Question 11

Canada has criticized Brazil's Exhibit Bra 2 on the ground that it deals with large, rather than regional aircraft. (*See, e.g., Canada's Response to Brazil's Question 8*). However, two of Canada's three examples deal with large rather than regional aircraft - American Airlines and US Air. In Canada's view, it would appear, transactions involving large aircraft may be used to support Canada's point, but not Brazil's. Another double standard.

Furthermore, one of those carriers - American Airlines - through its American Eagle subsidiary, is a customer of the Canadian producer, Bombardier. Canada does not use that sale to illustrate its point.

The same is true of the one sale involving a regional aircraft, the sale to Northwest. This airline is also a customer of Bombardier. Canada, however, provides no examples involving Bombardier sales. This is noteworthy given that Bombardier sales account for a larger share of the regional jet market than do Embraer sales.

The Panel will recall that in March of last year, its interim report was prematurely released to the parties through error. While the original Panel proceeding was in progress, both Embraer and Bombardier bid for the Northwest business. Northwest informed the companies that it would wait for the Panel results before deciding. Late in the afternoon of the day the interim report was prematurely released, Northwest chose to purchase from Bombardier.

Brazil would also note that all three airlines are US carriers. To the extent they purchase from Boeing, there presumably is no government financing involved. The other two purchases, from British Aerospace and Airbus, might have involved government support (Canada's evidence is silent on the question), but there is no suggestion by Canada that these transactions involved the below-CIRR financing Canada admits making available.

Next, Brazil would note Canada's reference to the sale of \$190 million in asset-backed bonds to support the sale of 42 Embraer ERJs to American Airlines. The rate specified in Canada's evidence is 7.79 per cent. According to the OECD web site, accessed 16 February 2000, the applicable CIRR rate was 7.19 per cent for the period 15 January to 14 February 2000, and 7.70 per cent for the period 15 February to 14 March 2000.

Brazil submits that this evidence itself demonstrates that PROEX, which was involved in the American Airlines transaction, provides no material advantage in the field of export credit terms.

Finally, Brazil notes that throughout its answer to this question, Canada refers to basis points "above Treasury rates." This short-hand can be misleading, as there are many Treasury rates. Brazil bases PROEX on the 10-year bill. CIRR is constructed from shorter-term instruments.

Question 12

Brazil would note the continuing confusion surrounding Canada's position. Canada appears to say (1) that in the market commercial rates below CIRR occur and (2) these may be met by WTO Members without regard to either paragraph of item (k). If this is true, Brazil wonders why we are here. Or perhaps Canada means that Canada may operate in this below-CIRR environment but that Brazil may not.

Canada's answer defies logic and denies equity. Canada admits that commercial market rates can be and have been below CIRR, and that CIRR is not necessarily an appropriate benchmark for the market. Under Canada's standard, it - and not Brazil - may "step through the market window" and provide financial support below CIRR. When Canada does it, there is no "benefit" within the meaning of the SCM Agreement. When Brazil does it, Brazil is securing a material advantage.

II. FOR BOTH PARTIES

Question 1

No comments.

Question 2

Canada's own evidence, presented in response to Question 11 from the Panel, contradicts its statement that, "By design, PROEX always results in a net interest rate that is below CIRR or that is materially below market." As noted in Brazil's comments to Canada's response to Question 11, the applicable rate in the transaction cited was 7.79 per cent while the applicable CIRR, at that time, was no higher than 7.38 per cent. (The rate applicable on 14 February, the date of Canada's response).

Canada's claim that PROEX "will invariably secure a 'material advantage,' whether it is below or above CIRR" leads to the conclusion that, in Canada's view, CIRR is meaningless as a benchmark for material advantage. This statement is hard to reconcile with Canada's answer to Question 1, in which it adheres to the view that CIRR is the appropriate benchmark for measuring material advantage.

Finally, we note that Canada puts the phrase "case-by-case" basis in quotation marks, suggesting disapproval. How else, however, does Canada decide when the "market" is below CIRR?

III. CANADA'S RESPONSES TO THE PANEL'S 7 FEBRUARY QUESTION

For Canada

Question 1

This is blatant evidence of Canada's double standard. If meeting a rate that a borrower could get on the market does not confer a benefit for Canada, then meeting that same rate does not confer a benefit for Brazil. This has nothing to do with *a contrario* interpretations of item (k). Without a benefit, there is no subsidy and item (k) becomes irrelevant, as does the question of material advantage. Canada makes these decisions, we are told, on a "case-by-case" basis. Canada does not explain why Brazil may not do the same.

IV. CANADA'S RESPONSES TO QUESTIONS FROM BRAZIL

Question 1(a)

Brazil will rely on the Panel's recollection as to Canada's statement. Brazil would note that the phrase used by Canada, "*outside* the terms and conditions under the *OECD Arrangement*," would encompass rates below-CIRR.

Question 1(b)

Canada's reply makes clear that it decides on a "case-by-case" basis, a privilege it is unwilling to extend to Brazil.

Questions 2(a)-(c)

No further comment.

Question 2(d)

Brazil would note that the rates to which Canada refers, as well as the rates contained in its Exhibit CDN-15, are commercial rates in domestic markets that do not reflect the presence of government Export Credit Agencies. Further, as noted in Brazil's comment on Canada's response to Question 11 from the Panel, most of these transactions involve large aircraft. By the standards Canada would apply to Brazil's Exhibit 2, these are irrelevant.

Question 3

Once again, Canada notes that it unilaterally decides on market conditions on a case-by-case basis, but does not say why Brazil is barred from doing the same.

Question 4

If market window operations below CIRR do not confer a subsidy because they do not confer a benefit, Brazil does not understand the grounds on which Canada would preclude Brazil from joining Canada in that below-CIRR market. Regardless of the financial contribution Brazil might make with PROEX, if there is no benefit, there is no subsidy.

Question 5

No further comment.

Question 6

No further comment.

Question 7

Brazil agrees wholeheartedly with Canada's statement, "There is no commercial bank that could provide such rates without the benefit of an Ex-Im Bank guarantee." That is Brazil's point. It is Brazil's further point that Brazil cannot provide a comparable guarantee, and, therefore, must find other ways to permit its exporter to be competitive with the subsidized exporters of the OECD members, such as Boeing and Bombardier.

Brazil disagrees with Canada's assertion that, "This transaction is influenced by and clearly reflects particular US-China policy issues." It may well be that the Ex-Im guarantee reflects a policy of the US government. But the rate granted by a non-government commercial bank, LIBOR plus 3 basis points, has nothing to do with such policy. That is the private rate the guarantee - whatever its motive - is able to bring to the US exporter, Boeing.

Canada has provided no evidence, beyond its assertion, that this transaction involving the US export credit agency and a major international bank is an "isolated example " and is not typical.

Question 8

Here Canada again suggests that because Brazil's example involves large aircraft, "it is completely irrelevant to the market conditions applicable to the commercial market financing of regional aircraft." By this standard, at least two-thirds of Canada's response to Question 11 is "completely irrelevant." Once again, there is one standard for Canada, another for Brazil.

Question 9

Brazil will defer to Canada's expertise regarding the *OECD Arrangement*, but would suggest that the US loan guarantee is compliant with the SCM Agreement because it conforms to item (j) of Annex I of the SCM Agreement, rather than item (k). Brazil would agree, however, that guarantees compliant with item (j) certainly are relevant to the market in which credit support under item (k) is provided.

Question 10

This appears to Brazil to be a non-answer.

ANNEX 2-6

BRAZIL'S COMMENTS ON THE INTERIM REVIEW

These comments are made in accordance with Art. 15.2 of the DSU.

In *paragraph 6.41*, the Panel states that it does not appear that Brazil argued that it's *a contrario* interpretation of paragraph 1 of item (k) of the Illustrative List applied even when the subsidies "do not fall within the scope of footnote 5." Brazil does not recall confining its interpretation of item (k) to the "scope of footnote 5," and certainly did not intend to do so. In this regard, Brazil notes that in the fifth paragraph of its 14 February 2000 Response to Question 10 from the Panel, Brazil said, "Footnote 5 to the SCM Agreement makes clear that the List has a purpose other than pure illustration." Beyond this, the response deals with the text of item (k), not the scope of footnote 5.

In *paragraph 6.53*, the third sentence begins, "Because *banks* in many cases have a lower cost of borrowing than the governments of developing countries ..." (Emphasis added). While Brazil does not dispute the accuracy of this statement, it was not the basis of Brazil's argument. If banks were the only actors in the market for aircraft financing, Brazil would not need to prove interest rate support for Embraer's transactions. It is the fact that *governments* - particularly Canada through its Export Development Corporation - are able to offer potential customers financing support on terms that are more attractive than the terms offered by banks that requires Brazil to act. Put differently, if banks were the sole providers of financing for aircraft, Embraer would not need Proex. It is precisely because banks are not the sole providers that Proex is needed. In this regard, Brazil believes that footnote 48 contains a more accurate description.

ANNEX 3-1

SUBMISSION OF THE EUROPEAN COMMUNITIES
(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4261
II. BUSINESS CONFIDENTIAL INFORMATION	4262
III. WHEN IS THE SUBSIDY "GRANTED"?	4262
IV. DO THE CHANGES TO THE PROEX PROGRAMME BRING IT INTO COMPLIANCE?	4264
V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL	4266
VI. CONCLUSION	4266

I. INTRODUCTION

1. The European Communities (hereafter "the EC") makes this third party submission because of its systemic interest in the correct interpretation of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").
2. Canada claims (paragraph 29) that:
Brazil's withdrawal of prohibited PROEX export subsidies must include, at a minimum, two actions:
first, it must cease to grant subsidies found to have been prohibited, in respect of commitments made before the date of compliance for regional aircraft exported after that date; and
second, Brazil must make the necessary modifications to the programme to eliminate export subsidies in respect of future commitments.
3. In paragraph 30, Canada states that:
the above two actions constitute the only means by which Brazil could be found to have discontinued the granting of PROEX prohibited export subsidies and, accordingly, found to have withdrawn such subsidies in accordance with its obligation to implement the recommendations and rulings of the DSB.
4. Brazil only addresses the second of these actions in its first submission - the measures it has taken to bring the programme into compliance. It does not comment on existing commitments.
5. The EC would note that both Parties seem to agree that, despite the changes made to the PROEX programme, Brazil still does not comply with the terms of Article 27.2 of the SCM Agreement. In view of that, it may be legitimate for the Panel to assume that Article 3.1(a) of the SCM Agreement continues to apply to the PROEX payments.
6. The EC will comment on the facts and arguments of the parties as they appear from the Reports and the first written submissions of the parties. The arguments

presently before the Panel are not however as yet fully developed and the EC anticipates that it will have more to say at the third party session of the meeting with the Panel. The EC does not consider that it is appropriate for it at this stage to discuss arguments that have not yet been developed by the parties.

7. Section III will discuss the question of when a subsidy comes into existence and consequently which subsidy payments are affected by the obligation to implement the report. Section IV discusses what Brazil considers to be the "defence" contained in the first paragraph of item (k) of the Illustrative List. Finally, Section V addresses Canada's proposal concerning a "Transparency Agreement".

II. BUSINESS CONFIDENTIAL INFORMATION

8. The EC must first recall its position on the special procedures for the protection of "Business Confidential Information."

9. The EC recognizes that certain information used in panel proceedings may be of such a nature that particular care is called for to protect it. The EC cannot accept however that protective procedures are adopted which it is impossible for the EC to follow. As the EC explained before the Appellate Body, EC officials are not allowed to enter into personal commitments to third country governments concerning the conduct of dispute settlement proceedings. Such obligations may only be undertaken by the EC, which is bound vis-à-vis other WTO Members by Article 18.2 DSU to ensure that confidential information is protected. In the case of the EC, the effectiveness of this obligation is ensured by the fact that EC officials are all bound by the EC Treaty and their terms of employment not to disclose confidential information, including business confidential information.

III. WHEN IS THE SUBSIDY "GRANTED"?

10. Canada has requested that Brazil cease to "grant" prohibited subsidies, and not that Brazil "withdraw" those subsidies. Thus, Canada's request does not require the Panel to address the question of whether the obligation to "withdraw" a subsidy may entail, at least in some cases, the obligation to request the reimbursement of all or part of a subsidy already "granted", a question which was extensively argued in the main proceeding. The EC notes that this question has not been raised either by Brazil in the parallel case concerning Canada's measures.

11. The EC agrees with Canada that, irrespective of the implications of the generally accepted principle that WTO remedies are not retroactive for the interpretation of the term "withdraw" in Article 4.7 of the SCM Agreement, the obligation to "withdraw" a prohibited subsidy implies necessarily the obligation to at least cease to "grant" that subsidy.

12. As argued by Canada, the withdrawal of a prohibited subsidy under Article 4.7 may not imply a lesser obligation than to "bring into conformity" that subsidy under Article 19.1 of the DSU. Article 3.2 of the SCM Agreement, the provision infringed by Brazil, provides that Members "shall neither grant nor maintain" prohibited subsidies. Thus, it is plain that in order to bring the measures into conformity with Article 3.2, Brazil must cease to "grant" the prohibited subsidies, as requested by Canada.

13. Canada's request, nevertheless, raises the issue of the point at which the subsidies found to be prohibited must be deemed "granted". Canada takes the view that PROEX payments are "granted" when the NTN- I bonds are issued. Consequently, Brazil should cease from issuing new NTN- I bonds from the date of compliance, even in those cases where it is required to do so by a letter of commitment. Brazil, on the other hand, has argued in the main proceeding, and appears to have assumed for the purposes of implementing the Report, that the PROEX payments are "granted" when the letters of commitment are issued. On that premise, Brazil would be prevented from issuing new letters of commitment, but not from issuing new NTN- I bonds, unless the term "withdraw" in Article 4.7 of the ASCM had to be interpreted as requiring the reimbursement or, at least, the non-maintenance of an already "granted" subsidy.¹

14. In the main proceeding, the EC argued that the prohibited subsidies are "granted" when the sales contracts are concluded. The EC, nevertheless, agrees now with Canada's position that the subsidies are "granted" when the NTN- I bonds are issued, given the Appellate Body's conclusion that (at paragraph 158):

"For the purposes of Article 27.4, ... the export subsidies for regional aircraft under PROEX are "granted" when all the legal conditions have been fulfilled that entitle the beneficiary to receive the subsidies. We share the Panel's view that such an unconditional legal right exists when the NTN-I bonds are issued.

15. The Appellate Body's conclusion is confined by its own terms to Article 27.4 of the ASCM. Yet, the Appellate Body report gives no indication that the PROEX payments should be deemed "granted" at an earlier moment for other purposes. Indeed, the Appellate Body report does not suggest that the term "granted" may have different meanings in other contexts. Instead, the Appellate Body emphasized that it is necessary to distinguish between the issue of when a subsidy is "granted" and the issue of whether a subsidy "exists" (at paragraphs 156-157):

Consequently, for the purposes of Article 27.4, we see the issue of the *existence* of a subsidy and the issue of the point at which that subsidy is *granted* as two legally distinct issues. Only one of those issues is raised here and, therefore, must be addressed. That issue is: when is this subsidy, which admittedly exists, actually *granted*?

¹ Canada did argue, however, that if the Panel were to find that the subsidy was granted at the time of the signing of the letters of commitment that the Panel then find that Brazil cannot "maintain" the subsidy by issuing the NTN-I bonds. In view of the Panel's findings (confirmed by the Appellate Body) that the subsidy was granted when the bonds are issued it was not necessary for the Panel to rule on Canada's alternative argument. In particular, in para. 195 of its report the Appellate Body stated that

"Canada makes a conditional appeal. Canada requests that, if we accept Brazil's argument and reverse the finding of the Panel that the export subsidies for regional aircraft under PROEX are "granted" at the time of issuance of the NTN-I bonds for the purposes of Article 27.4 of the SCM Agreement, then we should also reverse the Panel's decision not to make a finding on whether Brazil had acted inconsistently with its obligations not to "maintain" export subsidies under Article 3.2 of that Agreement.¹ As we have not accepted Brazil's argument and have, therefore, not reversed the finding of the Panel on when the export subsidies for regional aircraft under PROEX are "granted", it is not necessary for us to consider this conditional appeal by Canada".

In our view, the Panel did not have to determine whether the export subsidies for regional aircraft under PROEX constituted a "direct transfer of funds" or a "potential direct transfer of funds", within the meaning of Article 1.1(a)(i), in order to determine when the subsidies are "granted" for the purposes of Article 27.4. Moreover, the Panel compounded its error in finding that the "financial contribution" in the case of PROEX subsidies is *not* a "potential direct transfer of funds" by reasoning that a letter of commitment does not confer a "benefit". In this way, in its interpretation of Article 1.1(a)(i), the Panel imported the notion of a "benefit" into the definition of a "financial contribution". This was a mistake. We see the issues - and the respective definitions - of a "financial contribution" and a "benefit" as two separate legal elements in Article 1.1 of the *SCM Agreement*, which *together* determine whether a subsidy *exists*, and not whether it is *granted* for the purpose of calculating the level of a developing country Member's export subsidies under Article 27.4 of that Agreement. [footnotes omitted]

16. Applying those categories to the case at hand, it can be said that while the prohibited subsidies "existed" from the moment when the letters of commitment were issued (and as such could be the subject of dispute settlement), they will not be "granted" until the NTN-I bonds are issued.

17. For the above reasons, the EC considers that Brazil has not properly implemented the Report if it continues to issue NTN-I bonds after the date of compliance.

IV. DO THE CHANGES TO THE PROEX PROGRAMME BRING IT INTO COMPLIANCE?

18. Brazil did not dispute before the Panel that PROEX payments are subsidies and are contingent upon export performance. Instead, it relied on Article 27.2 and the first paragraph of item (k) of Annex I in order to excuse the violation of Article 3.1 (a).

19. Before the present implementation Panel, Brazil has not claimed that there is no violation of Article 3.1 (a) or that Article 27.2 applies. It merely relies on what it alleges to be an "affirmative defence" contained in the first paragraph of item (k).

20. The EC would recall its view that the first paragraph of item (k) is not an "affirmative defence". That provision simply deems certain practices to be prohibited export subsidies. From that, however, it cannot be inferred *a contrario* that an export credit which is not caught by the first paragraph of item (k) is not a prohibited export subsidy.

21. The Appellate Body did not find the contrary. It simply held that the conditions for the application of the "affirmative defence" invoked by Brazil were not satisfied, even if such an "affirmative defence" should be available. (The Appellate Body uses always the term "affirmative defence" between quotation marks). Therefore, the Appellate Body did not need to decide whether the first paragraph of item (k) did provide an affirmative defence.

22. For the above reasons, the EC would suggest that, before addressing Brazil's claim that the PROEX scheme no longer confers a "material advantage", the Panel

should examine whether the first paragraph of item (k) provides in fact an affirmative defence.

23. Accordingly, the comments here below are submitted by the EC only in the event that the Panel was to conclude that item (k) provides an affirmative defence.

24. The EC agrees with Brazil that the benchmark for determining whether subsidies are used "to secure a material advantage" within the meaning of the first paragraph of item (k) of Annex I is "the marketplace".

25. The Appellate Body seems to have considered that the rates below the relevant CIRR may be presumed "to secure a material advantage" (at paragraph 182):

The fact that particular net interest is below the relevant CIRR is a positive indication that the government payment in that case has been "used to secure a material advantage in the field of export credits"

26. The presumption established by the Appellate Body is fully justified, having regard to the way in which the CIRR rates are determined. Nevertheless, the EC would agree with Brazil that such presumption is rebuttable. Accordingly, a Member might in some circumstances demonstrate through positive evidence that a net interest rate below the relevant CIRR does not provide a "material advantage". The EC is of the view, however, that Brazil has failed to do so in the case at hand.²

27. Since Brazil is invoking what it claims to be an "affirmative defence", it bears the burden of proving that the floor which it has established, i.e. the 10-years United States Treasury Bonds plus a spread of 20 basis point, satisfies the test of the first paragraph of item (k). The EC considers that Brazil has not met that burden of proof.

28. Indeed, the only evidence provided by Brazil consists of an example of a loan guaranteed by the Export Import Bank of the United States. One single example cannot be considered as sufficient evidence. Moreover, there are a number of important differences between that example and the PROEX programme which cast doubts on the relevance of Brazil's example.

29. Brazil's example concerns a leasing transaction, whereas the PROEX payments are granted with respect to sales. In a leasing transaction, the lessor enjoys the additional security that it remains the owner of the financed asset until the loan is reimbursed. Hence, it can afford to charge a lower interest rate. Another significant difference is that in Brazil's example, the interest rate is based on LIBOR and is, therefore, a floating rate. Moreover, it is not correct to calculate the cost of the guarantee fee simply by allocating the amount paid up-front to the guarantor over the duration of the loan. In reality, on the basis of the facts available, the actual annualized cost of the guarantee fee would appear to be as high as 60 bps, instead of 30 bps.

30. Brazil's additional argument based on the so-called "market window" support is also flawed. The mere fact that, according to certain interpretations, the OECD Arrangement does not prevent the Participants to provide "market window" support at rates below the CIRR rates does not allow to conclude that PROEX rates do not

² The floor established by Brazil is much lower than the relevant CIRR rate. It may be estimated that, as of the date of this submission, the relevant CIRR rate is 7,38 (= yield on the 7 year bonds for US dollar + 100 bps, i.e. 6,38 + 1,00) while the PROEX rate, according to Brazil's submission, would be 6,80.

secure a "material advantage". For that, Brazil should have provided evidence showing that the Participants to the Arrangement are actually providing "market window" support in the relevant market for aircraft at rates which are not just below the CIRR rates but also below, or at least at the same level, as those made available through the PROEX scheme. Moreover, Brazil should have demonstrated that "market window" support in the relevant market for aircraft is so widespread that the "commercial rate" is in practice the same as the "market window" rate.

V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL

31. Canada proposes to enter into a transparency agreement with Brazil to ensure that financing complies with the SCM Agreement and asks the Panel to suggest this in its recommendations.

32. Canada and Brazil are of course free to settle their dispute in whatever way they wish so long as the settlement complies with the WTO Agreement.

33. The EC does not however consider that it would be appropriate for the Panel to suggest a transparency agreement. Canada and Brazil already have an obligation to notify all their subsidies, including the ones found by the Panel in this case. They do not seem to have fully complied with this obligation. It would appear more appropriate for the Panel to insist that Canada and Brazil fulfil their WTO commitments than to make the suggestion requested by Canada.

VI. CONCLUSION

34. The state of the arguments presented by the parties and the information and time for reflection available to the EC has not allowed it to make as full a contribution to the reflections of the Panel as it might have liked. It will therefore supplement its arguments at the Third Party Session in the light of the other submissions to be presented to the Panel before that meeting.

ANNEX 3-2

SUBMISSION OF THE UNITED STATES

(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4267
II. MEASURES TAKEN BY BRAZIL TO COMPLY WITH THE DSB'S RULINGS AND RECOMMENDATIONS	4267
A. The Issuance of PROEX Bonds on Aircraft Exported After 18 November 1999 Pursuant to Commitments Made Before that Date Is Inconsistent with Brazil's Obligations Under Articles 3.2 and 4.7 of the SCM Agreement	4268
B. Brazil's Position on the Conformity of PROEX Financing with Item (k) of the Illustrative List is Based Upon a Misinterpretation of the Appellate Body's Decision.....	4270
III. CANADA'S PROPOSAL FOR "VERIFICATION PROCEDURES"	4273
IV. CONCLUSION	4274

I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the Article 21.5 proceeding that Canada has requested to review Brazil's implementation of the Dispute Settlement Body's ("DSB") recommendations and rulings in *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R, 14 April 1999 ("Panel Report"); WT/DS46/AB/R, 2 August 1999 ("Appellate Body Report"). The United States will comment upon Brazil's reported decision to continue issuing PROEX bonds on aircraft exported after 18 November 1999 under commitments made before that date and Brazil's rationale for its claim that its modifications to PROEX render the programme consistent with the WTO Agreement on Subsidies and Countervailing Measures ("the SCM Agreement") and the DSB's rulings and recommendations. The United States will also comment briefly on Canada's proposal to establish "verification procedures" that it claims will "facilitate a definitive resolution of this dispute."¹ The United States does not comment at this time upon the other issues raised in this proceeding.

II. MEASURES TAKEN BY BRAZIL TO COMPLY WITH THE DSB'S RULINGS AND RECOMMENDATIONS

2. Canada claims that the measures taken by Brazil in respect of the *Programa de Financiamento às Exportações* ("PROEX") and export subsidies on sales of Bra-

¹ Canada Submission, paras. 39-46.

zilian regional aircraft neither withdraw the export subsidies nor otherwise comply with the SCM Agreement and the findings and recommendations of the Panel and the Appellate Body² Due to the fundamental importance of this issue, the United States wishes to make certain brief observations that it hopes will assist the Panel in reaching its own determinations.

A. *The Issuance of PROEX Bonds on Aircraft Exported After 18 November 1999 Pursuant to Commitments Made Before that Date Is Inconsistent with Brazil's Obligations Under Articles 3.2 and 4.7 of the SCM Agreement*

3. Canada asserts that Brazil intends not to withdraw PROEX subsidies with respect to aircraft exported after 18 November 1999 under commitments reached before that date, and that a failure to do so would constitute a violation of Articles 3.2 and 4.7 of the SCM Agreement.³ Brazil does not respond to Canada's assertions in its submission. If Canada's description of Brazil's intentions is correct, however, then the United States agrees with Canada (and will not repeat its arguments) that Brazil's position would constitute the granting of prohibited export subsidies in violation of Article 3.2 and a failure to withdraw under Article 4.7.

4. Due to the fundamental importance of this issue, the United States submits the following additional observations, which reflect US concerns regarding the broader implications of the position of Brazil (and the EC, if it continues with the arguments it made before the Panel and the Appellate Body) on the operation of dispute settlement under the SCM Agreement.

5. Implicit in Brazil's position is the proposition that remedies in WTO dispute settlement are not retroactive, a proposition with which the United States does not disagree.⁴ However, also implicit in Brazil's position is the proposition that a subsidy comes into, and goes out of, existence simultaneously at the moment of its granting. With this proposition the United States strongly disagrees.

6. In the subsidies area, it is well-accepted that the timing and duration of a subsidy are two different things, and that a subsidy can have a duration that extends over a period of years. This concept was recognized in the Tokyo Round Subsidies Committee's *Guidelines on Amortization and Depreciation*, which called for the allocation of certain subsidies over time.⁵ This concept is also reflected in paragraph 7 of Annex IV of the SCM Agreement, which refers to subsidies "the benefits of which are allocated to future production", and which contemplates that subsidies granted prior to the entry into force of the WTO Agreement are actionable under Part III of the SCM Agreement. It also is reflected in the report of the Informal Group of Experts which was charged with fleshing out the details for calculating subsidies under

² Canada Submission, para. 1.

³ Canada Submission, paras. 16-17, 25-31.

⁴ The United States notes that the issue of the prospective nature of the remedy under Article 4.7 of the SCM Agreement is also an issue involved in the forthcoming Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126. The United States would be happy to provide additional written views on this issue to the Panel in light of that report.

⁵ BISD 32S/154.

Annex IV of the SCM Agreement.⁶ Finally, this concept is reflected in the countervailing duty practice of Members such as the United States, the EC, and Canada, so that, for example, a subsidy granted in 1995 will be attributed to, and be countervailable with respect to, production or exports in 1999.⁷

7. In the case of a subsidy that is properly allocated over several years (as would be the case with respect to the PROEX subsidies in question), the withdrawal of that portion of the subsidy allocated to future time periods would not constitute a retroactive remedy or retroactive implementation. Instead, it would constitute prospective implementation based on a recognition of the distinction between the measure conferring a subsidy and the subsidy itself. While a subsidy comes into existence at a particular point in time, the duration of the subsidy can extend over a period of years, depending on the nature of the subsidy in question.

8. In this case, Canada has kept matters simple by merely insisting that Brazil not issue new bonds after 18 November 1999.⁸ The argument made by Brazil and the EC before the Appellate Body that a cessation of the issuance of further PROEX bonds would be disruptive to private parties proves too much. It is the rare case in which the behaviour of private parties is *not* disrupted when WTO dispute settlement results in a recommendation and ruling that a Member withdraw a measure on which private parties have come to rely or on which they have based their plans. As recognized by Appellate Body Member Beeby, "[i]n virtually every case in which a measure has been found to be inconsistent with a Member's obligations under the GATT 1994 or any other covered agreement, and therefore, must be brought into conformity with that agreement, some degree of adjustment by the domestic industry of the Member concerned will be necessary."⁹ Moreover, it is difficult to see how anyone,

⁶ *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures*, G/SCM/W/415 (25 July 1997), paras. 1-2. The SCM Committee "took note of" this report and its recommendations at its April, 1998 meeting. *Committee on Subsidies and Countervailing Measures; Minutes of the Regular Meeting Held on 23-24 April 1998*, G/SCM/M/16 (15 July 1998), paras. 75-76.

⁷ In the case of the United States, the rules for allocating subsidies over time are set forth primarily in section 351.524 of the Department of Commerce's countervailing duty regulations. G/SCM/N/1/USA/1/Suppl.4 (29 March 1999), pages 129-131. In the case of Canada, the concept is expressed most clearly in section 27 of its *Regulations Respecting Special Import Measures*, G/SCM/N/1/CAN/3 (10 September 1997), page 174. In the case of the EC, the concept is expressed generally in Article 4.C.3(d) of Council Regulation (EC) No. 3284 of 22 December 1994, G/SCM/N/1/EEC/1 (31 March 1995), page 12, while detailed rules are included in its recently issued *Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations* (98/C 394/04), section F of which recognizes that "[a]s many subsidies have effects for a number of years, subsidies granted before the investigation period should also be investigated in order to determine what portion of such subsidy is attributable to the investigation period ...". G/SCM/N/1/EEC/2/Suppl.2 (8 January 1999), page 9.

⁸ As the United States understands it, Canada is not asking that bonds issued prior to the establishment of the panel be repaid.

⁹ Award of the Arbitrator, *Indonesia - Certain Measures Affecting the Automobile Industry*, Arbitration under Article 21.3(c) of the DSU ("Indonesia Autos"), WT/DS54/15, WT/DS55/14, WT/DS/59/13, WT/DS/64/12, 7 December 1998, DSR 1998:IX, 4029, para. 25. Mr. Beeby also noted that "the Award of the Arbitrator in *Japan - Taxes on Alcoholic Beverages* ... rejected the argument that adverse effects on producers (and consumers) of the products involved constitute

whether in the private or government sector, could have a legitimate expectation regarding subsidies that are prohibited by the SCM Agreement.

9. The position that a WTO dispute cannot affect prior government subsidy commitments, if accepted, would eviscerate the utility of WTO dispute settlement as a vehicle for addressing trade distortive subsidies. As an example, assume that Country X provides a \$1 billion grant to Company Y in order to allow Company Y to construct a facility that will produce widgets for export. A WTO panel finds, and the Appellate Body affirms, that the grant is a prohibited export subsidy. However, at the time when the DSB adopts the panel report, Country X already has disbursed the \$1 billion to Company Y and Company Y already has contracted for the construction of the facility.

10. As the United States understands the position of Brazil and the EC, the best remedy that could come from this case is that Country X would not be able to provide another subsidy to Company Y. However, the damage to Company Y's foreign competitors would continue as widgets produced by Company Y would continue to be subsidized by virtue of the \$1 billion grant.

11. The United States submits that this is an absurd result that is not mandated by the terms of the SCM Agreement, the DSU, or public international law, and that would render the increased disciplines of the SCM Agreement meaningless. Instead, an appropriate outcome in the above hypothetical would be, for example, a repayment by Company Y to Country X of that portion of the \$1 billion grant allocated to time periods post-dating the Dispute Settlement Body's adoption of its recommendations and rulings. Another alternative would be the conversion of that portion to a commercial rate loan from the government of Country X to Company Y. The precise method of withdrawal of the subsidy might depend upon the domestic law of Country X. If a withdrawal was not permissible under that domestic law, then compensation or countermeasures would be appropriate.

12. The instant dispute involves a much simpler situation than the "widget" example discussed above. As the United States understands it, Canada is not demanding that Brazil recover funds already paid out or recover revenue already foregone. Instead, Canada simply is insisting that Brazil not pay out additional prohibited subsidies in the form of PROEX bonds. In the view of the United States, such a remedy is consistent with the terms of the SCM Agreement and the DSU. If such a remedy is not considered acceptable, then WTO dispute settlement is largely useless as a tool for addressing distortive subsidies.

B. Brazil's Position on the Conformity of PROEX Financing With Item (k) of the Illustrative List is Based Upon a Misinterpretation of the Appellate Body's Decision

13. Canada's second claim in this proceeding is that, for new financing commitments, Brazil has failed to modify PROEX in a way that brings the programme into conformity with the SCM Agreement. Brazil disagrees, on the grounds that it has established a "floor" for future PROEX financing that does not secure a material

'particular circumstances' that should be taken into account in determining the reasonable period of time under Article 21.3(c) of the DSU." *Id.*, para. 25, note 19.

advantage in comparison with other types of financing available in the export financing "marketplace." The United States submits that Brazil's position is based upon a misinterpretation of the Appellate Body's decision.

14. In Brazil's view, the Appellate Body held "that the appropriate reference for determining whether a material advantage is secured by PROEX interest equalization payments for aircraft is the 'marketplace' for export financing", and that the Commercial Interest Reference Rate ("CIRR") of the OECD *Arrangement on Guidelines for Officially Supported Export Credits* is but "one example" of an appropriate benchmark for making such a comparison.¹⁰ Relying on this interpretation of the Appellate Body's holding, Brazil argues that PROEX financing would not secure a material advantage within the meaning of item (k) unless it was below the CIRR rate and any other rate available in the "marketplace" for export financing. In the view of the United States, this is not what the Appellate Body said.

15. In its report, the Appellate Body characterized the issue at hand as "whether the export subsidies for regional aircraft under PROEX 'are used to secure' for Brazil 'a material advantage in the field of export terms'" within the meaning of the first paragraph of item (k) of the Illustrative List.¹¹ The Appellate Body first noted that it viewed the second paragraph of item (k) as "useful context" for interpreting the "material advantage" clause in the first paragraph. It then opined that:

[t]he *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are "used to secure a material advantage in the field of export credit terms." *Therefore, in our view, the appropriate comparison to be made in determining whether a payment is "used to secure a material advantage", within the meaning of item (k), is between the actual interest rate applicable in a particular export sales transaction after deduction of the government payment (the "net interest rate") and the relevant CIRR.*¹²

Thus, it is not correct to state that the Appellate Body identified the CIRR rate as only "one example" for determining whether a payment is used to secure a material advantage within the meaning of item (k).¹³

16. Brazil relies upon its misinterpretation of the Appellate Body's holding to argue that PROEX conforms with item (k) because two other types of financing available in the marketplace - loan guarantees and market windows - provide rates that are lower than those available through PROEX. For the following reasons, the United States submits that the existence of loan guarantees and market windows has no relevance to this dispute.

¹⁰ Brazil Submission, para. 9.

¹¹ Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 181.

¹² *Id.* (emphasis added).

¹³ *Id.*, para. 182. Indeed, the Appellate Body went so far as to state that "[t]he fact that a particular net interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms.'" *Id.*

17. First, the issue in this proceeding is whether Brazil has complied with the DSB's recommendations and rulings, not whether the Appellate Body was wrong to hold that the CIRR is the appropriate benchmark for determining compliance with the material advantage clause of item (k). An Article 21.5 proceeding is not a forum for seeking modifications to the Appellate Body's findings, and Brazil's implicit attempt to do so here should be rejected. In the view of the United States, while the Appellate Body could have chosen another benchmark for determining compliance with item (k), the CIRR was an appropriate choice, since it represents an extrinsic measurement that is part of an international undertaking that is specifically recognized in the SCM Agreement.

18. Second, loan guarantees - or, more accurately, export credit guarantees - are governed exclusively by item (j) of the Illustrative List, not by item (k). The provision by governments of export credit guarantee programmes at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes constitute prohibited export subsidies under item (j) of the Illustrative List. Such programmes have no relevance, however, to determining whether PROEX conforms with item (k).

19. Third, Brazil's discussion of so-called "market windows" mischaracterizes the status of such practices under the *OECD Arrangement*. Brazil claims in its submission that:

Some Participants in the Arrangement take the position that "official support" consists only of the provision of support at rates below the government's cost of funds. Support at rates equal to or above the government's cost of funds, in the view of these Participants, is so-called "market window" support. In the view of these Participants, so long as support is provided above the government's cost of funds - through the "market window" - it may be provided at rates below CIRR rates and remain consistent with the requirements of the Arrangement.¹⁴

Brazil then claims that the failure of the Participants in the *OECD Arrangement* to "reach a conclusion" on the issue of market windows and the definition of official support means that market windows are not inconsistent with the obligations under the *OECD Arrangement* in the view of the OECD.¹⁵ In Brazil's view, this means that countries that use market window financing are "in conformity with the Arrangement" and that Brazil may then use market windows as a benchmark for judging the conformity of its own financing with the obligations of item (k).

20. The United States agrees with Brazil that the issue of "market windows" has not been resolved in the OECD. However, there is no language in the *OECD Arrangement* which suggests that the definition of "official support" is limited to financing that is below the cost of funds to the providing government. Moreover, to date, there has been no special regime in the *OECD Arrangement* that establishes financial rules for "market windows" that differ from the CIRR. In the absence of

¹⁴ Brazil Submission, para. 19.

¹⁵ Brazil Submission, para. 23.

such rules, the only relevant benchmark established in an "international undertaking" for purposes of the second paragraph of item (k) remains the CIRR.

21. Therefore, when the Appellate Body employs "*OECD Arrangement*" rates for purposes of determining the existence of a "material advantage" in the first paragraph of item (k), the only relevant rate that currently exists is the CIRR. It goes without saying that the failure of the OECD to reach agreement on the treatment of "market windows" for purposes of the *OECD Arrangement* has no bearing upon whether "market window" financing complies with item (k).

22. The United States has nothing further to add on the issue of whether Brazil's amendments to PROEX comply with the rulings and recommendations of the Dispute Settlement Body.

III. CANADA'S PROPOSAL FOR "VERIFICATION PROCEDURES"

23. Finally, the United States wishes to comment briefly on Canada's proposal to establish "verification procedures," which it asserts will "facilitate a definitive resolution of this dispute."¹⁶ Canada is willing to accept similar procedures in *Canada - Measures Affecting the Export of Civilian Aircraft*¹⁷ if Brazil agrees to accept the procedures in this case. Canada asserts that "it would be useful if the Panel were to suggest that the Parties develop such procedures, consistent with its authority under Article 19.1 of the DSU."¹⁸

24. In the view of the United States, if they so desire, Canada and Brazil certainly may agree to establish procedures that would enable each party to monitor the other's compliance with the rulings and recommendations applicable to the programmes at issue. However, the United States disagrees that Article 19.1 of the DSU would permit the Panel to suggest such procedures. By its plain terms, Article 19.1 permits a panel to suggest ways to implement the recommendations that it makes after concluding that a measure is inconsistent with a covered agreement. It does not permit - or even contemplate - that a panel may take further steps and play some role in monitoring the implementation process itself. As the Appellate Body stated in *India - Patent Protection for Pharmaceutical and Agricultural Products*:

[a]lthough panels enjoy some discretion in establishing their own working procedures, this discretion does not extend to modifying the substantive provisions of the DSU. ... Nothing in the DSU gives a panel the authority to disregard or to modify other explicit provisions of the DSU.¹⁹

¹⁶ Canada Submission, paras. 39-46.

¹⁷ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443 and Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.

¹⁸ Canada Submission, para. 46.

¹⁹ Appellate Body Report, *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India - Patents (US)*"), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:1, 9, para. 92.

25. Furthermore, the United States observes that nothing would prevent Canada and Brazil from agreeing on "transparency" procedures under Article 25 of the DSU, which permits parties by mutual agreement to resort to arbitration as an alternative to dispute settlement. Article 25.2 of the DSU explicitly permits parties to agree on the procedures to be followed in that context.²⁰

26. Lacking additional details, the United States is not in a position to comment upon the actual structure that the verification procedures would take. Once again, this presumably would be an issue for the parties to decide among themselves.

IV. CONCLUSION

27. The United States thanks the Panel for providing an opportunity to comment on the important issues at stake in this proceeding, and hopes that its comments will prove to be useful.

²⁰ DSU, art. 25.2.

ANNEX 3-3

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(4 February 2000)

TABLE OF CONTENTS

		Page
1.	Introduction	4275
2.	Panels may not decide extra petitem	4275
3.	The requirement to withdraw subsidies can only be prospective	4276
3.1	The text and context of the relevant provisions	4276
3.2	The object and purpose of the WTO Agreement	4278
3.3	Past practice	4280
3.4	Application to subsidies and the present case	4280
4.	When do PROEX subsidies exist?	4281
5.	Item (k) of the Illustrative List	4283

1. Introduction

28. The European Communities makes this third party submission because of its systemic interest in the correct interpretation of the *SCM Agreement* and the correct application of the DSU.

29. The EC is in particular most concerned by the fact that the recent Article 21.5 panel on *Australia - Automotive Leather*¹ has considered itself entitled to interpret the WTO Agreement as allowing retroactive remedies. Since similar issues may be involved in this case and the present Panel may have to confront the question, the EC feels it must devote some time today to explaining why the approach of the Article 21.5 panel on *Australia - Automotive Leather* is a serious error.

2. Panels May not Decide Extra Petitem

30. The Panel in this case ought not to reach the issue of retroactivity of remedies which proved so problematic in the Article 21.5 report by the *Australia - Automotive Leather* since the terms of reference of this Panel are carefully circumscribed² as covering only aircraft delivered after 18 November, whether pursuant to contracts entered into before 18 November or after 18 November 1999. In this case the time of delivery corresponds to the time of export and to the time when NTN-1 bonds are issued. This is according to the Appellate Body the time when the subsidy is granted.

¹ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States* (“*Australia – Automotive Leather II (Article 21.5 – US)*”), WT/DS126/RW, adopted 11 February 2000, DSR 2000;III, 1189.

² WT/DS46/13 of 26 November 1999.

31. WTO dispute settlement is a *member-driven* process that can only be initiated by members and is continuously under the control of the parties who are free to choose the panellists they desire and to terminate the process when they wish. The DSU expressly states that the purpose of dispute settlement is to *preserve* the rights and obligations of Members, that it cannot add to or diminish those rights and that it should encourage amicable settlements and aim at a satisfactory resolution of disputes.

32. The Appellate Body made clear in *India - Patent Protection*³ that a claim that has not been made in the request for the establishment of the panel cannot be the subject of a finding by a panel and explained this *inter alia* on the grounds of procedural fairness.⁴

33. Although there is in principle no bar to the parties or the panel developing new *arguments* during the process, the EC considers that this does not allow new arguments to be developed by a panel which declare or assume the existence of rights that the parties have not claimed. Such action raises the same systemic and procedural fairness concerns as arise when a panel makes findings on a new claim.

34. The Panel may not therefore find in this case that Brazil has failed to implement the report retrospectively since Canada has only asked for a finding that the report has not been implemented with respect to deliveries made after 18 November 1999.

3. The Requirement to Withdraw Subsidies can only be Prospective

35. However, since it cannot be excluded that arguments about retroactive remedies under the *SCM Agreement* may arise in this case and in view of the unacceptability of retroactive remedies for the EC, and we are sure for other Members, the EC will now set out its view and comment on the *Australia - Automotive Leather* report.

36. The EC agrees with the parties to this dispute and the other third party that the remedy under Article 4 *SCM Agreement*, like all other remedies under the WTO dispute settlement system, can only be, and were only intended by the Members to be, *prospective* in nature. They are not intended to and indeed cannot remove the effects of a trade distortion or restriction situated in the past.

3.1 The Text and Context of the Relevant Provisions

37. The terms "withdraw the measure" or "withdraw the subsidy" in Article 4.7 *SCM Agreement* do not require retroactive implementation any more than the term "bring the measure into conformity" in Article 19.1 DSU.

38. The term "withdraw" is a general term which may cover many different concepts including revocation, repeal, repayment of money, liquidation of an interest or

³ Report by the Panel on *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products - Complaint by the European Communities and their Member States*, ("India - Patents (EC)"), WT/DS79/R, adopted 22 September 1998, DSR 1998:VI, 2661, paras. 85 - 90.

⁴ See esp. para. 88.

a neutralization of an effect. The definitions in the New Shorter Oxford Dictionary include:²⁵

Take back or away (something bestowed or enjoyed).

Cause to decrease or disappear.

Remove (money) from a place of deposit.

39. It is used in Article 4.7 precisely because there may be many ways of implementing a panel report concerning export subsidies - as the EC will discuss in more detail below.

40. It does not imply a retroactive remedy but rather in the context a prospective remedy. If an investment is withdrawn the investor may receive more or much less than he put in. A right, or even an obligation, to withdraw does not imply recovering exactly the sum originally invested. Indeed Articles 3.7 and 26.1(b) DSU also use the term "withdrawal of the measure" when referring to implementation in the sense of Article 19.1 DSU and this has been held to mean only prospective implementation in the report of the Article 21.5 panel in *European Communities - Bananas - Recourse by Ecuador*,⁵ where the panel held that:

In framing this issue for consideration, we do not imply that the European Communities is under an obligation to remedy past discrimination. Article 3.7 of the DSU provides that "... the first objective of the dispute settlement is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements." This principle requires compliance *ex nunc* as of the expiry of the reasonable period of time for compliance with the recommendations and rulings adopted by the DSB. If we were to rule that the licence allocation to service suppliers of third-country origin were to be "corrected" for the years 1994 to 1996, we would create a retroactive effect of remedies *ex tunc*. However, in our view, what the EC is required to ensure is to terminate discriminatory patterns of licence allocation with *prospective* effect as of the beginning of the year 1999.

41. In the same way, the Article 22.6 Report on the recourse to Article 22 DSU by the US in *EC - Bananas*,⁶ considered that the level of nullification and impairment had to be assessed as it existed at the end of the reasonable period of time (which may, for a number of reasons, be different from that which existed before). This supports the view that the obligation to implement only relates to the future, not the past.

42. An additional element of context supporting the non-retroactivity of remedies in the WTO is the fact that both Articles 19.1 DSU and 4.7 *SCM Agreement* allow Members a period of time in which to implement panel reports. Since these provi-

²⁵ New Shorter English Oxford Dictionary - CD - January 1997.

⁵ Report by the Panel on *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Article 21.5 by Ecuador* ("EC - Bananas III (Article 21.5 - Ecuador)"), WT/DS27/RW/ECU, 12 April 1999, DSR, 1999:II, 803, para. 6.105.

⁶ Decision by the Arbitrators, *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* ("EC - Bananas III (US) (Article 22.6 - EC)"), WT/DS27/ARB/, 9 April 1999: II, 725.

sions do not require *immediate* implementation, why should they be interpreted to require *retroactive* implementation?

3.2 The Object and Purpose of the WTO Agreement

43. The above interpretation is fully supported by a consideration of the object and purpose of the WTO Agreement.

44. The fundamental reason why WTO remedies are not retroactive is that the objective of the WTO are the removal of restrictions on trade, not compensation for past restrictions or the creation of rights to retaliate by restricting trade in the future. This objective can only be achieved by ensuring that trade-restricting or trade distorting-measures are removed for the future. Past trade restrictions or distortions *cannot* be remedied. In particular, creating new restrictions and distortions in the future cannot eliminate the fact that trade was distorted or restricted in the past but in fact only frustrate the object and purpose of the WTO Agreement. The situation is very different from legal procedures that seek to provide monetary compensation.

45. Specifically, in the case of subsidies, a benefit and a corresponding trade advantage that has been enjoyed in the past cannot be removed. All that can be removed is the benefit that is yet to be enjoyed. A requirement to remove more than the prospective benefit in an effort to "punish" or "deter" or "compensate" would logically mean that the company concerned suffers a *disadvantage* for the future. This would not remove the earlier benefit and the resulting restrictions or distortions of trade but merely create new ones contrary to the fundamental objectives of the WTO.

46. Indeed, the *Australia - Automotive Leather* panel did itself recognize that there was no intent in the *SCM Agreement* that the remedy attempt to restore the *status quo ante* or to provide reparation or compensation when it ruled that there was no basis on which to add interest to the amount to be repaid.

47. An additional purpose of the WTO and in particular the dispute settlement is to provide "security and predictability to the multilateral trading system" (Article 3.2 DSU). This purpose is also frustrated by retroactive remedies.

48. It is clear that the operation of the WTO Agreement can *affect* the rights and obligations of private operators even though as international law, it cannot *create* rights and obligations for private operators except where this expressly provided for.⁷ The EC is firmly of the view that the WTO Agreement and the *SCM Agreement* in particular do not have direct effect in municipal legal systems - that is they are not "self-executing". This fact has consequences for the degree of interference in private rights that the WTO Agreements were intended to give rise.

49. The EC would observe more generally that under the *SCM Agreement* there is a distinction to be drawn between the interest of private parties in the continuation of a law or other general measure and the individual rights arising out of a particular act of a government, such as the grant of a subsidy. The former can be withdrawn,

⁷ This view is confirmed by the Report by the Panel on *United States - Sections 301-310 of the Trade Act of 1974 ("US - Section 301 Trade Act")*, WT/DS152/R, adopted 27 January 2000, DSR 2000:II:815, para. 7.72.

the latter cannot be simply be revoked under the constitutional systems of most WTO Members.

50. Consequently, the EC considers that the obligation to "withdraw" the prohibited export subsidy in Article 4.7 SCM Agreement can only be to withdraw the general measure or programme to the extent that it is contrary to the *SCM Agreement* and, as regard individual or "one-off" subsidies to withdraw that portion of it that corresponds to the future effects, that is the prospective benefit, and not that which corresponds to effects which have occurred in the past.

51. The panel in *Australia - Automotive Leather* relied in fact heavily on a different "object and purpose" argument to support its interpretation. This was that a retro-active remedy was necessary in order to allow an effective remedy.⁸

52. The *Australia - Automotive Leather* panel expressly states in paragraph 6.37: "we decline to read 'withdraw the subsidy' in a manner that does not give it effective meaning." Its motivation is explained in paragraph 6.35 as follows:

In our view, terminating a programme found to be a prohibited export subsidy, or not providing, in the future, a prohibited subsidy, may constitute withdrawal in some cases. However such actions have no impact and consequently no enforcement effect, in the case of prohibited subsidies granted in the past. Under Australia's approach ... prohibited export subsidies granted in the past and for which there is no continuing export contingency, would be beyond the effective reach of a recommendation to "withdraw the subsidy," no matter how clear the violation of Article 3.1(a) of the *SCM Agreement* might be.⁹

53. The *Australia - Automotive Leather* panel seems to be saying that its rigorous interpretation of the terms of the *SCM Agreement* would lead to a different conclusion to that it arrives at in this case where the defending party would have to take some other unpalatable action. It seems therefore that the basis for the Panel's finding is that the need for a *deterrent effect* in the *SCM Agreement*.

54. The EC would observe that this approach based on requiring an effective remedy or a deterrent effect might mean that a subsidy which is paid in instalments over, say, 10 years would be treated differently to a subsidy of equivalent value paid immediately. In the former case, if the *Australia - Automotive Leather* panel had been confronted with the former subsidy it might have considered that that cessation of future payments was sufficient withdrawal (on the basis that there would have been an "effective remedy"). In the latter case it would have required repayment of the whole amount. This would treat equivalent subsidies differently for no good reason and elevate form over substance. The approach advocated by the EC and the parties in that case would allow the two cases to be treated consistently.

55. The EC contests that the *SCM Agreement* or any other WTO Agreement is intended to have any deterrent effect. The remedies are intended to be purely remedial. In some cases it may not be possible to remedy a violation except by clarifying the Agreements in such a way that future violations will be avoided.

⁸ Paras. 6.35 to 6.38 of the report.

⁹ Para. 6.34.

56. But the "need for an effective remedy" argument of the *Australia - Automotive Leather* panel is in any event misguided since the correct approach of withdrawing the prospective portion of the benefit of the financial contribution does provide an effective remedy. The *Australia - Automotive Leather* panel's reason for rejecting this approach was, apart from its wrong interpretation of the word "withdraw", simply that "the valuation of the benefit of a subsidy, its allocation over time, and the calculation of the "prospective portion" thereof, are complicated questions, for which there are no guidelines in the SCM Agreement."¹⁰

57. This is not acceptable. WTO dispute settlement generally and subsidy proceedings in particular will often involve complex issues of fact but this is no reason for a panel to abandon its mission and require, for example, the repayment of the whole of the financial contribution rather than just a part. This is just as unacceptable as saying that since it is difficult to calculate a precise amount, no amount need be repaid.

3.3 Past Practice

58. The absence of a remedy for past and consummated violations has always been a well-known feature of the GATT/WTO system. It is established and accepted that it can lead in some cases to there being no remedy at all for the complaining party. The EC considers that this established practice confirms the conclusions it reaches above.

59. A useful discussion of the practice of the GATT Contracting Parties is contained in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*.¹¹ In the WTO, panels have also always operated on the basis that remedies cannot be retroactive and the EC has already referred the Panel to the reports in the banana litigation.

3.4 Application to Subsidies and the Present Case

60. There may be several ways of withdrawing a prohibited export subsidy in a particular case. The application of the above principles to the case of prohibited export subsidies must bear in mind that such subsidies are made up of three elements. First there must be a financial contribution. Second, for there to be a subsidy, the financial contribution must give rise to a benefit to the recipient. Third the subsidy is only prohibited if it is contingent upon export performance. Each of these elements may have components that are past and components that only arise in the future.

61. Withdrawing the measure or prohibited export subsidy may be achieved by effectively withdrawing any of these elements. Of course in some circumstance the choice may be constrained by the practical impossibility of withdrawing an element.

¹⁰ Para. 6.44 of the *Australia - Automotive Leather* Report.

¹¹ See e.g. the discussion in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*. GPR/DS.2/R, adopted on 13 May 1992, paras. 4.21, 4.24 and 4.26.

62. It may in some cases be impossible to withdraw one or other of these elements. Thus the *Australia - Automotive Leather* panel noted that removal of the export contingency was not possible in that case since the contingency was found to exist at the date of grant which was in the past. But equally, withdrawal of effects that have already been manifested, including a benefit which has been enjoyed in the past, is also not possible. The only effects that can be prevented, that is the only benefit that can be withdrawn, is the benefit that is yet to be enjoyed in the future. Attempting to withdraw a benefit enjoyed in the past by ordering the repayment of the whole of the financial contribution paid simply imposes a penalty on the company (even though the panel attempts to deny this) for the future which may even create a new and additional distortion of trade contrary to the object and purpose of the WTO Agreement.

63. As Brazil correctly notes, the economic beneficiary of the PROEX subsidies is Embraer whose export of aircraft is thereby facilitated. This benefit is enjoyed at the time the export sale takes place which is when the NTN-1 bonds are issued. It is not an investment subsidy which is enjoyed over a period of time as the US wrongly assumes without giving any reasons. If the subsidy is to be withdrawn by withdrawing the benefit, then this means that no more subsidies under the old PROEX should be given for export sales after the 18 November 1999. The fact that the Brazilian government may be contractually committed to provide PROEX support for export sales after that date cannot excuse the failure to withdraw the subsidy from that date. A government cannot contract out of its *SCM Agreement* obligations.

64. Brazil's argument that it might be sued for breach of contract is also without merit and does not prevent it from implementing the report by ceasing new PROEX payments for exports occurring after 18 November. If it is sued by anyone, this will be the other party to the assistance, the foreign airline or the bank. If Brazil has to pay compensation to these persons because it cancels a commitment to give PROEX support on a future export of an aircraft, this will not benefit Embraer and will not make withdrawal of the subsidy by this means impracticable.

4. When do PROEX Subsidies Exist?

65. The Panel will recall that the question of when PROEX subsidies exist is a question which was much debated in the original proceedings and before the Appellate Body. The EC view was that the most appropriate moment for considering a subsidy to come into existence is the point in time when all the legal conditions for its grant (or payment) are irrevocably fulfilled. Before that time there is merely an expectation that the subsidy will be available and the benefit cannot be considered to yet be enjoyed. The Appellate Body appears to share that view,¹² although there is some uncertainty arising from the fact that the Appellate Body expressly stated that it did not need to decide when a subsidy exists, only when it is granted for the purpose of Article 27.4 *SCM Agreement*.

¹² Appellate Body Report, *Brazil - Export Financing Programme for Aircraft ("Brazil - Aircraft")*, WT/DS46/AB/R, adopted 20 August 1999, DSR: III, 1161, para. 158.

66. Brazil argues that it became legally bound to grant PROEX subsidies on the sale of a large number of aircraft before 18 November 1999 and that these are subsidies which need not, indeed cannot, be withdrawn.

67. The EC is not however aware of any change in the PROEX scheme as it applies to those aircraft which would change the conclusion of the Panel and the Appellate Body in the original proceeding that all the legal conditions for the grant of PROEX subsidies are not fulfilled until the aircraft are exported which is the same as the time that the bonds are issued. This is of course a factual question and the EC cannot comment further in the absence of factual information.

68. There is one legal issue on which the EC will comment however. In Section D (paragraphs 13 to 23) of its second written submission, Brazil argues that a finding that the subsidy is granted only at the time when the aircraft is exported would reduce the injury provision in Article 5, which is applicable in both Parts III and V of the SCM Agreement, to inutility as regards the aircraft sector. Brazil claims that because aircraft are ordered in advance, in combination with a financing package, injury to other competitors is effectively suffered when the order is made. If it were considered that the subsidy is only granted when each export is made, the Member suffering injury would have to wait until aircraft were actually imported into its territory before being able to impose a countervailing duty or request dispute settlement under Part III, since prior to this moment there would be no subsidy. However, by this stage the injury, in terms of lost jobs, output etc would have already been suffered by the domestic producers, and could not be repaired.

69. The EC would make the following comments:

- It is clear that the application of countervailing duty rules to the export of large capital goods poses some problems since there is not a continuous flow of imports and continuous injury as is assumed for the purpose of these proceedings. However, the EC does not consider that a possible difficulty of applying countervailing duty rules (which may also exist in other cases) should determine the interpretation to be given to the notion of subsidy.
- The Panel and the Appellate Body have not decided that export subsidies for aircraft only exist when aircraft are exported *in general*, merely that the operation of the PROEX scheme as they understood it implied that the subsidy in that case was only granted at a point in time that coincided with export. It is not therefore possible to draw any general conclusions for the interpretation of the *SCM Agreement* from this factual situation. In any event, if Brazil is arguing that the factual situation is different, it should seek to demonstrate this.
- The EC considers that Brazil's speculation about the implications of the Appellate Body's apparent views on the appropriate moment a subsidy "exists" for Part III of the *SCM Agreement* is unconvincing. First the EC notes that Article 5 *SCM Agreement* only incorporates the definition of "injury" from the countervailing duty rules and not the other conditions in Article 15. It provides that the "subsidy" should not cause injury not actual imports. Part III of the *SCM Agreement* must also be applicable to subsidy *programmes* as well as individual payments. In this case, the mere *availability* of a subsidy will be relevant as the

panel found in the *US - Foreign Sales Corporations* case.¹³ In the case of subsidy programmes such as the PROEX, injury in the importing country may often be felt even though the industry in the exporting country has not yet secured the benefit of the financial contribution (but this is merely available to it). Brazil's explanation of the functioning of the aircraft market shows how this can arise. The *potential availability* of subsidies may affect the intensity of competition for an order and thus cause injury, even before the subsidy is paid.

5. Item (k) of the Illustrative List

70. The EC now comes to the issue of Item (k) of the Illustrative List. It has been possible up to now for both the Panel and the Appellate Body to avoid deciding on the relationship between Article 3.1(a) *SCM Agreement* and the Illustrative List, by rejecting Brazil's arguments even assuming that the first paragraph of Item (k) is an "affirmative defence".

71. The arguments have now developed to a state that this may no longer be possible. The US is now stating that Item (k) is not an exception but a constituent part of the definition of subsidy and the prohibition in Article 31.(a) *SCM Agreement*. A consequence of this would seem to be that Canada has to prove that the new PROEX payments are inconsistent with what it regards as the sole relevant the definition of export subsidy in the first paragraph of Item (k).

72. The EC repeats that the US position is untenable.

73. The EC view is that the first paragraph of item (k) is not an "affirmative defence". That provision simply deems certain practices to be prohibited export subsidies. From that, however, it cannot be inferred *a contrario* that an export credit which is not caught by the first paragraph of item (k) is not a prohibited export subsidy.

74. The Appellate Body did not find the contrary. It simply held that the conditions for the application of the "affirmative defence" invoked by Brazil were not satisfied, even if such an "affirmative defence" should be available. (The Appellate Body uses always the term "affirmative defence" between quotation marks). Therefore, the Appellate Body did not need to decide whether the first paragraph of item (k) did provide an affirmative defence.

75. The EC has set out in its written submission the defects it sees with Brazil's arguments seeking to bring the new PROEX outside the scope of the first paragraph of Item (k).

¹³ Report by the Panel on *United States - Tax Treatment for "Foreign Sales Corporations"* ("US - FSC"), WT/DS108/R, adopted 20 March 2000, DSR 2000:IV, 1677, paras. 7.174 - 7.175.

ANNEX 3-4

ORAL STATEMENT OF THE UNITED STATES

(4 February 2000)

1. Mr. Chairman and Members of the Panel, it is my honour to appear before you today to present the views of the United States as a third party in this Article 21.5 proceeding. I know that the Panel has already read our written submission, so I will not restate those points here. My comments will be brief, and will focus primarily on the comments contained in the EC's and Canada's briefs of 17 January. Although I had not planned to do so, I will also comment briefly on the panel's decision in the *Australian Leather* case, given the EC's comments this morning.

2. The first issue that I would like to address today is the EC's and Canada's comments concerning whether item (k) of the Illustrative List constitutes an "affirmative defence" under the SCM Agreement. The United States respectfully submits that item (k) does not create an affirmative defence that has the effect of negating the otherwise applicable and independent provisions of the SCM Agreement. Rather, item (k) - as well as the other items in the Illustrative List - sets forth the standard for determining whether the particular type of financing described therein does or does not constitute a prohibited export subsidy.

3. The United States would also like to comment briefly on Canada's and the EC's comments regarding whether item (k) gives rise to an *a contrario* interpretation. The United States agrees with Canada that the Appellate Body did not opine on this issue. In fact, the Appellate Body pointedly declined to do so on the grounds that the Panel did not rule on the issue and the lack of a Panel finding was not appealed.¹ To the extent that Brazil is implying that the Appellate Body *did* make a finding on this issue, it is mistaken.

4. In our view, the Panel does not need to reach this issue. We recall the Panel's statement in its original decision (at para. 7.17) that, in order to rule for Brazil, it needed to find in Brazil's favour on three points. First, it needed to find that PROEX payments are "the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits." Then, it needed to find that PROEX payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of item (k). If the Panel were to answer both of these points in Brazil's favour, then, and only then, would it need to determine whether PROEX payments are permitted if they are not used to secure a material advantage.

5. The United States believes that the Panel should only address the third point if it needs to. The question whether the Illustrative List permits *a contrario* interpretations has been thoroughly briefed in another case and is before the Appellate Body at this time.

¹ Report of the Appellate Body, *Brazil - Export Financing Programme for Aircraft*, ("Brazil - Aircraft"), WT/DS46/AB/R, 20 August 1999, DSR: III, 1161, para. 187.

6. In the event that the Panel concludes that it does need to address this issue, however, then the United States provides the following additional comments. The United States submits that the only logical reading of item (k) is that a practice which is described by item (k), but which does not secure a material advantage in the field of export credit terms, does not constitute an export subsidy prohibited by the SCM Agreement. With respect to the so-called *a contrario* interpretation, one must begin with footnote 5 to Article 3.1(a), which provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." Footnote 5 makes clear that a practice referred to by the Illustrative List as *not* constituting an export subsidy is not prohibited by Article 3.1(a) or any other provision of the SCM Agreement. Thus, if PROEX subsidies constitute "export credits" or "payments" within the meaning of item (k), but do not run afoul of the standards set forth in item (k), no further analysis is needed; the PROEX subsidies are not prohibited under any provision of the SCM Agreement.

7. Because footnote 5 seems clear, the opponents of the "*a contrario*" interpretation focus on the word "illustrative". Specifically, while everyone involved in this dispute appears to agree that the Illustrative List is "illustrative", they disagree on the manner in which it is illustrative. The opponents of the "*a contrario*" interpretation argue that if a particular type of financial contribution is described by a particular paragraph in the Illustrative List, but cannot be considered an export subsidy under the standard contained in the particular paragraph, that financial contribution nonetheless can be found to be an export subsidy under some other standard.

8. In the view of the United States, this is not what the drafters intended when they used the term "illustrative". Instead, a more reasonable interpretation is that the drafters used the term "illustrative" simply to signify that not all types of financial contributions are covered by the Illustrative List. For example, the reimbursable loans under Technology Partnerships Canada - loans that were found to be export subsidies in the companion case to this dispute - do not fall under any of the items in the Illustrative List, and their status as prohibited or permitted would not be governed by the Illustrative List. However, where a paragraph of the Illustrative List *does* address a particular type of financial contribution, that paragraph sets forth the standard for determining whether the financial contribution is or is not an export subsidy.

9. Consider, for example, paragraph (j) of the Illustrative List, which deals with export guarantee and insurance programmes. Looking just at the standard for premium rates, premium rates give rise to an export subsidy if they are "inadequate to cover the long-term operating costs and losses of the programmes." Implicit in paragraph (j), however, is the notion that premium rates do not give rise to an export subsidy if they are "adequate" to cover long-term operating costs and losses. Thus, on its face, paragraph (j) provides Members with a predictable standard to use in establishing and administering export guarantee and insurance programmes.

10. Under the approach advocated by Canada and the EC, however, any predictability is lost. For example, if paragraph (j) was only "illustrative" in the way that term is interpreted by Canada and the EC, there would be numerous ways in which an export insurance or guarantee programme could be considered to be an export subsidy even though the premium rates conform to the standard in paragraph (j). If premium rates were inadequate to cover *short-term* operating costs *or* losses, a programme could be considered to be an export subsidy. If premium rates were inadequate to cover short- or long-term *non-operating* costs, a programme could be con-

sidered to be an export subsidy. If premium rates were less than what an exporter might pay for comparable coverage in the marketplace, there could be an export subsidy under a "benefit to recipient" approach. This would be particularly true in a situation where a specific export transaction involves an unusually severe risk of non-payment or currency fluctuation. The permutations are endless.

11. Furthermore, the counter-arguments made on this issue are not persuasive. The EC has argued previously that in order for footnote 5 to exclude a measure from the prohibitions of the SCM Agreement, there has to be "a clear statement in Annex I that a measure *does not constitute* an export subsidy"² or "an 'affirmative statement' in the Illustrative List to the effect that a measure does not constitute an export subsidy."³

12. However, the text of footnote 5 does not require such a "clear" or "affirmative" statement, and there is a reason for this: the drafters had a different intent. Footnote 5 first appeared in the third draft agreement prepared by the Chairman of the Negotiating Group on Subsidies.⁴ In this draft, footnote 5 appeared for the first time - as footnote 4 to Article 3.1(a). Footnote 4 read as follows: "Measures *expressly* referred to in the Illustrative List as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." (Emphasis added). Thus, the original version of footnote 5 had an additional word - "expressly" - which, had it been retained, might have supported the EC interpretation.

13. The word "expressly" was not retained, however. In the very next draft, the word was deleted from the footnote (still numbered as footnote 4).⁵ This change demonstrates that the drafters intended to expand, rather than restrict, the scope of footnote 5. The change also demonstrates that the drafters did not intend the sort of narrow construction of footnote 5 advanced by Canada and the EC.

14. The second principal counter-argument is that the US approach somehow would transform the Illustrative List into an exhaustive list that allegedly would allow "all sorts of measures" to escape the export subsidy prohibition. For example, in the past, the EC has cited item (a) of the Illustrative List - which prohibits "direct subsidies" - and claimed that under the US approach, *indirect* export subsidies would escape item (a) and, thus, prohibition under Article 3.1(a).⁶

15. However, this is a mischaracterization of the US position. First, as previously noted, the US position is *not* that the Illustrative List is exhaustive. Instead, the US position is that the Illustrative List does not deal with all possible financial contributions, but for those that it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned. Second, in the case of the item (a) example, the US position is that item (a) simply does not address "indirect" subsidies. Thus, indirect subsidies do not "escape" any prohibition. Instead, the standard for a prohibited *indirect* subsidy must either be found elsewhere

² FSC Panel Report, para. 4.932 (emphasis in original).

³ *Brazil - Aircraft*, para. 77.

⁴ MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990).

⁵ MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

⁶ Panel Report, *United States - Tax Treatment for "Foreign Sales Corporations"* ("US - FSC"), WT/DS108/R, adopted 20 March 2000, DSR 2000:IV, 1677, para. 4.933-4.934.

in the Illustrative List or, if the provisions of the Illustrative List are silent, in the general principles of Articles 1 and 3.1(a) of the SCM Agreement.

16. Finally, the opponents of the "*a contrario*" position have never been able to explain how their approach to footnote 5 and the Illustrative List does not render various portions of the Illustrative List ineffective. For example, Canada and the EC have been unable to explain how their approach does not render the "material advantage" clause of item (k) superfluous; *e.g.*, under this approach, a below-cost export credit is prohibited *whether or not* it secures a material advantage. Because such an outcome is incorrect under public international law, a correct interpretation of footnote 5 and the Illustrative List is that the provisions of the Illustrative List are controlling with respect to the measures addressed therein.

17. Shifting focus, the United States would like to comment briefly on Brazil's reference to US Export Import Bank loan guarantees and market windows used by certain countries, including Canada. On one hand, for the reasons contained in our written submission, the United States agrees with the EC and Canada that Brazil's discussion of loan guarantees and market windows is an apples and oranges discussion that is not relevant to this dispute. On the other hand, the United States does not necessarily agree with their analyses of these instruments. The United States submits for example that the failure of the OECD to reach agreement on the treatment of "market windows" for purposes of the *OECD Arrangement* does not mean that market windows are consistent with the *Arrangement*. For present purposes, suffice it to say that the status of these instruments under the SCM Agreement is an issue for another day.

18. Finally, the United States would like to comment briefly on certain broader points that we hope will influence the spirit in which the Panel evaluates this dispute.

19. This proceeding, as well as the companion proceeding brought by Brazil against Canada, is extremely important, for it revolves around the critical issue of compliance with DSB rulings and recommendations and the resultant effect on the SCM Agreement's ability to discipline prohibited and injurious subsidies.

20. As the Panel noted in its opinion in the *Canadian Aircraft* case, subsidies by their very nature involve situations where governments insert themselves into the marketplace by providing benefits to favoured companies, that is, financial contributions on better than market terms. While the SCM Agreement allows certain non-injurious subsidies, it flatly prohibits export subsidies. These two cases are a good example of why this is so.

21. When a government chooses to provide an export subsidy, it effectively is deciding to interfere in the marketplace to provide its producers with an unjustified advantage over their foreign competitors *in their competitors' home markets and in third country markets*. Inevitably, this provokes a response from the affected countries and their producers. For example, Brazil argued before the Appellate Body that PROEX subsidies were intended to match the subsidies provided by the Government of Canada to Bombardier. The result is a ruinous subsidy competition that distorts the world trading system, punishes taxpayers, and bleeds off resources that might be better used for other purposes. The governments concerned may well want to call off this competition; effective rules on export subsidies, effectively enforced, can make this possible.

22. Finally, I would like to comment briefly on the panel's decision in the *Australian Leather* Article 21.5 proceeding. If the Panel would like a detailed response on

this issue, I would prefer to provide it in writing. However, I am happy to provide some initial oral comments.

23. As an initial matter, the United States agrees that the panel's decision in the *Leather* case is not directly relevant to this dispute, because Canada is not seeking the repayment of PROEX subsidies. Instead, Canada simply is insisting that Brazil not pay out additional prohibited subsidies in the form of PROEX bonds. For this reason, the Panel does not need to reach the issue addressed by the *Leather* panel.

24. If the Panel is nonetheless interested in our views, then I would simply observe that the *Leather* panel has spoken, so it is appropriate to conclude that its determination is definitive with regard to that case. The United States intends to support adoption of the report at the next meeting of the Dispute Settlement Body.

25. However, the *Leather* panel was considering a particular type of subsidy, namely, a large, non-recurring grant that was given in the past. The panel itself acknowledged that the proper manner of withdrawing a prohibited export subsidy may differ from case to case.

26. While the panel's conclusion in *Leather* went beyond the position that we took, we cannot fault the logic of that conclusion.

ANNEX 3-5
**RESPONSES OF THE EUROPEAN COMMUNITIES
TO QUESTIONS POSED BY THE PANEL**

(14 February 2000)

TABLE OF CONTENTS

	Page
QUESTIONS FROM THE PANEL	4289
QUESTION 1 TO CANADA.....	4289
QUESTION 3 TO CANADA.....	4290
QUESTION 5 TO CANADA.....	4290
QUESTION 6 TO CANADA.....	4291
QUESTION 7 TO CANADA.....	4291
QUESTION 10 TO CANADA.....	4291
QUESTION 12 TO CANADA.....	4292
QUESTION 2 TO BRAZIL	4292
QUESTION 3 TO BRAZIL	4292
QUESTION 12 TO BRAZIL	4293

QUESTIONS FROM THE PANEL

1. The European Communities (hereafter "the EC") makes the following brief comments on the questions from the Panel in this case.

QUESTION 1 TO CANADA

Please state your views about whether, under the "material advantage" clause as interpreted by the Appellate Body, the CIRR is the exclusive benchmark for determining whether a material advantage has been secured, or whether as argued by Brazil, a different benchmark might prevail if it could be demonstrated that interest rates in the marketplace were lower than the CIRR.

Response

2. The EC does not believe that the CIRR is the exclusive benchmark for assessing material advantage under the first paragraph of item (k). It notes that the Appellate Body considered the OECD Arrangement could be "appropriately viewed as one example of an international undertaking providing a specific market benchmark."¹

¹ Report by the Appellate Body on *Brazil - Export Financing Programme for Aircraft*, ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 181.

QUESTION 3 TO CANADA

Please state whether, in the view of Canada, Participants to the Arrangement are required to respect the CIRR (a) in respect of "pure cover"; (b) in respect of floating interest rate transactions.

Response

3. Participants to the Arrangement are not required to respect CIRR in respect of "pure cover".
4. The EC would point out that floating rates cannot technically respect the CIRR, but that in order to provide an "equivalent" solution a reasonable margin, depending on the currency and on the credit period, should be added on top of floating rates.
5. Any party not using the CIRR but something below would have to base its defence on the first paragraph of item (k) and provide evidence that demonstrates its compliance therewith.

QUESTION 5 TO CANADA

Canada states (second submission, footnote 24) that, in order to compare a floating interest rate expressed in LIBOR to a US Treasury Bond, a "swap spread" must be added. Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional aircraft:

- (a) **provided floating interest-rate export credits the initial interest rate of which was below the CIRR applicable as of the date of the transaction less the relevant swap spread prevailing as of that date?**
- (b) **provided guarantees in respect of floating interest-rate export credits the initial interest rate of which was below the CIRR applicable as of the date of the transaction less the relevant swap spread prevailing as of that date?**

If your answer is affirmative, please inform the Panel as to the initial interest rate applicable to the export credit(s) in question, the 10-year US Treasury Bond rate prevailing as of the date the export credit was provided and the relevant swap spread prevailing as of that date.

Response

6. Swap rates are rates used for first class banks in high income OECD Countries. According to preliminary information available to the EC, taking the Euro as a reference currency, albeit for a short period of time, suggests that the differences between the 7 year swap rate and the corresponding CIRR are between 30 and 80 basis points.

QUESTION 6 TO CANADA

Canadian Exhibit CDN-11 appears to establish a "swap spread" between floating interest rates and 7-year fixed interest rates. Canada however uses this swap spread to compare a floating interest rate to a 10-year US Treasury Bond rate. Please explain.

Response

7. The reason why the 7 year bullet bonds are used as base rate for longer term CIRR is that the average life of this instrument is equivalent to long term credit with semi annual instalments.

QUESTION 7 TO CANADA

The Appellate Body has stated that "the appropriate comparison to be made in determining whether a payment is 'used to secure a material advantage', within the meaning of item (k), is between the actual interest rate applicable in a particular export transaction after deduction of the government payment (the 'net interest rate') and the relevant CIRR" (WT/DS46/AB/R, para. 54). It could be argued that whether PROEX interest rate equalization results in a net interest rate below CIRR will depend upon the initial, pre-equalization interest rate, and PROEX interest rate equalization does not necessarily result in a below-CIRR net interest rate in any given transaction. Please comment.

Response

8. The EC observes that to the extent that the Panel is being asked to examine in this case whether the PROEX programme has been brought into conformity with the SCM Agreement or not, it is not necessary to examine individual transactions but rather whether PROEX still allows export subsidies to be granted.

QUESTION 10 TO CANADA

Canada states (second submission, para. 51) that "a rate of 10-year Treasury Bonds + 20 bps is, under no circumstance, available to the purchasers of regional aircraft in direct financing at market rates". Is such a rate available to the purchasers of regional aircraft through modalities other than direct financing, e.g., through loan guarantees? Please support your answer.

Response

9. 20 basis points on top of the 10 year bond would be equivalent to a 50 basis point margin against the 100 basis points required in the CIRR system. Since the average difference between a 10 year bond and a 7 year one (the longer benchmark for building the CIRR) is in the range of 20-30 bp, this solution would give a rate which would be 50 bp lower than the CIRR.

QUESTION 12 TO CANADA

The Appellate Body refers to the CIRR as a minimum commercial rate, and it could be argued that it was for that reason that it chose the CIRR as reference point for evaluating material advantage. Canada has stated that commercial rates below CIRR are possible. Does this not suggest that, to the extent that a commercial rate below CIRR exists, that commercial rate should represent the reference point for evaluating material advantage?

Response

10. The EC notes that the Appellate Body stated in paragraph 182 of its Report that:

In any given case, whether or not a government payment is used to secure a "material advantage", as opposed to an "advantage" that is not "material", may well depend on where the *net* interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available. The fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been "used to secure a material advantage in the field of export credit terms".

11. It seems clear to the EC from this that the existence of a single case of a commercial rate below CIRR is not sufficient to reduce the benchmark.

QUESTION 2 TO BRAZIL

Canada considers that, consistent with Article 3.2 of the SCM Agreement, withdrawal of a subsidy under Article 4.7 of the Agreement entails, as a minimum, ceasing to grant or maintain subsidies found to be prohibited under Article 3.1 of the SCM Agreement. Do you agree? Please explain your answer.

Response

12. In the view of the EC the word "maintain" in Article 3.2 SCM Agreement is used to refer to subsidy programmes, and the word "grant" to refer to the individual payments under the programmes. Thus a Member may not maintain export subsidy programmes and may not grant export subsidies in any other way (ad hoc or under other programmes).

QUESTION 3 TO BRAZIL

The Appellate Body has ruled that, for the purpose of Article 27.4 of the SCM Agreement, export subsidies for regional aircraft under PROEX are "granted" when the NTN-1 bonds are issued. WT/DS46/AB/R, para. 158, Article 3.2 of the SCM Agreement provides that a Member "shall neither grant or maintain" export subsidies. Is it your view that export subsidies for regional aircraft under PROEX are "granted" at a different point in time for the pur-

poses of Article 3.2 then for the purposes of Article 27.4? If so, please explain the basis for that view.

Response

13. The EC finds it difficult to consider that the word "grant" should have a different meaning in Article 3.2 than in Article 27 SCM Agreement.

QUESTION 12 TO BRAZIL

Brazil argues (second submission, paras. 24-26) that if it does not issue bonds pursuant to letters of commitment issued before 18 November 1999, it can be sued for breach of contract.

- (a) **In this respect, please explain to whom Brazil owes an alleged contractual obligation under the letter of commitment.**
- (b) **In the original dispute in this case, Brazil submitted a legal opinion (exhibit BRA-17) stating that letters of commitment could not be annulled because they were "a perfect legal act, absolutely licit and practised based on legal provisions". In document G/ADP/W/281-G/SCM/W/291 dated 2 February 1996, Brazil stated that, "[h]aving been incorporated into the Brazilian legal system by means of a Presidential decree (Decree No. 1355, dated 30 December 1994), the WTO Agreements have the same hierarchical level as laws, and are subordinate only to the Federal Constitution". Please comment.**

Response

14. The EC cannot comment on the Brazilian legal system but would observe that the fact that an international agreement "has the same hierarchical level as laws" does not necessarily mean that it had direct effect or is "self executing." Even less does it imply that where the granting of a contractual right may involve a breach of the relevant international agreement (by the State), that contractual obligation should be considered void.

ANNEX 3-6

RESPONSES OF THE UNITED STATES TO QUESTIONS OF THE PANEL (14 February 2000)

TABLE OF CONTENTS

	Page
QUESTIONS POSED ON 3 FEBRUARY 2000	4294
FURTHER QUESTIONS.....	4297

QUESTIONS POSED ON 3 FEBRUARY 2000

For Canada

Q1. Please state your views about whether, under the "material advantage" clause as interpreted by the Appellate Body, the CIRR is the exclusive benchmark for determining whether a material advantage has been secured, or whether, as argued by Brazil, a different benchmark might prevail if it could be demonstrated that interest rates in the marketplace were lower than the CIRR.

Response

The CIRR is the exclusive benchmark for determining whether a "material advantage" has been secured, as that term is used in item (k).

Q3. Please state whether, in the view of Canada, Participants to the Arrangement are required to respect the CIRR (a) in respect of "pure cover"; (b) in respect of floating interest rate transactions.

Response

With respect to question (a), in the view of the United States, Participants to the Arrangement are not required to respect the CIRR in respect of "pure cover" because pure cover is governed by item (j). "Pure cover" for export credits by a Participant is provided through export credit guarantee or insurance programmes. Item (j) sets forth the benchmark for insurance and guarantee programmes; *i.e.*, premium rates charged must not be inadequate to cover the long-term operating costs and losses of the programme.

With respect to question (b), under the Arrangement, there are no provisions for an official floating interest rate. Therefore, floating interest rates are prohibited by the Arrangement unless arrived at through pure cover.

Q8. To what extent do you consider the OECD Arrangement is legally binding on Canada?

Response

The OECD Arrangement is not a treaty that creates formal rights and obligations under international law, but is a "gentleman's agreement" among the Participants. Canada has agreed to abide by the guidelines contained in the Arrangement. In that sense, all export credit activity by Canada, including all export credit activity of the Export Development Corporation, is bound by the Arrangement.

Q12. The Appellate Body refers to the CIRR as a *minimum* commercial rate, and it could be argued that it was for that reason that it chose the CIRR as reference point for evaluating material advantage. Canada has stated that commercial rates below CIRR are possible. Does this not suggest that, to the extent that a commercial rate below CIRR exists, that commercial rate should represent the reference point for evaluating material advantage?

Response

No. Because the CIRR is the exclusive internationally agreed upon reference point for evaluating the minimum level for officially-supported export credits, it is the appropriate reference point for evaluating material advantage.

For Brazil

Q1. Canada states in its rebuttal submission that "[a] net interest rate of 20 basis points above the 10-year Treasury Bond rate is well below CIRR" (para. 33). Brazil itself states in its first submission that "Brazil chose a point of reference other than CIRR for PROEX based on evidence that, in the case of aircraft, the marketplace in fact supports lower interest rates" (para. 10). Does Brazil acknowledge that a net interest rate of 20 basis points above the 10-year US Treasury Bond rate is below CIRR? If not, please provide historical examples of periods where such a net interest rate was equal or higher than the CIRR rate.

Response

The United States notes that a review of 30 years of data (1970-1999) shows that at no point during that period did the long-term CIRR (monthly average of the 7-year U.S. treasury bond + 100 bps - applicable to transactions with a repayment term greater than 8.5 years) go below the monthly average 10-year treasury bond + 20 bps. On average during that period, the long-term CIRR was 73 bps higher than the 10-year treasury bond + 20 bps benchmark proposed by Brazil.

Q2. Canada considers that, consistent with Article 3.2 of the SCM Agreement, withdrawal of a subsidy under Article 4.7 of the SCM Agreement entails, as a minimum, ceasing to grant or maintain subsidies found to be prohibited

under Article 3.1 of the SCM Agreement. Do you agree? Please explain your answer.

Response

The United States agrees with Canada. For one thing, the remedy flowing from a finding that an obligation has been violated should bear some relationship to the obligation itself. In this case, because the obligation is to not grant or maintain a prohibited subsidy, the remedy should result in the offending Member adhering to that obligation.

In addition to this general observation, however, one meaning of "withdraw" is to "refrain from proceeding with (a course of action, a proposal, etc.)".¹ Thus, the ordinary meaning of "withdraw" in this context would be to refrain from granting or maintaining subsidies found to be prohibited.

Q3. The Appellate Body has ruled that, for the purposes of Article 27.4 of the SCM Agreement, export subsidies for regional aircraft under PROEX are "granted" when the NTN-1 bonds are issued. WT/DS46/AB/R, para. 158. Article 3.2 of the SCM Agreement provides that a Member "shall neither grant nor maintain" export subsidies. Is it your view that export subsidies for regional aircraft under PROEX are "granted" at a different point in time for the purposes of Article 3.2 than for purposes of Article 27.4? If so, please explain the basis for that view.

Response

In the view of the United States, in the context of this case, the PROEX subsidies are "granted", for purposes of Article 3.2, when the NTN-1 bonds are issued.

Q10. Brazil states (first submission, para. 4) that the Appellate Body held that "Members are *permitted* to obtain an "advantage" in the field of export credit terms provided that advantage is not "material" (emphasis added). The Appellate Body did not however address the issues of whether the first paragraph of item (k) can be used as an affirmative defense, nor whether PROEX payments are "payments" within the meaning of that item. Please comment.

Response

The Panel is correct in its description of what the Appellate Body did and did not address. In the view of the United States, the PROEX payments constitute "payments by [an export credit agency] of all or part of the costs incurred by ... financial institutions in obtaining credits" within the meaning of the first paragraph of item (k).

With respect to the status of item (k), the United States disagrees that the first paragraph constitutes an "affirmative defense". Instead, for the reasons set forth in

¹ *New Shorter Oxford English Dictionary* (1993).

the *Statement of the United States at the Third Party Session*, 4 February 2000, paras. 2-16, the first paragraph of item (k) sets forth the standard for determining when an export credit or a "payment" constitutes a prohibited export subsidy under the SCM Agreement. Thus, the first paragraph is not an "affirmative defense" or an "exception" to something else. Accordingly, if the PROEX payments are found to be "payments" within the meaning of the first paragraph, the burden is on the complainant - Canada - to demonstrate that those payments are inconsistent with the requirements of the first paragraph.

Q11. The Appellate Body refers to the CIRR as a minimum *commercial benchmark*. Thus, it could be argued that any alternative benchmark in the marketplace for determining whether a payment is used to secure a material advantage must be undistorted by government intervention. Please comment.

Response

There is no alternative benchmark in the marketplace to the CIRR for determining whether a payment is used to secure a material advantage. The CIRR is the exclusive benchmark for this determination.

For both parties

Q1. The Appellate Body has referred to the CIRR as "a *minimum commercial interest rate*". The US dollar CIRR is however constructed on the basis of US Treasury bond yields. Further, Canada has stated (second submission, para. 40) that US Treasury Bonds are fixed rate reference benchmarks, while LIBOR is a floating rate benchmark. That being the case, to what extent can CIRR rates be considered relevant to establishing a "minimum commercial interest rate" in respect of floating interest rates?

Response

CIRR rates cannot be considered relevant to establishing a "minimum commercial interest rate" in respect of floating interest rates. There are no provisions for floating interest rates in the Arrangement, therefore, official floating interest rates are prohibited by the Arrangement. Floating interest rates are only allowed under the Arrangement when they are arrived at through pure cover. For purposes of determining whether floating rate financing confers material advantage for the purposes of item (k), floating rate financing confers material advantage if it is constructed in such a way that it could drop below CIRR levels.

FURTHER QUESTIONS

For Canada

Q1. Canada stated at the meeting with the Panel on 4 February 2000 that, if the Export Development Corporation provides financing at rates equal to or

higher than its borrowing costs, but below the CIRR, that practice may still not constitute a subsidy because no benefit is conferred. That would mean that there may exist a market benchmark lower than the CIRR. Does Canada agree that if Brazil, for instance, used that same benchmark, which is lower than the CIRR, no subsidy would exist as per the Canadian argument because no benefit is conferred?

Response

The Export Development Corporation (EDC) is subject to the terms of the Arrangement when providing export credits. If EDC provides financing rates below the CIRR, Canada is conferring a benefit. Whether or not such financing constitutes a prohibited export subsidy under the first paragraph of item (k) is a separate question and one which is not the subject of this proceeding.

**CANADA - MEASURES AFFECTING THE EXPORT
OF CIVILIAN AIRCRAFT
RECOURSE BY BRAZIL TO ARTICLE 21.5 OF THE DSU**

Report of the Appellate Body

WT/DS70/AB/RW

*Adopted by the Dispute Settlement Body
on 4 August 2000*

Brazil, *Appellant*
Canada, *Appellee*
European Communities, *Third Participant*
United States, *Third Participant*

Present:
Feliciano, Presiding Member
Bacchus, Member
Ehlermann, Member

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4299
II. ARGUMENTS OF THE PARTICIPANTS AND THE THIRD PARTICIPANTS	4301
A. Claims of Error by Appellant - Brazil	4301
B. Arguments by Appellee - Canada	4303
C. Third Participants	4304
III. ISSUE RAISED IN THIS APPEAL	4305
IV. TECHNOLOGY PARTNERSHIPS CANADA	4305
V. FINDINGS AND CONCLUSIONS	4313

I. INTRODUCTION

1. Brazil appeals certain issues of law and legal interpretation in the Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU* (the "Article 21.5 Panel Report").¹ The Article 21.5 Panel was established to consider a complaint by Brazil that certain measures taken by Canada to comply with the recommendations and rulings of the Dispute Settlement Body (the "DSB"), in *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*")², were not consistent with Article 3.1(a) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement").

¹ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft - Recourse by Brazil to Article 21.5 of the DSU* ("*Canada - Aircraft*" (Article 21.5 - Brazil)), WT/DS70/RW, adopted 4 August 2000.

² The recommendations and rulings of the DSB resulted from the adoption, by the DSB, of the Appellate Body Report in *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), adopted 20 August 1999, WT/DS70/AB/R, DSR 1999:III, 1377 and the original Panel

2. The original panel found, *inter alia*, that "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft" and "[Technology Partnerships Canada] assistance to the Canadian regional aircraft industry [constitute] export subsidies inconsistent with Article[s] 3.1(a) and 3.2 of the *SCM Agreement*"³. The original panel concluded that "Canada shall withdraw [these] subsidies ... within 90 days."⁴

3. Before the Appellate Body, Canada appealed certain of the original panel's legal interpretations relating to Technology Partnerships Canada ("TPC") assistance. Canada did not appeal the original panel's findings relating to the Canada Account. The Appellate Body upheld the original panel's finding that TPC assistance to the Canadian regional aircraft industry constitutes export subsidies inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

4. Canada took steps to implement the recommendations and rulings of the DSB with respect to both the Canada Account and TPC. Taking the view that these measures were not consistent with Article 3.1(a) of the *SCM Agreement*, Brazil requested that the matter be referred to the original panel, pursuant to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").⁵ On 9 December 1999, in accordance with Article 21.5 of the DSU, the DSB referred the matter to the original panel. The Article 21.5 Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 9 May 2000.

5. The Article 21.5 Panel concluded that:

... (1) Canada has implemented the 20 August 1999 DSB recommendation that Canada withdraw TPC assistance to the Canadian regional aircraft industry within 90 days, and that (2) Canada has failed to implement the 20 August 1999 recommendation of the DSB that Canada withdraw the Canada Account assistance to the Canadian regional aircraft industry within 90 days.⁶

6. On 22 May 2000, Brazil notified the DSB of its intention to appeal certain issues of law covered in the Article 21.5 Panel Report and legal interpretations developed by the Article 21.5 Panel, pursuant to Article 4.8 of the *SCM Agreement* and paragraph 4 of Article 16 of the DSU, and filed a Notice of Appeal pursuant to Rules 20 and 31(1) of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). Brazil appeals the Article 21.5 Panel's findings relating to TPC; the Article 21.5 Panel's findings relating to the Canada Account are not appealed by Canada and, therefore, do not form part of this appeal. On 29 May 2000, Brazil filed its ap-

Report in that dispute, *Canada – Measures Affecting the Export of Civilian Aircraft* ("Canada – Aircraft"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443. The DSB recommended that Canada "withdraw" its prohibited export subsidies within 90 days, that is, by 18 November 1999.

³ Original panel report, *Canada - Aircraft*, *supra*, footnote 2, para. 10.1.

⁴ *Ibid.*, para. 10.4.

⁵ WT/DS70/9 (23 November 1999).

⁶ Panel Report, *Canada - Aircraft (Article 21.5 - Brazil)*, *supra*, footnote 1, para. 6.2.

pellant's submission.⁷ On 5 June 2000, Canada filed an appellee's submission.⁸ On the same day, the European Communities and the United States each filed a third participant's submission.⁹

7. The oral hearing in the present appeal was held on 21 June 2000. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. ARGUMENTS OF THE PARTICIPANTS AND THE THIRD PARTICIPANTS

A. *Claims of Error by Appellant - Brazil*

8. Brazil alleges that the Article 21.5 Panel erred in law by failing to observe the clear mandate in its terms of reference¹⁰ and the requirement in Article 21.5 of the DSU that it review the revised TPC programme for its consistency with Article 3.1(a) of the *SCM Agreement*. Instead, the Article 21.5 Panel limited its review to whether the revised TPC was consistent with the recommendations and rulings of the DSB in the original dispute and concluded that "Canada has *implemented the DSB recommendation* in respect of TPC assistance to the Canadian regional aircraft industry."¹¹ (emphasis added) The Article 21.5 Panel also considered that its review was limited to the specific "factual circumstances" detailed in the original panel report.¹² In conducting its review in this limited fashion, the Article 21.5 Panel rejected certain evidence and legal arguments, raised by Brazil, that related to the consistency of the new measure with Article 3.1(a) of the *SCM Agreement*. In view of these errors, Brazil requests that the Appellate Body reverse the Article 21.5 Panel's findings and conclusions with respect to the revised TPC programme.

9. According to Brazil, Article 21.5 of the DSU requires a panel to conduct a four-part analysis: (i) whether the parties disagree as to (ii) the existence or (iii) consistency with a covered agreement of (iv) measures taken to comply with the recommendations and rulings of the DSB. Brazil considers that the sole question in this appeal relates to element (iii). The term "consistency" is defined as "[t]he quality, state, or fact of being consistent; agreement (*with* something, *of* things etc.); uniformity, regularity."¹³ The word "consistent" is defined as "[a]greeing in substance or form; congruous, compatible (*with*, [*to*]), not contradictory; marked by uniformity or regularity."¹⁴ The ordinary meaning of Article 21.5, therefore, requires an evaluation of a Member's implementation measures for agreement or congruity with the covered agreements. This could, in the view of Brazil, involve a review of those measures for

⁷ Pursuant to Rule 21(1) of the *Working Procedures*.

⁸ Pursuant to Rule 22 of the *Working Procedures*.

⁹ Pursuant to Rule 24 of the *Working Procedures*.

¹⁰ WT/DS70/9 (23 November 1999).

¹¹ Panel Report, *Canada - Aircraft (Article 21.5 - Brazil)*, *supra*, footnote 1, para. 6.1.

¹² *Ibid.*, para. 5.17.

¹³ Brazil's appellant's submission, para. 16, citing *The New Shorter Oxford English Dictionary* (Fourth Ed. 1993).

¹⁴ *Ibid.*

consistency with *any* provision of *any* covered agreement, subject only to the original panel's terms of reference and the scope of the claim brought under Article 21.5.

10. This interpretation, Brazil believes, is supported by the context of Article 21.5, namely the overall implementation mechanism detailed in Articles 21 and 22 of the DSU. Monitoring compliance would become meaningless if Members could satisfy their implementation obligations by adopting remedial measures that are inconsistent with their WTO obligations. In that case, a Member would be able to shield its implementation measures from the "expedited" review envisioned in Article 21.5¹⁵ by tailoring measures around the specific "factual circumstances" addressed in the original panel or Appellate Body decisions. The implementing Member may also wish to establish that its implementation measures are WTO-consistent. The review by panels, under Article 21.5, of implementation measures for consistency with the covered agreements also enhances one of the central purposes of the DSU, namely prompt compliance with the recommendations and rulings of the DSB and prompt settlement of WTO disputes.

11. Brazil notes that other Article 21.5 panels have concluded that their mandate included the determination of whether a Member's implementation measures were consistent with the covered agreements, and not just with the specific recommendations and rulings of the DSB and the specific factual circumstances of the original panel and Appellate Body reports.¹⁶

12. By limiting its review under Article 21.5 of the DSU to whether the revised TPC programme is consistent with the recommendations and rulings of the DSB, the Article 21.5 Panel rejected as irrelevant evidence submitted by Brazil in support of one of its principal legal arguments.¹⁷ The evidence rejected is evidence on the revised TPC's continued "specific targeting" of the aerospace and regional aircraft industries. The Article 21.5 Panel reasoned that the evidence and argument involved "factual circumstances which themselves were not part of our original ruling"¹⁸ and that such, therefore, were "not relevant to the present dispute, which concerns the issue of whether or not Canada has *implemented the DSB recommendation* on TPC assistance to the Canadian regional aircraft industry."¹⁹ (emphasis added)

¹⁵ Panel Report, *Australia - Measures Affecting Importation of Salmon - Recourse to Article 21.5 of the DSU by Canada* ("*Australia - Salmon (Article 21.5 - Canada)*"), WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2035, para. 7.10.

¹⁶ *Ibid.*; Report by the Panel on *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Article 21.5 by Ecuador* ("*EC - Bananas III (Article 21.5 - Ecuador)*"), WT/DS27/RW/ECU, 12 April 1999, DSR, 1999:II, 803, para. 6.8.

¹⁷ Before the Article 21.5 Panel, Brazil made four arguments with a view to establishing that the revised TPC involves *de facto* export contingent subsidies that are inconsistent with Article 3.1(a) of the *SCM Agreement*. The four arguments that Brazil made were: that the revised TPC programme "specifically targeted" the Canadian regional aircraft industry for assistance because of its export-orientation; the nearness-to-the-market of the projects to be funded by the TPC; the "implicit" inclusion of export performance in the new TPC selection and assessment criteria; and, the absence of complete documentation for the revised TPC programme and the failure to replace all of the documentation relating to the "old" TPC (Brazil's four arguments are summarized in para. 5.15 of the Panel Report, "*Canada - Aircraft*" (*Article 21.5 - Brazil*), *supra*, footnote 1, and elaborated more fully in paras. 5.16, 5.19, 5.27 and 5.35 of the Article 21.5 Panel Report).

¹⁸ *Ibid.*, para. 5.17.

¹⁹ *Ibid.*

13. Brazil recalls the importance, in the original panel report, of the export-orientation or export propensity of the Canadian regional aircraft industry.²⁰ This export-orientation is translated into TPC's funding priorities, which have also not changed with the revised TPC. Since the inception of the programme, Brazil states, 65 per cent of TPC contributions have gone to the aerospace industry. Similarly, Canada has acknowledged that two-thirds of all contributions under the revised TPC will go to that industry. The economic significance of this specific targeting is considerable, since Canada has slated available funds under the revised TPC to increase by 396 per cent between now and 2003. In sum, Brazil argued to the Article 21.5 Panel that where the overwhelming export orientation of an industry has been repeatedly heralded by a government, and cited as its motivation for funding that industry, the continued specific targeting of that industry can serve as a fact from which an inference of *de facto* export contingency can be drawn. The Article 21.5 Panel's erroneous interpretation of the legal standard in Article 21.5, however, prevented it from making this analysis.

14. For these reasons, Brazil requests that the Appellate Body find the Article 21.5 Panel to have been in error, and that it accordingly reverse the Article 21.5 Panel's findings and conclusions with respect to the revised TPC. Brazil acknowledges the difficulty faced by the Appellate Body in completing the Article 21.5 Panel's analysis in this case, in which some facts are in dispute or are not the subject of a specific factual finding by the Article 21.5 Panel.

B. Arguments by Appellee - Canada

15. In this proceeding, Brazil claims that the Article 21.5 Panel did not make a determination as to whether the amended TPC programme conforms with Article 3.1 (a) of the *SCM Agreement*, and that this alleged failure constitutes a legal error. In Canada's view, Brazil's appeal is without merit. The Article 21.5 Panel specifically found that Canada had complied with the DSB recommendations regarding TPC assistance. Since the DSB's recommendations in the original dispute *included* a recommendation for Canada to conform TPC assistance to its *obligations under the SCM Agreement*, the Article 21.5 Panel did make the finding that, according to Brazil, the Article 21.5 Panel did not make.

16. Canada notes that Brazil devotes much time to arguing points that are not disputed by Canada and, more significantly, are not inconsistent with the decision of the Article 21.5 Panel. Canada does not dispute that the mandate of the Article 21.5 Panel was to assess whether Canada's implementation measures comply with the recommendation of the DSB that Canada bring TPC into conformity with Canada's obligations under the *SCM Agreement*.

17. Brazil's arguments that Canada had not eliminated TPC's alleged "targeting" of industries with a propensity to export were rejected because the *same allegations and arguments* had already been considered in the original panel proceedings, where they were found not to form part of the basis for the finding that TPC assistance was export contingent. In rejecting Brazil's claims of "specific targeting", the Article 21.5 Panel was not refusing to consider *new* facts; it was rejecting the need to *reconsider*

²⁰ Original Panel Report, *Canada - Aircraft*, *supra*, footnote 2, para. 9.325.

facts and contentions that had not changed. Brazil's argument was precisely that *nothing had changed* regarding the alleged targeting. The Article 21.5 Panel rejected that argument because Brazil was presenting the same allegations that had not been, and continued not to be, a basis for finding export contingency. In fact, Brazil was asking the Article 21.5 Panel to reconsider, and perhaps overrule, the original panel and Appellate Body decisions on a point that Brazil did not appeal during the original proceedings before the Appellate Body.

18. Canada, therefore, requests that the Appellate Body reject Brazil's appeal as there is no basis for Brazil's contention that the Article 21.5 Panel failed to assess whether Canada's "measures taken to comply with the recommendations and rulings" of the DSB were in conformity with the *SCM Agreement*.

C. *Third Participants*

1. *European Communities*

19. The European Communities begins with comments on the agreement reached between Brazil and Canada, in this dispute, *inter alia*, on the conduct of proceedings under Article 21.5 of the DSU. The European Communities believes that, although parties may make agreements relating to procedural issues in dispute settlement proceedings, such agreements may not affect the rights of third parties. In certain Article 21.5 disputes, parties have agreed bilaterally to dispense with formal consultations under Article 4 of the DSU. The European Communities considers this to be inconsistent with the DSU and prejudicial to third party rights. While this issue was not raised before the Article 21.5 Panel and is not the subject of an appeal, the European Communities considers that it would be useful to all Members to have a ruling on this issue and would appreciate a statement from the Appellate Body to the effect that "the parties to a dispute may not enter into agreements regarding the conduct of dispute settlement proceedings that prejudice the rights and interests of other Members, in particular to participate as third parties."²¹

20. The European Communities agrees with Brazil that monitoring compliance under Article 21.5 of the DSU should be meaningful and consistent with the DSU's objective of prompt settlement and compliance. The terms of reference of an Article 21.5 panel must be considered to include the "matter" before the original panel, as well as the additional question of whether that "matter" has been properly resolved (existence and consistency of implementation measures). However, Article 21.5 does not allow an examination of claims that could have been - but were not - included in the original panel's terms of reference. Nor could an Article 21.5 review extend to *any* provision of *any* covered agreement, subject only to the terms of reference and the scope of the claim brought under Article 21.5. For instance, it would be inappropriate for Brazil to argue, under Article 21.5 of the DSU, that the revised TPC programme was inconsistent with Article 5 of the *SCM Agreement*.

21. In the present dispute, however, the Article 21.5 Panel was entitled to examine the compatibility of the restructured TPC with Article 3.1(a) of the *SCM Agreement*. In conducting this examination, the Article 21.5 Panel was required to consider

²¹ European Communities' third participant's submission, para. 15.

all the factual circumstances of the amended programme in order to ensure that the *de facto* export contingency had *in fact* been removed. The European Communities acknowledges that, in its substantive analysis, the Article 21.5 Panel compared the new factual situation with the old, rather than assessing the new factual situation under the *SCM Agreement*. However, since the substance of Brazil's complaint was that in reality "nothing had changed" in the restructured TPC, it is perhaps understandable that the Article 21.5 Panel considered that the questions of the existence of implementation of the DSB's recommendations and rulings and of the conformity with the *SCM Agreement* were very similar, if not the same.

22. The European Communities believes the Article 21.5 Panel correctly understood its mandate under Article 21.5 of the DSU. However, there are indications in its Report, notably in paragraph 5.17, that the Article 21.5 Panel may not have actually applied the appropriate legal standard. The European Communities, nonetheless, considers that the facts before the Article 21.5 Panel did not establish, as a legal matter, that the restructured TPC was inconsistent with Article 3.1(a) of the *SCM Agreement*. Even if the Panel had taken the "specific targeting" into account, this would not have altered the outcome of the case. Canada is not precluded from limiting eligibility for a subsidy to certain sectors or from concentrating funding on certain industries. Moreover, the export-oriented nature of the regional aircraft industry cannot *by itself* justify such a finding.

2. United States

23. In its submission, the United States avers that it "has a strong interest in the systemic implications of the issues presented in this appeal."²² However, the United States does not make specific arguments on the substantive issues involved. As a result, no arguments by the United States are summarized here.

III. ISSUE RAISED IN THIS APPEAL

24. This appeal raises the issue of whether the Article 21.5 Panel erred in finding that Canada had "implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry"²³, in particular, by declining to examine Brazil's argument that the revised TPC programme is inconsistent with Article 3.1(a) of the *SCM Agreement* on the ground that that industry is "specifically targeted" for TPC assistance because of its export-orientation.

IV. TECHNOLOGY PARTNERSHIPS CANADA

25. The original panel found, for the reasons enumerated in paragraph 9.340 of the original panel report, that TPC assistance to the Canadian regional aircraft industry involved subsidies that were contingent, in fact, upon export performance and, thus, inconsistent with Article 3.1(a) of the *SCM Agreement*.²⁴ The Article 21.5 Panel

²² United States' third participant's submission, p. 1.

²³ Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.42.

²⁴ Original Panel Report, *Canada - Aircraft*, *supra*, footnote 2, para. 9.348.

summarized, as follows, the steps taken by Canada to implement the recommendations and rulings of the DSB regarding TPC:

5.3 Canada has taken two types of action in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. First, Canada has terminated existing TPC activities in the Canadian regional aircraft sector. Thus, Canada (1) has cancelled funding under five TPC transactions identified by Canada, (2) has withdrawn approvals-in-principle for two new TPC funding projects in the regional aircraft sector, and (3) has closed all TPC files in the regional aircraft sector.

5.4 Second, Canada has restructured the TPC programme and documentation so that, in its opinion, most of the factual considerations forming the basis for the Panel's finding of *de facto* export contingency no longer apply. According to Canada, the only factual consideration still applicable is the export orientation of the Canadian regional aircraft industry.

26. Brazil's complaint, in the Article 21.5 proceedings, regarding TPC was limited to the second type of action taken by Canada to comply with the recommendations and rulings of the DSB, namely the restructuring of the TPC programme. Brazil does not disagree with the manner in which Canada has terminated existing TPC activities in the Canadian regional aircraft sector, and the Article 21.5 Panel did not examine those termination measures.

27. Before the Article 21.5 Panel, Brazil made four different arguments to establish that the revised TPC programme involves *de facto* export contingent subsidies that are inconsistent with Article 3.1(a) of the *SCM Agreement*.²⁵ The Panel considered each of these arguments in turn. For the reasons quoted below, the Article 21.5 Panel declined to examine the substance of the first of the four arguments made by Brazil, namely that the revised TPC programme "specifically targeted" the Canadian regional aircraft industry for assistance because of its export-orientation:

... the "specific targeting" concept (in those or other words) *did not form part of our reasoning regarding contingency in fact on export performance in that dispute*. ... That is, of the factual considerations enumerated by us at para. 9.340 of our Report, **none** concerned the alleged targeting of the Canadian aerospace industry generally, or the Canadian regional aircraft industry in particular, by TPC, **none** concerned the amount of total TPC funding directed at the Canadian aerospace or regional aircraft industries, and **none** concerned the fact that the aerospace or regional aircraft industries were eligible for TPC assistance. ... Indeed, we consider that the question of whether TPC assistance is "specifically targeted" to the aerospace and

²⁵ Brazil's four arguments are identified, *supra*, in footnote 17 of this Report. These four arguments are also summarized in para. 5.15 of the Article 21.5 Panel Report and elaborated more fully in paras. 5.16, 5.19, 5.27 and 5.35 of the Article 21.5 Panel Report.

regional aircraft industries is not relevant to the present dispute, which concerns the issue of *whether or not Canada has implemented the DSB recommendation* on TPC assistance to the Canadian regional aircraft industry.²⁶ (italics added)

28. The Article 21.5 Panel next stated that the recommendations and rulings of the DSB:

... cannot have required Canada to take implementation action to ensure that TPC assistance is not "specifically targeted" at the aerospace and regional aircraft industries, *because such alleged "specific targeting" did not form part of the basis for the finding of de facto export contingency that gave rise to that recommendation.*²⁷ (emphasis added)

29. The Article 21.5 Panel then held, as regards this argument of Brazil, that:

... we do not consider it necessary to examine Brazil's argument that "nothing has changed" because TPC assistance continues to "specifically target" the Canadian aerospace and regional aircraft industries.²⁸

30. The Article 21.5 Panel went on to examine the merits of Brazil's three other arguments and rejected each of them. The Article 21.5 Panel, therefore, concluded that it was "unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry."²⁹

31. Brazil's present appeal is limited to the Article 21.5 Panel's treatment of its argument relating to the "specific targeting" of the Canadian regional aircraft industry because of its export-orientation.³⁰ On appeal, Brazil submits that the Article 21.5 Panel erred by failing to examine the revised TPC programme for its consistency with Article 3.1(a) of the *SCM Agreement*, as required by Article 21.5 of the DSU and by the Article 21.5 Panel's terms of reference.³¹ Instead, Brazil asserts that the Article 21.5 Panel limited its review to an examination only of whether Canada had amended the TPC programme to make it consistent with "the recommendations and rulings of the DSB".³² Brazil contends that in so doing, the Article 21.5 Panel erred by confining itself to the original panel's findings in *Canada - Aircraft* and by declining to consider Brazil's "specific targeting" argument.

32. Article 4.7 of the *SCM Agreement* provides:

²⁶ Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.17.

²⁷ *Ibid.*

²⁸ Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.18.

²⁹ *Ibid.*, para. 5.42.

³⁰ Brazil's appellant's submission, para. 12, and statement by Brazil at the oral hearing in response to questioning. Brazil appeals the Article 21.5 Panel's treatment of Brazil's "first category of evidence", which related to the fact that "industries eligible for 'new' TPC assistance remain specifically targeted because of their export orientation and the expectation that that export orientation will continue" (Brazil's appellant's submission, para. 9).

³¹ WT/DS70/9 (23 November 1999).

³² Article 21.3 of the DSU.

If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member *withdraw the subsidy* without delay. ... (emphasis added)

33. Pursuant to this provision, the recommendations and rulings of the DSB in the original proceedings required Canada to "withdraw" the measure "found to be a prohibited export subsidy". As we have already noted, the Article 21.5 Panel's terms of reference embrace only the measures taken by Canada with a view to restructuring the TPC programme, which was found to involve prohibited export subsidies.³³ As such, the present proceedings involve only the measures taken by Canada for the purpose of "withdrawing" the prohibited export subsidies through the restructuring of the TPC programme. We are, therefore, not asked, in this appeal, to address any other aspect of Canada's obligation, under Article 4.7 of the *SCM Agreement*, to "withdraw" the measures found to be prohibited export subsidies.

34. Canada restructured the TPC programme by amending TPC's operating documentation, with effect from 18 November 1999. In that respect, Canada introduced, *inter alia*, the following new TPC documents: "Special Operating Agency Framework Document"; "Terms and Conditions"; "Investment Application Guide"; and, "Investment Decision Document". The new TPC "Terms and Conditions" document states that the "granting of contributions will not be contingent, either in law or in fact, upon actual or anticipated export performance" (Section 6.1). This is repeated in the TPC Investment Application Guide (Section 5). Section 5 of that Guide also states that "administering officials will not request or consider information concerning the extent to which applicant or recipient enterprises do or may export."

35. The subject-matter of these proceedings is determined by Article 21.5 of the DSU, as well as, of course, by the Panel's terms of reference. Article 21.5 of the DSU stipulates:

Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. ...

36. Proceedings under Article 21.5 do not concern just *any* measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those "measures *taken to comply* with the recommendations and rulings" of the DSB. In our view, the phrase "measures taken to comply" refers to measures which have been, or which should be, adopted by a Member to bring about compliance with the recommendations and rulings of the DSB. In principle, a measure which has been "taken to comply with the recommendations and rulings" of the DSB will *not* be the same measure as the measure which was the subject of the original dispute, so that, in principle, there would be two separate

³³ WT/DS70/9 (23 November 1999). In the document requesting recourse to Article 21.5, Brazil identified the "new terms and conditions and a new administrative framework for the [TPC] program".

and distinct measures³⁴: the original measure which *gave rise* to the recommendations and rulings of the DSB, and the "measures taken to comply" which are - or should be - adopted to *implement* those recommendations and rulings. In these Article 21.5 proceedings, the measure at issue is a new measure, the *revised* TPC programme, which became effective on 18 November 1999 and which Canada presents as a "measure taken to comply with the recommendations and rulings" of the DSB.

37. Brazil asserts that this revised TPC programme is not "consistent" with Article 3.1(a) of the *SCM Agreement*, and Canada agrees that the Article 21.5 Panel was entitled to examine the revised TPC programme for its "consistency" with Canada's obligations under Article 3.1(a).³⁵ We agree with the parties that the "consistency" of the revised TPC programme with Article 3.1(a) of the *SCM Agreement* is the relevant issue. Furthermore, in our view, the obligation of the Article 21.5 Panel, in reviewing "consistency" under Article 21.5 of the DSU, was to examine whether the new measure - the revised TPC programme - was "in conformity with", "adhering to the same principles of" or "compatible with" Article 3.1(a) of the *SCM Agreement*.³⁶ In short, both the DSU and the Article 21.5 Panel's terms of reference required the Article 21.5 Panel to determine whether the revised TPC programme involved prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement*.

38. We add also that the examination of "measures taken to comply" is based on the relevant facts proved, by the complainant, to the Article 21.5 panel, during the panel proceedings. Therefore, the "minimum implementation standard" that the Article 21.5 Panel expressed and which, it said, was "effectively" agreed between the parties, should be viewed with caution.³⁷ The Article 21.5 Panel said that Canada's implementation should " 'ensure' that *future* TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance."³⁸ (emphasis added) The use in this standard of the words "ensure" and "future", if taken too literally, might be read to mean that the Panel was seeking a strict guarantee or absolute assurance as to the *future* application of the revised TPC programme. A standard which, if so read, would, however, be very difficult, if not impossible, to satisfy since no one can predict how unknown administrators would apply, in the unknowable future, even the most conscientiously crafted compliance measure.

39. In conducting its review under Article 21.5 of the DSU, the Article 21.5 Panel declined to examine Brazil's argument that "the Canadian regional aircraft industry

³⁴ We recognize that, where it is alleged that there exist *no* "measures taken to comply", a panel may find that there is *no* new measure.

³⁵ We note that the claim made by Brazil relating to the revised TPC programme, in this Article 21.5 dispute, is the *same* as the claim made by Brazil in the original proceedings in relation to the TPC programme as previously constituted. In both cases, Brazil complained that the measure at issue was inconsistent with Article 3.1(a) of the *SCM Agreement*. These proceedings do not, therefore, involve a claim under a provision of the *SCM Agreement*, or, even, a claim under a covered agreement, that was not examined in the original proceedings in *Canada - Aircraft*.

³⁶ See the dictionary meanings of "consistency" and "consistent" in *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. I, p. 486 and *The Concise Oxford Dictionary* (Clarendon Press, 1995), p. 285. The dictionary meaning of "consistency" includes the "quality" or "state" of "being consistent".

³⁷ Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.12.

³⁸ *Ibid.*

continues to be 'specifically targeted' for TPC assistance because of its undisputed export orientation."³⁹ The Article 21.5 Panel stated that this argument "did not form part" of the reasoning of the original panel and was "not relevant to the present dispute, which concerns the issue of whether or not Canada *has implemented the DSB recommendation...*"⁴⁰ (emphasis added)

40. We have already noted that these proceedings, under Article 21.5 of the DSU, concern the "consistency" of the revised TPC programme with Article 3.1(a) of the *SCM Agreement*.⁴¹ Therefore, we disagree with the Article 21.5 Panel that the scope of these Article 21.5 dispute settlement proceedings is limited to "the issue of whether or not Canada *has implemented the DSB recommendation*". The recommendation of the DSB was that the measure found to be a prohibited export subsidy must be withdrawn within 90 days of the adoption of the Appellate Body Report and the original panel report, as modified - that is, by 18 November 1999. That recommendation to "withdraw" the prohibited export subsidy did not, of course, cover the new measure - because the new measure did not exist when the DSB made its recommendation. It follows then that the task of the Article 21.5 Panel in this case is, in fact, to determine whether the new measure - the revised TPC programme - is consistent with Article 3.1(a) of the *SCM Agreement*.

41. Accordingly, in carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the "measures taken to comply" from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings. Although these may have some relevance in proceedings under Article 21.5 of the DSU, Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel. In addition, the relevant facts bearing upon the "measure taken to comply" may be different from the relevant facts relating to the measure at issue in the original proceedings. It is natural, therefore, that the claims, arguments and factual circumstances which are pertinent to the "measure taken to comply" will not, necessarily, be the same as those which were pertinent in the original dispute. Indeed, the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the "consistency with a covered agreement of the measures taken to comply", as required by Article 21.5 of the DSU.

42. Consequently, in these proceedings, the task of the Article 21.5 Panel was not limited solely to determining whether the revised TPC programme had been rid of those aspects of the original measure - the TPC programme, as previously constituted - that had been identified in the original proceedings, in the context of all of the facts, as not being consistent with Canada's WTO obligations. Rather, the Article 21.5 Panel was obliged to examine the revised TPC programme for its consistency with Article 3.1(a) of the *SCM Agreement*. The fact that Brazil's argument in these Article

³⁹ Panel Report, *Canada - Aircraft*" (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.16.

⁴⁰ *Ibid.*, para. 5.17.

⁴¹ *Supra*, para. 37.

21.5 proceedings "did not form part" of the original panel's reasoning relating to the *previous* TPC programme does not necessarily mean that this argument is "not relevant" to the Article 21.5 proceedings, which relate to the *revised* TPC programme. In our view, the Article 21.5 Panel should have examined the merits of Brazil's argument as it relates to the *revised* TPC programme. We conclude, therefore, that the Article 21.5 Panel erred by declining to examine Brazil's argument that the revised TPC programme "specifically targeted" the Canadian regional aircraft industry for assistance because of its export-orientation.⁴²

43. With a view to resolving this dispute, and considering that the undisputed facts on the record are adequate for this purpose, we believe that we should complete the Article 21.5 Panel's analysis by examining this argument. In so doing, we observe that the essence of Brazil's argument is that the Canadian regional aircraft industry is "specifically targeted" for assistance in two different ways under the revised TPC programme.

44. First, Brazil notes that the "Eligible Areas" for TPC assistance include "Aerospace and Defence", and that these industrial sectors are the sole such sectors to be identified expressly as eligible for TPC assistance. The other two "Eligible Areas" are "Environmental Technologies" and "Enabling Technologies", which could involve projects drawn from any industrial sector, including "Aerospace and Defence". In Brazil's view, the express identification of "Aerospace and Defence" as "Eligible Areas" puts these industrial sectors, which include the Canadian regional aircraft industry, in a privileged position and represents "specific targeting" of the Canadian regional aircraft industry. Second, Brazil maintains that the Canadian regional aircraft industry is also "specifically targeted", in practice, through the allocation of TPC funding assistance. According to Brazil, 65 per cent of TPC funding has, in the past, "gone to the [Canadian] aerospace industry".⁴³

45. Brazil maintains that the reason for these two types of "targeting" is the high export-orientation of the industry. In support of this argument, Brazil relies on a series of statements made by Canadian Government Ministers, Members of Parliament, other government officials, and by the TPC itself, regarding the objectives of TPC.⁴⁴ Brazil acknowledges that the statements it relies upon were made in connection with the *old* TPC programme, as *previously* constituted. Brazil argues, nevertheless, that the "specific targeting" is a fact that tends to establish that the revised TPC programme involves subsidies which are *de facto* export contingent.

46. Canada does not contest any of the factual assertions made by Brazil in presenting its "specific targeting" argument. However, Canada emphasizes that the statements Brazil relies upon were made in relation to the *old* TPC programme, not to the *revised* programme. Canada also states that no TPC assistance has been granted or committed under the *revised* TPC programme to the Canadian regional aircraft industry. In other words, Canada asserts that there have been, thus far, no transactions involving the Canadian regional aircraft industry under this new measure. Brazil does not contest this assertion.

⁴² Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1, para. 5.18.

⁴³ Brazil's first submission to the Article 21.5 Panel, para. 21 (Panel Report, *Canada - Aircraft* (Article 21.5 - Brazil), *supra*, footnote 1).

⁴⁴ *Ibid.*, para. 19

47. It is worth recalling that the granting of a subsidy is not, in and of itself, prohibited under the *SCM Agreement*. Nor does granting a "subsidy", without more, constitute an inconsistency with that Agreement. The universe of subsidies is vast. Not all subsidies are inconsistent with the *SCM Agreement*. The only "prohibited" subsidies are those identified in Article 3 of the *SCM Agreement*; Article 3.1(a) of that Agreement prohibits those subsidies that are "contingent, in law or in fact, upon export performance". We have stated previously that "a subsidy is prohibited under Article 3.1(a) if it is 'conditional' upon export performance, that is, if it is 'dependent for its existence on' export performance."⁴⁵ We have also emphasized that a "relationship of conditionality or dependence", namely that the granting of a subsidy should be "tied to" the export performance, lies at the "very heart" of the legal standard in Article 3.1(a) of the *SCM Agreement*.⁴⁶

48. To demonstrate the existence of this "relationship of conditionality or dependence", we have also stated that it is *not* sufficient to show that a subsidy is granted in the knowledge, or with the anticipation, that exports will result.⁴⁷ Such knowledge or anticipation does not, taken alone, demonstrate that the granting of the subsidy is "contingent upon" export performance. The second sentence of footnote 4 of the *SCM Agreement* stipulates, in this regard, that the "*mere fact* that a subsidy is granted to enterprises which export shall not *for that reason alone* be considered to be an export subsidy...". (emphasis added) That fact, by itself, does not, therefore, compel the conclusion that there is a "relationship of conditionality or dependence", such that the granting of a subsidy is "tied to" export performance. However, we have also said that the export-orientation of a recipient "may be taken into account as a relevant fact, provided it is one of several facts which are considered and is not the only fact supporting a finding" of export contingency.⁴⁸ (underlining added)

49. Recalling all this, at its core, we see Brazil's argument about "specific targeting" essentially as a contention that the *SCM Agreement* precludes the two types of targeting Brazil identifies simply because of the high export-orientation of the Canadian regional aircraft industry. However, in our view, the fact that an industrial sector has a high export-orientation is not, by itself, sufficient to preclude that sector from being expressly identified as an eligible or privileged recipient of subsidies. Nor does the high export-orientation of an industry limit, in principle, the amount of subsidies that may be granted to that industry. As we have said, granting subsidies, in itself, is

⁴⁵ Appellate Body Report, *Canada - Certain Measures Affecting the Automotive Industry* ("Canada - Automotive Industry"), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995, para. 123. See also Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 166.

⁴⁶ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 171; Appellate Body Report, *Canada - Automotive Industry*, *supra*, footnote 45, para. 107. We note that, in our Report, in *Canada - Aircraft*, we said that the distinction between *de facto* and *de jure* contingency lies in the "evidence [that] may be employed to prove that a subsidy is export contingent" (*supra*, footnote 2, para. 167). While *de jure* contingency must be demonstrated on the basis of the "words of the relevant ... legal instrument", *de facto* contingency "must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy" (Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 167).

⁴⁷ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 172.

⁴⁸ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 173.

not prohibited. Under Article 3.1(a) of the *SCM Agreement*, the subsidy must be *export contingent* to be prohibited. The two "targeting" factors *may* very well be relevant to an inquiry under Article 3.1(a) of the *SCM Agreement*, but they do not necessarily provide conclusive evidence that the granting of a subsidy is "*contingent*", "*conditional*" or "*dependent*" upon export performance. In these proceedings, we do not see the two "targeting" factors, by themselves, as adequate proof of prohibited export *contingency*.

50. Moreover, the evidence that Brazil relies upon in seeking to demonstrate that the Canadian regional aircraft industry is "specifically targeted" *because of* its high export-orientation relates to the TPC as *previously* constituted, and not to the *revised* TPC programme.⁴⁹ In particular, Brazil relies upon evidence of the high proportion of TPC funding allocated to the Canadian regional aircraft industry under the *old* TPC programme and on statements made in connection with that programme by Canadian Government Ministers, Members of Parliament, officials, and by TPC itself. The burden of explaining the relevance of the evidence, in proving the claim made, naturally rests on whoever presents that evidence. Brazil has not offered any convincing explanation as to why the evidence relating to the *old* TPC programme continues to be relevant to the *revised* TPC programme. We do not believe we should simply assume that this particular evidence is relevant in respect of the revised TPC programme.

51. For all these reasons, we find that Brazil has not sufficiently established that the Canadian regional aircraft industry is "specifically targeted" *because of* its high export-orientation.

52. We conclude that Brazil has failed to establish that the revised TPC programme is inconsistent with Article 3.1(a) of the *SCM Agreement*. We also conclude that Brazil has failed to establish that Canada has not implemented the recommendations and rulings of the DSB. The outcome of the present proceedings does not, of course, preclude possible subsequent dispute resolution proceedings regarding the WTO-consistency of the revised TPC programme, or of specific instances of assistance actually granted under that programme.

V. FINDINGS AND CONCLUSIONS

53. For the reasons set out in this Report, the Appellate Body finds that the Article 21.5 Panel erred by declining to examine Brazil's argument that the revised TPC programme is inconsistent with Article 3.1(a) of the *SCM Agreement* on the ground that the Canadian regional aircraft industry is "specifically targeted" for TPC assis-

⁴⁹ As we have noted, *supra*, in para. 46, Canada asserts that no funding has been granted to the Canadian regional aircraft industry under the revised TPC programme, and Brazil does not contest this assertion.

tance because of its export-orientation. However, the Appellate Body finds that Brazil has failed to establish that the revised TPC programme is inconsistent with Article 3.1(a) of the *SCM Agreement* and, accordingly, that Brazil has failed to establish that Canada has not implemented the recommendations and rulings of the DSB.

**CANADA - MEASURES AFFECTING THE EXPORT
OF CIVILIAN AIRCRAFT**

Recourse by Brazil to Article 21.5 of the DSU

Report of the Panel

WT/DS70/RW

Adopted by the Dispute Settlement Body

on 4 August 2000

as Modified by the Appellate Body Report

TABLE OF CONTENTS

	Page
I. INTRODUCTION AND FACTUAL BACKGROUND.....	4317
II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES.....	4320
III. ARGUMENTS OF THE PARTIES AND THIRD PARTIES	4320
IV. INTERIM REVIEW	4320
A. Comments by Brazil	4320
B. Comments by Canada.....	4321
V. FINDINGS	4322
A. Technology Partnerships Canada	4322
1. Summary of Original Canada - Aircraft Findings on TPC.....	4322
2. Description of the Measures Taken by Canada to Implement the DSB's Recommendations.....	4322
3. Summary of the Parties' Arguments.....	4323
(a) Brazil	4323
(b) Canada	4323
4. Evaluation by the Panel	4324
(a) Scope of the Disagreement between the Parties.....	4324
(b) Burden of Proof	4325
(c) Substantive Analysis.....	4326
(i) Eligible Industries Remain Specifically Targeted because of their Export Orientation	4326
(ii) Interest in Near-Market Projects	4328
(iii) Export Performance as an Implicit Selection and Assessment Criterion.....	4330
(iv) Documentation.....	4333

		Page
	(d) Alternative Implementation Methods	4335
	(e) Repayment of Prior TPC Assistance to the Canadian Regional Aircraft Industry	4335
	(f) Summary.....	4337
B.	Canada Account	4337
1.	Summary of Original Canada - Aircraft Findings on Canada Account	4337
2.	Summary of the Parties' Arguments	4338
	(a) The Measure at Issue	4338
	(b) Standard for Assessing Canada's Implementation	4340
	(c) Sufficiency of the Policy Guideline	4341
3.	Evaluation by the Panel	4342
	(a) Textual Analysis of the Second Paragraph of Item (k)	4343
	(i) What are "Export Credit Practices" in the Sense of Item (k) of the Illustrative List of Export Subsidies?	4344
	(ii) What are the Arrangement's "Interest Rates Provisions"?	4345
	(iii) Which Types of "Export Credit Practices" Could Conceptually be "in Conformity with" the "Interest Rates Provisions" of the OECD Arrangement in its Current Form?	4348
	(iv) What Provisions and Considerations are Relevant to Judging "Conformity" with the Arrangement's "Interest Rates Provisions" and Hence Qualification for the Safe Haven in Item (k)?.....	4352
	(b) Considerations Based on the Context of the Second Paragraph of Item (k) and the Object and Purpose of the SCM Agreement	4359
	(c) The Sufficiency of the Policy Guideline to Ensure that Future Canada Account Transactions in the Regional Aircraft Sector Will Qualify for the Safe Haven of the Second Paragraph of Item (k), and that Prohibited Export Subsidies under Canada Account thereby Have Ceased	4363
	(i) Substance of the Policy Guideline	4363

	Page
(ii) Form of the Policy Guideline	4366
(d) Summary	4367
VI. CONCLUSION	4368
ANNEX 1-1 (FIRST SUBMISSION OF BRAZIL).....	4369
ANNEX 1-2 (REBUTTAL SUBMISSION OF BRAZIL).....	4386
ANNEX 1-3 (FIRST ORAL STATEMENT OF BRAZIL).....	4409
ANNEX 1-4 (CONCLUDING STATEMENT OF BRAZIL).....	4417
ANNEX 1-5 (RESPONSES BY BRAZIL TO QUESTIONS FROM THE PANEL)	4421
ANNEX 1-6 (COMMENTS OF BRAZIL ON CANADA'S RESPONSES TO QUESTIONS FROM THE PANEL)	4432
ANNEX 2-1 (FIRST SUBMISSION OF CANADA)	4433
ANNEX 2-2 (REBUTTAL SUBMISSION OF CANADA)	4455
ANNEX 2-3 (ORAL STATEMENT OF CANADA)	4460
ANNEX 2-4 (ANSWERS TO QUESTIONS POSED TO CANADA BY THE PANEL AND BY BRAZIL)	4477
ANNEX 2-5 (COMMENTS OF CANADA ON BRAZIL'S RESPONSES TO THE QUESTIONS FROM THE PANEL)	4498
ANNEX 3-1 (SUBMISSION OF THE EUROPEAN COMMUNITIES)	4500
ANNEX 3-2 (SUBMISSION OF THE UNITED STATES).....	4506
ANNEX 3-3 (ORAL STATEMENT OF THE EUROPEAN COMMUNITIES).....	4512
ANNEX 3-4 (ORAL STATEMENT OF THE UNITED STATES).....	4523
ANNEX 3-5 (ANSWER OF THE UNITED STATES TO QUESTIONS POSED BY BRAZIL)	4526
ANNEX 3-6 (ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL)	4527
ANNEX 3-7 (RESPONSES BY THE EUROPEAN COMMUNITIES TO THE QUESTIONS FROM THE PANEL AND FROM BRAZIL)	4534

I. INTRODUCTION AND FACTUAL BACKGROUND

1.1 On 20 August 1999, the Dispute Settlement Body ("the DSB") adopted the Appellate Body Report in WT/DS70/AB/R and the Panel Report and recommendations in WT/DS70/R as upheld by the Appellate Body Report in the dispute *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"). In its report, the Panel found, regarding Canada Account, that the Canada Account debt financing at issue constituted "subsid[ies] contingent in law ... upon export performance" prohibited by Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), and that in granting this prohibited export subsidy,

Canada had necessarily acted in violation of Article 3.2 of the SCM Agreement, i.e., that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constituted export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement. The Panel found with regard to Technology Partnerships Canada ("TPC") that TPC assistance to the Canadian regional aircraft industry constituted "subsidies contingent ... in fact ... upon export performance", contrary to Articles 3.1(a) and 3.2 of the SCM Agreement.

1.2 The Panel recommended that Canada withdraw these subsidies within 90 days. The Appellate Body recommended that the DSB request that Canada bring its export subsidies found in the Panel Report, as upheld by the Appellate Body Report, to be inconsistent with Canada's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement into conformity with its obligations under that Agreement. Specifically, the Appellate Body recalled that the Panel had recommended that Canada withdraw the subsidies identified in sub-paragraphs (b) and (f) of paragraph 10.1 of the Panel Report within 90 days.

1.3 On 18 November 1999, Canada submitted to the Chairman of the DSB, pursuant to Article 21.6 of the Dispute Settlement Understanding ("the DSU"), a status report (WT/DS70/8) on implementation of the recommendations of the DSB in the dispute. The status report described measures taken by Canada which in Canada's view implemented the DSB's rulings to withdraw the measures within 90 days.

1.4 With respect to Canada Account debt financing for the export of Canadian regional aircraft, which was found to be inconsistent with Canada's obligations under the SCM Agreement, the status report indicated that there would be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account financing. In addition, the Minister for International Trade had approved a policy guideline requiring that all Canada Account transactions after that date for all sectors, not only those involving the regional aircraft sector, comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (the "*OECD Arrangement*"). By this policy, the Minister undertook not to authorize any transaction under the Canada Account unless it complied with the *OECD Arrangement*, and no Canada Account transaction may proceed without such Ministerial authorization.

1.5 Concerning TPC assistance to the Canadian regional aircraft industry which was found to be inconsistent with Canada's obligations under the SCM Agreement, the status report stated that Canada would not make any disbursements pursuant to any existing TPC Contribution Agreement for the Canadian regional aircraft industry effective 18 November 1999. In this respect, Canada had amended TPC's Contribution Agreements pertaining to the Canadian regional aircraft industry in order to terminate all obligations to disburse funds effective 18 November 1999. As a result, some \$16.4 million of funding pursuant to those agreements would go undisbursed. In addition, Canada had cancelled the conditional approval given prior to the Appellate Body report for two other regional aircraft industry projects. Canada attached to this communication letters confirming cancellation of such funding. Canada also had taken steps to restructure TPC in order to bring the structure and administrative practices of the Agency into conformity with the SCM Agreement and so to avoid future disputes in this matter. TPC had been re-mandated by the government and now operated under revised Terms and Conditions and Framework Document. The revisions covered such core activities as project eligibility, assessment criteria, and repayment principles.

1.6 On 23 November 1999, Brazil submitted a communication to the Chairman of the DSB (WT/DS70/9) seeking recourse to Article 21.5 of the DSU. In that communication, Brazil indicated its view that the measures taken by Canada to comply with the recommendations and rulings of the DSB were not consistent with the SCM Agreement and the DSU, and that therefore Canada had not implemented the recommendations of the DSB concerning either Canada Account or TPC. In particular, regarding Canada Account, Brazil recalled that there were a large number of provisions in the *OECD Arrangement* that allowed for derogations from its general rules. Therefore, in Brazil's view, Canada's vague statement that the new policy guideline complied with the *OECD Arrangement* was inconsistent with the recommendations and rulings of the DSB and Article 3 of the SCM Agreement. In addition, Brazil had not received any documentation with the revised policy guidelines of Canada Account. Regarding TPC, Brazil had no information on the new administrative framework for the programme, and since TPC payments were contingent in fact upon export performance, compliance by Canada with Article 3 of the SCM Agreement required more than a mere reformulation of some of the TPC rules and regulations.

1.7 Accordingly, Brazil indicated, because "there [was] a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB" between Brazil and Canada, within the terms of Article 21.5 of the DSU, Brazil sought recourse to Article 21.5 in the matter and requested that the DSB refer the disagreement to the original panel, if possible, pursuant to Article 21.5. Brazil attached¹ the terms of an agreement reached by Brazil and Canada concerning the procedures to be followed pursuant to Articles 21 and 22 of the DSU. Brazil stressed that such agreement did not prejudice its rights concerning an appeal of the review panel report.

1.8 At its meeting on 9 December 1999, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Brazil in document WT/DS70/9. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS70/9, the matter referred to the DSB by Brazil 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."

1.9 The Panel was composed as follows:

Chairperson: Mr. David de Pury
Members: Mr. Maamoun Abdel-Fattah
Mr. Dencho Georgiev

1.10 Australia, the European Communities and the United States reserved their rights to participate in the Panel proceedings as third parties.

1.11 The Panel met with the parties and third parties on 6 February 2000.

1.12 The interim report of the Panel was sent to the parties on 31 March 2000. The parties submitted written comments on the interim report on 7 April 2000. On 14 April 2000, Canada responded to two comments made by Brazil. Brazil chose not to

¹ See Annex to document WT/DS70/9.

respond to Canada's comments on the interim report. Neither party requested an interim review meeting with the Panel. The final report of the Panel was sent to the parties on 28 April 2000.

II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

2.1 Brazil requests the Panel to "determine that Canada has not implemented the recommendations and rulings of the DSB or otherwise complied with its obligations under the Subsidies Agreement".

2.2 Canada requests the Panel to "reject Brazil's claim".

III. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

3.1 With the agreement of the parties, the Panel has decided that in lieu of the traditional descriptive part of the Panel report setting forth the arguments of the parties, the parties' submissions will be annexed in full to the Panel's report. Accordingly, the submissions of Brazil are set forth in Annex 1, and the submissions of Canada are set forth in Annex 2. In addition, the third party submissions of the European Communities and the United States are set forth in full in Annex 3. Australia, the only other third party, made neither a written nor an oral submission.

IV. INTERIM REVIEW

4.1 On 7 April 2000, both parties requested the Panel to review, in accordance with Article 15.2 of the DSU, precise aspects of the interim report issued on 31 March 2000. Neither party requested an additional meeting with the Panel. Canada responded to two of the comments made by Brazil.

A. Comments by Brazil

4.2 Brazil identified two typographical errors in the interim report, which have been corrected.

4.3 Regarding para. 5.32, Brazil asked us to state that sales forecasts will in some instances be used in the context of "new" TPC assistance to the Canadian regional aircraft industry. There is nothing in the record to suggest that sales forecasts will definitely be used in the context of the new TPC. Furthermore, in responding to Brazil's comment, Canada asserted that "[I]t is not certain that sales forecasts will *ever* be used in the context of the 'new' TPC assistance to the regional aircraft industry". Accordingly, we have not made the change requested by Brazil.

4.4 In respect of para. 5.33, Brazil asserted that the third sentence of this paragraph does not accurately reflect the factual record in these proceedings. Brazil argued that documentary evidence that it submitted establishes that "increased export performance" is in fact identified by Industry Canada as a "net economic benefit" to Canada as that term is defined by the "new" TPC. However, it is possible for a transaction to have "net economic benefit" without export performance. Although export performance may well provide net economic benefit, the opposite is not necessarily true. We have amended the third sentence of this paragraph, in order to clarify that

nowhere in the "new" TPC Investment Decision Document or the "new" TPC Investment Application Guide (the two documents referred to in that paragraph) is export performance identified as a "technological" or "net economic benefit".

4.5 With regard to para. 5.37, Brazil questioned our finding that "Brazil has failed to cite to any Canadian submission to the Panel which contains any such argument". Brazil referred to Exhibit CAN-9 in support. However, Exhibit CDN-9 does not contain any argument by Canada that it has implemented the DSB recommendation on TPC by removing the word "export" from the "old" TPC documents referenced therein. It simply includes a list of TPC documents in effect prior to 17 November 1999. Indeed, some of the "old" TPC documents cited in Exhibit CDN-9 do not even contain the word "export" (see, for example, Repayment of Contributions Policy Guidelines, Project Summary Form, and Statement of Work). We have made no change to this paragraph.

4.6 In order to avoid any misstatement of Brazil's arguments concerning the Appellate Body report in *Chile - Alcohol* (WT/DS87/AB/R and WT/DS110/AB/R), we have deleted former footnote 45.

4.7 Brazil requested the inclusion of a new footnote at the end of the first sentence of paragraph 5.50. Brazil asked the Panel to include text taken from para. 45 of Canada's first written submission (Annex 2-1) and para. 15 of Canada's second written submission (Annex 2-2). In response, Canada asserted that Brazil's proposed footnote "takes language from Canada's submission out of context. This could lead to the perpetuation of the misunderstanding of Canada's position on this point." We agree with Canada. In any event, we note that the relevant text is included in the aforementioned Annexes to the Panel's report. We have therefore not included the new footnote requested by Brazil.

B. *Comments by Canada*

4.8 Regarding our findings on Canada Account, Canada indicated that it understood the reference in paragraph 5.147(d) of our report to Article 24 of Annex III of the *OECD Arrangement* to mean that humanitarian tied aid falls within the safe haven of the second paragraph of item (k) and therefore can be provided under Canada Account. Canada requested that we insert a statement in our findings to clarify this. We have made no finding in respect of humanitarian tied aid, and therefore have inserted footnotes 102 and 127 to so indicate.

4.9 Canada further noted regarding our findings on Canada Account that in a given transaction, there could be a combination of a guarantee or an insurance policy by an export credit agency issued in favour of a lending bank and the provision of interest rate support by the participating country to the lending bank. Canada stated that Canada understood us to consider that such a transaction would fall within the safe haven of the second paragraph of item (k) because it includes "official financing support", and requested that we insert a statement in our findings to clarify this point. We have inserted footnotes 97 and 103 to reiterate and clarify our finding as to the provisions of the *Arrangement* that would need to be respected in order for such a transaction to be in conformity with the interest rate provisions of the *Arrangement*, and to recall our finding that conformity with the SCM Agreement of a guarantee or insurance as such could only be judged on the basis of Articles 1 and 3 of that Agreement.

4.10 Canada requested that we insert an introductory sentence before paragraph 81 of its oral statement (Annex 2-3). We have inserted the requested sentence at the beginning of that paragraph.

V. FINDINGS

A. *Technology Partnerships Canada*

1. *Summary of Original Canada - Aircraft Findings on TPC*

5.1 In the original *Canada - Aircraft* proceeding, Brazil adduced evidence concerning five TPC transactions in the regional aircraft sector. The Panel noted that "three [of the five] transactions accounted for 68% of TPC contributions to the aerospace and defence sector during the period 1996-1997." The Panel found "that Brazil's arguments concerning these three specific contributions establish a *prima facie* case that TPC assistance to the Canadian regional aircraft industry confers 'benefits' within the meaning of Article 1.1(b) of the SCM Agreement". The Panel therefore found that "TPC assistance to the Canadian regional aircraft industry constitutes 'subsidies' within the meaning of Article 1.1 of the SCM Agreement". The Panel then found, on the basis of a number of "considerations" / "facts", that "TPC assistance to the Canadian regional aircraft industry is ... 'contingent ... in fact ... upon export performance' within the meaning of Article 3.1(a) of the SCM Agreement". In light of the above, the Panel concluded that "TPC assistance to the Canadian regional aircraft industry constitutes 'subsidies contingent ... in fact ... upon export performance', contrary to Articles 3.1(a) and 3.2 of the SCM Agreement".

5.2 The Appellate Body upheld the Panel's finding that "TPC assistance to the Canadian regional aircraft industry" is contingent on export performance, within the meaning of Article 3.1(a) of the SCM Agreement.

2. *Description of the Measures Taken by Canada to Implement the DSB's Recommendations*

5.3 Canada has taken two types of action in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. First, Canada has terminated existing TPC activities in the Canadian regional aircraft sector. Thus, Canada (1) has cancelled funding under five TPC transactions identified by Canada, (2) has withdrawn approvals-in-principle for two new TPC funding projects in the regional aircraft sector, and (3) has closed all TPC files in the regional aircraft sector.

5.4 Second, Canada has restructured the TPC programme and documentation so that, in its opinion, most of the factual considerations forming the basis for the Panel's finding of *de facto* export contingency no longer apply. According to Canada, the only factual consideration still applicable is the export orientation of the Canadian regional aircraft industry.

3. Summary of the Parties' Arguments

(a) Brazil

5.5 Brazil notes that, consistent with Article 4.7 of the SCM Agreement, the Panel and the DSB recommended that Canada "withdraw" its prohibited export subsidies. Brazil recalls that the Panel found that prohibited export subsidies were provided in the form of TPC assistance to the Canadian regional aircraft industry. Accordingly, Brazil considers that Canada should withdraw the TPC programme altogether with regard to the Canadian regional aircraft industry. At a minimum, Brazil considers that Canada's TPC implementation measures must ensure that prohibited export subsidies cannot be granted to the regional aircraft industry, and not merely that they might not be granted. Brazil states that withdrawal of the prohibited TPC subsidy programme should consist of measures that make it clear to the Panel that Canada is not simply going to continue the same TPC programme as before once the present Article 21.5 proceedings are completed. Brazil asserts that Canada's implementation measures change only the superficial evidence of export contingency (by purging from TPC documents any express reference to the word "export"), but make no substantive change whatsoever in the underlying programme.

5.6 As an argument in the alternative, Brazil also requests repayment of prior TPC assistance to the Canadian regional aircraft industry, if either (1) the Panel considers itself required to follow the reasoning of the *Australia - Leather Article 21.5* panel², or (2) the Panel finds that there can be no grounds for making a finding concerning *de facto* export contingency under the "new" TPC programme in the absence of actual financial contributions granted under the "new" TPC.

(b) Canada

5.7 Canada submits that the measures it has taken fully satisfy the requirement to withdraw the TPC assistance to the Canadian regional aircraft industry that was found to constitute prohibited export subsidies. Canada considers that these measures "ensure" - through programmatic changes - that any future assistance under the TPC programme with respect to regional aircraft will be consistent with the SCM Agreement. Canada denies Brazil's assertion that it is obliged to withdraw / abolish the TPC programme in respect of the Canadian regional aircraft industry. Canada asserts that it can implement the Panel's recommendation by replacing the "old" WTO-inconsistent TPC programme with a "new" WTO-consistent programme.

5.8 With regard to Brazil's qualified request for repayment, Canada asserts that it was the operation of TPC in the regional aircraft sector that was at issue in the previous proceeding, and that it is the operation of TPC, as newly constituted, that is at issue in this Article 21.5 proceeding. Canada asserts that since there is no evidence, and, indeed, no suggestion, that new subsidies have been granted to "circumvent" a Panel ruling, repayment of subsidies, even if such a remedy were available under the SCM Agreement, is not warranted.

² *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW, adopted 11 February 2000, DSR 2000:III, 1189, hereinafter "*Australia - Leather Article 21.5*".

4. Evaluation by the Panel

(a) Scope of the Disagreement between the Parties

5.9 Brazil's primary³ claim concerns the measures taken by Canada to restructure the TPC programme insofar as it will apply in the future to the Canadian regional aircraft industry. In particular, Brazil's primary claim raises issues concerning the substance of the prospective implementation action undertaken by Canada. With respect to Brazil's primary claim, therefore, there is no disagreement between the parties resulting from the fact that, in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry, Canada has taken prospective action. The parties agree that to "withdraw" the subsidy in this case requires some sort of prospective action on the part of Canada.

5.10 We recall that Article 21.5 disputes arise "[w]here there is *disagreement* as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings"⁴ of the DSB. Since there is no disagreement between the parties⁵ that, in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry, Canada is required to take some form of prospective action, we do not consider it necessary to provide a comprehensive interpretation of what is required for an implementing Member to "withdraw" a prohibited export subsidy. Rather, it is sufficient to conclude (and we note that the parties seem to agree with this) that a Member cannot be understood to have withdrawn a prohibited subsidy if it has not *ceased to provide* such a subsidy, as that Member therefore would not have ceased to violate its WTO obligations in respect of such a subsidy. In our view, therefore, Canada's obligation arising from the DSB's recommendation in this dispute includes the obligation to cease providing prohibited export subsidies to the regional aircraft sector under the TPC. We note that in the circumstances of this Article 21.5 proceeding concerning TPC, such an assessment is by nature forward-looking. Accordingly, we shall focus on Canada's restructuring of the TPC programme insofar as it will apply to the Canadian regional aircraft industry in the future. If necessary, we shall then examine Brazil's alternative claim regarding past TPC assistance to the regional aircraft industry.

5.11 With regard to the future, Brazil claims that Canada should abolish / withdraw the TPC programme in respect of the Canadian regional aircraft industry. At a minimum, though, Brazil asserts that Canada must "ensure" that *de facto* export subsidies cannot be granted to the regional aircraft industry, and not merely that they might not be granted.⁶ According to Brazil, if Canada maintains funding to the Cana-

³ Only in the alternative does Brazil raise any claims concerning *past* TPC assistance to the regional aircraft industry. However, Brazil has explicitly stated that a remedy concerning (exclusively) future TPC assistance to the regional aircraft industry is preferred (see para. 5.45 below).

⁴ Emphasis supplied.

⁵ We recall that we are not, at this juncture, addressing Brazil's alternative claim regarding repayment of past TPC assistance to the Canadian regional aircraft industry.

⁶ Brazil could be understood to have proposed an impossible implementation standard, since no sovereign state will ever be able to provide an absolute guarantee that it will not in the future provide *de facto* export subsidies. Any such guarantee would effectively eliminate the totality of a state's discretionary authority. Brazil acknowledges this point, by stating that "[o]bviously, a sovereign state cannot [eliminate all of its discretionary authority] and remain a sovereign state" (Brazil's reply to

dian regional aircraft industry under the "new" TPC, Canada must ensure that the program will operate in full compliance with the SCM Agreement.⁷ Canada denies that it is required to abolish / withdraw the TPC programme in respect of the Canadian regional aircraft industry, but asserts that it "has taken the steps within Canada's control to *ensure* that any assistance that TPC may provide in the future to the Canadian regional aircraft industry will not be contingent on export performance in law or in fact".⁸

5.12 Thus, Brazil and Canada effectively agree on the need for Canada to satisfy Brazil's minimum implementation standard, *i.e.*, to "ensure" that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance. The parties disagree, however, on whether Canada has taken sufficient steps to satisfy that standard. To resolve this disagreement, we must examine whether or not Canada has taken sufficient steps to ensure that future TPC assistance to the regional aircraft industry will not be *de facto* contingent on export performance.

(b) Burden of Proof

5.13 In examining this issue, we note that "Brazil recognises that it bears the burden of showing that Canada has failed to implement. ... It then becomes Canada's burden to explain how Brazil was wrong and how Canada's purported changes actually constitute effective implementation."⁹ Canada agrees that the initial burden of proof falls on Brazil.

5.14 We agree that Brazil, as the complaining party, bears the burden of proof in this proceeding. We agree with the Appellate Body's statement in *EC - Hormones* that "[t]he initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency ...",¹⁰ and consider that this should apply in the context of Article 21.5 proceedings. Since the burden is on Brazil (*i.e.*, the complaining party) to show that Canada has failed to implement the recommendation of the DSB (by reference to the minimum implementation standard agreed on by the parties), Brazil must establish that Canada has failed to "ensure" that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance.

TPC question 1(a) from the Panel). In light of Brazil's acknowledgement, we understand Brazil to argue that Canada need only ensure that *de facto* export subsidies cannot be granted to the regional aircraft industry *within the context of the "new" TPC programme*. This understanding is confirmed by Brazil's assertion that "Canada must *ensure* that the *program* will operate in full compliance with the [SCM] Agreement" (Second written submission of Brazil (Annex 1-2), para. 19, underline emphasis supplied).

⁷ Ibid.

⁸ Canada's reply to the Panel's TPC question 2, para. 57 (Annex 2-4), emphasis supplied.

⁹ Brazil's reply to the Panel's TPC question 1(a) (Annex 1-5).

¹⁰ Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("EC – Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 December 1998, DSR 1998, I:135, para. 98.

(c) Substantive Analysis

5.15 Brazil considers that it has discharged its burden of proof by demonstrating "that all the essential elements of the [TPC] program *remain unchanged*, and that many of these elements will never change".¹¹ In this regard, Brazil claims that the facts surrounding the "new" TPC still support an inference of *de facto* export contingency. In particular, Brazil refers to the following four factors which, in its opinion, lead to an inference that future TPC assistance to the Canadian regional aircraft industry continues to be *de facto* export contingent:

- eligible industries remain "specifically targeted" because of their export orientation;
- eligible activities continue to betray an interest in near-market projects;
- export performance is an implicit selection and assessment criterion; and
- many TPC documents have not yet been replaced or amended.

We shall examine each of these factors in turn.

(i) Eligible Industries Remain Specifically Targeted because of their Export Orientation

5.16 Brazil argues that the continued *de facto* export contingency of TPC may be inferred from the fact that the Canadian regional aircraft industry continues to be "specifically targeted" for TPC assistance because of its undisputed export orientation.¹² Brazil asserts that "[n]othing, in short, has changed - neither the industries eligible for TPC contributions, nor the recognized export-orientation of the industry that enjoys the lion's share of those contributions, nor the significance of that industry's export orientation to Canadian government officials, nor that industry's prospects for continued dominance of TPC's treasury. None of these factors is destined for change."¹³ Brazil asserts that, to maintain the export orientation of the Canadian regional aircraft industry, "the Canadian aerospace industry receives the vast majority of the rapidly increasing pool of TPC funds available".¹⁴ Brazil further argues that "in choosing which industry would receive the lion's share of 'old' and 'new' TPC funds, Canada was not casually indifferent to the trading patterns of that industry. Instead, Canada chose, as TPC's showcase, an industry that exports significantly more than others, *because* it exports significantly more than others. The 'new' TPC retains a focus on contributions to the aerospace industry."¹⁵ According to Brazil, "the targeted industries of the 'old' TPC are the same recipients under the 'new' TPC".¹⁶

5.17 Thus, we understand Brazil to argue that "nothing has changed" because TPC assistance continues to be "specifically targeted" at the Canadian aerospace or regional aircraft industries, in the sense that these industries will continue to receive the "vast majority", or "lion's share", of TPC assistance. In addressing this argument,

¹¹ Brazil's reply to TPC question 1(a) from the Panel (Annex 1-5) (emphasis supplied).

¹² Brazil's reply to TPC question 2 from the Panel (Annex 1-5).

¹³ Brazil's first written submission, para. 22, Annex 1-1).

¹⁴ Brazil's first written submission, para. 23 (Annex 1-1).

¹⁵ Brazil's second written submission, paras 32 and 33 (Annex 1-2).

¹⁶ Brazil's concluding remarks, para. 9 (Annex 1-4).

we recall that the "specific targeting" concept (in those or other words) did not form part of our reasoning regarding contingency in fact on export performance in that dispute. While we do not exclude the possibility that, in a given case, a factual circumstance of "specific targeting" might be considered by a panel to be part of the totality of facts leading to an inference of export contingency, this was not the case in the original *Canada - Aircraft* dispute. That is, of the factual considerations enumerated by us at para. 9.340 of our Report, **none** concerned the alleged targeting of the Canadian aerospace industry generally, or the Canadian regional aircraft industry in particular, by TPC, **none** concerned the amount of total TPC funding directed at the Canadian aerospace or regional aircraft industries,¹⁷ and **none** concerned the fact that the aerospace or regional aircraft industries were eligible for TPC assistance. Arguing a failure to implement on the grounds that there has been no change in alleged factual circumstances, which themselves were not part of our original ruling, is of questionable merit and logic. Indeed, we consider that the question of whether TPC assistance is "specifically targeted" to the aerospace and regional aircraft industries is not relevant to the present dispute, which concerns the issue of whether or not Canada has implemented the DSB recommendation on TPC assistance to the Canadian regional aircraft industry. That recommendation cannot have required Canada to take implementation action to ensure that TPC assistance is not "specifically targeted" at the aerospace and regional aircraft industries, because such alleged "specific targeting" did not form part of the basis for the finding of *de facto* export contingency that gave rise to that recommendation.¹⁸ The fact that "nothing has changed" concerning the alleged "specific targeting" of the aerospace and regional aircraft industries therefore has no bearing on the present dispute.

¹⁷ We recall that, in our original findings, we referred to the fact that three specific transactions examined by us accounted for approximately 68 per cent of TPC contributions to the aerospace and defence sector during the period 1996-1997 (see para. 9.307 of *Canada - Aircraft*, WT/DS70/R). However, we made this factual reference in the context of our original findings on subsidization. This factual reference played no part whatsoever in our original findings on *de facto* export contingency.

¹⁸ We note the statement of the *Australia - Leather Article 21.5* panel (which Brazil has quoted in its reply to the Panel's TPC question 5 (see Annex 1-5)) that "[t]he specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance ... do not, in our view, determine what is required in order to 'withdraw the subsidy' within the meaning of Article 4.7 of the SCM Agreement" (WT/DS126/RW, adopted 11 February 2000, note 24). We do not understand this statement to mean that factual considerations underlying a panel's finding that a subsidy is *de facto* export contingent are irrelevant for determining what action must be taken to remove that *de facto* export contingency. Indeed, the context in which that statement was made by the *Australia - Leather Article 21.5* panel was altogether different. In that case, the question of implementation of the DSB's recommendation was addressed, in the first instance by the parties, on the basis of the "subsidy" element, rather than the "export contingency" element, of the prohibited subsidy. Specifically, the parties both made arguments concerning the *amount of the subsidy* that should be repaid, and Australia based its arguments concerning this point on its interpretation of the panel's original finding of *export contingency*. The quoted statement of the panel was made in addressing this argument, and we believe was intended to express the view that the basis for the original finding of *de facto* export contingency was not useful or relevant for calculating the amount of the subsidy to be repaid.

5.18 For these reasons, we do not consider it necessary to examine Brazil's argument that "nothing has changed" because TPC assistance continues to "specifically target" the Canadian aerospace and regional aircraft industries.

(ii) Interest in Near-Market Projects

5.19 Brazil argues that the *de facto* export contingency of future TPC funding to the Canadian regional aircraft industry should be inferred from the fact that the available descriptions of eligible activities under the "new" TPC betray an interest in "near market" projects with high commercialization potential. Brazil also argues that essentially the same projects continue to be eligible for "new" TPC contributions as were eligible under the "old" TPC, such that "if funding for the development of commercial products was available in the 'old' TPC, it is similarly available in the 'new' TPC, and as it did before contributes to an *inference* of *de facto* export contingency".¹⁹

5.20 We recall that our earlier findings in *Canada - Aircraft* were based in part on the express recognition in the 1996/1997 TPC Business Plan that "TPC's 'approach' in the aerospace and defence sector is to '[d]irectly support the *near market* R & D projects with *high export potential*'".²⁰

5.21 In its review of our findings, the Appellate Body asserted that, if a panel takes the "nearness-to-the-export-market factor" into account, "it should treat it with considerable caution". ... [T]he mere presence or absence of this factor in any given case does not give rise to a presumption that a subsidy is or is not *de facto* contingent upon export performance". Accordingly, we shall proceed with caution when addressing Brazil's arguments regarding the alleged nearness-to-the-export-market of "new" TPC projects in the regional aircraft sector.

5.22 We note that the 1996-1997 TPC Business Plan, which contained the aforementioned reference to "near market R & D projects with high export potential" is no longer valid, and no longer exists for the purposes of TPC as it is now constituted.²¹ The 1996-1997 TPC Business Plan is therefore irrelevant when considering whether future TPC assistance to the Canadian regional aircraft industry will be *de facto* contingent on export performance.²²

5.23 In order to substantiate its claim that eligible activities for "new" TPC funding betray an interest in near-market projects, Brazil states that, according to "new" TPC documentation, TPC will fund "projects 'aimed at the discovery of knowledge, with the objective that such knowledge may be useful in *developing new products*,' and those projects leading to 'translation of industrial research findings into a plan, blue-

¹⁹ First written submission of Brazil (Annex 1-1) at para. 30.

²⁰ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443.

para. 9.340, emphasis in original findings.

²¹ Oral statement of Canada (Annex 2-3) at para. 45.

²² For the reasons set forth at para. 5.40, we see no reason to draw any inferences concerning Canada's failure to provide the 2000/2001 - 2001/2002 TPC Business Plans, which are still under development.

print or *design for new, modified or improved products ...*".²³ In response, Canada asserts that the inclusion of Industrial Research as an Eligible Activity "permits TPC to support earlier stage research and development that is further removed from the production and sale of specific products. The pre-competitive development category of eligible activity enables TPC to support the development of horizontal technologies that cut across the operations of recipient firms ... rather than the development of specific products".²⁴

5.24 In our view, the mere fact that the results of a project may in the future be useful in the development of new products, or the modification / improvement of existing products, does not by itself render the project near-market. This view is confirmed by former footnotes 28 and 29 to former Article 8.2(a) of the SCM Agreement²⁵, concerning non-actionable subsidies, which appears to have strongly influenced Canada's choice of wording in the "new" TPC documents cited by Brazil.²⁶ In our view, the non-actionable subsidy projects referred to in former footnotes 28 and 29 concerned "industrial research" and "pre-competitive development activity" projects that were sufficiently removed from the market to suggest that their impact on the market was likely to be minimal. As a result, it would be incongruous for us to find similarly defined TPC projects to be "near-market".

5.25 Brazil has also argued that "new" TPC eligible activities betray an interest in "near market" projects because they are similar to "old" TPC eligible activities which were found to be "near market". In this regard, Brazil relies exclusively on a description of "old" TPC activities contained in a January 1998 TPC website excerpt.²⁷ According to Brazil, the description of "new" TPC eligible activities is similar to the

²³ Second written submission of Brazil (Annex 1-2) at para. 35 (emphasis in Brazil's submission). Brazil is referring to the "new" TPC Terms and Conditions, and the "new" TPC Investment Application Guide, at this juncture.

²⁴ First written submission of Canada (Annex 2-1) at para. 34.

²⁵ Pursuant to Article 31 of the SCM Agreement, Articles 8 and 9 of that Agreement applied for an initial period of five years, ending 31 December 1999, and could have been extended beyond that date on the basis of a consensus by the SCM Committee. As of 31 December 1999, no such consensus had been reached.

²⁶ Former footnote 28 provided:

The term "industrial research" means planned search or critical investigation aimed at discovery of new knowledge, with the objective that such knowledge may be useful in developing new products, processes or services, or in bringing about a significant improvement to existing products, processes or services.

Former footnote 29 provided:

The term "pre-competitive development activity" means the translation of industrial research findings into a plan, blueprint or design for new, modified or improved products, processes or services whether intended for sale or use, including the creation of a first prototype which would not be capable of commercial use. It may further include the conceptual formulation and design of products, processes or services alternatives and initial demonstration or pilot projects, provided that these same projects cannot be converted or used for industrial application or commercial exploitation. It does not include routine or periodic alterations to existing products, production lines, manufacturing processes, services, and other on-going operations even though those alterations may represent improvements.

²⁷ First written submission of Brazil (Annex 1-1) at para. 29.

description of "old" TPC eligible activities found in the January 1998 TPC website excerpt. We do not consider it necessary to pursue this argument, since our original finding that TPC funding in the aerospace & defence sector (and therefore in the regional aircraft industry component thereof) was focused on "near market" projects was based on the aforementioned statement in the 1996-1997 TPC Business Plan, and *not* the January 1998 TPC website excerpt. We therefore do not see the relevance of comparing the "new" description of eligible activities with the "old" description of TPC eligible activities contained in the January 1998 TPC website excerpt. Of far greater relevance, however, is the fact that the 1996/1997 TPC Business Plan, which contained the explicit reference to "near market" projects ("with high export potential") is no longer valid for the "new" TPC. Aerospace & defence activities eligible for "new" TPC funding will necessarily differ from aerospace & defence activities eligible for funding under the "old" TPC, since - as provided for in the 1996/1997 TPC Business Plan - "old" TPC funding in the aerospace & defence sector was explicitly and exclusively focused on "near-market projects", which - on the basis of the evidence before us - is not the case for "new" TPC funding in the aerospace & defence sector²⁸.

5.26 Accordingly, Brazil has failed to demonstrate that the available descriptions of eligible activities under the "new" TPC betray an interest in "near market" projects with high commercialization potential, or that activities eligible for funding under the "new" TPC are essentially the same as those eligible for funding under the "old" TPC.²⁹

(iii) Export Performance as an Implicit Selection and Assessment Criterion

5.27 Brazil notes that the goals and objectives of the "new" TPC, like those of the "old" TPC,³⁰ concern the creation of Canadian jobs, the increase of Canadian economic growth, or the increase of Canadian wealth. Brazil asserts that an inference of *de facto* export contingency may be drawn from an intimate "link" between (1) the

²⁸ We note as well the Industry Canada press release concerning the "new" TPC (Exhibit BRA-18), which was cited by Brazil in connection with its "specific targeting" argument (First oral statement of Brazil (Annex 1-3) at para. 20). Although this document has not been identified by Brazil in connection with its "near market" argument, nonetheless we have examined it in this context to determine the extent to which it might be relevant to the question of whether the same projects or similarly "near market" projects as were funded under the "old" TPC would continue to be funded under the "new" TPC. We conclude that this document does not contain information relevant to this question. In particular, this document indicates that the same companies are "free" to apply for funds under the "restructured" TPC on the basis of a new application form. In our view, this cannot be construed as meaning that the same projects would be considered eligible, specifically *because* of the reference to the fact that TPC has been restructured and the application form revised.

²⁹ We note Brazil's argument that "[r]emoving 'commercialization' or the 'near market R&D' focus from TPC's focus ... and shifting instead to a focus on 'industrial research and pre-competitive development,' would not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy" (First written submission of Brazil (Annex 1-1) at para. 25). We agree. For that reason, our conclusion in the preceding para. does not preclude us from examining other factual arguments adduced by Brazil to demonstrate that future TPC assistance to the regional aircraft industry will be *de facto* contingent upon export performance.

³⁰ First written submission of Brazil (Annex 1-1) at para. 32.

fulfilment of these goals and objectives and (2) exports. Brazil asserts that, because of this "link", TPC assistance to the regional aircraft industry will be implicitly conditioned on, or tied to, export performance.

5.28 Canada notes that the mandate and overall programme objective of the restructured TPC provide that "TPC is a technology investment fund established to contribute to the achievement of Canada's objectives of increasing economic growth, creating jobs and wealth, and supporting sustainable development".³¹ According to Canada, the restructured TPC's mandate and objectives do not encompass the enhancement of exports or Canada's export base.

5.29 We recall that our original findings were based in part on the Terms and Conditions of the "old" TPC, which stated that the Aerospace & Defence component of the TPC would be "directed to projects that will maintain and build upon the ... **export base** extant in the aerospace and defence sector".³² We note that the Terms & Conditions of the "new" TPC no longer explicitly direct the Aerospace & Defence component thereof at projects that maintain and build upon the "export base" of the aerospace & defence sector. It is presumably for this reason that Brazil refers to the alleged implicit conditionality between the grant of "new" TPC assistance to the Canadian regional aircraft industry and the export performance of that industry.

5.30 While it is certainly true that the provision of funds on the basis of the "new" TPC's mandate and objectives could result in additional exports by funded sectors, we recall the Appellate Body's ruling that the mere knowledge, or anticipation, that exports will result from a subsidy does not by itself render that subsidy *de facto* contingent on export performance, because it does not by itself demonstrate conditionality.

5.31 Brazil has argued that the requisite conditionality may be inferred from the fact that recipients of "new" TPC assistance implicitly "commit to export performance". In this regard, Brazil has sought to draw an analogy with the facts of the *Australia - Leather* case³³ where the panel, in Brazil's own words, "determined that requesting undifferentiated sales performance targets led to an inference of *de facto* export contingency because the Australian government knew that in order to reach those targets, the recipient would have to export".³⁴ According to Brazil, "[t]he same logic applies in the case of the Canadian regional aircraft industry; the Canadian government knows that the industry exports virtually all its products, and thus to reach sales forecasts, it must export".³⁵

5.32 Without taking any view on the findings of the *Australia - Leather* panel, we note that Brazil has adduced no evidence that "new" TPC assistance to the Canadian regional aircraft industry will be conditioned on the fulfilment of sales targets (as

³¹ TPC Terms & Conditions, and SOA Framework (see First written submission of Canada (Annex 2-1) at para. 22).

³² *Canada - Aircraft*, *supra*, footnote 20, para. 9.340, bullet 12 (emphasis supplied).

³³ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, (hereinafter "*Australia - Leather*"),

³⁴ Second written submission of Brazil (Annex 1-2) at footnote 62.

³⁵ *Ibid.*

was found to be the case in *Australia - Leather*³⁶). Brazil claims instead that the grant of "new" TPC assistance to the regional aircraft industry is contingent on the fulfilment of sales forecasts. However, in response to a question from the Panel, Brazil was unable to adduce any evidence to substantiate its claim of contingency on sales forecasts. Brazil only adduced evidence to the effect that sales forecasts will be used in the context of the "new" TPC programme.³⁷ In response, Canada explicitly denied that the granting of TPC assistance to the regional aircraft sector is contingent on the fulfilment of sales forecasts.³⁸ In the absence of any evidence to the contrary, we see no reason to doubt Canada's explicit denial. Furthermore, although sales forecasts may be used in the context of "new" TPC assistance to the regional aircraft industry, as they were under the "old" TPC,³⁹ this does not by itself mean that "new" TPC assistance to the Canadian regional aircraft industry will be contingent on fulfilment of those sales forecasts. The fact that a subsidy repayment schedule may be based on royalties from forecast sales does not mean that compliance with the sales forecast becomes a condition for the bestowal of the subsidy; it simply means that a sales forecast was used to fix the repayment schedule.⁴⁰ This situation is different from that before the *Australia - Leather* panel, where the relevant payments were "conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets".⁴¹ For these reasons, we disagree with Brazil that the logic of the *Australia - Leather* panel applies in the present case.

5.33 Furthermore, we note that Part 4 of the "new" TPC Investment Decision Document requires TPC administrators to record the "[b]enefits [of the project] to Canada". Section 5 of the "new" TPC Investment Application Guide defines "technological and net economic benefits to Canada" as "increasing economic growth, creating jobs and wealth, and supporting sustainable development". Nowhere in these documents is increased export performance identified as a "technological" or "net economic benefit" to Canada. Indeed, Part 4 of the aforementioned Investment Decision Document explicitly provides that "TPC will not accept or consider infor-

³⁶ The *Australia - Leather* panel found that relevant payments were "conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets" (see Panel Report, *Australia - Leather*, *supra*, footnote 33, para. 9.71).

³⁷ Brazil's reply to the Panel's TPC question 3 (Annex 1-5).

³⁸ Comments of Canada on Brazil's replies to questions (Annex 2-5) at para. 11.

³⁹ According to an Industry Canada News Release dated 18 November 1999 (Exhibit BRA-18, page 4) repayment schemes will be based on "e.g. royalties on total company or division sales ...". We note that the use of sales forecasts in the context of royalty-based financing schemes in the civil aircraft sector is not uncommon, and on its own appears to have no particular implications under the SCM Agreement, as evidenced by footnote 16 of that Agreement ("Members recognize that where royalty-based financing for a civil aircraft programme is not being fully repaid due to the level of actual sales falling below the level of forecast sales, this does not in itself constitute serious prejudice ...").

⁴⁰ Furthermore, we note that the royalties that will form the basis of any royalty-based financing scheme will be "royalties on total company or division sales", and not "royalties tied to product sales" (see 18 November 1999 Industry Canada press release (Exhibit BRA-18)). Presumably, therefore, the sales forecasts referred to by Brazil will be company- or division-wide. We are reluctant to conclude that the fulfilment of company- or division-wide sales forecasts could constitute a condition for the grant of product- or project-specific assistance.

⁴¹ Panel Report, *Australia - Leather*, *supra*, footnote 33, para. 9.71.

mation concerning the extent to which a company does or may export". The only conclusion that we can reach from the face of these documents is that projects will be compared against one another, and eventually selected for funding, on the basis *inter alia* of the amount of technological and/or net economic benefits to which they are expected to give rise. While it is clear that for some projects, these benefits will derive largely or exclusively from exports, there is no factual basis in the documents (which are at this point the only available evidence) on which to conclude that projects generating the most *exports* will be those selected for funding. Indeed, the documents indicate that the administrators simply will not have specific information about the volume of exports that might result from any project for which TPC funding is sought. Thus, whereas TPC assistance is conditional on a project having certain technological or net economic benefits to Canada, in our view this simply cannot be assumed to be synonymous with export performance, and therefore it does not mean *ipso facto* that such assistance is contingent on export performance. This remains true even though TPC administrators know that fulfilment of net economic benefits in certain cases may be likely to result in increased exports. The fact that they will have no concrete quantifiable information on exports in our view will act in practical terms to limit their discretion to select projects on the basis of export performance.

5.34 For the above reasons, we are not persuaded that "new" TPC assistance to the regional aircraft industry will be implicitly conditioned on, or tied to, export performance as a result of an intimate "link" between (1) the fulfilment of the "new" TPC goals and objectives and (2) exports.

(iv) Documentation

5.35 Brazil notes that a large proportion of "old" TPC documents, some of which were relied on by the Panel in our original findings of *de facto* export contingency, have not yet been replaced or amended or, if they have, they have not yet been provided to the Panel. Brazil considers that these documents have therefore not been cleansed of references to the term "export", despite Brazil's understanding that Canada claims to have implemented the recommendations and ruling of the DSB "by removing references to the term 'export' from TPC documents".⁴² Brazil claims that the failure to replace or amend the relevant "old" TPC documents demonstrates that Canada has failed to implement the DSB's recommendation by failing Canada's own measure of what constitutes effective implementation, namely the removal of references to "export" from TPC documents. In the alternative, Brazil claims that Canada's failure to provide certain "new" TPC documents supports a presumption that as-yet-unreplaced TPC documents supporting the Panel's original inference of *de facto* export contingency still apply.

5.36 Canada acknowledges that not all TPC documents have yet been replaced. However, Canada asserts that the key TPC documents (the Terms and Conditions and the Special Operating Agency ("SOA") Framework Document) are in place, and that all subsidiary TPC documents must respect the authority provided in these key documents. This authority explicitly requires that TPC be administered in accordance

⁴² Second submission of Brazil (Annex 1-2) at para. 51.

with Canada's international obligations, including its WTO obligations. Canada further asserts that no "old" TPC documents are valid under the "new" TPC programme, and that "old" TPC documents no longer exist for the purposes of the "new" TPC programme.

5.37 As a preliminary matter, we do not understand Canada to have argued that it has implemented the DSB recommendation on TPC assistance to the Canadian regional aircraft industry by, in Brazil's own words, "removing references to the term 'export' from TPC documents". Brazil has failed to cite to any Canadian submission to the Panel which contains any such argument. We therefore reject Brazil's claim that Canada has failed to implement the DSB recommendation by Canada's own measure of what constitutes effective implementation.

5.38 It is regrettable that Canada has not yet been able to finalize all documents concerning the operation of the "new" TPC programme, since those documents may have provided useful insight into the operation of the "new" TPC programme in respect of the Canadian regional aircraft industry. However, we note that the two key TPC documents are in place, and that Brazil has failed to demonstrate⁴³ that anything in these documents leads to an inference of export contingency. We also note Canada's assertion that all subsidiary TPC documents must respect the authority contained in those two key documents.

5.39 Furthermore, we note Canada's assertion that "old" TPC documents are no longer valid, and "no longer exist for the purposes of TPC as it is now constituted".⁴⁴ In the absence of any evidence from Brazil leading us to doubt this assertion, we see no reason why we should presume that as-yet-unreplaced - but invalid - TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. Indeed, we recall that the "new" TPC Investment Application Guide provides that "TPC will not accept or consider information concerning the extent to which your company does or may export". The continued application of any of the "old" TPC documents relied on by the Panel in our original findings of *de facto* export contingency would be manifestly at odds with this statement.

5.40 In light of the above, we see no basis for relying on previous TPC documents, which are no longer applicable, and which were a contributory factor that helped to demonstrate the *de facto* export contingency of "old" TPC assistance to the regional aircraft industry, to conclude that "new" TPC assistance to the regional aircraft industry will also be *de facto* contingent on export performance.

5.41 For these reasons, we are unable to find that Canada has failed its own measure of what constitutes effective implementation (*i.e.*, the removal of references to "export" from TPC documents), and we are equally unable to presume that as-yet-unreplaced - but invalid - TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. Indeed, with regard to the "new" TPC documentation that has been made available by Canada, we find it difficult to imagine what additional elements could usefully have been included by Canada to demon-

⁴³ As discussed above, we are not persuaded by Brazil's arguments concerning the alleged "link" between export performance and fulfilment of the TPC goals and objectives set forth in the Terms and Conditions.

⁴⁴ Oral statement of Canada (Annex 2-3) at para. 45.

strate that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance.

Conclusion

5.42 For the above reasons, we are unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. Our conclusion is based on our analysis of those facts currently surrounding the application of the restructured TPC programme which are relevant to Canada's implementation of the DSB recommendation on TPC assistance to the regional aircraft industry. Of course, the facts surrounding the application of the restructured TPC programme may change. The above conclusion in no way prejudices the issue of whether TPC assistance to the regional aircraft industry granted in the context of changed factual circumstances would, or would not, be *de facto* contingent on export performance in the future.

(d) Alternative Implementation Methods

5.43 We recall Brazil's argument that Canada be required to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry by withdrawing the TPC programme altogether with regard to the Canadian regional aircraft industry. We note that withdrawal of the TPC programme from the Canadian regional aircraft industry would exceed the minimum implementation standard agreed on by the parties (*i.e.*, to ensure that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance). Since we have concluded that Canada has fulfilled the minimum implementation standard agreed on by the parties, the question of whether or not Canada should do more (by withdrawing the TPC programme altogether from the Canadian regional aircraft industry) is not a relevant issue.

5.44 In addition, Brazil also argued that Canada could implement the DSB recommendation on TPC assistance to the Canadian regional aircraft industry either by making TPC generally available, or by ensuring that future assistance did not take the form of a subsidy. However, we do not understand Brazil to argue that Canada has failed to implement the DSB recommendation by failing to take either course of action. It is therefore not necessary for us to consider this matter further.

(e) Repayment of Prior TPC Assistance to the Canadian Regional Aircraft Industry

5.45 We recall that Brazil made a conditional request for repayment of prior TPC assistance to the Canadian regional aircraft industry. Brazil has clearly stated that this "is an alternative, though not a preferred, remedy".⁴⁵

5.46 Brazil's request for repayment is conditional on either or both of two scenarios materialising: first, if the Panel considers itself required to follow the interpretation of Article 4.7 of the SCM Agreement offered by the panel in *Australia - Leather Article 21.5*; second, if the Panel considers that it cannot render a judgement con-

⁴⁵ Brazil's reply to the Panel's TPC question 6 (Annex 1-5).

cerning Brazil's allegations of *de facto* export contingency under the restructured TPC programme as a result of the absence of any financial contributions made under the restructured programme. In the latter case, Brazil considers that it will be left without an "effective remedy" apart from the retroactive repayment of past TPC assistance to the Canadian regional aircraft industry.

5.47 With regard to the first condition, we are aware that the *Australia - Leather Article 21.5* panel recently found that a DSB recommendation to "withdraw" a prohibited export subsidy under Article 4.7 of the SCM Agreement "is **not** limited to prospective action only but may encompass repayment of the prohibited subsidy".⁴⁶ However, Brazil has explicitly expressed the "hope"⁴⁷ that the Panel does not consider itself bound to follow *Australia - Leather Article 21.5*. Indeed, Brazil "believes that the Panel in *Australia - Leather* [Article 21.5] reached a result that is not required by the language of the [SCM] Agreement"⁴⁸, and "does not believe that this or any other Panel should follow *Australia - Leather* [Article 21.5]".⁴⁹

5.48 In light of these comments by Brazil, we consider that Brazil does not in fact want us to make any finding along the lines of *Australia - Leather Article 21.5*. The same is more obviously true of Canada⁵⁰. As noted above, we consider that a panel's findings under Article 21.5 of the DSU should be restricted to the scope of the "disagreement" between the parties. In the present case, therefore, we do not consider it necessary to make any finding as to whether Article 4.7 of the SCM Agreement may encompass repayment of subsidies found to be prohibited.

5.49 The second condition attached to Brazil's request for repayment of past TPC assistance to the Canadian regional aircraft is based on Brazil understanding Canada to argue that the Panel is precluded from finding whether "new" TPC assistance to the regional aircraft industry will be *de facto* contingent on export performance because Canada has not provided any such assistance under the "new" TPC programme. Brazil considers that if the Panel were to follow such an approach, Brazil would be left without any "effective remedy" other than repayment of past assistance.

5.50 We are in no doubt that Brazil has misunderstood Canada's position. Canada has asserted that it "manifestly did not take" the position understood by Brazil. Canada has confirmed that it "believes that this Panel can - and indeed should - assess whether the restructured TPC programme implements the DSB's rulings and recommendations regarding *de facto* export contingency".⁵¹ Thus, both Canada and Brazil agree that the Panel should examine the "new" TPC programme, even in the absence of any assistance to the Canadian regional aircraft industry having been granted under that "new" programme.

⁴⁶ Panel Report, *Australia - Leather Article 21.5*, *supra*, footnote 2, para. 6.39, emphasis in original.

⁴⁷ Oral statement of Brazil (Annex 1-3) at para. 30.

⁴⁸ *Ibid.* at para. 27.

⁴⁹ *Ibid.* at para. 34.

⁵⁰ Canada informed the Panel that, in the *Brazil - Aircraft* Article 21.5 proceedings, Canada "indicated very clearly that its interpretation of the obligation to withdraw export subsidies under Article 4.7 of the [SCM] Agreement does not allow for a retroactive withdrawal of subsidies that have already been granted" (Oral statement of Canada (Annex 2-3) at para. 88).

⁵¹ Oral statement of Canada (Annex 2-3) at para. 30.

5.51 In light of the above, neither of the conditions attached to Brazil's alternative request for repayment have been met. We therefore do not consider it necessary to address the substance of that request.

(f) Summary

5.52 In summary, we are unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. Moreover, we have found that it is not necessary to consider the alternative implementation methods identified by Brazil. Finally, we have found that neither of the conditions attached to Brazil's request for repayment have been met.

B. Canada Account

1. Summary of Original Canada - Aircraft Findings on Canada Account

5.53 The Canada Account operates under the mandate of the EDC, and, per EDC's 1995 annual report, is used to "support export transactions which the federal government deems to be in the national interest but which, for reasons of size or risk, [the EDC] cannot support through regular export credits"⁵².

5.54 Regarding whether the Canada Account financing conferred subsidies, we found, on the basis of evidence concerning two financing transactions at "close to commercial" terms, that Canada Account financing in the regional aircraft sector provided subsidies, as, in our view, the reference to "close to commercial" terms constituted evidence which Canada failed to rebut that the financing was provided on below-market terms. Concerning the question of export contingency, the Panel found, on the basis of an admission by Canada that all debt financing from EDC (under which the Canada Account operates) in the civil aircraft sector since January 1995 had taken the form of export credits, and on the basis of the EDC's announced purpose in providing financing to support and develop directly or indirectly Canada's export trade, that Canada Account financing was contingent in law on export performance. Thus we found that "the Canada Account debt financing at issue constituted prohibited export subsidies", and that "Canada Account financing since 1 January 1995 for the export of Canadian regional aircraft constitute[s] export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement".⁵³

5.55 Neither party raised an appeal specifically concerning our finding on Canada Account, but Canada did appeal as a horizontal issue our determination that the existence of a "benefit" in the sense of SCM Article 1 should be determined on the basis of a comparison with the market. The Appellate Body upheld this market-based approach.

⁵² EDC 1995 Annual Report, "Canada Account Profile" (cited in para. 9.211 of our report in the original dispute (WT/DS70/R)).

⁵³ We recall that Canada did not seek to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies in Annex 1 of the SCM Agreement.

2. *Summary of the Parties' Arguments*

(a) The Measure at Issue

5.56 Canada identifies two types of measures concerning Canada Account which it states implement the Panel's recommendation, mandated by SCM Article 4.7, to "withdraw the subsidies without delay".

5.57 Canada argues *first*, that the two transactions examined by the Panel have been completed (in 1996 and 1998), so that there will be no further deliveries of regional aircraft under these transactions, and that no new Canada Account financing has been granted in the regional aircraft sector since 18 November 1999 (*i.e.*, the expiry of the 90-day period for withdrawal of the prohibited Canada Account subsidies⁵⁴). Thus, Canada asserts that it has completed the (past) financing transactions under the Canada Account found by the Panel to be subsidies contingent in law upon export performance⁵⁵. Brazil does not challenge this assertion, nor does Brazil seek further action by Canada with respect to these past subsidies. Given that there is no "disagreement" between the parties concerning Canada's implementation in respect of the past Canada Account subsidies, we do not consider further this aspect of that implementation.⁵⁶

5.58 *Second*, Canada indicates that it has adopted a new Policy Guideline to the effect that any future Canada Account financing for regional aircraft will comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* ("the *OECD Arrangement*" or "*the Arrangement*")⁵⁷. In Canada's view, the Policy Guideline means that any such financing would *not* be considered prohibited export subsidies pursuant to the second paragraph of item (k) of the Illustrative List of Export Subsidies ("the Illustrative List") found in Annex I to the SCM Agreement. The specific wording of the Guideline is that any transaction or class of transactions under Canada Account "which does not comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* would not be in the national interest"⁵⁸. Canada states that the Guideline operates such that any future Canada Account transactions that do not comply with the *OECD Arrangement* would not be in the national interest. Given that under the EDC legislation, the Minister for International Trade, whose authorization is required, can only authorize financing under the Canada Account that is found to be in the national interest, and as financing that does not comply with the *OECD Arrangement* will be deemed by the Minister not to be in the national interest, Canada argues that prohibited export subsidies can no longer be provided under Canada Account. That is, Canada maintains, to the extent that any future Canada Account financing constitutes export subsidies in the sense of SCM Articles 1 and 3, it will be covered by the "safe harbour" of the second paragraph of item (k) of the Illustrative List, under which (in Canada's words) export credits that

⁵⁴ Panel Report, Canada – Aircraft, *supra*, footnote 20, para. 10.4.

⁵⁵ First submission of Canada (Annex 2-1) at para. 62.

⁵⁶ We recall that the scope of Article 21.5 proceedings is in principle defined by the scope of the "disagreement" between the parties as to implementation (see para. 5.10 above).

⁵⁷ Although the Panel's ruling concerned Canada Account financing only in the regional aircraft sector, according to Canada the new policy guideline applies to all Canada Account financing.

⁵⁸ Exhibit CDN-13.

"comply" with "the interest rates provisions" of the *OECD Arrangement* are not to be considered prohibited export subsidies⁵⁹.

5.59 We note that the scope of our ruling in the original dispute of necessity determines the nature/scope of the measures that Canada needs to take in order to implement our recommendation to withdraw the subsidy. In particular, the question is whether our ruling was limited to the two transactions that we examined in the original dispute⁶⁰ or covered the Canada Account programme as a whole (at least in respect of the regional aircraft sector), as applied.

5.60 In this regard, Brazil argues that our ruling was not limited to the two transactions that we examined in the original dispute. Rather, Brazil believes that our ruling went beyond these transactions and covered the Canada Account programme as a whole, as applied. Thus, Brazil argues, Canada has an obligation to do more than simply complete the two transactions and refrain from providing new financing, and must at a minimum demonstrate that prohibited export subsidies *cannot* be provided via the Canada Account in the *future*. Thus, for Brazil, the measure at issue in this dispute is the action taken by Canada in respect of the *future application* of the Canada Account *programme*.

5.61 We note that Canada's view concerning the scope of our original ruling and thereby the scope and nature of the measure at issue is consistent with that of Brazil. In particular, Canada states that "[a]lthough the Panel's conclusion concerned the programme as applied, it did not appear to be limited by its terms to the two transactions that had been before the Panel. Consequently, Canada understood the Panel ruling to mean that it was essential to take steps to ensure that any future financing transactions involving regional aircraft would be consistent with Canada's obligations under the SCM Agreement". Canada argues that it has done so, by issuing the Policy Guideline "making clear that any financing transaction not in compliance with the *OECD Arrangement* (necessarily including the interest rates provisions thereof), will not be approved for Canada Account financing"⁶¹. Thus, Canada argues, future Canada Account transactions will be consistent with Canada's obligations under the SCM Agreement in that they will qualify for the safe haven in the second paragraph of item (k) of the Illustrative List⁶².

⁵⁹ See, e.g., Oral statement of Canada (Annex 2-3) at para. 68. We note that Canada uses the term "comply with" in the Policy Guideline and in certain of its arguments, while the second para. of item (k) uses the term "conformity with". We understand Canada's argument to be that any future Canada Account transactions will be eligible for the safe haven in the second para. of item (k). Thus we assume that Canada intends to refer to "conformity with" when it uses the term "comply with". This assumption appears to be confirmed by Canada's assertion that the Policy Guideline "does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement ..." (see para. 5.72 below).

⁶⁰ These were the only two Canada Account transactions involving the regional aircraft sector during the period covered by our initial review in this dispute (1 January 1995 - 30 June 1998).

⁶¹ Canada's reply to the Panel's Canada Account question 5 (Annex 2-4).

⁶² We note here that there is no disagreement between the parties that Canada Account financing remains contingent on export performance, as Brazil has argued that this is the case and Canada has not contested this argument. In fact, Canada does not even argue that *subsidies* will not continue to be provided in the regional aircraft sector. Rather, Canada's argument is that any future Canada Account subsidies for regional aircraft will not be *prohibited* by virtue of qualifying for the safe haven of the second para. of item (k).

5.62 We agree with the parties concerning the scope of our original ruling. Specifically, that ruling covered Canada Account as applied in the regional aircraft sector. In our view, therefore, this gives rise to an obligation on Canada's part to address elements of the Canada Account *programme* in order to implement the DSB's recommendation. Thus, the measure at issue in this dispute is the actions taken by Canada in respect of the Canada Account *programme*, namely, the Policy Guideline.

(b) Standard for Assessing Canada's Implementation

5.63 Our task is to assess whether the Policy Guideline is inconsistent with Canada's obligation to "withdraw" the prohibited subsidies under the Canada Account. We do not believe that it is necessary for us to develop a comprehensive definition of the term "withdraw the subsidy" (the only available remedy for prohibited subsidies pursuant to SCM Article 4.7) to be able to make this assessment. Rather, it is sufficient to conclude (and we note that the parties seem to agree with this) that a Member cannot be understood to have withdrawn a prohibited subsidy if it has not *ceased to provide* such a subsidy, as that Member therefore would not have ceased to violate its WTO obligations in respect of such a subsidy. In our view, therefore, Canada's obligation arising from the DSB's recommendation concerning prohibited subsidies under the Canada Account includes the obligation to cease providing prohibited export subsidies to the regional aircraft sector.

5.64 We note that in the circumstances of this Article 21.5 proceeding concerning Canada Account, such an assessment is by nature forward-looking. That is, the simple absence of new Canada Account transactions in the regional aircraft sector since 18 November 1999 does not provide a sufficient basis for us to conclude one way or another as to whether prohibited export subsidies under that programme have ceased. Rather, to be able to reach a conclusion on this issue, we must consider the Policy Guideline in terms of its effects on the *future application* of the Canada Account *programme*. Here again, we note that the parties do not disagree.

5.65 This raises the question of what standard we should use to make such a determination. We note that the parties' arguments indicate that both consider the correct standard to be whether or not the Policy Guideline "ensures" that prohibited subsidies have ceased. Brazil states, for example, that Canada is required, through implementation, "at a minimum to *ensure* that prohibited export subsidies via the Canada Account *cannot* be granted"⁶³. Canada for its part also accepts the appropriateness of the "ensure" standard, as it argues that the Policy Guideline "*ensure[s]* that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)"⁶⁴.

5.66 Since there is no disagreement between the parties on this matter, we consider that the standard put forward by the parties, that of "ensuring" the cessation of prohibited export subsidies in the future, is appropriate in this case. Thus, we shall examine whether the Policy Guideline is sufficient to "ensure" that in future the Canada

⁶³ Second written submission of Brazil (Annex 1-2) at para. 19. Emphasis supplied.

⁶⁴ Oral statement of Canada (Annex 2-3) at para. 67. Emphasis supplied.

Account programme, as it will be applied, will not provide prohibited export subsidies to the Canadian regional aircraft industry.

(c) Sufficiency of the Policy Guideline

5.67 The parties disagree over the sufficiency of the Policy Guideline as a means of ensuring that in future Canada Account will not provide prohibited export subsidies to the regional aircraft sector, as to both its substance and its form.

5.68 As noted, Brazil argues as a general matter that Canada is required, through implementation, "at a minimum to ensure that prohibited export subsidies via the Canada Account *cannot* be granted"⁶⁵. In other words, Brazil seeks an assurance that prohibited export subsidies through Canada Account have definitively ceased. Brazil argues that the Policy Guideline lacks any precision and therefore is inadequate to constitute such an assurance. We recall as set forth in para. 5.14 that Brazil, as the complaining party, bears the burden of proof in this dispute, specifically to establish that Canada has failed to "ensure" that future Canada Account transactions in the regional aircraft sector will not provide prohibited export subsidies.

5.69 Brazil argues that the Guideline simply states that as a policy matter, the Minister for International Trade will not approve transactions that are not in compliance with the *OECD Arrangement*. For Brazil, the Policy Guideline is a "vague hortatory statement[]" regarding Canada's intentions. Brazil specifically takes issue with Canada's argument that the Guideline states an intention to meet the criteria to qualify for an exception under the second paragraph of item (k) of the Illustrative List of export subsidies through conformity with the "interest rates provisions" of the *OECD Arrangement*. Brazil argues that the Guideline does *not* say this, and that even if it did, Canada does not define the interest rate provisions with which it intends to comply, or how it will apply those provisions. Without such precision, it is not evident to Brazil that Canadian practices would qualify for the specific "safe haven" in the second paragraph of item (k). In particular, Brazil points to the fact that, whereas the second paragraph of item (k) refers specifically to conformity with "the interest rates provisions" of the *OECD Arrangement*, the Policy Guideline refers to compl[iance] with "the OECD Arrangement" more generally. In Brazil's view, this difference in terminology, along with the absence of any detail in the Policy Guideline as to what Canada means by compliance with "the OECD Arrangement" and the basis on which eligibility of Canada Account transactions for the safe haven in the second paragraph of item (k) will be judged, means that the Policy Guideline is insufficient to implement the DSB's recommendation.

5.70 In Brazil's view, Canada's "minimum burden" with respect to implementation concerning the Canada Account is to "explain with some precision what 'comply with the OECD Arrangement' will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in future"; and Canada has failed to discharge this burden. In other words, for Brazil, Canada has the burden of demonstrating its entitlement to the "positive defense" offered by the second paragraph of item (k).

⁶⁵ Second written submission of Brazil (Annex 1-2) at para. 19. Emphasis supplied.

5.71 Concerning the question of substantive compliance with the *OECD Arrangement*, Canada agrees with Brazil that the burden would be on Canada, as the one making use of the "exception" to the SCM Agreement set forth in the second paragraph of item (k) of the Illustrative List, to prove that it is entitled to that exception. Canada appears to differ with Brazil concerning the timing, however. Whereas Brazil believes that this burden exists now, Canada argues that it would need to be satisfied only at such future point as Canada invoked the second paragraph of item (k) and were challenged with respect to that defense.

5.72 In terms of effectiveness, however, Canada argues that the Policy Guideline "does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)". That is, Canada argues that any future Canada Account financing that otherwise would constitute an export subsidy will fall within the safe haven of the second paragraph of item (k) and thus not be prohibited under the SCM Agreement.

3. *Evaluation by the Panel*

5.73 As noted, Canada's defense to Brazil's claim is that the Policy Guideline ensures that all future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k). Thus, to be able to determine whether this is the case, we must resolve basic interpretational issues concerning that provision.

5.74 First, we must determine what constitute "export credit practices" in the sense of the second paragraph of item (k). Thereafter, we must consider how to make a determination in respect of the "conformity" of such practices with the "interest rates provisions" of the relevant "international undertaking", specifically, the *OECD Arrangement*. In considering this issue, we turn to a detailed examination of the *text*⁶⁶ of the *OECD Arrangement*⁶⁷, as whatever the scope of the term "export credit practices" in the sense of the second paragraph of item (k), at present only such practices that are "in conformity with the interest rates provisions" of that *Arrangement* qualify for the safe haven of the second paragraph of item (k).

5.75 After our review of the *Arrangement's* text, we next consider a number of systemic issues that arise in the context of the second paragraph of item (k). In particular, we evaluate our conclusions drawn from the texts of item (k) and of the *Arrangement* in the light of the context of item (k) and the object and purpose of that provision and the SCM Agreement. In particular, we consider whether our conclusion based on the texts is consistent with the overall object and purpose of the SCM

⁶⁶ We recall that Article 31.1 of the *Vienna Convention on the Law of Treaties* provides 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 the light of its object and purpose".

⁶⁷ We recall that the *Bananas III* panel found it necessary to interpret certain provisions of the *Lomé Convention*, since it was referred to in the WTO General Council's *Lomé waiver* (Panel Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Complaint by the United States*, WT/DS27/R/USA, adopted 25 September, 1977, DSR 1997:II, 943, para. 7.97). We likewise consider it necessary to interpret certain provisions of the *OECD Arrangement*, since it is referred to in the second para. of item (k) of Annex I of the SCM Agreement.

Agreement of disciplining trade distorting subsidies while at the same time maintaining special and differential treatment for developing countries in respect of export subsidies.

5.76 In the light of our conclusions on the above issues, we then need to consider whether the Policy Guideline does, as Canada argues, ensure in respect of the Canada Account programme that any future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k).

(a) Textual Analysis of the Second Paragraph of Item (k)

5.77 Before commencing our detailed textual analysis, we recall that the second paragraph of item (k) reads as follows:

"Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement".

5.78 It is well accepted that the *OECD Arrangement* is an "international undertaking on official export credits" in the sense of the second paragraph of item (k).⁶⁸ Moreover, in practice the *OECD Arrangement* is at present the only international undertaking that fits this description. Thus, we understand the essence of the second paragraph of item (k) at least at present to be that "an export credit practice" which is in "conformity" with "the interest rates provisions" of the *OECD Arrangement* "shall not be considered an export subsidy prohibited by" the *SCM Agreement*⁶⁹.

⁶⁸ This was confirmed by the Appellate Body in *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), adopted 20 August 1999, WT/DS46/AB/R, DSR1999:III, 1161, para. 180.

⁶⁹ We take note of the reference to "a successor undertaking" in the second para. of item (k). In this regard, first, it is clear from this reference that to the extent that the *Arrangement* today is the only undertaking of the kind referred to in the second para. of item (k), if in the future a "successor undertaking" were to take effect, export credit practices conforming with the interest rate provisions of that undertaking also would be eligible for the safe haven in that para.. Thus, our detailed analysis of the *Arrangement* in its *present* form is not in any way intended to exclude this possibility. Second, for purposes of our analysis of the *Arrangement*, we assume that the *Sector Understandings* on Export Credits for Ships, for Nuclear Power Plant, and for Civil Aircraft, contained in Annexes I-III of the *Arrangement*, form an integral part of the *Arrangement* itself. Even if in the strict sense this were not the case (an issue that we do not here decide), in our view these *Sector Understandings* at a minimum would constitute "successor undertakings" in the sense of the second para. of item (k), as the *Arrangement* as originally implemented in 1979 did not contain these Annexes. Rather, its very brief sector-specific provisions (which at the time pertained to conventional power plants, to ground satellite communications stations, and to ships) were contained in para. 4 of its main text. The *Sector Understandings* were negotiated and implemented later, and incorporate by reference provisions of the *Arrangement*. Thus, if they are not formally integral to the *Arrangement*, there is no doubt that these *Understandings* at a minimum constitute successor undertakings, and thus, conformity with the "interest rates provisions" of the *Understandings* would qualify an export credit practice for the safe haven in the second para. of item (k).

5.79 Given this, in practice eligibility for item (k)'s safe haven from the prohibition on export subsidies is defined entirely in terms of the *OECD Arrangement*, at least for the time being. Thus, the critical element of our analysis must be to examine the *Arrangement* in detail, to determine what it applies to and how conformity with its interest rate provisions can be determined. We consider therefore that before we can come to any judgement as to the sufficiency or insufficiency of the Policy Guideline to ensure that all transactions under the Canada Account will be eligible for the safe haven in item (k), as Canada argues, we must determine the answers to the following questions: (1) what are "export credit practices" in the sense of item (k) of the Illustrative List; (2) what are the "interest rates provisions" of the *OECD Arrangement*; (3) which types of export credit practices conceptually could be in conformity with the interest rate provisions of the *Arrangement* in its current form; (4) what provisions and considerations are relevant to judging conformity with the *Arrangement's* interest rates provisions? Only once we have answered these questions will we be in a position to judge whether the Canada Account Policy Guideline is sufficient to ensure that Canada Account transactions in the future will qualify for the safe haven of the second paragraph of item (k) (or at any rate should be presumed to qualify therefor, in the absence of evidence to the contrary).

(i) What Are "Export Credit Practices" in the Sense of Item (k) of the Illustrative List of Export Subsidies?

5.80 Because at the most basic level the safe haven in the second paragraph of item (k) is available only for certain "export credit practices", we must first consider the definition and scope of this term. We consider that in its ordinary meaning, this must be a relatively broad term. That is, this term on its own suggests any practices that might be associated in some way with export credits (i.e., export financing). This certainly would involve export credits as such, but presumably other sorts of practices as well. The first paragraph of item (k) provides useful context in this regard. In particular, we note that the first paragraph refers exclusively to "export credits" and "credits", in contrast to the second paragraph's reference to "export credit practices". This supports the conclusion that the second paragraph of item (k) concerns a broader range of "practices" than export credits as such.

5.81 In our view, the *OECD Arrangement* provides further context for understanding the term "export credits", particularly in view of the role of the *Arrangement* in determining qualification of the safe haven in the second paragraph of item (k). Here we note in particular the stated "scope of application" of the *Arrangement*, found in its Article 2, namely "all official support for exports of goods and/or services, or to financial leases" with repayment terms of two years or more, as well as tied aid⁷⁰. This supports our view of the broad meaning of "export credit practice". Furthermore, we can conceive of no basis to consider any practice associated with

⁷⁰ Canada states that, pursuant to the *Arrangement's Sector Understanding on Export Credits for Civil Aircraft*, tied aid for aircraft is not permitted except for humanitarian purposes. (Oral statement of Canada (Annex 2-3) at Attachment, footnote 1.)

export credits as *a priori* not constituting an "export credit practice" in the sense of the second paragraph of item (k).⁷¹

(ii) What Are the Arrangement's "Interest Rates Provisions"?

5.82 Before considering in detail the question of the *OECD Arrangement's* "interest rates provisions" and "conformity" therewith, we note that in its own words, the *Arrangement* is a "Gentlemen's Agreement" among its participants, which "seeks to encourage competition among exporters from the OECD-exporting countries based on quality and price of goods and services exported rather than on the most favourable officially supported export credits", by placing "limitations on the terms and conditions of export credits that benefit from official support", including minimum premium benchmarks, the minimum cash payments to be made at or before the starting point of credit, maximum repayment terms and minimum interest rates which benefit from official financing support. Thus, it "sets out the *most generous* repayment terms and conditions that may be supported". The *Arrangement* applies to officially supported export credits with repayment terms of two years or more, relating to exports of goods and/or services or to financial leases, and addresses the circumstances in which official support in the form of trade-related tied and partially untied aid may be given and/or mixed with officially supported export credits⁷². It contains, in addition to its main text, special *Sector Understandings* which apply to aircraft, ships and nuclear power plant. The Participants to the *Arrangement*, as listed in Article 1(a) thereof, are "Australia, Canada, the European Community (which includes the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom) Japan, Korea, New Zealand, Norway, Switzerland, and the United States"⁷³.

5.83 To answer the question of which are the interest rate provisions of the *Arrangement*, we once again turn to its ordinary meaning. Here we note that there is no section of the *Arrangement* entitled "Interest rates provisions", nor does the *Arrangement* use or define this term. Nevertheless, we note that there are a number of provisions that specifically address interest rates as such. These are Article 15 - Minimum Interest Rates; Article 16 - Construction of CIRRs; Article 17 - Application of CIRRs; Article 18 - Cosmetic Interest Rates; and Article 19 - Official Support for Cosmetic Interest Rates. (In addition, in the specific context of this dispute, Article 22 of the *Sector Understanding on Export Credits for Civil Aircraft*⁷⁴ covers

⁷¹ As discussed below, this does not mean that all such practices can be "in conformity with" the interest rate provisions of the *OECD Arrangement*. However, while there may be no basis in the *Arrangement* in its current form to judge the "conformity" of all such practices with the *Arrangement's* "interest rates provisions" (i.e., those provisions simply may not apply to all such practices), this clearly does not *a priori* exclude the possibility that new provisions or undertakings might be developed in the future that would permit such a judgement in respect of such practices.

⁷² *OECD Arrangement*, "Introduction" section. Emphasis added.

⁷³ Article 1(b) further provides that "[o]ther countries willing to apply these Guidelines may become Participants following prior invitation of the existing Participants".

⁷⁴ Annex III of the *OECD Arrangement*.

minimum interest rates with respect to all new aircraft except large aircraft⁷⁵, along with spare engines, spare parts, maintenance and service contracts in respect of those aircraft⁷⁶, and Article 28(b) covers minimum interest rates with respect to used aircraft.)

5.84 Among these provisions, Article 15 appears to contain the basic interest rate provisions of the *Arrangement*, as the other provisions identified that specifically address interest rates seem to be dependent on and thus subordinate to it. Specifically, Article 15 establishes the basic rule that "minimum interest rates" are to be applied, i.e., respected, by all Participants when providing "official financing support". After establishing as a general principle the application of "minimum interest rates", Article 15 goes on to specify that the Commercial Interest Reference Rates ("CIRRs"), "shall" be applied. Specifically in respect of regional aircraft, Articles 22 and 28(b) of Annex III (the *Sector Understanding* for civil aircraft) provide that the CIRRs "shall" apply.

5.85 We note that the basic rule, that "minimum interest rates shall apply" is worded in a general manner, suggesting the possibility that more than one framework or system of "minimum interest rates" (i.e., other than the CIRRs) could be agreed under the *Arrangement*, and that to the extent that this is the case, these other systems also would constitute particular "minimum interest rates" in the sense of the *Arrangement*. Indeed this is the case with respect to the *Sector Understandings* for ships (which applies a minimum interest of 8 per cent in all cases) and for nuclear power plant (which applies "Special Commercial Interest Reference Rates"). We note further, however, that at present, the only "minimum interest rates" referred to in (and thus covered and regulated) by the main text of *Arrangement* are the CIRRs, and that as indicated, the CIRRs apply to regional aircraft, pursuant to the Articles 22 and 28(b) of the *Sector Understanding* for civil aircraft.

5.86 With respect to the CIRRs, Article 15 contains a number of general rules, all essentially oriented toward ensuring that the CIRRs reflect commercial fixed-interest lending rates and practices. In particular, Article 15 states that the CIRRs should represent final commercial lending interest rates in the domestic market of the currency concerned, that they should closely correspond to the rate for first-class domestic borrowers, that they should be based, where appropriate, on the funding cost of fixed interest-rate finance over a period of no less than five years, that they should not distort domestic competitive conditions, and that they should closely correspond to a rate available to first-class foreign borrowers.

⁷⁵ We note that, according to the list of aircraft models in the *Sector Understanding* on civil aircraft, aircraft with up to 70 seats are classified as other than large aircraft. This is consistent with information provided during the original dispute, i.e., that regional aircraft generally are in the 30-70 seat range. (Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("Canada – Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, at footnote 535).

⁷⁶ Spare engines, spare parts, maintenance and service contracts are covered by Part 3 of the *Sector Understanding* concerning civil aircraft. Article 27 of that *Understanding* provides that except as specifically set forth in Part 3, the relevant provisions of Parts 1 and 2 apply to spare engines, spare parts, and maintenance and service contracts. As there are no specific provisions in Part 3 concerning interest rates, the applicable interest rates for spare engines, spare parts, maintenance and service contracts in respect of regional aircraft thus would be those in Part 2 (i.e., the CIRRs).

5.87 Article 16 puts into concrete technical terms how CIRRs are to be constructed, i.e., on the basis of a fixed margin over government bond yields of varying maturities. More specifically, this Article provides that the CIRR for a currency generally should be at a fixed margin of 100 basis points above a base rate, which in turn is set at either a three-year, five-year or seven-year government bond yield, depending on the repayment terms of the financing in question, or at a five-year government bond yield for all maturities, at the option of the country providing the support⁷⁷. Article 16 also provides that countries lending in a currency other than their own shall apply the CIRRs for that currency. Finally, Article 16 contains provisions whereby a country can change the base rate system that it applies, and whereby a CIRR can be established for the currency of a non-Participant (if a Participant wishes to provide official support in that currency).

5.88 Article 17, concerning the application of CIRRs, limits the amount of time in which interest rates can be fixed, and imposes an additional margin over the CIRR where financing terms are fixed in advance of the contract date. In addition, where official financing support for floating rate loans is provided, the lender is not allowed to offer the borrower the option of applying the lower of the CIRR at the time of the contract or the short-term lending rate, over the life of the loan. That is, the borrower is not permitted during the life of a loan to switch between the CIRR as of the contract date and a short-term rate, depending on which is lower at a given time⁷⁸.

5.89 Finally, Articles 18 and 19 impose limits on "cosmetic interest rates", which the *Arrangement* describes as rates below the relevant CIRR which benefit from official support, and which may involve a compensatory measure including a corresponding increase in the contract value or other contractual adjustment. These Articles provide, *inter alia* that official financing support by means of direct financing shall not be provided at rates below the CIRR, and that other official financing support also shall not be offered at below-CIRR (cosmetic) rates. Thus, these provisions appear to be intended to prevent Participants from offering official financing support for lower-than-CIRR financing, whether or not the below-CIRR rate is achieved directly through the face interest rate or through adjustment of the other terms and conditions of the financing to circumvent the CIRR minimum.

5.90 In particular, we note that pursuant to Article 19(c), a Participant intending to support a transaction should clarify, in response to an inquiry from another Participant, the "*financial terms and mechanisms, including the compensatory measure*" (emphasis supplied), while pursuant to Article 19(d) a Participant with information suggesting that "non-conforming terms" may have been offered by another Participant shall try to determine whether the transaction benefits from official financing support and whether or not the terms of the support conform to the provisions of Article 15 ("minimum interest rates"). An important conclusion that we draw from

⁷⁷ Specific exceptions are set forth for the Yen and for the Euro.

⁷⁸ Canada argues in its answers to questions (see Canada's replies to the Panel's Canada Account questions 2(b), 2(d) (Annex 2-4)) that Article 17(b) of the *Arrangement* means that official support in the form of floating rate financing is in conformity with the *Arrangement*. While Article 17(b) does refer to floating rate financing, it contains no minimum interest rate rule in respect of such financing, and indeed makes clear that the CIRR is not applicable thereto. The issue of floating rate financing and Article 17(b) is discussed in more detail in paras. 5.102 - 5.106, *infra*.

this is that the mechanism in 19(c) and (d) clearly implies that *conformity with the CIRR* cannot be judged unless *all terms and conditions* of a transaction, including any "compensatory measures", are known.

5.91 There are no other provisions of the *Arrangement* that directly or explicitly pertain to the interest rate, and thus it would seem that the natural reading of the *Arrangement* is that the above-mentioned articles constitute the entirety of the *Arrangement's* "interest rates provisions" (at least in respect of regional aircraft). Clearly the central one of these provisions is the CIRR, which as noted is the only minimum interest rate system defined and thus regulated by the *Arrangement* in this sector⁷⁹.

5.92 We note that our view as to which are the interest rate provisions of the *Arrangement* is very different from that of Canada. Canada presented a list of what it considers those provisions to be⁸⁰, which, as Canada explains, encompasses all provisions of the *Arrangement* that in Canada's view affect the interest rate as such or the amount of interest paid in a transaction. In support of its position, Canada argues that compliance with the CIRR alone should not be enough to qualify an "export credit practice" for the safe haven in item (k)⁸¹. We agree that this is an important consideration, and as noted above, Article 19 (which both we and Canada have identified as one of the "interest rate provision") seems to suggest a way to address this question of "circumvention". Thus, it is by no means evident to us that the best or only way to address this question is through an expansive definition, such as that proposed by Canada, of what constitute the "interest rates provisions" of the *Arrangement*. (This issue is discussed in detail in paras. 5.107-5.114, *infra*.)

(iii) Which Types of "Export Credit Practices" Could Conceptually be "in Conformity with" the "Interest Rates Provisions" of the OECD Arrangement in its Current Form?

5.93 Having identified the "interest rates provisions" of the *OECD Arrangement*, we are next faced with the question of the types of "export credit practices" in respect of which interest rate provisions exist and therefore apply. This is a critical question, because, as noted above, qualification for the safe haven of the second paragraph of item (k) at present is exclusively determined by the conformity of an "export credit practice" with the interest rate provisions of the *Arrangement*. Thus, before we can be in a position to determine the conformity of a given export credit practice with those interest rate provisions, we will need to know whether it is of the type that conceptually could be subject to, and thus in conformity with, those provisions. This

⁷⁹ As noted, the other *Sector Understandings* (on export credits for ships and for nuclear power plant) also have interest rate rules, which are specific to those sectors.

⁸⁰ See, Oral statement of Canada (Annex 2-3) at paras. 69-80 and Attachment. In this list, Canada identifies the following Articles of the *Arrangement* as its interest rates provisions relevant to regional aircraft: 2, 3, 7, 9, 10, 13, 14, 15, 16, 17, 19, 21(a), 26, and 29, and identifies as well the following Articles of the *Sector Understanding*: 21, 22, 23, 24, and 25 of Annex III, Part 2 (new aircraft other than large aircraft), and 28, 29, 30 and 31 of Annex III, Part 3 (spare engines, spare parts, maintenance and service contracts).

⁸¹ Oral statement of Canada (Annex 2-3) at para. 76.

means, as a matter of logic, that conformity with the interest rate provisions is a meaningful issue only in respect of types of export credit practices for which such provisions exist.

5.94 Thus, we return to Article 15 which, as we noted, is the *Arrangement's* central interest rate provision in that it sets forth the basic minimum interest rate rule. The chapeau of Article 15 reads in relevant part as follows:

"The Participants providing official financing support through direct credits/financing, refinancing and interest rate shall apply minimum interest rates; the Participants shall apply the relevant Commercial Interest Reference Rates (CIRRs)."

5.95 Thus Article 15 makes very clear what is subject to its minimum interest rate rule. That is, Article 15 states explicitly that what is subject to the minimum interest rate rules is not all forms of "official support" covered by the *Arrangement* but rather "official financing support", which is limited to "*direct credits/financing, refinancing or interest rate support*"⁸². In other words, this provision of the *Arrangement* seems to specify that at present these, and only these, forms of "official support" covered by the *Arrangement* are subject to the minimum interest rate rule.

5.96 We note that the minimum interest rate rule specifically applicable to regional aircraft⁸³ (i.e., paragraph 22 of Part 2 of Annex III of the *Arrangement*, the part of the *Sector Understanding* on civil aircraft other than large aircraft), is identical to that in Article 15 of the *Arrangement*. In particular, this provision states:

"The Participants providing official financing support shall apply minimum interest rates; the Participants shall apply the relevant CIRR set out in Article 15 of the *Arrangement*".

5.97 Thus, we conclude that in the case of regional aircraft, as is the general rule under the *Arrangement*, what is subject to the minimum interest rate rule is official financing support - direct credits/financing, refinancing or interest rate support.

5.98 On the basis of our identification of the *Arrangement's* "interest rates provisions" and of the types of "export credit practices" to which those provisions apply, the only logical conclusion that we can draw is that the only *forms* of export credit practices which at present are potentially eligible for the safe haven are those subject to the interest rate provisions of the *Arrangement* in its current form, namely *direct credits/financing, refinancing and interest rate support*⁸⁴. By implication, this means that the other forms of official support for export credits covered by the *Arrangement* (e.g., guarantees and insurance), are simply not eligible for the safe haven, because they are not covered by the existing interest rate rule, and therefore cannot be "in conformity" or out of conformity with it. Thus, for now, there is no safe haven from

⁸² The Introduction section of the *Arrangement* contains the same definition of "official financing support" as that in Article 15.

⁸³ Canada, in its list of *Arrangement* provisions that it considers to be the interest rate provisions, refers to this provision as relevant in the context of regional aircraft. As noted in footnote 75 above, this is consistent with information provided in the original dispute.

⁸⁴ With repayment terms of two years or more, recalling that the *Arrangement's* coverage is limited to transactions of this maturity.

the prohibition on export subsidies for these forms of official support⁸⁵. Rather, their conformity with the SCM Agreement can only be judged on the basis of Articles 1 and 3 of that Agreement.

5.99 We note that Canada takes a very different position, arguing that export credit insurance and guarantees ("pure cover") also are subject to the "interest rates provisions" of the *Arrangement* and thus are eligible for the safe haven. Specifically, Canada argues that export credit guarantees involve an interest rate in respect of the underlying loan, and that the guaranteed loan itself must respect the relevant interest rate provisions, which for Canada means that the "interest rates provisions" apply to guarantees/insurance as such⁸⁶. On the basis of the above discussion, however, Canada's reading of the *Arrangement* does not seem to be supported by the text thereof, given that Article 15 explicitly omits from its own scope of application guarantees and insurance.

5.100 Moreover, we note that the *Arrangement* establishes explicit rules concerning guarantees and insurance, specifically by establishing minimum premium benchmarks. The minimum benchmarks are set with respect to adequacy of premiums to cover the "sovereign" and "country" credit risk involved in supported transactions. These benchmarks also apply explicitly to official financing support. Thus, both the minimum premium rule and the minimum interest rate rule on their faces make clear whether or not they apply to guarantees and insurance.

5.101 The conclusion that *only* official financing support is potentially eligible for the safe haven does not necessarily mean, however, that *all* official financing support would be eligible. Rather, continuing the logic of the analysis, it would appear that the safe haven could only be potentially available to those specific kinds of official financing support to which the CIRRs (or if applicable, the special minimum interest rates under the *Sector Understandings*) apply, given that these are the *only existing* systems of minimum interest rates under the *Arrangement*. Thus, in the case of regional aircraft, as the CIRRs are the relevant minimum interest rates, it is only support that is subject to the CIRRs with respect to which "conformity" with minimum interest rates - which are exclusively defined in terms of the CIRRs - even would be relevant and could be judged. Thus, the question of which export credit practices pertaining to regional aircraft are potentially eligible for the safe haven in the second paragraph of item (k) cannot be fully answered without considering the nature of the CIRRs.

5.102 Perhaps the most important aspect of the CIRRs⁸⁷ in this regard is that they are *fixed* interest rates established for various currencies, rather than floating rates. In particular, under Article 15 of the *Arrangement*, as a general principle CIRRs are to be established on the basis of fixed interest rate finance over a period of no less than five years. Article 16 provides more specifically that CIRRs generally are to be set at 100 basis points above the medium- to long-term yields on government bonds issued in the relevant currencies. Given that they are expressed solely as *fixed* interest rates,

⁸⁵ As noted above, this by no means rules out the possibility that in the future interest rate provisions might be developed for other types of export credit practices, in which case the safe haven would potentially be available for such practices.

⁸⁶ Canada's reply to the Panel's Canada Account question 2(b) (Annex 2-4) at para. 9.

⁸⁷ As is the case as well for the other specific interest rates in certain of the *Sector Understandings*.

the CIRRs can only meaningfully be applied to transactions with fixed interest rates. That is, there is simply no practical or meaningful way to apply rules concerning minimum *fixed* interest rates to *floating* rate transactions⁸⁸. Thus, we conclude that only official financing support at fixed interest rates is subject to minimum interest rates, given that the CIRRs are expressed as, and thus can only apply to, fixed rate transactions.

5.103 As noted above, Canada argues that Article 17(b) of the *Arrangement* authorizes, and thus makes eligible for the safe haven of item (k), official financing support at floating rates, even where such financing is at a below-CIRR interest rate. In particular, Canada states that Article 17(b) establishes that "the minimum floating interest rate is the 'short-term market rate'"⁸⁹, and further argues that this is "generally understood to refer to international benchmarks such as LIBOR".

5.104 Article 17(b) reads as follows:

"b) Where official financing support is provided for floating rate loans, banks and other financing institutions shall not be allowed to offer the option of the lower of either the CIRR (at the time of the original contract) or the short-term market rate throughout the life of the loan."

Thus, as Canada notes, Article 17(b) does contain a reference to official support for floating rate loans. In our view this text does not, as Canada argues, clearly *authorize* official support for floating rate financing at rates below CIRR⁹⁰, or establish that any such financing is "in conformity" with the interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven in item (k).

5.105 Indeed, Article 17(b) does not set forth *any* specific rules with respect to the absolute or relative levels of interest rates at which floating rate financing can be offered. Rather, Article 17(b) appears exclusively to pertain to (and to prohibit) the possibility that a lender could offer a borrower the option to switch between an interest rate at the CIRR that was prevailing on the date of the original contract and the short-term market rate prevailing at any given moment during the life of the loan. Thus, in our view, the reference to the "short-term market rate" is only a descriptor of the prevailing floating interest rate. In our view, this provision simply recognizes that, over the life of a loan, short-term interest rates may move above and/or below the fixed interest rate that was prevailing at the original date of the loan contract, and establishes a rule prohibiting switching between fixed and floating-rate financing

⁸⁸ Canada also is of this view. (Canada's reply to the Panel's Canada Account question 2(b) (Annex 2-4) at para. 8.)

⁸⁹ Canada's reply to the Panel's Canada Account question 2(b) (Annex 2-4) at para. 8.

⁹⁰ We are aware that the subject of official support at floating interest rates has been under discussion among *Arrangement* Participants for some time (See, e.g., Canada's reply to the Panel's Canada Account question 2(b) (Annex 2-4) at para. 8). Our understanding is that some Participants believe that such support is fully authorized and fully qualifies for the safe haven in the second para. of item (k), while others believe that it is permitted but not subject to any minimum interest rate rule, and still others believe that it is outright prohibited under the *Arrangement*. We note that in any case, Canada has indicated that "except in cases of matching or humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed-rate financing at interest rates at or above CIRR." (Canada's reply to the Panel's Canada Account question 3(d) (Annex 2-4) at para. 1.)

throughout the life of the loan to take advantage of such movements. This is not the same as affirmatively authorizing the provision of floating rate financing at interest rates below the relevant CIRR, or indeed as establishing *any* rule whatsoever concerning minimum levels for floating interest rates. We can find no basis for reading into this provision any such rule, let alone any implicit reference to LIBOR or any other putative "minimum" floating interest rate.

5.106 Thus, on the basis of the foregoing analysis we conclude that the safe haven in the second paragraph of item (k) at present is potentially available *only* to export credit practices in the form of direct credits/financing, refinancing, and interest rate support at fixed interest rates with repayment terms of two years or more⁹¹. In other words, any such practices involving floating interest rates, as well as official support for export credits with shorter maturity or in the forms of guarantees and insurance, because none are *subject to the Arrangement's* "interest rates provisions", most especially the CIRR but also the sector-specific minimum interest rates in the *Sector Understandings*, would not be eligible for the safe haven, as it simply would not be possible to judge their "conformity" with the relevant interest rate provisions of the *Arrangement*, all of which pertain exclusively to fixed rates.

(iv) What Provisions and Considerations are Relevant to Judging "Conformity" with the Arrangement's "Interest Rates Provisions" and Hence Qualification for the Safe Haven in Item (k)?

5.107 Having determined which export credit practices are *potentially* eligible for the safe haven in the second paragraph, we recall that of course, not every individual transaction that is so eligible will necessarily qualify for that safe haven. Rather, to take advantage of the safe haven, eligible export credit practices must be "in conformity with the interest rates provisions"⁹² of the *Arrangement*. Thus, we turn next to the question of how, i.e., on the basis of what provisions and considerations, conformity with the interest rate provisions should be judged.

5.108 It is in this context of "conformity", rather than the context in which it was provided by Canada, that Canada's list of the provisions that it considers to be the "interest rates provisions"⁹³ arguably is most relevant. That is, as noted above, Canada has identified a sizeable list of provisions which it argues must be considered part of the *Arrangement's* "interest rates provisions", because these provisions directly or indirectly affect the amount of interest charged and the timing of when it is paid. In Canada's view, the fact that item (k) refers to "interest rates provisions" and not simply to the "interest rate" means that it must refer to more than the CIRR standing alone. In other words, Canada argues, if this term referred only to the CIRR, the benefit of the safe haven would be extended to financing transactions that apply

⁹¹ Here, we again emphasize that in our view, it would be perfectly possible for minimum interest rates to be negotiated in respect of floating rate transactions. Were this to be done, such transactions in our view would be potentially eligible for the safe haven.

⁹² Second para., item (k), emphasis supplied.

⁹³ Oral statement of Canada (Annex 2-3) at paras. 69-80 and Attachment.

the CIRR, but do not abide by *any* of the other *Arrangement* rules, such as those relating to maximum terms and minimum risk premiums, thereby circumventing the disciplines of the SCM Agreement⁹⁴.

5.109 As discussed above, the text of the *Arrangement* itself seems to define its "interest rates provisions" much more narrowly than argued by Canada. Nevertheless, Canada's basic point is very important, and seems to us to go to the issue of *conformity*. That is, if not *supported* and *reinforced* by provisions related to the financing terms and conditions other than the interest rate, a minimum interest rate rule standing alone could exercise no real discipline on the generosity of terms of official support for export credits. Obviously, any financing transaction has a number of terms and conditions, many of which do directly or indirectly affect the interest rate. These include, as Canada points out, the amount of the cash down payment, the maximum repayment term, the timing of principal and interest payments, maximum "holding periods" or lock-in periods for interest rates, risk premiums, and similar terms. To use an example, if the interest rate of a transaction were fixed at CIRR, but for example the repayment term was 30, 50 or 100 years, or no amortization of principal was required over the life of the loan, the fact that the interest rate respected the CIRR would not in any real sense discipline the terms of the financing. Thus, if the generosity of the other terms and conditions were unlimited, such terms and conditions could completely circumvent any limiting effect that the minimum interest rate rule was intended to exercise.

5.110 Of course, the *Arrangement* does address and set limits with respect to many such terms and conditions, not limited to the minimum interest rate. Thus, in developing an approach for determining whether a given "official financing support" transaction qualifies for the safe haven of the second paragraph of item (k), it would seem appropriate to adopt an approach to the question of "conformity" with the interest rate provisions that is sufficiently broad to capture *not just* conformity with the CIRR standing alone, but *also* respect for the *Arrangement's* limits on the generosity of the other financing terms having an effect on the interest rate. That is, recalling⁹⁵ that the stated purpose of the *Arrangement* is, *inter alia*, to "encourage competition among exporters...based on quality and price of goods and services exported rather than on the most favourable officially supported terms", by placing "limitations on the terms and conditions of export credits that benefit from official support", it would not make sense from the standpoint of the *Arrangement* to so narrowly interpret the concept of "conformity" with the interest rate provisions as to provide an exemption under the SCM Agreement for transactions that unabashedly circumvent that purpose. Nor would such a narrow interpretation make sense from the standpoint of the SCM Agreement, as doing so would have the effect of exempting from the prohibition on export subsidies practices that respected the CIRRs in name only, even if their other terms were so generous as to remove any limiting effect of the minimum interest rate rule.

5.111 In our view, Articles 19(c) and (d) of the *Arrangement* (which concern official support for cosmetic interest rates) appear in effect to establish this very ap-

⁹⁴ Ibid. at paras. 75-77.

⁹⁵ See para. 5.82 *supra*.

proach to judging conformity with the *Arrangement's* interest rate provisions. That is, as discussed above⁹⁶, Articles 19(c) and (d) provide for an evaluation by a Participant of *all terms and conditions* of a transaction in order to judge whether it "conform[s] to the provisions of Article 15", i.e., the minimum interest rate rule.

5.112 Article 27 of the *Arrangement*, concerning the "no derogation engagement", provides further contextual support for this approach to judging conformity with the interest rate provisions, in the sense that it refers to all elements of a financing transaction as parts of a single package. Specifically, under this provision, Participants are not to *derogate* from "maximum repayment terms, minimum interest rates, premium benchmarks, the six-month limitation on the validity period for export credit terms and conditions, or extend the repayment term by extending the repayment date of the first instalment of principal set out in the *Arrangement*". Thus, the *Arrangement* seems to recognize that financing terms and conditions must be treated as a package, and that derogation from one will undercut the others.

5.113 By the same token, however, we do not agree with the very broad reading advocated by Canada of what "conformity" with the interest rate provisions would be, as this reading would sweep in *inter alia* all of the provisions that permit various kinds of exceptions and derogations from some provisions of the *Arrangement* that affect interest rates. In particular, we cannot reconcile identifying as "conforming" with the interest rate provisions any practice that on its face *breaks*, i.e., *does not conform with*, the interest rate rules (even where this is tolerated as matching). Such a reading would seriously undermine the disciplines of the SCM Agreement in the field of export credits. (We discuss the provisions of the *Arrangement* concerning exceptions and derogations in more detail in paragraphs 5.120-5.125, *infra*.)

5.114 Thus, we conclude that full conformity with the "interest rates provisions" - in respect of "export credit practices" subject to the CIRR - must be judged on the basis not only of full conformity with the CIRR but in addition full adherence to the other rules of the *Arrangement* that operate to support or reinforce the minimum interest rate rule by limiting the generosity of the terms of official financing support.

Provisions of the Arrangement imposing disciplines or limits that reinforce the minimum interest rate rule

5.115 A review of the *Arrangement* in the light of the above discussion suggests that the provisions that would need to be respected in order for official financing support to be in full conformity with the interest rate provisions would include, in addition to the provisions concerning the CIRR, most of the articles of Chapter II of the *Arrangement*, along with (for this dispute) most of the articles of Annex III, Parts 2 and 3 (*Sector Understanding* on Export Credits for Civil Aircraft, All New Aircraft Except Large Aircraft (Part 2) and Used Aircraft, Spare Engines, Spare Parts, Maintenance and Service Contracts (Part 3)). These provisions are discussed in detail in this section.

⁹⁶ At paras. 5.89-5.92, *supra*.

5.116 Taking Chapter II of the *Arrangement* first, the first provision thereof, Article 7 on cash payments, limits the generosity of financing terms by establishing a minimum percentage that must be paid in cash (i.e., a maximum percentage that can be financed). Article 8 defines the starting and ending point of the repayment term, Article 9 defines the starting point of credit for different types of contracts, and Article 10 establishes specific maximum repayment terms for different categories of countries. Article 12 establishes criteria and procedures for classifying countries for maximum repayment terms. Article 13 establishes rules concerning the schedule for repayment of principal. Again, the underlying purpose of all of these provisions is to set limits on the generosity of the financing terms.

5.117 Article 14 establishes rules governing the schedule and other aspects relating to the payment of interest, with a view to ensuring that interest is paid at regular intervals over the life of a loan, rather than deferred, again imposing limits on the generosity of the financing terms. Article 20 requires the application of risk premiums at least sufficient to cover sovereign credit risk and country credit risk⁹⁷. (Subsidiary to Article 20, Articles 21, 22, 23, and 24 establish various rules and procedures for setting and verifying the minimum premium benchmarks, on a Participants'-wide basis.) Article 25 sets limits on the amount and kind of official support that can be provided for so-called "local costs"⁹⁸. (According to Canada, the local cost provision is not relevant in the context of aircraft finance⁹⁹.) Finally, Article 26 establishes the maximum validity period for credit terms and conditions for an individual export credit or line of credit, again limiting the generosity of the financing terms and thus reinforcing the minimum interest rate rule.

5.118 Similar provisions pertaining directly to regional aircraft are found in Part 2 of the *Sector Understanding* for civil aircraft (Annex III), pertaining to new aircraft other than large aircraft¹⁰⁰, as well as in Part 3 of that *Understanding*, which pertains to used aircraft (of all sizes), spare engines, spare parts, maintenance and service contracts¹⁰¹. Specifically, Article 21 of the *Sector Understanding* fixes maximum repayment terms for different categories of new "non-large" aircraft and Article 28 does the same for different categories of used aircraft. In addition, Article 23 of the *Sector Understanding*, pertaining to "non-large" aircraft, provides that the insurance premium or guarantee fee shall not be waived in whole or in part. Article 24 of that Annex prohibits aid support except in the form of untied grants, although it appears to permit tied aid for humanitarian purposes¹⁰². Article 29 (a) - (c) of the *Sector Un-*

⁹⁷ The *Arrangement's* risk premium rules apply equally to direct financing, refinancing, guarantees and insurance.

⁹⁸ Article 25 defines local costs as expenditures for goods and services in the buyer's country that are necessary either for executing the contract or for completing the project of which the exporter's contract forms a part, which costs exclude commissions payable to the exporter's agent in the buyer's country.

⁹⁹ Canada's reply to the Panel's Canada Account question 2(a) (Annex 2-4) at para. 4

¹⁰⁰ As indicated above, regional aircraft, i.e. aircraft with no more than 70 seats, are covered by Part 2 of the *Sector Understanding* on civil aircraft.

¹⁰¹ There are also similar provisions in the other *Sector Understandings*, but these are not relevant to this dispute and so are not mentioned here.

¹⁰² We note that in our view it is unlikely that any tied aid for truly humanitarian purposes would be challenged under the SCM Agreement as a prohibited subsidy. As this issue is not before us, we do

derstanding establish limits on the financing terms for spare engines and spare parts, while Article 30 establishes limits on official financing support for maintenance and service contracts.

5.119 Thus, all of the provisions identified above limit the generosity of some aspect of the financing terms where official financing support is provided, and thereby reinforce the minimum interest rate rule. While not all of these provisions would necessarily apply in respect of any given instance of official financing support, under the approach described, those that did apply would need to be respected fully for that transaction to be "in conformity" with the *Arrangement's* interest rate provisions and thus to qualify for the safe haven in the second paragraph of item (k) of the Illustrative List of Export Subsidies¹⁰³.

Provisions of the Arrangement providing for exceptions and derogations

5.120 The final Articles of Chapter 2 (in particular Articles 27 and 29), as well as Articles 25, 29(d) and 31 of Annex III, concern *inter alia* various situations in which certain variations, exceptions and derogations from the *Arrangement's* terms are foreseen and explicitly permitted or not prohibited. Articles 47-53 contain procedures (notifications, etc.) to be followed in these situations. In our view, it is not obvious on its face that sweeping *all* of these provisions into the group of provisions that must be respected for a transaction to be in "conformity" with the interest rate provisions would be consistent with the approach outlined above. This is because these provisions essentially run counter to, rather than reinforcing, the *Arrangement's* minimum interest rate rule and other limits on the generosity of financing terms. Thus, the issue is whether a transaction that makes use of flexibilities and/or outright departures from the rules through any or all of these Articles or any part(s) thereof can be considered to be "in conformity" with the interest rate provisions in the sense of item (k). On the one hand, an argument could be made that anything that is explicitly not prohibited by the *Arrangement* must be *ipso facto* "in conformity" with it, even if it is recognized as a derogation. (This is in fact what Canada argues¹⁰⁴.) On the other hand, if even matched derogations (i.e., *non-conforming* departures from the rules) are considered to be "in conformity", then the notion of "conformity" cannot be understood to represent a discipline or limitation of any kind.

5.121 We note in this context as an initial matter that not all exceptions under the *Arrangement* are necessarily equal. In this regard, Canada itself makes a distinction between "variations", which are "permitted" "within limits" under the *Arrangement*, and the "matching" of terms and conditions that are "outside of the *Arrangement's*

not consider it necessary to make a finding regarding whether any such aid would qualify for the safe haven of the second para. of item (k).

¹⁰³ In this connection, we note that a transaction that involved interest rate support and a guarantee or insurance would need to respect the interest rate provisions of the *Arrangement*, as well as the requirements pertaining to minimum premia and all of the other provisions identified above that applied to the transaction, for that transaction to be "in conformity" with the interest rate provisions of the *Arrangement*. As noted above (at para.5.98) the conformity of insurance or guarantees as such with the SCM Agreement can only be judged on the basis of Articles 1 and 3 of the Agreement.

¹⁰⁴ See, e.g., Canada's reply to the Panel's Canada Account question 3(i) (Annex 2-4).

rules"¹⁰⁵. In its answers to questions, Canada confirms that this distinction is the same as that in the *Arrangement's* Chapter IV (procedures) between "permitted exceptions" and "derogations"¹⁰⁶. Chapter IV makes clear on the one hand that permitted exceptions in fact refer to certain variations in terms that are foreseen and permitted, subject to limits, under various specific provisions of the *Arrangement*. Chapter IV further makes clear on the other hand that derogations are terms and conditions that depart from the *Arrangement's* provisions, i.e., in a way not foreseen and not permitted, even within limits, under the plain language of the *Arrangement*.

5.122 We turn to the specifics of the Articles in question while bearing in mind all of these general considerations. Article 27 of Chapter 2, entitled the "no derogation engagement for export credits", in fact envisages certain deviations. That is, as noted, this Article provides that Participants shall not derogate from maximum repayment terms, minimum interest rates, minimum premium benchmarks, the limitation on the validity period for credit terms and conditions, and shall not extend the repayment term by extending the repayment date of the first instalment of principal per Article 13(a).

5.123 Nevertheless, Article 27 goes on to provide that countries may go below the relevant minimum premium benchmark in certain cases where the country credit risk is "externalised/removed or limited/excluded for the entire life of the debt repayment obligation". Chapter IV (Article 48) explicitly refers to this deviation as a "permitted exception". Article 49 identifies a list of "permitted exceptions" having to do *inter alia* with maximum repayment terms, principal and interest payments, and discounts to minimum sovereign risk premium benchmarks.

5.124 Article 29, on matching, further clarifies the distinction between "derogations" and "permitted exceptions". In particular, while under this Article there is a general permission to match terms and conditions offered by both Participants and non-Participants, some matching, i.e., where Participants "match credit terms and conditions by supporting terms that *comply* with the *Arrangement*"¹⁰⁷ is not considered a derogation. Rather, this seems to refer to matching another country's offer of terms that are within the permitted variations that exist under certain provisions. (For example, under Article 10, there is a certain amount of permitted variation concerning maximum repayment terms, which is explicitly recognized in Article 49 as a permitted exception. Article 51 specifically deals with the matching of permitted exceptions.) Thus, if a country offers terms that are within permitted variations, the *Arrangement* appears to consider that such terms "comply" with the provisions of the *Arrangement*, and that any matching of those terms therefore also "complies". Canada agrees with this interpretation¹⁰⁸.

5.125 On the other hand, Article 29 further provides that if an initiating offer "*does not comply* with the *Arrangement*"¹⁰⁹, competing Participants are permitted to match those non-complying terms. The *Arrangement* defines "derogation" as terms and

¹⁰⁵ Oral statement of Canada (Annex 2-3) at Attachment, introductory para. and para. concerning Article 29.

¹⁰⁶ Reply of Canada to the Panel's Canada Account questions 3(k) and 3(l) (Annex 2-4).

¹⁰⁷ Emphasis supplied.

¹⁰⁸ Canada's reply to the Panel's Canada Account question 3(k) (Annex 2-4).

¹⁰⁹ Emphasis supplied.

conditions that "depart from" the rules of the *Arrangement*¹¹⁰; thus, this reference in Article 29 equates non-compliance with derogation. This reading is confirmed in Article 47(b), which refers to derogations as "*non-conforming* terms and conditions". That is, these parts of the matching provisions confirm that, although matching of derogations is in certain cases not prohibited, this does not alter the fact that both the original derogation and the matching remain, by the *Arrangement's* own terms *out of conformity* with the provisions of the *Arrangement*¹¹¹. We note that Canada takes the opposite view, namely that the initial derogation does not comply with the *Arrangement*, but that matching, because tolerated, does fully comply therewith¹¹². For the reasons discussed above, however, we disagree. In our view, Canada's approach would directly undercut real disciplines on official support for export credits¹¹³.

Conclusion based on textual analysis

5.126 As the foregoing discussion indicates, the text of the *Arrangement* provides considerable guidance concerning how the term "conformity" in the second paragraph of item (k) of the Illustrative List should be understood. In the first place, the *Arrangement* text provides explicitly that derogations from provisions of the *Arrangement*, and the matching of such derogations, do not "conform" with the provisions of the *Arrangement*.¹¹⁴ Thus, any transaction that involves derogations or matching of derogations by definition cannot be in conformity with the *interest rate provisions* of the *Arrangement*, as under the approach outlined above, conformity with the interest rate provisions requires conformity not just with the minimum interest rate rule but also with the other provisions that support/reinforce that rule. As such, an otherwise eligible transaction¹¹⁵ involving derogations or matching of derogations could not qualify for the safe haven of the second paragraph of item (k). On the other hand, the *Arrangement* explicitly defines permitted exceptions and the

¹¹⁰ *OECD Arrangement* Article 47(a).

¹¹¹ We also note, in the context of "derogations", Article 28 of the *Arrangement* which allows action to avoid or minimise losses, i.e., establishment of more favourable terms and conditions than *permitted*, after the contract award, where the sole intention is to avoid or minimise losses from events which could give rise to non-payment or claims. In other words, where a default or similar event has occurred or is likely, renegotiation of more favourable terms than permitted is not prevented by the *Arrangement*. Under the approach outlined, if there were such a renegotiation, a transaction that had previously qualified for the safe haven would fall outside of it to the extent that the renegotiated terms were in fact "more favourable than permitted".

¹¹² Canada does not appear to disagree with the reading that both derogations and matching are out of accord with the *Arrangement's* rules, but nevertheless argues that matching is "compliant" with the *Arrangement* (Canada's replies to the Panel's Canada Account questions 3(i) and 3(l) (Annex 2-4)).

¹¹³ Our analysis of matching of derogations and permitted exceptions applies equally to the relevant provisions of Parts 2 and 3 of the *Sector Understanding* for civil aircraft (i.e., its Articles 25, 29(d) and 31).

¹¹⁴ Canada does not appear to disagree with the reading that both derogations and matching are out of accord with the *Arrangement's* rules, but nevertheless argues that matching is "compliant" with the *Arrangement* (Canada's replies to the Panel's Canada Account questions 3(i) and 3(l)).

¹¹⁵ That is, a transaction at a fixed interest rate involving official financing support.

matching of permitted exceptions, within the allowed limits, to be in compliance, i.e., in conformity with the relevant provisions of the *Arrangement*. Therefore, under this approach, making use of permitted exceptions, within the specified limits, would not disqualify an eligible transaction from the safe haven, so long as the transaction conformed with the minimum interest rate and all of the other applicable disciplines.

5.127 Through the above textual analysis, we have arrived at a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or matching of derogations.

(b) Considerations Based on the Context of the Second Paragraph of Item (k) and the Object and Purpose of the SCM Agreement

5.128 It is clear from the above that a textual analysis leads us to a tentative conclusion that the safe haven in the second paragraph of item (k) of the Illustrative List of Export Subsidies is considerably narrower than argued by Canada. That is, the textual analysis suggests that a number of export credit practices covered by the *Arrangement* would not qualify for the safe haven because of their form or maturity alone (i.e., those not in the form of official financing support, and those with repayment terms of less than two years). The textual analysis also suggests that application of the CIRR (or relevant sector-specific minimum interest rate) by itself, while a necessary condition for "conformity with the interest rates provisions" of the *Arrangement*, is not a sufficient condition therefor; in addition, the other provisions supporting the minimum interest rate rule, to the extent that they apply to a given transaction, also would need to be fully respected for a transaction to be "in conformity" with the interest rate provisions. Thus to the extent that a transaction derogated in some respect from any of those provisions, or involved matching of another country's derogation, that transaction would not be "in conformity" with the *Arrangement's* interest rate provisions.

5.129 In our view, this reading of the text of the second paragraph of item (k) and of the *OECD Arrangement* is the most natural and logical reading, as it flows from the words of those texts. We recognize, however that there is another possible reading of these provisions, namely the broad reading advocated by Canada. In considering this alternative reading, we note that it is incumbent upon us to try to resolve any ambiguities in the texts in a manner which is the most consistent possible with the object and purpose of the SCM Agreement and of the WTO Agreement. In our view, the

object and purpose of the SCM Agreement and the WTO Agreement do not support the textual analysis proposed by Canada. Rather, they support the textual analysis developed by the Panel above.

5.130 In particular, under Canada's approach, all *substantive* provisions of the *OECD Arrangement* would be considered its "interest rates provisions" and all "export credit practices" which conformed to those of the "interest rates provisions" applicable to them would be "in conformity with" the interest rate provisions of the *OECD Arrangement*. That is, under this approach, the term "interest rates provisions" would be understood as a means of distinguishing the *substantive* from the *procedural* provisions of the *Arrangement*, in recognition of the fact that non-Participants cannot use those procedural provisions. In other words, the safe haven would be understood to apply to all types of practices covered by the *Arrangement* that are in compliance with the relevant substantive provisions of the *Arrangement*, whether or not any minimum interest rate applied in respect of the export credit practice in question¹¹⁶.

5.131 One implication of the broad approach in this context is that any practice that *is not out of conformity* with the relevant provisions of the *Arrangement*, whether or not even covered by provisions explicitly pertaining to interest rates, would qualify for the safe haven in item (k)¹¹⁷. In this regard, matching of derogations, because tolerated although not in compliance, would be considered to be "in conformity" under this approach. We note that the main argument in support of this sort of a broad reading of the term "in conformity with the interest rates provisions", would be that the Participants to the *OECD Arrangement* would not have on the one hand negotiated for themselves a set of rules in the OECD with a broad scope, covering, regulating in different ways, and permitting a variety of practices, and on the other hand negotiated a safe haven in item (k) of the SCM Agreement covering only a subset of those practices.

¹¹⁶ Thus, under Canada's approach, in addition to direct financing, refinancing and interest rate support, which are subject to the minimum interest rate rule, guarantees and insurance, which are subject to other rules but not to the minimum interest rate rule, would be eligible for the safe haven. In addition, Canada argues that "matching" of "derogations" also would be eligible for it, on the basis that such matching is not prohibited. Derogations are terms and conditions that do not comply with the *Arrangement*. As noted, the *Arrangement* does not prohibit Participants from matching the terms of such derogations/non-compliant terms offered by Participants as well as non-Participants.

¹¹⁷ One example is that of export credit guarantees, which as discussed above, are subject under the *Arrangement* to rules concerning minimum premiums, but are not subject to any specific provision on interest rates. Under this broad approach, so long as this general rule was respected, such guarantees would qualify for the safe haven, even if the provision of the guarantee allowed the interest rate to fall below the minimum interest rate (the CIRR). Because the minimum interest rate rule does not apply to guarantees, under this interpretation that rule would not act to limit the eligibility of the guarantee for the safe haven, in spite of the guarantee's effect on the interest rate. Another example would be the provision of floating rate financing. Here again, because the CIRR is only expressed in terms of fixed interest rates, it cannot be applied to floating rate financing. Thus, this approach would say that floating rate financing which respected other provisions concerning financing (e.g., cash payments, maximum financing terms, etc.) would qualify for the safe haven, even if the interest rate were set far below the market rate, on the basis that by not being covered by the CIRR it was not out of conformity with it, and thereby was in conformity with it.

5.132 In considering this alternative approach, we note first that the second paragraph of item (k) is quite unique in the sense that it creates an exemption from a prohibition in a WTO Agreement, the scope of which exemption is left in the hands of a certain *subgroup* of WTO Members - the Participants, all of which as of today are OECD Members - to define, and to change as and when they see fit. Given this, it is important that the second paragraph of item (k) not be interpreted in a manner that allows that subgroup of Members to create for itself *de facto* more favourable treatment under the SCM Agreement than is available to all other WTO Members. The *OECD Arrangement*, as a plurilateral arrangement to which most WTO Members are not Participants, clearly has the *potential* to give rise to such differential treatment of Participants and non-Participants.

5.133 Related to this, i.e., because the *Arrangement* as such is in the hands of a subgroup of WTO Members, it is important that any interpretation of the second paragraph of item (k) provide clarity and certainty concerning what the (SCM Agreement) rules are and how to comply with them. Thus, any interpretation should be clear and transparent, and capable of application by all Members, rather than left to the discretion of individual Members or groups of Members.

5.134 In our view, the reading advocated by Canada would pose serious problems in respect of these important considerations. In particular, information about the actions of Participants is available *only* to Participants. None of this information is published, nor can it be obtained upon request by non-Participants. Thus, a reading that would, for example, include within the safe haven in the second paragraph of item (k) a transaction involving matching of a derogation, would put all non-Participants at a systematic disadvantage as they would not have access to the information about the terms and conditions being offered or matched by Participants. This concern obviously is relevant as well to the issue of transparency and clarity of the rules. We note that the CIRRs and the sector-specific interest rates are published. Therefore, all WTO Members, whether Participants or not, can offer financing on terms consistent with the minimum interest rates¹¹⁸. Similarly, the text of the *Arrangement* itself sets forth the limits to most of the permitted exceptions. Thus these as well can be applied by all WTO Members, whether Participants or not¹¹⁹. Financing terms and conditions known only to Participants clearly cannot be universally applied.

¹¹⁸ We note that, by contrast, no information is published on the minimum premium benchmarks. Thus, only Participants have access to this information. Given this, it is at present impossible for a non-Participant to have any idea whether a given transaction respects the rules concerning minimum premiums. Thus, until such time as the Participants make this information publicly available, non-Participants should be presumed to be respecting the minimum premium rules in the context of any analysis under the second para. of item (k). Canada also has recognized this issue and come to the same conclusion. In particular, Canada states that "it would be unreasonable to expect a non-OECD WTO Member to charge a premium level which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the *Arrangement*. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second para. of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants" (Canada's reply to the Panel's Canada Account question 3(h)).

¹¹⁹ As in the case of minimum premiums, however, where the *Arrangement* text does not set forth explicit limits to permitted variations (e.g., Article 49(a)(2) of the *Arrangement*) and no information

5.135 We note further in this context the particular potential for different, indeed *stricter*, rules *de facto* applying to developing than to developed countries, or at a minimum for developed countries to be able *de facto* to enjoy the same less strict rules as are provided *de jure*, through the SCM Agreement's special and differential treatment provisions, to developing countries. Arguably, such situations would be out of keeping with one of the key stated purposes of the WTO Agreement, namely the need for positive efforts on behalf of developing countries (which is the basis for the extensive special and differential treatment provisions of the SCM Agreement)¹²⁰.

5.136 In particular, the broad approach advocated by Canada would in fact raise the issue of structural inequity in respect of developing countries. Specifically, this approach could result in either more favourable treatment, *de facto*, for developed compared to developing countries, or the *de facto* elimination of special and differential treatment for developing countries. An example of the first case would be provision of a government guarantee, which on its face is not subject to any interest rate rule. In practical terms, an interpretation of item (k) that would allow any government to make available to a borrower its own cost of borrowing through the provision of a guarantee and have that guarantee qualify for the protection of the second paragraph of item (k), irrespective of the interest rate applied, would generate a result that was systematically skewed in favour of developed countries. This is because developing countries' cost of borrowing will normally be higher than that of developed countries, meaning that the former arguably could never meet the financing terms offered by the latter. An example of the second case would be a reading of item (k) whereby a developed country could match the (subsidized, but because of SCM Article 27 not prohibited) terms offered by a developing country, and qualify for the protection of the second paragraph of item (k). In this case, special and differential treatment *de facto* would be eliminated.

5.137 Third, it is important to keep in mind the role of the safe haven in the second paragraph of item (k) in the overall context of the prohibition on export subsidies. In particular, we note that export subsidies are prohibited because of their direct trade-distortive effects, and that among the various forms of export subsidies, subsidized export credits arguably have the most immediate and thus greatest potential to distort trade flows. In view of this, we believe that an interpretation of item (k) that would create a very broad exemption from prohibition in respect of export credits would not be consistent with the purpose of that prohibition in the context of the SCM Agreement. In particular, the broad reading would significantly weaken any actual disciplines on export credits and related practices. In effect, this approach would say that practices not explicitly subject to the CIRR but in conformity with other provisions of the *Arrangement* could have effective interest rates well below CIRR and nevertheless be protected by the second paragraph of item (k). Under this approach as

is published concerning specific cases of such variations, non-Participants should be presumed to be respecting such limits in the context of any analysis under the second para. of item (k).

¹²⁰ The Preamble to the WTO Agreement states that "there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development". Article 27 of the SCM Agreement, special and differential treatment of developing country Members, makes operational this principle in the context of the WTO rules on subsidies.

well, matching of derogations no matter how low the interest rate or how generous the other terms also would qualify for that protection, even where the initiator of the derogation was not a WTO Member. In such circumstances, there would be no real disciplines of any kind on export credits. Such a reading of the *Arrangement* and of item (k) at a minimum would raise the question of why either of these sets of rules was necessary.

5.138 Moreover, this latter situation would have the unheard-of result of allowing WTO Members to opt out of WTO rules on the basis of the behaviour of non-WTO Members. An interpretation that would excuse non-conformity with the SCM Agreement on the grounds that such behaviour was necessitated by the behaviour of non-WTO Members, would be unacceptable¹²¹, and would represent a radical and unjustifiable departure from all practice under GATT and WTO. In no case to date has any Member's conformity with GATT/WTO rules been defined by the behaviour of non-Members.

5.139 Finally, in our view the negotiating history of this provision does not support the broad reading advocated by Canada. In particular, we note that an early (if not the first) Tokyo Round proposal concerning this provision referred to the broad term "substantive guidelines", rather than the narrower term "interest rates provisions". (Proposal of the United States dated 6 December 1978.) The proposal did not identify or define this term, however. The reference to "substantive" provisions was not pursued in the negotiations, as the first version to be included in a Chairman's draft text of the Tokyo Round Subsidies Code of what became the second paragraph of item (k) (dated 15 December, 1978, just two weeks after the US proposal), already referred to the narrower term "interest rates provisions".

5.140 In sum, we recognize that there is another possible reading of the second paragraph of item (k) and of the *OECD Arrangement*. In our view, however, such a reading generates a result that in addition to being much more difficult to sustain on the basis of a textual analysis, is simply inconsistent with the overarching principles and purposes of the WTO Agreement and the SCM Agreement, including by introducing an imbalance of Members' rights and obligations to the detriment of developing countries.

- (c) The Sufficiency of the Policy Guideline to Ensure that Future Canada Account Transactions in the Regional Aircraft Sector will Qualify for the Safe Haven of the Second Paragraph of Item (k), and that Prohibited Export Subsidies under Canada Account Thereby Have Ceased

- (i) Substance of the Policy Guideline

5.141 Having confirmed our approach to determining whether an individual transaction qualifies for the safe haven of the second paragraph of item (k), we turn now

¹²¹ E.g., if there were no limits on offering equivalent terms and conditions to those offered by a non-WTO Member.

to the question at the heart of this dispute in respect of Canada Account, namely whether the Policy Guideline is sufficient to ensure that future Canada Account transactions in the regional aircraft sector will qualify for that safe haven, and that prohibited export subsidies under Canada Account in that sector thereby have ceased. We note as an initial matter the case-by-case nature of the required analysis outlined above. Because of this, there is a limit on the extent to which we can judge definitively today whether a given future Canada Account transaction in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k).

5.142 This being said, however, we recall that in Brazil's view, "the minimum burden accorded to Canada must be to explain with some precision what 'comply with the OECD Arrangement' will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in the future". Given that Canada has stated that the Policy Guideline "ensure[s] that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)"¹²², in our view it is incumbent upon Canada to provide an explanation not only of what in its view constitutes conformity with the interest rate provisions of the *OECD Arrangement*, but also how the Policy Guideline ensures such conformity.

5.143 We note that Canada has in fact provided certain explanations on these points¹²³. As discussed in the previous sections, the approach to this question that we have adopted differs considerably in substance from the approach advocated by Canada, however. Thus, even if the Policy Guideline contained all of the details that Canada has provided in its arguments concerning "conformity" with the "interest rates provisions" of the *Arrangement*, we would find on substantive grounds that it would not ensure that future Canada Account transactions would so conform. We note, however, that in fact the Policy Guideline contains no details at all, but simply indicates that transactions that "do not comply" with "the OECD Arrangement" will not be considered to be in the national interest. Thus, we find that the Policy Guideline is insufficient to accomplish what Canada says it will accomplish, namely to "ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)".

5.144 In particular, the Policy Guideline is both generally worded and worded in the negative. In both of these aspects it seems to fall considerably short of what might reasonably be considered the minimum sufficient assurance which Canada wishes to provide. Concerning the generality of the wording, as just noted, the Policy Guideline simply refers to compliance with the *OECD Arrangement*. As has been discussed in detail, however, general conformity with whichever provisions of the *Arrangement* happen to apply to a given transaction would not appear to be sufficient to qualify for the relatively narrow safe haven in the second paragraph of item (k). Rather, only conformity with the *Arrangement's* interest rate provisions, *which presupposes that those provisions apply* (i.e., that the practice in question is in the form

¹²² Oral statement of Canada (Annex 2-3) at para. 67.

¹²³ *Ibid.* at paras. 69-80 and Attachment.

of official financing support at fixed interest rates), along with conformity with the *Arrangement's* other disciplines on financing terms, would qualify a practice for the safe haven.

5.145 The negative wording of the Policy Guideline raises a similar concern. Specifically, the Guideline provides that any transaction or class of transactions that "*does not* comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits *would not* be in the national interest"¹²⁴, which under the governing legislation means that they cannot be authorized. This is not necessarily the same thing, however, as saying that *only* transactions that *do* comply *will* be considered to be in the national interest (and thereby can be authorized). In particular, this wording leaves open the possibility that transactions that are *not subject* to the interest rate provisions of the *Arrangement* (i.e., the CIRR) might be authorized on the grounds that they could not be deemed to be *out of compliance*, as the relevant provisions would not even apply. As discussed, however, we have found that any such transactions would not qualify for the safe haven.

5.146 In response to a question from the Panel concerning the negative wording of the Guideline, Canada argues that the use of the negative is necessary to preserve the discretion of the Minister *not* to authorize a transaction even if it does comply with the *Arrangement*, if the transaction is otherwise considered not to be in the national interest. We are not persuaded by this answer, however, as in our view it would be possible to craft affirmatively-worded language that would leave open this discretion¹²⁵.

5.147 We consider that for Canada to reasonably ensure (which it indicates is its intention) that future Canada Account transactions in the regional aircraft sector *will* qualify for the safe haven of the second paragraph of item (k) and therefore *will not* be prohibited export subsidies, a great deal more detail than is contained in the Policy Guideline would be needed, in particular, the following:

- (a) That all Canada Account transactions in the regional aircraft sector would take the form of either direct credits/financing, refinancing or interest rate support (i.e., official financing support) with repayment terms of two years or more;
- (b) That such official financing support would be at fixed interest rates;
- (c) That the net interest rates¹²⁶ of all such transactions would be at or above the relevant CIRR;
- (d) That all applicable provisions of Articles 7-10 and 12-26 of the *Arrangement*, and of Articles 18-24¹²⁷ and Articles 27-29(a)-(c) of Annex III would be respected in full;

¹²⁴ Exhibit CDN-13. Emphasis supplied.

¹²⁵ An example of such language could be along the lines that conformity with the interest rate provisions of the *Arrangement* would be treated by the Minister as a *necessary* but not necessarily sufficient condition for a Canada Account transaction to be considered to be in the national interest.

¹²⁶ In the case of interest rate support, the concept of *net* interest rates is key, as it is the interest rate *after* the support that must respect the CIRR.

¹²⁷ The reference to Article 24 of Annex III in this context is in respect of the requirement that no aid support be provided except in the form of an untied grant. As indicated above (at footnote 102) we make no finding concerning tied aid for humanitarian purposes.

- (e) That any permitted exceptions would be within the limitations specified in the relevant provisions of the *Arrangement*;
- (f) That no derogations would be made, either at Canada's initiative or via matching.

5.148 Given the lack of such detail, therefore, we find that Canada has not accomplished what it states it intends to accomplish through the Policy Guideline, namely to ensure cessation of prohibited export subsidies to the regional aircraft under Canada Account by ensuring that all future Canada Account transactions in the regional aircraft sector will qualify for the safe haven in the second paragraph of item (k).

(ii) Form of the Policy Guideline

5.149 In conjunction with its substantive criticisms of the Policy Guideline, Brazil appears also to consider its *legal form* inadequate, as in Brazil's view it contains only a general hortatory intention to comply with the *OECD Arrangement*. That is, Brazil argues that "at the implementation stage of dispute settlement proceedings, when a Member has already been found to be in violation of its WTO obligations, ... unelaborated policy guidelines offering vague hortatory statements regarding the Member's intentions do not constitute effective implementation"¹²⁸. In answer to a Panel question seeking clarification of why Brazil believes the Guideline to be only hortatory, Brazil argues that under Canadian law, Policy Guidelines are not binding and cannot fetter Ministerial discretion. That is, they provide guidance on how decision makers will exercise their discretion but they are not binding and do not require a specific outcome. In Brazil's view, for the Guideline to become mandatory under Canadian law, at a minimum mandatory language would need to be used, and provision would need to be made for consequences in the event of non-compliance¹²⁹.

5.150 Canada argues that through the Policy Guideline, the Minister for International Trade has adopted the policy that "*only* those transactions that comply with the *OECD Arrangement* will be considered to be in the national interest"¹³⁰. Canada further argues that "by this policy, the Minister informs EDC *and the world* that he will not authorize any financing transaction under the Canada Account programme unless it complies with the *OECD Arrangement*"¹³¹.

5.151 In response to a question from the Panel as to whether Canada considers that it has "undertaken" to respect all of the provisions of the *OECD Arrangement* and whether Canada considers that any such undertaking is legally binding on Canada, Canada states that Canada has "undertaken" to respect all of the provisions of the *OECD Arrangement* with respect to financing transactions under the Canada Account, and that through the Policy Guideline the Minister has "undertaken" not to authorise any financing transaction under Canada Account that does not comply with the *OECD Arrangement*. In Canada's view, for all practical purposes the effect of the Guideline is "almost the same" as that of a legislative instrument, because the exercise of discretion under the Canada Account programme is in the hands of the Min-

¹²⁸ Second submission of Brazil (Annex 1-2) at para. 72.

¹²⁹ Brazil's answer to the Panel's Canada Account question 1 to Brazil (Annex 1-5).

¹³⁰ First submission of Canada (Annex 2-1) at para. 57. (Emphasis in original.)

¹³¹ *Ibid.* at para. 58. (Emphasis supplied.)

ister and it is the Minister who has given the undertaking. Canada states that in addition, officials administering the programme and/or referring financing transactions to the Minister for authorization will act in accordance with the Guideline. In Canada's view, the Guideline is effective in *requiring* that all Canada Account financing transactions in the regional aircraft sector will comply with the *OECD Arrangement* and thereby comply with the interest rates provisions of the *Arrangement*¹³². Thus Canada emphasizes that, contrary to Brazil's argument, the Guideline is "serious and effective" and "not at all hortatory"¹³³.

5.152 We recall Brazil's statement concerning what it believes Canada's implementation obligation to be in respect of Canada Account, namely that "vague hortatory statements of a Members intentions" are not enough, and that Canada's "*minimum burden* ... must be to explain with some precision what 'comply with the OECD Arrangement' will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in the future"¹³⁴. Thus, Brazil's arguments concerning the Guideline's form are closely linked to its arguments concerning the Guideline's substance. As discussed above, we have found that the Policy Guideline's *substance* is not sufficiently precise to accomplish what Canada claims it will accomplish, that is, to *ensure* the definitive cessation of prohibited export subsidies to the regional aircraft sector under Canada Account. Accordingly, we do not need to, and do not, make a separate finding concerning the sufficiency of the legal *form* of the Guideline. We do note in principle, however, that whatever form a Member's implementation of a Panel ruling takes, it should involve sufficient limitation of discretion as to render that implementation legally effective.

(d) Summary

5.153 In summary, we have established a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). This process is based on the text of the SCM Agreement and the *OECD Arrangement*, read in the light of the object and purpose of the SCM Agreement. Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or

¹³² Canada's reply to the Panel's Canada Account question 4 (Annex 2-4).

¹³³ Canada's comments on Brazil's answers to question 1 from the Panel to Brazil (Annex 2-5).

¹³⁴ Second submission of Brazil (Annex 1-2) at para. 76. (Emphasis supplied.)

matching of derogations. We have applied this process to the Policy Guideline, and found that the Policy Guideline is not sufficient to ensure that future Canada Account transactions in the regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and thereby qualify for the safe haven in the second paragraph of item (k) of Annex I of the SCM Agreement.

VI. CONCLUSION

6.1 For the reasons set forth in this Report, and on the basis of those facts currently surrounding the application of the restructured TPC programme which are relevant to Canada's implementation of the DSB recommendation on TPC assistance to the regional aircraft industry, we conclude that Canada has implemented the DSB recommendation in respect of TPC assistance to the Canadian regional aircraft industry. However, we conclude that the measures taken by Canada to comply with the DSB recommendation on the application of the Canada Account programme are not sufficient to ensure that future Canada Account transactions in the Canadian regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and are therefore not sufficient to ensure that such Canada Account transactions will not be prohibited export subsidies.

6.2 Accordingly, we conclude that (1) Canada has implemented the 20 August 1999 DSB recommendation that Canada withdraw TPC assistance to the Canadian regional aircraft industry within 90 days, and that (2) Canada has failed to implement the 20 August 1999 recommendation of the DSB that Canada withdraw the Canada Account assistance to the Canadian regional aircraft industry within 90 days.

6.3 Canada requests that we suggest, pursuant to Article 19.1 of the DSU, the establishment of verification procedures in respect of Canada's future arrangements to bring any subsidies in respect of Canada Account financing transactions for regional aircraft into compliance with the SCM Agreement, provided that such procedures are also applicable to Brazil with respect to its implementation of the rulings and recommendations in *Brazil- Export Financing Programme for Aircraft*. Canada asks only that the Panel endorse the establishment of such verification procedures, and is not proposing an ongoing role for the Panel should a verification process be established. Brazil does not, in principle, oppose the establishment of such verification procedures, but considers that they are not compatible with the spirit, if not the letter, of Article 19 of the DSU. Brazil believes that such procedures are better agreed to by the parties in the course of bilateral consultations.

6.4 We note that, by virtue of Article 19.1 of the DSU, the Panel "may suggest ways in which the Member concerned could implement the recommendations". In our view, Article 19.1 envisions suggestions regarding what could be done to a measure to bring it into conformity or, in the case of Article 4.7 of the SCM Agreement, what could be done to "withdraw" a prohibited subsidy. It does not address the issue of surveillance of those steps. For that reason, we decline to make the suggestion requested by Canada.¹³⁵

¹³⁵ This does not mean that the Panel in any way discourages agreements between WTO Members that may facilitate transparency with regard to the implementation of WTO obligations.

ANNEX 1-1**FIRST SUBMISSION OF BRAZIL
(23 December 1999)****TABLE OF CONTENTS**

	Page
I. INTRODUCTION	4370
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS	4371
A. Canada Should Withdraw the TPC Programme Entirely, as it Relates to the Regional Aircraft Industry	4371
B. Canada's Implementation Strategy does not Change the Status of TPC Contributions as Subsidies under Article 1 of the Subsidies Agreement	4371
C. The Amendments to the TPC Programme are Cosmetic, and do not Change the Status of TPC Contributions to the Canadian Regional Aircraft Industry as De Facto Export Contingent under Article 3 of the Subsidies Agreement	4372
1. The Canadian Regional Aircraft Industry Remains Export-Oriented, and the Canadian Government's Recognition of the Significance of that Export-Orientation Is Still Evident	4374
2. Canada's Removal of the "Near to Market" Terminology from TPC Documents Is Irrelevant	4376
3. The Goals and Objectives of the TPC Programme Remain Intimately Linked to Export	4378
4. Canada Has Failed to Provide Many Documents Necessary to Determine Whether the 'New' TPC Programme Remains De Facto Contingent on Export	4381
III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS	4382
IV. CONCLUSION	4384
LIST OF EXHIBITS	4385

I. INTRODUCTION

1. In *Canada - Measures Affecting the Export of Civilian Aircraft*¹, subsidies by the Canadian government to the regional aircraft industry *via* two programmes - Canada Account and Technology Partnerships Canada ("TPC") - were determined by this Panel and the Appellate Body to constitute prohibited export subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement"). Pursuant to Article 4.7 of the Subsidies Agreement, the Panel and the Appellate Body identified the subsidies to be withdrawn by Canada: Canada Account debt financing for the export of Canadian regional aircraft, and TPC assistance to the Canadian regional aircraft industry.²

2. The Panel's and the Appellate Body's recommendations and rulings regarding Canadian withdrawal of these subsidies were adopted by the Dispute Settlement Body ("DSB") on 20 August 1999. On 18 November 1999, the 90-day period for implementation of the DSB's recommendations and rulings expired. On 19 November 1999, Canada announced measures ostensibly constituting implementation of the DSB's recommendations and rulings. Brazil has attached Canada's 19 November 1999 letter to the DSB, and its 19 November 1999 statement to the DSB, as Exhibits Bra-1 and Bra-2, respectively.

3. The Canadian measures do not adequately implement the DSB's recommendations and rulings, and the impugned programmes remain inconsistent with the Subsidies Agreement. As a result, and under Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Brazil requested that the DSB refer the matter to this Panel for resolution.³ Pursuant to that request, the Panel was established on 9 December 1999.

4. Brazil will demonstrate in this submission that the measures heralded by Canada as effective implementation of its obligations under the Subsidies Agreement are little more than cosmetic, and make no substantive changes to the underlying subsidy programmes. Accordingly, Brazil reiterates its request that the Panel resolve, in these proceedings, the disagreement between Brazil and Canada regarding "the existence or consistency with [the Subsidies Agreement] of measures taken to comply with the recommendations and rulings of the DSB."⁴

¹ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443. [hereinafter "Panel Report"]; Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/AB/R, adopted 20 August, 1999, DSR 1999:III, 1377. [hereinafter "Appellate Body Report"].

² Panel Report, *Canada - Aircraft*, *supra*, footnote 1, paras. 10.1 ((b) and (f)), 10.3; Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 221.

³ Brazilian Letter to DSB, 23 November 1999 (Exhibit Bra-3).

⁴ DSU, Article 21.5.

II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS

A. Canada Should Withdraw the TPC Programme Entirely, as it Relates to the Regional Aircraft Industry

5. Canada's amendments to the TPC programme neither implement the recommendations and rulings of the DSB, nor bring TPC into conformity with the Subsidies Agreement. First, Canada's actions do not remove TPC contributions from the category of government financial contributions that confer a "benefit" and constitute a "subsidy." Second, *de facto* export contingency is still "*inferred*" from the total configuration of the facts constituting and surrounding" any TPC contributions to the Canadian regional aircraft industry.⁵

6. Particularly with regard to *de facto* export contingency, the cosmetic changes undertaken by Canada and described below are simply not enough. Were they sufficient, the entire purpose behind the prohibition of *de facto* export contingency in Article 3.1(a) of the Subsidies Agreement - to prevent circumvention of the provision prohibiting *de jure* export contingency - would be undermined.⁶ Withdrawing a *de facto* export subsidy like TPC, the very design and structure of which betrays its *de facto* export contingency, cannot adequately be achieved without complete and total abolition of the TPC programme altogether, as it applies to the Canadian regional aircraft industry.

7. The facts surrounding TPC's structure, objectives and economic backdrop, and the facts surrounding assistance to the regional aircraft industry, require this result to rid the programme of any remaining "inference" of *de facto* export contingency. This result, in fact, is also supported by the textual interpretation of the term "subsidy" proposed by Canada itself. Before the Appellate Body, Canada argued that the terms "[s]ubsidy" and "subsidy programme" are used interchangeably" in the Subsidies Agreement, and that TPC was a "subsidy programme" cognizable under the Subsidies Agreement.⁷ If this is the case, then the DSB's recommendation, pursuant to Article 4.7 of the SCM Agreement, that Canada "withdraw the subsidy," further confirms that Canada is required to withdraw TPC, in its entirety, as it relates to the regional aircraft industry.

B. Canada's Implementation Strategy does not Change the Status of TPC Contributions as Subsidies under Article 1 of the Subsidies Agreement

8. The status of TPC contributions as "subsidies" under Article 1 of the Subsidies Agreement remains unchanged by Canada's implementation strategy. TPC contributions are still "financial contribution[s] by a government," under Article

⁵ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 167.

⁶ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 19.

⁷ Submission of Appellant Canada, 13 May 1999, paras. 45-46 (Exhibit Bra-28).

1.1(a)(1) of the Subsidies Agreement. TPC's Special Operating Agency Framework Document ("TPC Framework Document") - the document that replaced, with only slight modifications, the "old" TPC Charter⁸ - states that "TPC's activities are funded through Parliamentary appropriations."⁹ Canada's announcements regarding implementation also do not suggest that TPC contributions are no longer provided in one of the forms listed in sub-paragraphs (i) through (iv) of Article 1.1(a)(1) to the Subsidies Agreement.

9. Canada has not, moreover, demonstrated that TPC contributions will no longer confer a "benefit" within the meaning of Article 1.1(b). The "benefit to recipient" standard adopted by the Panel, and affirmed by the Appellate Body, states that a "benefit" exists if a recipient has "received a 'financial contribution' on terms more favourable than those available to the recipient in the market."¹⁰ Indeed, the Panel determined that while TPC's rate of return on its contributions to the regional aircraft industry was projected at a maximum of [] per cent,¹¹ a commercial investor would expect a rate of return of 19.91 - 21.92 per cent on a similar investment. TPC contributions, therefore, are still on terms more favourable than those available to the recipient on the market.

10. TPC's most recent annual report, moreover, distinguishes TPC from commercial financial lenders: "[U]nlike commercial financial institutions that measure return solely in financial terms, the return to TPC is also measured in terms of a broad range of non-financial benefits to Canada that flow from successful projects."¹² The annual report also notes that given the failure of some TPC-funded projects, "TPC's expected repayment may be less than nominal."¹³

11. Under these circumstances, TPC contributions, even after implementation of Canada's purported compliance measures, continue to confer "benefits" and continue to constitute "subsidies" under Article 1.1(b) of the Subsidies Agreement.

C. The Amendments to the TPC Programme are Cosmetic, and do not Change the Status of TPC Contributions to the Canadian Regional Aircraft Industry as De Facto Export Contingent under Article 3 of the Subsidies Agreement

12. Canada's amendments to TPC are merely cosmetic, and do not constitute effective implementation of its obligations under the Subsidies Agreement. Even after the amendments to TPC:

the same three industry sectors will receive TPC assistance;

⁸ Superseded TPC Charter (*in* TPC Interim Reference Binder, March 1998) (Exhibit Bra-4).

⁹ TPC Special Operating Agency Framework Document, pg. 6 (Exhibit Bra-5) [hereinafter "TPC Framework Document"].

¹⁰ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 157; Panel Report, *Canada - Aircraft*, *supra*, footnote 1, para. 9.112.

¹¹ Panel Report, *Canada - Aircraft* *supra*, footnote 1, para. 9.312. *See also* Canada's reply to questions from the Panel, dated 21 December 1998, reply to question 33.

¹² TPC Annual Report, 1998-1999, pg. 20 (Exhibit Bra-6).

¹³ *Id.* at pg. 21.

- the same types of projects will be eligible for TPC funds;
- the same objectives and fundamental economic realities underlie TPC's creation and continued existence;
- the aerospace industry continues to receive far and away the greatest share of TPC contributions and disbursements; and,
- the Canadian aerospace industry in general, and the regional aircraft industry in particular, remains export-oriented.

13. The only real difference - apart from the fact that Canada forecasts available TPC funds to increase by 396 *per cent* between now and 2003¹⁴ - is that the word "export" is less ubiquitous than it was previously, at least in those documents made publicly available by the Canadian government.

14. This is not enough. As the Panel is aware, subsidies provided to the Canadian regional aircraft industry under the auspices of the TPC were found to be prohibited export subsidies *in fact*, rather than in law. A determination that subsidies are "contingent ... in fact ... upon export performance," in the words of the Appellate Body, "must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy ..." ¹⁵ This is distinct from a determination of *de jure* export contingency, which is demonstrated "on the basis of the words of the relevant legislation, regulation or other legal instrument." ¹⁶

15. Merely sanitizing publicly-released documents to remove references to the word "export" is not sufficient to bring Canada into compliance with this Panel's determination of *de facto* export contingency. According to the Appellate Body, demonstration of *de facto* export contingency depends not upon uncovering express reference to "export" as a condition for receipt of a subsidy (although such references abound in Canadian materials), but rather depends on the *inference* of export contingency drawn from the totality of the facts. This is the entire purpose of the *de facto* export contingency provision - to prevent Members from circumventing the prohibition of *de jure* export contingency by merely purging all references to the term "export." ¹⁷ It is this question of proof - demonstrating *express* contingency on export versus *inferred* contingency on export - that defines the very difference between a *de jure*, as opposed to a *de facto*, case.

16. Canada's implementation measures change only the superficial evidence of export contingency, but make no substantive change whatsoever in the underlying programme. *De facto* export contingency is still, in the words of the Appellate Body, "*inferred* from the total configuration of the facts constituting and surrounding" any TPC contributions to the Canadian regional aircraft industry, regardless of Canada's

¹⁴ TPC Annual Report, 1998-1999, pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6).

¹⁵ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 167 (emphasis in original).

¹⁶ *Id.*

¹⁷ *Id.* The European Communities initially proposed the *de facto* contingency prohibition "since experience has shown that government practices may be easily manipulated or modified in order to avoid this [*de jure*] prohibition," which on its own is therefore "open to circumvention." *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989).

efforts to purge from its documents express reference to the word "export."¹⁸ TPC's structure, objectives and economic backdrop require this inference, and thus require a determination that Canada has not complied with the recommendation and ruling of the DSB that Canada "withdraw the subsidy."

17. Canada may assert, as it has previously, that Brazil's claim of Canadian non-compliance rests solely on the fact that TPC subsidies are granted to "enterprises that export," a fact that, while certainly relevant to the Panel's review,¹⁹ cannot (under footnote 4 to the Subsidies Agreement) form the entire basis of a determination of *de facto* export contingency. In the sections to follow, however, Brazil will describe a *series of facts* both related to and apart from the export orientation of the Canadian regional aircraft industry. These facts, together, lead to the very same inference derived by the Panel in its original decision: TPC contributions to the Canadian regional aircraft industries remain *de facto* contingent upon and in fact tied to export performance.

1. *The Canadian Regional Aircraft Industry Remains Export-Oriented, and the Canadian Government's Recognition of the Significance of that Export-Orientation Is Still Evident*

18. An expert report included with Brazil's submissions to the Panel, and the Panel itself, noted the export orientation or the export propensity of the Canadian regional aircraft industry.²⁰ This fact remains unchanged. Brazil has attached, as Exhibit Bra-7, a series of tables and supporting documentation updating the results of this expert report. This update demonstrates that during the period from 23 October 1998 (the end date for the earlier expert report) through 15 December 1999, every sale of Canadian regional aircraft - without exception - was for export.

19. Moreover, the appeal of this export orientation to the Canadian government has not been eliminated by Canada's amendments to TPC:

- TPC has previously justified its support to its main beneficiary by pointing out that the industry is "highly *export* oriented".²¹
- The Canadian Minister of Industry has justified particular instances of TPC support with the statement that "[a]erospace is a crucial sector for Canada's economy, with *exports* growing at 10 per cent per year."²²
- The Leader of the Government in the House of Commons has stated that a key "output" of a TPC-supported project - the Dash 8-400 - is "the *building of exports*," which he argued was, along with job creation, "just what the government had in mind when we established" TPC.²³

¹⁸ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 167.

¹⁹ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 173.

²⁰ Panel Report, *supra*, footnote 1, para. 9.325 (footnote 623).

²¹ TPC Annual Report, 1996-1997, pg. 5 (emphasis added) (Exhibit Bra-8).

²² Industry Canada News Release, 10 January 1997 (emphasis added) (Exhibit Bra-9).

²³ Industry Canada News Release, 17 December 1996 (emphasis added) (Exhibit Bra-10).

- As recently as October 1999, the Canadian government touted the Canadian aerospace industry as "[g]lobally competitive with *exports* exceeding 70 per cent of output," and as "Commercial market focused/*Export Oriented*."²⁴ TPC, which "invests with industry in near-market opportunities," is listed among those government programmes supporting this export-based industry.²⁵
- Industry Canada's 1998/99 Survey of the Canadian Aerospace and Defence Industry, published on 29 November 1999, projects that the Canadian aerospace industry's *exports* will increase to 70 per cent of total sales in 2000.²⁶
- A June 1999 study sponsored in part by Industry Canada concludes that the Canadian aerospace industry *exported* 78 per cent of its production in 1998, and projects a 90 per cent increase in *export* sales during the period 1991-2001.²⁷ The same study notes that "rapid growth of the value of *export sales*" was achieved by a shift from exports of "manufactured components and sub-systems" to exports of "complete aircraft and systems."²⁸
- The Aerospace Industries Association of Canada projects that 71 per cent of the industry's sales revenue will be derived from exports in 2000,²⁹ and that the industry's "*exports* continue to be the principal engine of [its] growth"³⁰ - factors that surely did not escape Industry Canada when it succumbed to the Association's "advocacy efforts [to] secur[e] an additional \$150 million in funding for [TPC]."³¹

20. Like any other "fact" relevant under footnote 4 to the Subsidies Agreement, the Canadian government's acknowledgement of the overwhelming export orientation of the industry, and its admission that this factor drives the government's commitment to fund that industry, can serve in part as the basis for an *inference* that, without that export orientation, the abundant funding sources of TPC would not be available to the industry.

21. The crucial role the regional aircraft industry specifically, and the aerospace industry generally, play in Canada is translated into the funding priorities of Canadian subsidy programmes: as before the amendments announced by the Canadian government on 19 November, TPC continues to provide contributions to the same three categories of industry as before (Aerospace and Defence, Enabling Technolo-

²⁴ "Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999, pgs. 3, 33 (emphasis added) (Exhibit Bra-11).

²⁵ *Id.* at pg. 20.

²⁶ Industry Canada, "Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry," 29 November 1999 (emphasis added) (Exhibit Bra-12).

²⁷ "Canadian Aerospace Suppliers Base Strategy for Change," 25 June 1999, pgs. 1, 16-17 (relevant excerpt included at Exhibit Bra-13).

²⁸ *Id.* at pg. 17(emphasis added).

²⁹ Aerospace Industries Association of Canada Annual Report, 1999, pg. 4 (Exhibit Bra-14).

³⁰ *Id.* at pg. 13 (emphasis added).

³¹ *Id.* at pg. 12.

gies, and Environmental Technologies),³² and continues, as before, to be captive to the regional aircraft and the aerospace industry. Since inception of the programme, 65 per cent of TPC contributions have gone to the aerospace industry;³³ in the period 1998-1999, 76 per cent of TPC disbursements went to that industry.³⁴ The economic significance of this bias will become increasingly relevant to the industry in the coming years, since available TPC funds are slated to increase by 396 per cent between now and 2003.³⁵

22. Nothing, in short, has changed - neither the industries eligible for TPC contributions, nor the recognized export-orientation of the industry that enjoys the lion's share of those contributions, nor the significance of that industry's export orientation to Canadian government officials, nor that industry's prospects for continued dominance of TPC's treasury. None of these factors is destined for change.

23. When the Canadian government grants TPC funds to the Canadian regional aircraft industry - today as in the past - it is eminently aware, as its statements reveal, of that industry's overwhelming export-orientation. To keep it that way, the Canadian aerospace industry receives the vast majority of the rapidly increasing pool of TPC funds available. These facts lead directly to the unavoidable conclusion that, without exceptional export performance, the Canadian regional aircraft industry would not receive TPC subsidies. The inescapable inference is, therefore, that continued receipt of those subsidies is in fact tied to export performance.

2. *Canada's Removal of the "Near to Market" Terminology from TPC Documents Is Irrelevant*

24. As part of its implementation strategy, Canada announced that it will now "focus on promoting technological innovation and enhancing the technological capability of Canadian industry, rather than commercialization," and that eligible activities will now be for "industrial research and pre-competitive development."³⁶ Canada then goes on to specify three categories of TPC "Eligible Activities" - "industrial research," "pre-competitive development," and "studies."³⁷ Brazil makes the following three observations regarding this aspect of Canada's implementation strategy.

25. **First**, TPC's "new" emphasis on "technological innovation" rather than "commercialization" is presumably in response to the Panel's identification of TPC's focus on "near market R & D" projects as one factor supporting a finding of *de facto* export contingency.³⁸ This "new" emphasis, however, does not immunize TPC from characterization as a prohibited export subsidy. The Appellate Body noted that "[i]t

³² See Framework Document, pgs. 5-6 (Exhibit Bra-5). See also TPC Terms and Conditions, pg. 1 (Exhibit Bra-15); TPC Investment Application Guide, pgs. 3-4 (Exhibit Bra-16).

³³ TPC Current Statistics, 6 December 1999 (Exhibit Bra-17).

³⁴ TPC Annual Report, 1998-1999, pg. 27 (Exhibit Bra-6).

³⁵ *Id.* at pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure).

³⁶ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

³⁷ TPC Terms and Conditions, pg. 2 (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (Exhibit Bra-16).

³⁸ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, paras. 9.339, 9.340, 9.341.

is. . . no '*less ... possible*' that the facts, taken together, may demonstrate that a pre-production subsidy for research and development is 'contingent ... in fact ... upon ... export performance.'³⁹ Removing "commercialization" or the "near market R & D" focus from TPC's focus, therefore, and shifting instead to a focus on "industrial research and pre-competitive development,"⁴⁰ would not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy.⁴¹

26. **Second**, and to the extent that this factor is still relevant as one among many contributing to an *inference* of *de facto* export contingency,⁴² Canada's amendments to TPC do not in fact rid it of considerations regarding "commercialization." TPC's most recent "Current Statistics," published on the TPC website on 6 December 1999, state that "TPC contracted projects, if successful, are forecasted to *generate sales of more than \$89.6 billion ...*"⁴³ TPC still considers that its subsidies are to be used to "generate sales" - a virtual synonym for "commercialization."

27. Moreover, two of the categories of TPC "eligible activities" betray an interest in projects linked to actual products. Under the category of "Industrial research," TPC funds projects "aimed at the discovery of new knowledge, with the objective that such knowledge may be useful in *developing new products*, processes or services, or in bringing about a significant improvement to *existing products*, processes or services."⁴⁴ Eligible projects in the category of "Pre-competitive development" specifically include the "*translation* of industrial research findings *into* a plan, blueprint or *design for new, modified or improved products*, processes or services."⁴⁵

28. Finally, immediately after noting that "Canada's aerospace and defence industries supply regional and business jet and turboprop aircraft, commercial helicopters, propulsion and major avionics systems, and electronics parts and components, and aviation support systems such as air traffic control systems," TPC's website states that "[i]nvestments by Technology Partnerships Canada help this vital part of the Canadian economy maintain and expand its position of technological excellence and so contribute to the country's well-being."⁴⁶ The industry's successful commercialization of broad product lines, and TPC's role in "helping" the industry "maintain and expand" its position through commercialization of those products, are two factors that do not escape the Canadian government.

29. **Third**, the three categories of TPC "eligible activities" are remarkably similar pre- and post-implementation. Brazil has attached as Exhibit Bra-20 an excerpt from the TPC website, dated 21 January 1998, describing certain of the prerequisites for TPC assistance:

³⁹ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 174.

⁴⁰ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

⁴¹ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 167.

⁴² *Id.*

⁴³ TPC Current Statistics, 6 December 1999 (emphasis added) (Exhibit Bra-17).

⁴⁴ TPC Terms and Conditions, pg. 2 (emphasis added) (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (emphasis added) (Exhibit Bra-16).

⁴⁵ *Id.* (emphasis added).

⁴⁶ TPC website, "Aerospace and Defence," pg. 1 (Exhibit Bra-19).

The project activities must include one of the following: *development or demonstration* of a product, process and/or technology; certain *preproduction activities*; technical or marketing *feasibility studies*.⁴⁷

30. These descriptions exhibit considerable similarity to the "new" TPC categories of eligible activities: what was previously "development or demonstration" or "preproduction activities," for example, is now "pre-competitive development"; what was then the category of "feasibility studies" is now simply "studies."⁴⁸ Nothing of substance has changed; if funding for the development of commercial products was available in the "old" TPC, it is similarly available in the "new" TPC, and as it did before contributes to an *inference of de facto* export contingency.

3. *The Goals and Objectives of the TPC Programme Remain Intimately Linked to Export*

31. Canada's materials regarding the "new" TPC are replete with references to the programme's objectives, most commonly phrased as "increasing economic growth, creating jobs, and supporting sustainable development."⁴⁹ These same objectives are at times characterized as the "new" TPC's "programme objectives,"⁵⁰ but are repeated elsewhere in the TPC materials as part of the programme's mandate,⁵¹ selection criteria,⁵² assessment criteria,⁵³ or examples of strategic benefits to be established by an applicant to secure TPC funds.⁵⁴

32. These same objectives were also central to the "old" TPC. TPC's Charter and its Business Plan formerly stated that the programme's mandate was "to stimulate

⁴⁷ TPC website, "Project Identification and Description," 21 January 1998 (Exhibit Bra-20).

⁴⁸ *Compare Id. with* TPC Terms and Conditions, pg. 2 (Exhibit Bra-15).

⁴⁹ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

⁵⁰ TPC Framework Document, pg. 4 (Under section titled "Program Objectives," Canada states that "[c]ontributions under TPC will be administered in a way that will contribute to: increasing economic growth and creating jobs and wealth; supporting sustainable development ..." etc.) (Exhibit Bra-5).

⁵¹ *Id.* at pg. 4 (Under section titled "Mandate," Canada states that "TPC is a technology investment fund established to contribute to the achievement of Canada's objectives such as increasing economic growth, jobs and wealth creation, and supporting sustainable development.").

⁵² TPC Investment Application Guide, pg. 6 (Under section titled "What are the criteria that TPC uses for selecting investments," Canada notes that investment outlines and proposals are assessed on the extent to which they demonstrate, among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada (increasing economic growth, creating jobs and wealth, and supporting sustainable development).") (Exhibit Bra-16).

⁵³ TPC Terms and Conditions, pg. 2 (Under section titled "Assessment Criteria," Canada states that applications for TPC funds will be assessed according to the extent to which they demonstrate, among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada.") (Exhibit Bra-15).

⁵⁴ TPC Investment Application Guide, pg. 8 (Under section titled "What is the format for preparing a TPC investment outline," Canada states that certain information regarding "strategic benefit" must be demonstrated, including "[p]otential economic benefit to Canada (for example, jobs created or maintained, economic growth, wealth creation, sector or supplier development, contribution to sustainable development, new corporate mandates, leveraged investments, strategic alliances, etc.)." (Exhibit Bra-16).

economic growth and create jobs in Canada," and that two of its objectives were "to increase growth and wealth creation."⁵⁵ The "Terms and Conditions" document for the "old" TPC stated that the programme was to "contribute to achieving Canada's objectives of: (a) increasing economic growth and wealth creation; (b) supporting sustainable development," etc.⁵⁶ Similarly, the closing paragraph of Industry Canada News Releases announcing contributions under the "old" TPC included a statement that TPC "is a central element of the government's agenda to promote technological development as a catalyst for economic growth and job creation, through increased productivity and competitiveness."⁵⁷

33. More importantly, achieving these objectives - increasing or creating economic growth, wealth and jobs - has been expressly linked, by the Canadian government itself, as well as by other organizations, to the *export performance* of Canadian industry:

- Industry Canada's International Business Strategy ("CIBS") makes clear that "exports are critical to Canada's economic and social well-being, and serve as the engine that is driving Canada's economy."⁵⁸
- In particular, the CIBS makes explicit the connection between job creation and exports, arguing that "[i]ncrease [sic] trade means new and better jobs for Canadians - it is estimated that for every \$1 billion of exports, 11,000 Canadian jobs are created or sustained."⁵⁹
- In describing its "Jobs Strategy," the aim of which is "to co-ordinate efforts to create more and better jobs for Canadians," Industry Canada states that "[w]ith one in three Canadian jobs dependent on exports, a critical component of the Jobs Strategy is to encourage more Canadian firms to export ..."⁶⁰
- Industry Canada affirms that "Canada's economic growth and job creation in the past three years have been driven by exports to the United States."⁶¹
- In its review of the Aerospace and Defence sector, Industry Canada emphasizes that

[t]he Canadian aerospace and defence industry is a vital and growing component of our national economy. It is a major contributor to research and development (R&D); employment; national income; ex-

⁵⁵ Superseded TPC Charter (*in* TPC Interim Reference Binder, March 1998), pg. 3 (Exhibit Bra-4); TPC Business Plan, 1996-1997, pg. iii (Exhibit Bra-21).

⁵⁶ Superseded TPC Terms and Conditions (*in* TPC Interim Reference Binder, March 1998), pg. 1 (Exhibit Bra-22).

⁵⁷ *See, e.g.*, Industry Canada News Release, 10 January 1997 (Exhibit Bra-9); Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

⁵⁸ Industry Canada, CIBS Overview, "Executive Summary," pg. 2 (emphasis added) (Exhibit Bra-23).

⁵⁹ *Id.* at pg. 1 (emphasis added).

⁶⁰ Industry Canada, CIBS Strategic Overview, "International Business Development Priorities," pg. 1 (emphasis added) (Exhibit Bra-24).

⁶¹ Industry Canada, CIBS Geographic Overview, pg. 1 (emphasis added) (Exhibit Bra-25).

ports; national defence; and international prestige. It is also one of Canada's leading advanced-technology sectors, and its innovative products are recognized around the world. *It ranks fifth among world exporters of aircraft and aircraft parts, and could well achieve fourth place, if present trends continue. However, the continued growth of the aerospace and defence industry, and its contribution to the wealth and job creation in Canada, will depend largely on its ability to capture a growing share of world aerospace and defence markets.*⁶²

In other words, to achieve wealth and job creation in Canada - two of TPC's objectives - aerospace exports have been, are, and will be necessary.

- The Canadian Minister of Industry has identified the close relationship between Canadian aerospace exports, Canadian economic growth and the creation of Canadian jobs. According to the Minister, "[a]erospace is a crucial sector for Canada's economy, with exports growing at a rate of 10 per cent per year," with the result that "TPC's investment in [aerospace industry] projects will help increase the global competitiveness of this industry, while supporting jobs in Montreal, in Halifax and across the country, generating economic growth and export dollars."⁶³
- The Conference Board of Canada also acknowledges the link between exports and TPC's goals of job creation and increasing economic growth, noting that:

*Exports have been a driving force in the [Canadian] economy over the past 10 years, with real growth averaging 7 per cent on an annual basis - well ahead of the average 2 per cent annual real GDP growth. One in three jobs in Canada is dependent on trade. If Canadian business cannot continue to access markets abroad for their products, services and investments, the continued growth of the Canadian economy will be threatened.*⁶⁴

34. The significance of the link between export performance and growth, wealth or jobs has not changed with Canada's amendments to TPC. When TPC makes the increase or creation of economic growth, wealth and jobs part of its selection criteria,⁶⁵ its assessment criteria,⁶⁶ or a "strategic benefit" to be demonstrated by an applicant to secure a TPC subsidy,⁶⁷ the Panel should infer that it is implicitly conditioning receipt of that subsidy on export performance. Without committing to export performance, an applicant cannot meet TPC's selection or assessment criteria, cannot demonstrate that it will provide the requisite strategic benefits imposed by the TPC programme, and will not receive a TPC subsidy.

⁶² Industry Canada, CIBS Aerospace and Defence, pg. 1 (emphasis added) (Exhibit Bra-26).

⁶³ Industry Canada News Release, 10 January 1997 (emphasis added) (Exhibit Bra-9).

⁶⁴ Conference Board of Canada, *Performance and Potential 1999*, "Working Smarter, Not Harder," pg. 107 (footnote omitted) (emphasis added) (Exhibit Bra-27).

⁶⁵ TPC Investment Application Guide, pg. 6 (Section titled "What are the criteria that TPC uses for selecting investments") (Exhibit Bra-16).

⁶⁶ TPC Terms and Conditions, pg. 2 (Section titled "Assessment Criteria") (Exhibit Bra-15).

⁶⁷ TPC Investment Application Guide, pg. 8 (Section titled "What is the format for preparing a TPC investment outline") (Exhibit Bra-16).

4. *Canada Has Failed to Provide Many Documents Necessary to Determine Whether the 'New' TPC Programme Remains De Facto Contingent on Export*

35. Although Canada has made certain documents regarding the "new" TPC publicly available, many others have not been provided. The Panel's decision regarding TPC's *de facto* export contingency relied, for example, upon the TPC Business Plan, the TPC Aerospace and Defence Generic Model Agreement, TPC Project Summary Forms, and the two-volume, 350-page TPC Interim Reference Binder.⁶⁸ "Business confidential" documents provided by Canada with its replies to questions from the Panel in the original proceedings, moreover, were also relevant to a review of the question of *de facto* export contingency. These documents include Programme Forecasts and Progress Reports.⁶⁹

36. Yet, none of these documents has been made publicly available with regard to the "new" TPC. Since Canada has not produced replacements for these documents, the Panel should consider that the original documents still apply, and still, as before, constitute facts demonstrating that TPC subsidies are contingent in fact on export performance, as detailed in paragraph 9.340 of the Panel Report.

37. The "new" TPC Framework Document, moreover, refers to several new documents that Canada has not provided, including the Treasury Board's "repayable contributions policy,"⁷⁰ TPC's "Evaluation Framework,"⁷¹ any "specialized reports" developed for the TPC Advisory Board,⁷² "case evaluation" forms,⁷³ the "Memorandum of Understanding" between TPC and the Industry Sector,⁷⁴ "records of decisions" issued by the Secretariat of the Programmes and Services Board,⁷⁵ minutes of Interdepartmental Advisory Committee meetings and TPC Management Board meetings,⁷⁶ and "sector strategies, technical assessments, priorities and technology roadmaps" developed by the Sector Branches.⁷⁷

38. Canada cannot seriously claim compliance with the DSB's recommendations and rulings on the basis of amendments made to TPC - a programme judged to be a prohibited export subsidy - without actually demonstrating that those changes were made. As demonstrated in paragraph 9.340 of the Panel Report, the devil is indeed in the details of the TPC programme. Canada's failure to provide the documents listed

⁶⁸ Panel Report, *Canada - Aircraft, supra*, footnote 1, para. 9.340.

⁶⁹ These documents were included behind "BCI Tab 1" and "BCI Tab 2," respectively, to Canada's 21 December 1998 replies to questions from the Panel.

⁷⁰ TPC Framework Document, pg. 7 (Exhibit Bra-5). The press release announcing Canada's implementation strategy suggests that TPC's repayment policies have in fact been changed. Industry Canada News Release, 18 November 1999, pg. 4 ("Repayments will no longer be primarily based on royalties tied to product sales but will take different forms depending on the project ...") (Exhibit Bra-18).

⁷¹ TPC Framework Document, pg. 10 (Exhibit Bra-5).

⁷² *Id.*

⁷³ *Id.* at pg. 18, 20.

⁷⁴ *Id.* at pg. 18.

⁷⁵ *Id.* at pg. 19.

⁷⁶ *Id.*

⁷⁷ *Id.* at pg. 20.

in the preceding paragraph - which presumably detail its efforts at compliance - should lead the Panel to presume that the documents do not in fact demonstrate compliance.⁷⁸

III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS

39. Although Canada's 19 November 1999 statement to the DSB first claims that "there will be no deliveries of regional aircraft after 18 November 1999 benefitting from such Canada Account financing," it goes on to say that "any delivery of regional aircraft after 18 November 1999 which benefits from Canada Account financing will comply with the [OECD] Arrangement."⁷⁹ Brazil presumes, therefore, that Canada intends to retain the discretion to support sales or deliveries of Canadian regional aircraft with Canada Account financing.

40. Canada Account financing is still, under Article 3.1(a), contingent in law on export. Canada Account debt financing "takes the form of export credits and, in Canada's own words, was granted 'for export of goods'.⁸⁰ Canada Account export credits are issued, moreover, "for the purpose of supporting and developing, directly or indirectly, Canada's export trade."⁸¹

41. Confirming the Panel's conclusion of *de jure* export contingency, the President of the Export Development Corporation, which administers the Canada Account, has stated that "Canada Account funds are used to support *export transactions* which the federal government deems to be in the national interest but which, for reasons of size or risk, the Export Development Corporation (EDC) cannot support through regular export credits."⁸²

42. The materials submitted by Canada to the DSB purportedly demonstrating implementation do not speak to, much less alter, Canada Account's *de jure* export contingency. Brazil submits, therefore, that the Panel should maintain its previous ruling that Canada Account financing is *de jure* contingent on export, within the meaning of Article 3.1(a) of the Subsidies Agreement.

43. Regarding the status of Canada Account financing as a "subsidy" under Article 1 of the Subsidies Agreement, Canada's comments do not suggest that its implementation strategy removes such financing from the category of "financial contribution[s] by a government," under Article 1.1(a)(1) of the Subsidies Agreement. The press release announcing Canada's implementation, for example, states that "the col-

⁷⁸ The Panel may, of course, request these documents from Canada. Any refusal to provide these documents should lead to the inference and presumption that the documents reveal something short of Canadian compliance with the recommendations and rulings of the DSB regarding TPC.

⁷⁹ Exhibit Bra-2, pg. 2.

⁸⁰ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, para. 9.230.

⁸¹ *Id.*

⁸² Export Development Corporation, *Chairman and President's Message* (emphasis added) (Exhibit Bra-29). *See also* Panel Report, para. 6.149.

lection risk" for Canada Account transactions "ultimately rests with the Government of Canada."⁸³ Similarly, Canada's announcements do not suggest that Canada Account financing is no longer provided in one of the forms listed in sub-paragraphs (i) through (iv) of Article 1.1(a)(1) to the Subsidies Agreement.

44. Canada's statements outlining its implementation strategy do not, moreover, directly address the Panel's finding that Canada Account financing could be at rates "below the market,"⁸⁴ and thus on terms constituting a "benefit" under Article 1.1(b) of the Subsidies Agreement, *i.e.*, terms "more advantageous for the recipient than those available on the market."⁸⁵

45. To implement the DSB's recommendations and rulings, Canada simply states that under a "policy guideline" issued by the Minister for International Trade, no Canada Account transactions will be authorized unless they "comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits."⁸⁶

46. Canada appears to suggest that even if Canada Account financing otherwise constitutes a prohibited export subsidy, it is exempted by the so-called "safe harbor" in item (k) of the Illustrative List of Export Subsidies, included as Annex 1 to the Subsidies Agreement. This rather cryptic suggestion, however, is not sufficient to satisfy Canada's significant burden of establishing entitlement to what is an *affirmative* defence. Had Canada opted for this defence in the original Panel proceedings, it would have carried the significant burden of proving entitlement to it; leaving reliance on this defence to the implementation phase of dispute settlement proceedings does not change Canada's burden. Mere assertion of the defence, without more, is not enough.

47. For example, the OECD Arrangement on Guidelines for Officially Supported Export Credits - to which item (k) refers - includes 88 articles covering a wide variety of issues, along with an annex dedicated to aircraft. Canada has not specified which articles of the Arrangement or which portions of the aircraft annex are relevant under item (k), or precisely how it will maintain compliance with those provisions. Nor has Canada provided the Minister of International Trade's "policy guideline," under which future Canada Account financing allegedly compliant with the terms of the OECD Arrangement will apparently be issued.⁸⁷

48. For these reasons, Canada has not brought itself into compliance with either the recommendations and rulings of the DSB, or the terms of the Subsidies Agreement, with regard to the Canada Account.

⁸³ Industry Canada News Release, 18 November 1999, pg. 2 (Exhibit Bra-18).

⁸⁴ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, para. 9.224.

⁸⁵ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, para. 9.222.

⁸⁶ Canadian Statement to the DSB, pg. 2 (Exhibit Bra-2). *See also* Canadian Letter to the DSB (Exhibit Bra-1).

⁸⁷ *Id.* Should the Panel request this document from Canada, any refusal to provide it should lead to the inference and presumption that the document would reveal something short of Canadian compliance with the recommendations and rulings of the DSB regarding the Canada Account.

IV. CONCLUSION

49. Canada has not withdrawn the subsidies determined by the Panel and the Appellate Body to be prohibited export subsidies. The amendments proposed to TPC are inadequate to implement the recommendations and rulings of the DSB, and are not otherwise in compliance with Canada's obligations under the Subsidies Agreement. The cosmetic changes included in Canada's implementation strategy consist of little more than an effort to strike the word "export" from TPC documents. This is not sufficient to cure a programme rendered *de facto* export contingent, since *de facto* export contingency "must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy ..." ⁸⁸ Under the "facts constituting and surrounding" TPC subsidies, implementation of the DSB's recommendations and rulings and compliance with the Subsidies Agreement requires nothing short of complete and total withdrawal of TPC, as it relates to the regional aircraft industry.

50. With regard to the Canada Account, Canada's cryptic statement that debt financing under the programme will in future conform to the terms of the OECD Arrangement is not sufficient to discharge its burden of proving what amounts to an appeal to an affirmative defence.

51. Accordingly, Brazil requests that the Panel determine that Canada has not implemented the recommendations and rulings of the DSB or otherwise complied with its obligations under the Subsidies Agreement.

⁸⁸ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 167 (emphasis in original).

LIST OF EXHIBITS

Canadian Letter to DSB, 19 November 1999	Exhibit Bra-1
Canadian Statement to DSB, 19 November 1999	Exhibit Bra-2
Brazilian Letter to DSB, 23 November 1999	Exhibit Bra-3
Superseded TPC Charter (<i>in</i> TPC Interim Reference Binder, March 1998)	Exhibit Bra-4
TPC Special Operating Agency Framework Document	Exhibit Bra-5
TPC Annual Report, 1998-1999	Exhibit Bra-6
Updated Expert Report	Exhibit Bra-7
TPC Annual Report, 1996-1997	Exhibit Bra-8
Industry Canada News Release, 10 January 1997	Exhibit Bra-9
Industry Canada News Release, 17 December 1996	Exhibit Bra-10
"Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999	Exhibit Bra-11
Industry Canada, "Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry," 29 November 1999	Exhibit Bra-12
"Canadian Aerospace Suppliers Base Strategy for Change," 25 June 1999	Exhibit Bra-13
Aerospace Industries Association of Canada Annual Report, 1999	Exhibit Bra-14
TPC Terms and Conditions	Exhibit Bra-15
TPC Investment Application Guide	Exhibit Bra-16
TPC Current Statistics, 6 December 1999	Exhibit Bra-17
Industry Canada News Release, 18 November 1999	Exhibit Bra-18
TPC website, "Aerospace and Defence"	Exhibit Bra-19
TPC website, "Project Identification and Description," 21 January 1998	Exhibit Bra-20
TPC Business Plan, 1996-1997	Exhibit Bra-21
Superseded TPC Terms and Conditions (<i>in</i> TPC Interim Reference Binder, March 1998)	Exhibit Bra-22
Industry Canada, CIBS Overview, "Executive Summary"	Exhibit Bra-23
Industry Canada, CIBS Strategic Overview, "International Business Development Priorities"	Exhibit Bra-24
Industry Canada, CIBS Geographic Overview	Exhibit Bra-25
Industry Canada, CIBS Aerospace and Defence	Exhibit Bra-26
Conference Board of Canada, <i>Performance and Potential 1999</i> , "Working Smarter, Not Harder"	Exhibit Bra-27
Submission of Appellant Canada, 13 May 1999, paras. 45-46	Exhibit Bra-28
Export Development Corporation, <i>Chairman and President's Message</i>	Exhibit Bra-29

ANNEX 1-2

REBUTTAL SUBMISSION OF BRAZIL
(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	4387
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	4388
A. TPC Contributions Still Constitute Subsidies under Article 1 of the Subsidies Agreement.....	4388
B. Determining Whether Canada Has Implemented the Recommendations and Rulings of the DSB Does Not Require Evidence of TPC Contributions Subsequent to 18 November 1999.....	4388
1. Canada Mischaracterizes the Appellate Body's Test for De Facto Export Contingency.....	4388
2. Canada's Argument Reduces Article 21.5 to 'Inutility'	4389
C. Cosmetic Changes Do Not Cure TPC of De Facto Export Contingency	4390
1. TPC Remains Focused on the Aerospace Industry and the Regional Aircraft Industry, the Export Orientation of Which Has Been Singled out by the Canadian Government as Significant	4392
2. Removing the 'Near to Market' Terminology from TPC Documents is Irrelevant.....	4395
3. To Qualify for TPC Funds, Applicants Must Demonstrate a Contribution to Goals and Objectives Requiring a Commitment to Export Performance	4396
(a) Export Contingency Need Not Be the Sole Condition for Receipt of a Subsidy.....	4398
(b) Brazil Has Relied on Valid Evidence	4399
4. References to the Term 'Export' Have Not Been Removed from All TPC Documents.....	4400
III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	4403

	Page
A. Determining Whether Canada Has Implemented the Recommendations and Rulings of the DSB Does Not Require Evidence of Canada Account Financing Subsequent to 18 November 1999	4403
B. Canada's Claim that the Recommendations and Rulings of the DSB Required No Implementation by Canada Is in Error.....	4404
IV. CANADA'S PROPOSAL REGARDING THE ESTABLISHMENT OF 'VERIFICATION PROCEDURES'	4406
V. CONCLUSION	4407
LIST OF EXHIBITS	4408

I. INTRODUCTION

1. In its first submission¹ Canada claims to have adopted measures implementing the recommendations and rulings of the Dispute Settlement Body ("DSB") regarding the withdrawal of subsidies provided by the Canadian government to the regional aircraft industry *via* two programmes - Technology Partnerships Canada ("TPC") and Canada Account. In *Canada - Measures Affecting the Export of Civilian Aircraft*² these subsidies were determined to constitute prohibited export subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement"), and were accordingly ordered withdrawn, pursuant to Article 4.7 of that Agreement.

2. Brazil reiterates its claim that the Canadian measures do not adequately implement the DSB's recommendations and rulings, and that the impugned programmes remain inconsistent with the Subsidies Agreement. In this submission, Brazil addresses arguments levied by Canada in its first submission, and demonstrates that Canada's implementation measures are insufficient to comply with the recommendations and rulings of the DSB that it "withdraw " TPC and Canada Account subsidies to the regional aircraft industry.

¹ First Article 21.5 Submission of Canada, dated 10 January 2000 ["Canadian First Submission"].

² Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443. ["Panel Report"]; Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/AB/R, adopted 20 August, 1999, DSR 1999:III, 1377, ["Appellate Body Report"]

II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS

A. TPC Contributions Still Constitute Subsidies under Article 1 of the Subsidies Agreement

3. Without repeating the arguments included in paragraphs 8-11 of its first submission, Brazil simply reiterates that the legal status of TPC contributions as "subsidies" under Article 1 of the Subsidies Agreement remains unchanged under the "new" TPC.

4. Canada argues that the question whether TPC contributions will continue to constitute subsidies is "not the issue in this case."³ With this statement, Canada effectively concedes that should the Panel determine that contributions under the "new" TPC will continue to be contingent in fact on export performance under Article 3 of the Subsidies Agreement, it should also presume that those contributions will continue to constitute "subsidies" under Article 1 of the Agreement.

B. Determining Whether Canada has Implemented the Recommendations and Rulings of the DSB does not Require Evidence of TPC Contributions Subsequent to 18 November 1999

5. In its first submission, Canada contends that in the absence of new "financial contributions" to the regional aircraft industry made subsequent to 18 November 1999 under the "restructured" TPC, this Panel cannot judge whether Canada has effectively implemented the recommendations and rulings of the DSB. Specifically, Canada claims that "in the absence of any such financial contribution and a full consideration of those facts, there can be no grounds to support Brazil's allegations of *de facto* export contingency under the restructured TPC programme."⁴

6. Canada appears to draw this conclusion from the first element of the Appellate Body's test for *de facto* export contingency, which Canada characterizes as an inquiry into whether "there is granting of assistance by Canada."⁵ Since no new assistance has been granted under the "new" TPC, Canada asserts that the Panel cannot conclude that Canada has failed to implement the recommendations and rulings of the DSB. Canada's assertion is in error, for two reasons.

1. Canada Mischaracterizes the Appellate Body's Test for De Facto Export Contingency

7. First, Canada mischaracterizes and takes wholly out of context the first element of the Appellate Body's test. What the Appellate Body actually said is that

³ Canadian First Submission, para. 39.

⁴ *Id.* at para. 45.

⁵ *Id.* at para. 38.

the initial inquiry must be on whether the *granting authority* imposed a condition based on export performance in providing the subsidy. In the words of Article 3.2 and footnote 4, the prohibition is on the "*granting* of a subsidy", and not on receiving it. The treaty obligation is imposed on the *granting* Member, and not on the recipient. Consequently, we do not agree with Canada that an analysis of "contingent ... in fact ... upon export performance" should focus on the reasonable knowledge of the recipient.⁶

Brazil has retained the original italicized emphasis employed by the Appellate Body to demonstrate that the Appellate Body's point with this first element was to show the error of Canada's assertion that an interpreter should look to a subsidy *recipient's* knowledge to determine whether the recipient, rather than the grantor, understood the subsidy to be conditioned in fact on export performance.

8. To interpret this first element of the Appellate Body's test otherwise, as Canada suggests the Panel should, would be to render redundant Article 1.1 of the Subsidies Agreement - which already requires demonstration of a "financial contribution by a government." In *Brazil - Export Financing Programme for Aircraft*, the Appellate Body held that the Panel erred in importing the notion of a "benefit," from Article 1.1(b) of the Subsidies Agreement, into the definition of a "financial contribution" in Article 1.1(a); it termed these two sub-parts of the same Article "two separate legal elements."⁷ Since there was no textual basis to read one provision (regarding "benefit") into another provision (regarding "financial contribution"), the Appellate Body concluded that it was not permissible to do so.

9. Similarly, there is no textual basis to import the notion of a "financial contribution by a government," from Article 1 of the Subsidies Agreement, into the legal test of "contingen[cy] ... in fact ... upon export performance," from Article 3 of the Agreement. Nor, when read in context, does the Appellate Body's exposition of the first element of demonstrating *de facto* export contingency create such a requirement.

2. *Canada's Argument Reduces Article 21.5 to 'Inutility'*

10. Second, Canada's claim confuses a *de novo* challenge to a financial contribution *not yet judged* to be a prohibited export subsidy, with a challenge to those measures allegedly remedying something *already judged* to be a prohibited export subsidy. If accepted, Canada's claim would make measures allegedly constituting effective implementation impervious to effective challenge under Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"). This is because a Member determined by a Panel to have adopted measures constituting subsidies contingent in fact on export could, under Canada's theory, escape effective Article 21.5 scrutiny by merely refraining from *applying* any remedial measures until the 20-day time period to seek compensation has passed.⁸

⁶ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 170 (emphasis in original).

⁷ Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*"), WT/DS46/AB/R, adopted 20 August 1999, DSR: III, 1161, para. 157.

⁸ See DSU Article 22.2.

11. The opportunity to manipulate the system in this way did not escape Canada; according to TPC's website, Canada waited until 10 January 2000 to award its first contribution under the "new" TPC.⁹ Nor should it escape other Members. The effect, of course, would be to reduce Article 21.5 to "inutility," a result considered unacceptable by the Appellate Body.¹⁰ Members that have successfully challenged a subsidy contingent in fact on export would be left, effectively, with little more than a Pyrrhic victory. When it comes to enforcement of the most egregious of export subsidies - those subsidies determined by a Panel or the Appellate Body to be levied in a manner designed to *circumvent* the prohibition of *de jure* export contingency - Members would be left without an effective remedy.¹¹

12. Finally, beyond undermining Article 21.5, accepting Canada's theory would also undermine any incentive a Member would have to implement the DSB's recommendations and rulings at all. If implementation measures remedying a finding of a subsidy programme's *de facto* export contingency are impervious to effective challenge, what incentive would a Member have to undertake those implementation measures? More specifically, if all Canada considers it needed to do to insulate TPC from challenge was to refrain from making a contribution under the "new" TPC, why did it bother to undertake any implementation measures at all?

13. It would not have had to do so, under its own logic, since it could have defended Brazil's challenge under Article 21.5 strictly on the basis that no new subsidies to the regional aircraft industry had been granted. Obviously, Canada undertook the implementation measures detailed in its first submission because it considered itself compelled to do more than simply not issue TPC subsidies to the regional aircraft industry for the time being.¹² The fact that Canada felt compelled to do so demonstrates that it does not consider the absence of subsequent subsidies to immunize it from Brazil's Article 21.5 challenge. For this and the other reasons expressed above, Canada's argument must be rejected.

C. *Cosmetic Changes do not Cure TPC of De Facto Export Contingency*

14. "TPC assistance to the Canadian regional aircraft industry" was determined by the Panel and the Appellate Body to be contingent in fact on export perform-

⁹ Moreover, this contribution does not involve the regional aircraft industry. TPC News Release, 10 January 2000 (Exhibit Bra-30). According to TPC's website, no other TPC awards had been made since 17 November 1999, one day before expiration of the "reasonable period of time" for implementation. TPC News Release, 17 November 1999 (Exhibit Bra-31).

¹⁰ *United States - Standards for Reformulated and Conventional Gasoline*, ("US - Gasoline"), WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:1, 3, at 21 (An interpreter "is not free to adopt a reading that would result in reducing whole clauses or paras. of a treaty to redundancy or inutility.").

¹¹ The Panel will recall that the European Communities proposed the express prohibition of subsidies contingent in fact on export because the *de jure* provision is "open to circumvention." *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989).

¹² In para. 2 of its first submission, Canada confirmed this fact, characterizing its TPC implementation measures as "new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement."

ance.¹³ Canada's response, however, as demonstrated by its implementation strategy and detailed in its first submission, has been to treat TPC as though it had been judged *de jure*, rather than *de facto*, export contingent. Canada considers that by demonstrating that it made some changes to TPC, such as the removal of the term "export" from some (although not all) TPC documents, or the inclusion of self-serving statements regarding its undertaking not to consider export information, the task of implementing the DSB's recommendations and rulings is complete.

15. This is not effective implementation of a determination of *de facto* export contingency. According to the Appellate Body, while *de jure* export contingency is indeed demonstrated (or remedied) "on the basis of the words of the relevant legislation, regulation or other legal instrument," *de facto* export contingency is to be "*inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy ..."¹⁴ Brazil demonstrated in its first submission, at paragraphs 18-38, that the facts surrounding the "new" or the "restructured" TPC still support an inference of *de facto* export contingency. Under the "new" TPC,

- contributions remain targeted to specific industries - in particular, the aerospace industry, which is to continue, as before, receiving two-thirds of TPC fund¹⁵ - that are overwhelmingly export-oriented and recognized by the Government of Canada as such (discussed at section 1 below);
- the same types of projects continue to be eligible for "new" TPC funds as were eligible under the "old" TPC (discussed at section 2 below);
- applicants must demonstrate that they will contribute to goals and objectives the achievement of which requires a commitment to export performance, according to the Government of Canada itself (discussed at section 3 below);
- Canada has failed to amend or to provide documents that the Panel previously considered supported an inference of *de facto* export contingency (discussed at section 4 below).

16. Apart from removing references to the word "export" from some TPC documents, the only thing that the DSB's recommendations and rulings have prompted Canada to do is to increase, *by 396 per cent*, what TPC itself projects to be "Total funds available for new contributions in future years."¹⁶ Additionally, over the period 1998-2003, TPC's "Available contribution funding" is slated to increase from \$203 million to \$367 million.¹⁷

¹³ Panel Report, *supra*, footnote 2, paras. 10.1(f), 10.3; Appellate Body Report, *supra*, footnote 2, paras. 220(b), 221.

¹⁴ Appellate Body Report, *Canada - Aircraft, supra*, footnote 2, para. 167 (emphasis in original).

¹⁵ Canadian First Submission, para. 32. Canada notes at para. 32 that "it cannot be assumed that regional aircraft industry-related projects will receive the majority of the funds." This may be so, but is utterly irrelevant. If the regional aircraft industry is able to receive \$1 of funds contingent in fact on export performance, Canada has not implemented the recommendations and rulings of the DSB.

¹⁶ TPC Annual Report, 1998-1999, pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6). Canada complains in Annex A to its first submission that "[t]his is a distortion of the actual programme funding situation." Brazil reiterates that these figures are taken directly from the TPC Annual Report.

¹⁷ TPC Annual Report, 1998-1999, pg. 28 (row titled "Available contribution funding").

17. Thus, under the "new" TPC, the same recipient industries will receive even more government subsidies to undertake the same types of projects. This is not effective implementation.

18. The facts surrounding TPC, described in paragraphs 18-38 of Brazil's first submission, lead to the conclusion that funds granted to the regional aircraft industry under the "new" TPC will continue, unavoidably, to be contingent in fact on export performance. It is for this reason that Brazil argued, in its first submission, that "withdrawing the subsidy" in the case of TPC - the very design, structure, and economic reality of which betrays its *de facto* export contingency - cannot be achieved without withdrawal of the programme altogether, with regard to the regional aircraft industry.¹⁸

19. At a *minimum*, Canada's implementation measures must *ensure* that prohibited export subsidies *cannot* be granted to the regional aircraft industry under the facts surrounding the operation of TPC, and not merely that they *might not* be granted. Since TPC, as it applies to the regional aircraft industry, was judged *de facto* export contingent, maintaining funding under the "new" TPC requires that Canada *ensure* that the programme will operate in full compliance with the Subsidies Agreement. It is not sufficient for Canada to simply provide a framework which, in consideration of the "total configuration of the facts constituting and surrounding the granting of the subsidy"¹⁹, could permit it to maintain operation of TPC as a *de facto* export contingent programme. To constitute effective implementation, any amendments made by Canada to TPC should not focus on making the programme merely *de jure* compliant (which it may already have been), but instead on making it *de facto* compliant, on a consideration of the "total configuration of the facts."²⁰

20. A review of the "total configuration of the facts" reveals that Canada has not met this obligation. Brazil recalls that under the "new" TPC, the same industry recipients are getting even more TPC subsidies to undertake the same types of projects. This does not suggest effective implementation of a finding of *de facto* export contingency.

1. *TPC Remains Focused on the Aerospace Industry and the Regional Aircraft Industry, the Export Orientation of Which Has Been Singled out by the Canadian Government as Significant*

21. As discussed in Brazil's first submission, the same three industries eligible for funding under the "old" TPC are targeted for continued funding under the "new"

¹⁸ As discussed in para. 7 of its first submission, Brazil reiterates that this result is also supported by Canada itself. In its submissions to the Appellate Body, Canada argued that the word "subsidy" is used interchangeably with the term "subsidy programme" in the Subsidies Agreement, and that TPC is just such a "subsidy programme." See Submission of Appellant Canada, 13 May 1999, paras. 45-46 (Exhibit Bra-28). The requirement that Canada "withdraw the subsidy," therefore, must by force of Canada's own logic mean that it is required to withdraw TPC in its entirety.

¹⁹ Appellate Body Report, para. 167 (emphasis in original).

²⁰ *Id.*

TPC.²¹ Moreover, Canada has confirmed that the aerospace industry will continue, as it did under the "old" TPC, to receive two-thirds of all "new" TPC funds.²² Although the Panel determined that the regional aircraft industry had in its period of review received approximately 68 per cent of TPC funds allotted to the aerospace industry.²³ Canada contends that under the "new" TPC, "it cannot be assumed that regional aircraft-industry related projects will receive the majority of the funds."²⁴ Whether regional aircraft-industry related projects are to receive the *majority* of the "new" TPC's funds or *\$1* of those funds, if TPC subsidies remain *de facto* export contingent, Canada has not implemented the recommendations and rulings of the DSB.

22. Furthermore, Canada did not, with its amendments to TPC, change the nature of the Canadian aerospace industry generally or the regional aircraft segment specifically. Brazil has demonstrated that the Canadian aerospace industry in general and the regional aircraft segment in particular continue to be overwhelmingly export-oriented. More importantly, the Canadian government itself recognizes the exceptional export performance of the industry, and has cited that performance as its motivation for funding the industry.²⁵

23. Canada complains that certain of the Canadian government documents cited to establish this point, in paragraph 19 of Brazil's first submission, may not be relied upon to challenge Canada's implementation and to demonstrate a continued inference of *de facto* export contingency. According to Canada, this evidence "relates not to the restructured TPC, but to TPC as it was previously constituted."²⁶

24. Canada cites two decisions for support. At paragraph 41 of its first submission, Canada cites to what it claims to be a principle "duly recognised by the Panel in *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*." According to Canada, the Panel stated that "WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, thereby bringing themselves into compliance with their multilateral obligations under the SCM Agreement."²⁷

25. Brazil encourages the Panel to review paragraph 9.64 of the decision in *Australia - Leather*, for two reasons. First, the sentence extracted by Canada merely rec-

²¹ For a list of the three industries eligible for funds under the "new" TPC, *see, e.g.*, TPC Terms and Conditions, pg. 1, Section 3.1 ("Eligible Areas") (Exhibit Bra-15). For a list of the identical three industries eligible for funds under the "old" TPC, *see, e.g.*, Panel Report, paras. 6.173, 9.283.

²² Canadian First Submission, para. 32.

²³ Panel Report, *Canada - Aircraft*, *supra*, footnote 2, para. 9.307.

²⁴ Canadian First Submission, para. 32. Canada also states that "no new regional aircraft-related projects have been approved or contracted since 14 November 1997." This is simply not true. In March 1998, TPC announced a \$9.9 million subsidy to Sextant Avionique Canada Inc. for the development of both the avionics system for the Dash 8-400 and the flight control system for the CRJ-700. Panel Report, *supra*, footnote 2, para. 6.193.

²⁵ *See* Brazilian First Submission (and sources cited therein), para. 19. Regarding the role of the regional aircraft industry's export-orientation in TPC's funding decisions, *see, e.g.*, the comments by the Leader of the Government in the House of Commons, included in Brazil's first submission, para. 19.

²⁶ Canadian First Submission, para. 43.

²⁷ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, para. 9.64.

ords *an argument made by Australia*, rather than *a conclusion made by the Panel*. The Panel only offers its views on the issue in the final sentence of paragraph 9.64, commencing with its statement that "We agree that ..."

26. Even if the sentence extracted by Canada represents a conclusion of the Panel, however, that conclusion represents only half of the story. In the first instance, Canada has not "replaced" TPC contributions to the aerospace industry and the regional aircraft segment with anything else; TPC is still available to this same industry for the same types of projects even after implementation.

27. Moreover, after the sentence from *Australia - Leather* quoted by Canada, the Panel stated that even if measures previously constituting prohibited export subsidies are no longer in place, and have instead been "replaced" with purportedly non-prohibited "other measures" providing funds to the same recipient, statements made by a Member in conjunction with the earlier but now superseded measures are relevant to an analysis of the subsequent, purportedly compliant measures.²⁸

28. Therefore, since the "new" TPC has retained its focus on the same recipient industries funded under the "old" TPC, comments made by the Canadian government regarding its rationale for funding those recipients are relevant to the Panel's analysis of the "new" TPC. For example, the Leader of the Government in the House of Commons noted that a key "output" of the TPC-funded Dash 8-400 project was "the building of exports," which was, with job creation, "just what the government had in mind when we established" TPC.²⁹ Canada cannot seriously expect to maintain funding to the same industry under the "new" TPC, and yet at the same time escape the implications of its earlier statements regarding why it chose that industry in the first place. *Australia - Leather* provides support for the Panel, in its analysis of any "inferences" of *de facto* export contingency flowing from the surrounding facts, to consider statements by the Canadian government regarding its support for particular recipient industries of "old" TPC funding, where Canada has maintained its focus on those same recipients in the "new" TPC.

29. Canada also cites the Appellate Body in *Chile - Taxes on Alcoholic Beverages* for the principle that "previous ... measures" cannot be relied upon to assume continued non-compliance with a Member's obligations.³⁰ Since certain of the documents relied upon by Brazil pre-date 18 November 1999 - the date on which the "new" TPC took effect - Canada contends that any reliance upon them to infer *de facto* export contingency would fall afoul of the Appellate Body's ruling in *Chile - Alcohol*.

30. While Brazil does not quarrel with Canada's statement of the rule in *Chile - Alcohol*, that rule is simply inapplicable in the circumstances of this case. *Chile - Alcohol* did not, in the first instance, involve subsidies *de facto* contingent on export performance. Furthermore, Canada's objection, and its citation to the rule in *Chile - Alcohol*, would only have been appropriate and relevant had Brazil not relied upon

²⁸ *Id.* at para. 9.65.

²⁹ Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

³⁰ Canadian First Submission, para. 44, quoting Appellate Body Report, *Chile, Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 1999, DSR 2000:I, 281, para. 74.

the "measures" constituting the "new" TPC, and instead relied upon the "measures" constituting the "old" TPC.

31. But this is not the situation at hand. The facts enumerated in paragraph 19 of Brazil's first submission are not, to begin, Canadian "measures." They are instead facts that remain unaltered by anything Canada claims to have accomplished with its amendments to TPC. Canada has retained its commitment to offer two-thirds of "new" TPC funds to an industry that it has previously recognized as "highly export oriented"³¹, "globally competitive with exports exceeding 70 per cent of output,"³² and "crucial ... for Canada's economy, with exports growing at 10 per cent per year."³³ Even after 18 November 1999, Canada continues to recognize this industry as a source of ever increasing export revenue.³⁴ As far as Brazil is aware, nothing that Canada has proposed in restructuring TPC alters the truth of these statements.

32. These statements lead to the inference that in choosing which industry would receive the lion's share of "old" and "new" TPC funds, Canada was not casually indifferent to the trading patterns of that industry. Instead, Canada chose, as TPC's showcase, an industry that exports significantly more than others, *because* it exports significantly more than others.

33. The "new" TPC retains a focus on contributions to the aerospace industry. Canada simply cannot expect to retain a focus on this industry, and yet at the same time escape the inference created by all of its previous statements about the esteem in which it holds that industry *as a result of its export performance*. Such an expectation is neither credible, nor demanded by the rule in *Chile - Alcohol*. Some elements, essential to the Panel's and Appellate Body's consideration, were not, and cannot be, erased by the cosmetic amendments to TPC.

2. *Removing the 'Near to Market' Terminology from TPC Documents is Irrelevant*

34. Canada claims that TPC now focuses on funding projects aimed at "improving the technological capability of the firm or sector, rather than on the commercial viability and export potential of supported products."³⁵ In its first submission, Brazil noted, first, the Appellate Body's statement that "[i]t is ... no '*less possible*' that the acts, taken together, may demonstrate that a pre-production subsidy for research and development is 'contingent ... in fact ... upon ... export performance.'³⁶ Simply including "Industrial Research" as a category of funding under the "new" TPC does not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy.

³¹ TPC Annual Report, 1996-1997, pg. 5 (Exhibit Bra-8); "Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999, pg. 33 (Exhibit Bra-11).

³² "Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999, pg. 3 (Exhibit Bra-11).

³³ Industry Canada News Release, 10 January 1997 (Exhibit Bra-9).

³⁴ Industry Canada, "Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry," 29 November 1999 (Exhibit Bra-12).

³⁵ Canadian First Submission, para. 33.

³⁶ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 174.

35. Second, Brazil demonstrated that the available descriptions of eligible activities under the "new" TPC, to the extent they are different at all from eligible activities under the "old" TPC³⁷ betray an interest in "near market" projects with high commercialization potential. The "new" TPC Terms and Conditions, along with the "new" TPC Investment Application Guide, describe as eligible those projects "aimed at the discovery of knowledge, with the objective that such knowledge may be useful in *developing new products*," and those projects leading to "translation of industrial research findings into a plan, blueprint or *design for new, modified or improved products* ..."³⁸

36. Finally, Canada has withheld from the Panel documents that could shed some light on these categories of eligible activities, and whether they contribute to an inference of *de facto* export contingency - for example, the "new" TPC's "Framework Investment Proposals." Exhibit Cdn-9 states that Canada has not yet provided, and is still developing, this document, which presumably could contain a description of the three eligible categories of TPC projects.³⁹ Canada cannot claim, as it has in paragraphs 33-34 of its first submission, that it has implemented the recommendations and rulings of the DSB by making TPC "less near-market," without providing the documents demonstrating this fact.

3. *To Qualify for TPC Funds, Applicants Must Demonstrate a Contribution to Goals and Objectives Requiring a Commitment to Export Performance*

37. Brazil demonstrated in its first submission that to qualify for TPC funds, an applicant must demonstrate that it meets TPC's "selection criteria" and "assessment criteria," and that it provides the "strategic benefits" sought by the programme. Brazil also demonstrated that among those selection or assessment criteria and strategic benefits is the requirement that applicants establish that TPC funds would be used to create Canadian jobs, to increase Canadian economic growth, or to increase Canadian wealth. To wit:

- The "new" TPC's Investment Application Guide states that applicants' proposals "are assessed in the context of their relevance to the objectives of TPC, namely the extent to which they demonstrate," among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada (increasing economic growth, creating jobs and wealth, and supporting sustainable development)."⁴⁰
- The Investment Application Guide also states that a proposal must include information regarding the "strategic benefit" offered by the project, including

³⁷ Brazilian First Submission, paras. 29-30.

³⁸ TPC Terms and Conditions, pg. 2 (emphasis added) (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (emphasis added) (Exhibit Bra-16).

³⁹ Exhibit Cdn-9 (Serial 16). Although Canada claims that this document is not available, it is able at para. 34 of its first submission to describe in some detail what is included in one of the categories, "Industrial Research."

⁴⁰ TPC Investment Application Guide, pg. 6 (Exhibit Bra-16).

"[p]otential economic benefit to Canada (for example, jobs created or maintained, economic growth, wealth creation ...).⁴¹

- The "new" TPC's Terms and Conditions state that applicants' proposals "will be assessed in terms of the extent to which they demonstrate," among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada⁴², the latter of which are defined in the Investment Application Guide as "increasing economic growth, creating jobs and wealth, and supporting sustainable development."⁴³
- The "new" TPC's Investment Decision Document, to be completed by TPC officials evaluating an applicant's proposal, requires that those officials identify "strategic considerations" of the project that would constitute "benefits to Canada," including "the link between the proposed R&D initiative and achieving Canada's objectives of increasing economic growth, creating jobs and wealth and sustainable development."⁴⁴

38. In paragraph 33 of its first submission, Brazil then demonstrated, quoting numerous Industry Canada publications and the Canadian Minister of Industry, along with economic experts like the Conference Board of Canada, that creating Canadian jobs, increasing Canadian wealth and spurring Canadian economic growth requires, first and foremost, *exports*. These objectives are driven by, and cannot be achieved without, massive Canadian exports.

39. For a regional aircraft applicant for TPC funds to demonstrate a proposed project's contribution to "increasing economic growth, creating jobs and wealth," therefore, it must - even if implicitly - commit to export performance. The "new" TPC has, in other words, imposed mandatory selection and assessment criteria that can only be met if an applicant can demonstrate export performance. Such a requirement is the very essence of *de facto* "export contingency" - concealing export contingency in a requirement that does not actually employ the word "export."

40. The Panel is not here faced, however, with a situation in which it is required to determine that all subsidies contingent on "increasing economic growth, creating jobs and wealth," in all cases, are prohibited export subsidies, as Canada claims at paragraph 42 of its first submission. Brazil has discussed elsewhere in this and its first submission the "total configuration of the facts constituting and surrounding" TPC subsidies to the regional aircraft industry which lead to an "inference" of *de facto* export contingency.⁴⁵

41. For example, with the "new" TPC, Canada has retained as its target the aerospace industry, which will continue to receive two-thirds of all TPC funds.⁴⁶ The Panel found, and the Appellate Body confirmed, that this same funding under the "old" TPC was intended by Canada to circumvent its obligations under the Subsidies

⁴¹ *Id.* at pg. 8.

⁴² TPC Terms and Conditions, pg. 2 (Exhibit Bra-15).

⁴³ TPC Investment Application Guide, pg. 6 (Exhibit Bra-16).

⁴⁴ TPC Investment Decision Document, pg. 2 (Exhibit Cdn-7).

⁴⁵ Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 2, para. 167.

⁴⁶ Canadian First Submission, para. 32.

Agreement - it was provided contingent in fact on export performance.⁴⁷ The Canadian government has frequently extolled the overwhelming export-orientation of that industry generally, and the regional aircraft industry specifically⁴⁸ including in its decisions to award TPC funds.⁴⁹ It has, as such, shown something considerably more than casual indifference regarding the trading patterns of that industry retained in the "new" TPC as the main target for funding.

42. In these circumstances, the requirement that successful applicants demonstrate the ability to fulfill particular assessment and selection criteria that are inextricably linked to export becomes all the more significant, and adds to the inference that the "new" TPC retains its *de facto* export contingency. TPC knows, before it even sees an application, that regional aircraft industry applicants will be able to fulfill these criteria by virtue of their extreme export orientation. The deck, as the saying goes, is stacked. In these circumstances, TPC does not have to express the export contingency of its contributions; it knows that requiring applicants to demonstrate a proposal's ability to contribute to "increasing economic growth, creating jobs and wealth" is nothing more than a euphemism for export contingency, as that requirement applies to regional aircraft industry applicants.

43. In its decision in *Australia - Leather*, the Panel was faced with similar circumstances, and made a similar inference of *de facto* export contingency. Where Australia was aware that an applicant, to meet an objective or requirement for a subsidy, must, "of necessity, have to continue and probably increase exports," Australia's imposition of the objective or requirement was considered a condition on the grant of the subsidy.⁵⁰ The Panel reached this conclusion, in the circumstances of that case, even though there was no express mention of exports or an export requirement. In the specific circumstances of the case before this Panel, Brazil contends the Panel should do the same.

(a) Export Contingency Need Not Be the Sole Condition for Receipt of a Subsidy

44. Canada attempts to counter Brazil's claim with two arguments. First, Canada attempts, at paragraphs 22-25 of its first submission, to de-emphasize the requirement that a TPC applicant demonstrate how its proposal will "increase economic growth, jobs and wealth," by listing that requirement as one among many. Canada's attempt must fail, however. Article 3.1(a) of the Subsidies Agreement requires only that export performance be "one of several other conditions," and not the sole condition for receipt of a subsidy. It is, quite simply, irrelevant that the "new" TPC re-

⁴⁷ *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989) (The prohibition of subsidies contingent in fact on export was proposed because the *de jure* provision is "open to circumvention").

⁴⁸ See sources cited in Brazilian First Submission, para. 19.

⁴⁹ See, e.g., Industry Canada News Release, 17 December 1996 (The then-Government House Leader stated that "[t]hese two outputs of the Dash 8-400 project - the creation of jobs and the building of exports - are just what the government had in mind when we established Technology Partnerships Canada ...") (Exhibit Bra-10).

⁵⁰ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, para. 9.67.

quires that an applicant demonstrate "strategic benefits" or meet selection and assessment criteria that do not constitute evidence of *de facto* export contingency, as long as it must comply with one requirement that does constitute evidence of *de facto* export contingency.

(b) Brazil Has Relied on Valid Evidence

45. Second, Canada objects on two grounds to the evidence used by Brazil in paragraph 33 of its first submission to demonstrate that for the regional aircraft industry to increase economic growth, jobs and wealth in Canada requires export performance. In Annex A to its first submission, Canada argues, in the first instance, that Brazil's sources are "from the period prior to the restructuring of TPC."⁵¹

46. Canada's argument is in error. Brazil did not rely on evidence relating to TPC "as it was previously constituted," thus objecting to "previous [Canadian] measures," in the words of the Appellate Body in *Chile - Alcohol*.⁵² To demonstrate that applicants for TPC funds are required to show that their proposals provide "strategic benefits" or meet "selection" and "assessment criteria" related to the creation of Canadian jobs, economic wealth and growth, Brazil relied on the "new" TPC's Investment Application Guide, Terms and Conditions, and (in this submission) Investment Decision Document.⁵³ These citations are repeated above, at the outset of this section of Brazil's submission.

47. Brazil then went on, in paragraph 33 of its first submission, to demonstrate that according to the Canadian government and the Conference Board of Canada, increasing and creating Canadian jobs, economic wealth and growth requires exports. It is utterly irrelevant whether the statements supporting this conclusion, contained in paragraph 33 of Brazil's first submission, were made before or after 18 November 1999. As far as Brazil is aware, Canada did not, with its amendments to the TPC programme, change or even attempt to change these aspects of the Canadian economy. Unless Canada can show that something about the Canadian economy and the Canadian regional aircraft industry changed on 18 November 1999 as a result of its implementation measures, such that increasing and creating Canadian jobs, economic wealth and growth no longer depends, as a matter of necessity, on export, the documents and statements compiled by Brazil at paragraph 33 of its first submission retain both their validity and persuasive force, and contribute to an inference that TPC retains its *de facto* export contingency.

48. Canada also states that the evidence cited by Brazil in paragraph 33 of its first submission is either "of a general nature," providing "general sectoral information unrelated to TPC," or "from non-governmental sources."⁵⁴ Brazil notes, in the first instance, that six of the seven documents quoted in paragraph 33, to establish the link

⁵¹ Canadian First Submission, Annex A, para. 5.

⁵² *Id.* at paras. 43-44, quoting *Chile - Alcohol*, *supra*, footnote 30, para. 74.

⁵³ Brazilian First Submission, paras. 31, 34. Brazil notes that the Investment Decision Document was not available until Canada filed its first submission on 10 January 2000.

⁵⁴ Canadian First Submission, Annex A, para. 5 (introductory para. and discussion of the Industry Canada CIBS documents cited by Brazil at footnotes 60, 61 and 62 to para. 33 of its first submission).

between exports and the increase and creation of Canadian jobs, economic wealth and growth, were in fact published by Industry Canada, a government source. TPC is an agency of Industry Canada and reports to the Minister of Industry.⁵⁵

49. Brazil also notes that the source of this generic information regarding the Canadian economy is utterly irrelevant, as long as the source is reliable. As discussed above, Brazil first relied on the "new" TPC Investment Application Guide, Terms and Conditions, and (in this submission) Investment Decision Document⁵⁶ to demonstrate that applicants for TPC funds are required to show that their proposals provide "strategic benefits" or meet "selection criteria" and "assessment criteria" related to the creation of Canadian jobs, economic wealth and growth. To establish the link, in the Canadian economy, between exports and the increase of jobs, wealth and growth, Brazil then turned to documents published by Industry Canada.

50. To establish this link, why must Brazil rely, as Canada insists it must, solely on documents or statements made by TPC itself? TPC is not the only authority on the Canadian economy. TPC has itself elsewhere acknowledged its own reliance on other government authorities for what it dubs, in its first submission, "general sectoral information."⁵⁷ In the Memorandum of Understanding between TPC and the Industry Sector of Industry Canada, for example, TPC has committed to rely on Industry Canada's Industry Sector Branches as the "first source for technological and *sectoral analysis and advice*."⁵⁸ Sectoral advice emanating from Industry Canada is therefore considered reliable and persuasive by TPC. Brazil's citation to Industry Canada documents to establish a fundamental fact about the Canadian economy - the link between exports and the increase and creation of Canadian jobs, economic wealth and growth - is equally reliable and persuasive.

4. *References to the Term 'Export' Have Not Been Removed from All TPC Documents*

51. Canada has acknowledged that not all TPC documents have in fact been cleansed of references to the term "export." In Exhibit Cdn-9, Canada lists 40 TPC documents⁵⁹ only 13 (or 32 per cent) of which have been reformulated and provided to the Panel.⁶⁰ On the one hand, Canada claims that it has effectively implemented the recommendations and rulings of the DSB, thus ridding TPC of *de facto* export

⁵⁵ TPC Special Operating Agency Framework Document, cover page, pg. 8 (Exhibit Bra-5).

⁵⁶ Brazilian First Submission, paras. 31, 34.

⁵⁷ Canadian First Submission, Annex A, para. 5.

⁵⁸ Exhibit Cdn-10, pg. 1, para. 6 (emphasis added). Brazil notes that Industry Canada's Industry Sector focuses on "develop[ing] initiatives to maximize Canada's share of global trade and investment" and on "working with industry to get more Canadian firms involved in trade, in more sectors and in more markets." The result of Industry Sector's activities will be to "help Canada, the most open of G7 countries, become a nation of traders. Currently, Canada's top five exporters account for 21 per cent of Canadian exports and less than 10 per cent of Canadian SMEs export at all." *About the Industry Sector of Industry Canada*, Industry Canada website, published 27 May 1999 (Exhibit Bra-32).

⁵⁹ Although the list is numbered 1-36, Serial 16 actually lists five separate documents.

⁶⁰ In fact, only 12 of the 40 documents were provided to the Panel. Canada states, however, that there is no equivalent under the "new" TPC for the document listed as Serial 15.

contingency, by removing references to the term "export" from TPC documents. On the other hand, Canada has failed to provide 68 per cent of those documents.

52. Canada has, therefore, failed to implement the recommendations and rulings of the DSB, *by Canada's own measure of what constitutes effective implementation*. Alternatively, Canada's failure to provide certain "new" TPC documents supports a presumption that as-yet-unreplaced TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. In either case, Brazil requests that the Panel determine that Canada has failed effectively to implement the recommendations and rulings of the DSB.

53. Experience demonstrates that many of the documents not provided by Canada could potentially aid the Panel's determination whether Canada has effectively implemented the DSB's recommendations and rulings, since they served as some of the sources of facts from which the Panel inferred *de facto* export contingency. For example, a "new" TPC Aerospace and Defence Sector Generic Model Agreement has not been provided.⁶¹ The Panel determined that this Model Agreement served as one source of facts from which the *de facto* export contingency of TPC could be inferred, citing to the requirement that applicants "*distinguish between domestic sales and exports* when reporting forecast and actual sales."⁶²

54. Similarly, TPC's Business Plan was found by the Panel to include facts leading to an inference of *de facto* export contingency, with the statement that TPC's approach in the aerospace sector is to support projects with "*high export potential*."⁶³ Canada has not provided a Business Plan for the "new" TPC.

55. It is simply inaccurate to claim, as Canada has at paragraph 51 of its first submission, that the documents not yet completed and produced "will not exist until such time as the restructured programme approves and contracts new investments." Many of these documents are simply generic forms or templates, and were produced in the original proceedings without connection to any particular TPC investment. The Panel's conclusion that *de facto* export contingency could be inferred from those documents came not from information regarding any particular investments. Brazil refers, for example, to the TPC Aerospace and Defence Sector Generic Model Agreement⁶⁴ and the TPC Business Plan⁶⁵

⁶¹ It is unclear whether this document is mentioned in the list included as Exhibit Cdn-9. It may be Serials 8 or 9. In any case, the document has not been provided.

⁶² Panel Report, *Canada - Aircraft*, *supra*, footnote 2, para. 9.340 (bullet point 10) (emphasis in original). Brazil notes that even if the Model Agreement were to request only undifferentiated sales data and forecasts, without a distinction between domestic sales and exports, it would still lead to an inference of *de facto* export contingency in the instance of contributions to the Canadian regional aircraft industry. The Panel in *Australia - Leather*, *supra*, footnote 27, determined that requesting undifferentiated sales performance targets led to an inference of *de facto* export contingency because the Australian government knew that in order to reach those targets, the recipient would have to export. *Australia - Leather*, *supra*, footnote 27, para. 9.67. The same logic applies in the case of the Canadian regional aircraft industry; the Canadian government knows that the industry exports virtually all it produces, and thus to reach sales forecasts, it must export.

⁶³ Panel Report, *Canada - Aircraft*, *supra*, footnote 2, para. 9.340 (bullet point 2) (emphasis in original).

⁶⁴ *Id.* (bullet point 10).

⁶⁵ *Id.* (bullet point 2).

56. The same must be said of the "new" TPC documents cited by Canada as "under development" in Exhibit Cdn-9. It is by no means clear why many of these documents will not be created "until such time as the restructured programme approves and contracts new investments."⁶⁶ Brazil cites to some, but not all, of the examples of the "new" TPC documents listed in Exhibit Cdn-9 that are apparently "under development": the "TPC Repayment Policy" (Serial 2), "Assessment Guidelines for Due Diligence" (Serial 3), the various "Framework Investment Proposals" (Serial 16), the "TPC Business Plan" (Serial 18), "TPC Review Procedures" (Serial 20), "Special Purpose Equipment List" (Serial 21), "TPC Policies and Procedures on Incrementality, Irreversibility and Retroactivity" (Serial 25), etc. The nature of these documents does not suggest that they are in any way associated with individual contributions, such that they would not be created until contributions were made.

57. Even those documents that would, once completed, be associated with individual projects and contributions, start out as blank, generic forms or templates. These forms would certainly be developed well in advance of the grant of actual contributions under the "new" TPC. Brazil notes several examples from Exhibit Cdn-9, although this list is by no means exhaustive: "Standard Contribution Agreement" (Serial 8), "Performance Measures - Project Data Sheet" (Serial 23), "TPC Project File Structure" (Serial 24), "Evaluation Framework" (Serial 25), "Claims Package for Clients" (Serial 28), "PBS Integrity Review Checklist" (Serial 29), "Claims Verification Checklist" (Serial 32), "Contribution Verification Checklist" (Serial 36), etc. These "Standard Agreements," "Packages," "Sheets," "Frameworks," "Checklists" and the like should exist in the abstract, even without data regarding particular contributions written on them.

58. In any event, investments have already been approved under the "new" TPC. On 10 January 1999 - the very day on which Canada filed its first submission with this Panel and claimed that these documents were as yet unavailable because no contributions had yet been approved - TPC announced the award of a contribution to an Ontario company for the development of a robotics system. The news release recording this announcement is included as Exhibit Bra-30. Therefore, even if the TPC documents withheld from the Panel were in fact not produced until actual investments under the "new" TPC were approved, such approvals have in fact occurred. The documents should, therefore, exist.

59. If the Panel permits Canada to hold back these documents until after the close of these proceedings, and the documents, when eventually produced, betray evidence of continued *de facto* export contingency, Brazil may, of course, be able to bring a new case against TPC support. At the same time, however, the remedy provided Brazil under Article 21.5 of the DSU would be utterly and completely undermined. Telling Brazil to "wait and see" would reduce Article 21.5 to a nullity, a result that, according to the Appellate Body in *United States - Standards for Reformulated and Conventional Gasoline*, cannot attach.⁶⁷

⁶⁶ Canadian First Submission, para. 51.

⁶⁷ Appellate Body Report, *US - Gasoline*, *supra*, footnote 10, at 21 (An interpreter "is not free to adopt a reading that would result in reducing whole clauses or paras. of a treaty to redundancy or inutility.").

60. In sum, Canada cannot claim compliance with the DSB's recommendations and rulings *on the basis of amendments made to TPC documents*, without actually demonstrating that those amendments were made.⁶⁸ In fact, if documents that originally contributed to the Panel's inference of *de facto* export contingency do not yet exist for the "new" TPC, Canada has offered this Panel further evidence of its failure to implement the recommendations and rulings of the DSB by 18 November 1999. The Panel should conclude that Canada's failure to produce these documents constitutes a failure to implement the recommendations and rulings of the DSB, or, in the very least, should presume that the original documents, and the inferences of *de facto* export contingency drawn therefrom, continue to apply.

III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS

61. Canada's implementation of the recommendation that it withdraw "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft"⁶⁹ consists of a one-sentence "Policy Guideline" not to approve transactions that do not comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits.⁷⁰ In its first submission, Canada now asserts that the intent of this "Policy Guideline" is, specifically, to appeal to the second paragraph of Item (k) of the Illustrative List of Export Subsidies, and the OECD Arrangement's "interest rates provisions" cited therein.

62. This is, quite simply, insufficient. Canada's "Policy Guideline" merely suggests that prohibited export subsidies *via* Canada Account *might not* be granted; as noted above, to be sufficient, an implementation measure must instead *ensure* that prohibited export subsidies *cannot* be granted.

A. *Determining Whether Canada has Implemented the Recommendations and Rulings of the DSB does not Require Evidence of Canada Account Financing Subsequent to 18 November 1999*

63. In its first submission, Brazil argued that Canada has a burden to demonstrate its entitlement to a defence included in Item (k), since it chooses to appeal to such a defence.⁷¹ According to Canada, however, it has no obligation and bears no burden to demonstrate what compliance with Item (k) means unless, at some time "in the future, there is a financing transaction under Canada Account in relation to which Can-

⁶⁸ Of course, TPC also must not be *de facto* export contingent, based on the "total configuration of the facts constituting and surrounding" its operation. Appellate Body Report, *Canada - Aircraft*, supra, footnote 2, para. 167.

⁶⁹ Panel Report, *Canada - Aircraft*, supra, footnote 2, para. 10.1(b).

⁷⁰ Canadian First Submission, para. 57. See also Exhibit Cdn-13.

⁷¹ Brazilian First Submission, para. 46.

ada claims the exception in Item (k) and the exception is challenged.⁷² According to Canada, because the Panel "expressly did not find that the Canada Account programme *per se* was a prohibited export subsidy," and instead found that the Canada Account programme constituted a prohibited export subsidy as it was applied in the context of two specific transactions for the export of regional aircraft, Canada had no duty to do anything whatsoever in order to implement the Panel's ruling, other than to ensure that those two transactions were completed by 18 November 1999.⁷³

64. As it has for TPC, Canada therefore effectively claims that its implementation measures with regard to Canada Account are impervious to challenge under Article 21.5 of the DSU, since it has not yet extended Canada Account financing for regional aircraft subsequent to the adoption of those measures.

65. This position must be rejected. The consequence of Canada's position would be to reduce Article 21.5 of the DSU to "inutility" in any and all instances of successful "as applied" challenges to the violation by a Member of *any* of its WTO obligations (not just those contained in the Subsidies Agreement). A Member determined by a Panel to have maintained measures inconsistent with its WTO obligations could escape effective Article 21.5 scrutiny by merely refraining from applying those measures until the 20-day time period to seek compensation had passed.⁷⁴ Rendering Article 21.5 useless for the entire category of "as applied" challenges is not a result envisaged by the DSU, nor one accepted by the Appellate Body⁷⁵ and should therefore be rejected.

B. Canada's Claim that the Recommendations and Rulings of the DSB Required no Implementation by Canada is in Error

66. Canada's argument that the Panel's findings did not require it to take any action at all, apart from ensuring that the two Canada Account transactions identified in paragraph 54 of its first submission were completed by 18 November 1999, does not accord with the Panel's definition of the subsidy to be withdrawn. The Panel did not hold that only the two transactions identified in paragraph 54 of Canada's first submission were prohibited export subsidies. This is too narrow an interpretation of the Panel's determination regarding Canada Account financing "as applied." The Panel's conclusion was, rather, "that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement."⁷⁶ From 1 January 1995 onward, Canada Account debt financing for Canadian regional aircraft exports will be considered to constitute a prohibited export subsidy, unless Canada implements sufficient changes.

67. Thus, to achieve effective implementation, Canada was *required* to do more than simply ensure the completion of the two Canada Account transactions identified

⁷² Canadian First Submission, paras. 67-68.

⁷³ *Id.* at para. 56.

⁷⁴ See DSU Article 22.2.

⁷⁵ *US - Gasoline*, *supra*, footnote 10, at 21 (An interpreter "is not free to adopt a reading that would result in reducing whole clauses or paras. of a treaty to redundancy or inutility.").

⁷⁶ Panel Report, para. 10.1(b).

in paragraph 54 of its first submission. What it did is simply not enough, and is fully susceptible to challenge under Article 21.5 of the DSU.

68. The "Policy Guideline" included as Exhibit Cdn-13 states simply that the Minister for International Trade will, as a policy matter, not approve transactions that are not in compliance with the OECD Arrangement on Guidelines for Officially Supported Export Credits. Canada asserts that this "Policy Guideline" states an intention to "meet the criteria to qualify for an exception under the second paragraph of Item (k)" of the Illustrative List of Export Subsidies included in Annex 1 to the Subsidies Agreement.⁷⁷

69. The "Policy Guideline" does no such thing. It does not refer to conformity with the second paragraph of Item (k), or the "interest rates provisions" of the OECD Arrangement referred to therein. It merely states a hortatory intention to comply with the OECD Arrangement generally, without any indication of the specific provisions with which it intends to comply. Under the "Policy Guideline," it is by no means evident that Canadian practices would qualify it for the specific "safe haven" included in the second paragraph of Item (k).

70. Even Canada's assertion that the "Policy Guideline" refers to Item (k) and thus the "interest rates provisions" of the OECD Arrangement begs an obvious question - what does Canada consider to be the "interest rates provisions" of the Arrangement with which it will comply? Even if the Panel accepts Canada's bald, unsupported assertion that the reference in the "Policy Guideline" to compliance with the OECD Arrangement means, specifically, compliance with the second paragraph of Item (k) and the application of the Arrangement's "interest rates provisions," Canada has not identified which articles of the Arrangement constitute the "interest rates provisions" mentioned in Item (k).

71. In the DSB's recommendations and rulings regarding the Canada Account, Canada was determined to have maintained measures constituting or providing prohibited export subsidies. The Panel is not here conducting *de novo* review of Canada Account debt financing for regional aircraft. In these circumstances, implementing the DSB's recommendations and rulings regarding the Canada Account should at a minimum ensure that prohibited export subsidies *via* the Canada Account cannot be granted, and not merely that they might not be granted.

72. To determine whether the "Policy Guideline" so ensures, Canada should be held to a duty of disclosure similar to that contained in the notification provisions of Article 25 to the Subsidies Agreement, thus enabling Members to inform themselves of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will "comply with the OECD Arrangement" in future. Without the provision of this type of information, the lack of transparency regarding what Canada considers "comply with the OECD Arrangement" to mean, or with which "interest rates provisions" Canada intends to comply, will enable it to continue to operate the Canada Account as a prohibited export subsidy, undetected and undetectable. There will be no assurance that prohibited export subsidies will not continue. At the implementation stage of dispute settlement proceedings, when a Member has already

⁷⁷ Canadian First Submission, para. 68.

been found to be in violation of its WTO obligations, more is required; unelaborated policy guidelines offering vague hortatory statements regarding the Member's intentions do not constitute effective implementation.

73. If this is permitted, Canada will have accomplished a very clever trick - it will have successfully passed off as an implementation measure something that, in the original Panel proceedings, it repeatedly contended it was already doing.

74. In the original Panel proceedings, Canada submitted "that Canada Account activity is not inconsistent with Article 3 as it benefits from the exception contained in Item (k) of Annex I of the SCM Agreement."⁷⁸ More specifically, on three separate occasions, Canada represented to the Panel, without elaboration, that Canada Account financing and loan guarantees for exports "have been consistent with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I."⁷⁹

75. Canada subsequently decided not to invoke "the second paragraph of item (k) as a positive defence."⁸⁰ The relevant point, however, is that Canada expects to pass off the "Policy Guideline" contained in Exhibit Cdn-13 as a *new measure* sufficient to constitute valid implementation of the DSB's recommendations and rulings, when it was, according to its previous submissions to this Panel, already applying this measure well in advance of the Panel's determination that the Canada Account provides prohibited export subsidies to the Canadian regional aircraft industry.

76. To claim satisfactory implementation of the DSB's rulings and recommendations, Canada must bear the burden to do more than this. The minimum burden accorded Canada must be to explain with some precision what "comply with the OECD Arrangement" will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in future. Canada has failed to discharge this minimum burden. Accordingly, Brazil requests that this Panel determine that Canada has failed to implement the recommendations and rulings of the DSB with regard to the Canada Account.

IV. CANADA'S PROPOSAL REGARDING THE ESTABLISHMENT OF VERIFICATION PROCEDURES'

77. Canada proposes that the Panel suggest to the parties, pursuant to Article 19.1 of the DSU, that they establish a reciprocal arrangement for verifying their mutual compliance with their obligations under the Subsidies Agreement.⁸¹ Brazil notes that the parties have been engaged for some time in negotiations concerning these disputes and have discussed, *inter alia*, the question of verification. Brazil also notes,

⁷⁸ Panel Report, *supra*, footnote 2, para. 6.64.

⁷⁹ First Written Submission of Canada, 16 November 1998, para. 173 (Exhibit Bra-33). *See also* First Oral Submission of Canada, 26 November 1998, para. 101 ("Canada Account financing and loan guarantees for exports committed since the entry into force of the SCM Agreement have complied with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I.") (Exhibit Bra-34); Second Written Submission of Canada, 4 December 1998, para. 77 ("Canada Account transactions are consistent with the interest rates provisions of the OECD Consensus.") (Exhibit Bra-35).

⁸⁰ Panel Report, *supra*, footnote 2, para. 6.161. *See also Id.*, para. 9.225 (footnote 576).

⁸¹ Canadian First Submission, paras. 59-61.

however, that the issue of transparency thus far has had to do with Canada's programmes, not Brazil's.⁸²

78. While Brazil does not, in principle, oppose such an agreement, it considers that resolution of the matter in the context of dispute settlement is not clearly compatible with the spirit, if not the letter, of Article 19 of the DSU. Brazil also believes that such an arrangement is better agreed to by the parties in the course of bilateral discussions. It is, in particular, fundamentally necessary for Brazil that any such arrangement involves balanced and truly reciprocal offers of transparency, not only by Brazil, but also by Canada. Discussions between the parties in this regard are ongoing, but no agreement has been reached either on the specific Canadian and Brazilian programmes to be included and subjected to verification, or on the institutional framework for a potential monitoring mechanism.

V. CONCLUSION

79. For the reasons expressed in this and Brazil's first submission, Canada has not withdrawn the subsidies determined by the Panel and the Appellate Body to be prohibited export subsidies. The implementation measures Canada has adopted, in the case of both TPC and Canada Account, merely suggest to Members that Canada *might not* continue to grant subsidies contingent in fact on export performance, rather than provide an *assurance* that it *cannot* do so.

80. Moreover, Canada's defence - that its implementation measures are protected from challenge until such time as they are actually applied - is untenable. Such a solution reduces Article 21.5 of the DSU to inutility, and would render hollow a finding that a Member had maintained measures inconsistent with its WTO obligations.

81. Accordingly, Brazil requests that the Panel reject Canada's defence, and determine that Canada has not implemented the recommendations and rulings of the DSB with regard to TPC and Canada Account.

⁸² Both the Panel and the Appellate Body noted Canada's failure to produce documents requested by the Panel in the original proceedings. Appellate Body Report, *supra*, footnote 2, para. 199 ("Canada refused to provide the information requested by the Panel."). *See also* Panel Report, *supra*, footnote 2, paras. 6.80, 6.171, 6.203, 6.258, 6.259, 6.260, 6.279, 6.303, 6.304, 6.326, 6.327, 9.176, 9.188, 9.218, 9.244, 9.253, 9.272, 9.293, 9.294, 9.299, 9.303, 9.313, 9.314 (footnote 621), 9.327, 9.345, 9.347 (footnote 633).

LIST OF EXHIBITS

TPC News Release, 10 January 2000	Exhibit Bra-30
TPC News Release, 17 November 1999	Exhibit Bra-31
<i>About the Industry Sector of Industry Canada</i> , Industry Canada website, published 27 May 1999	Exhibit Bra-32
First Written Submission of Canada, 16 November 1998, para. 173	Exhibit Bra-33
First Oral Submission of Canada, 26 November 1998, para. 101	Exhibit Bra-34
Second Written Submission of Canada, 4 December 1998, para. 77	Exhibit Bra-35

ANNEX 1-3**FIRST ORAL STATEMENT OF BRAZIL**

(6 February 2000)

Mr. Chairman and Members of the Panel,

1. Brazil thanks the Panel for this opportunity to present its views regarding Canada's implementation of the Report in *Canada - Measures Affecting the Export of Civilian Aircraft*. As the Panel is aware, Brazil considers that the implementation measures adopted by Canada to withdraw subsidies provided by the Canadian government to the regional aircraft industry *via* two programmes - Technology Partnerships Canada, or "TPC," and Canada Account - are inadequate. The measures remain inconsistent with the Subsidies Agreement and the rulings and recommendations of the Dispute Settlement Body.

Significance of 18 November

2. Let me begin by addressing Canada's argument that the Panel may not consider anything that happened before 18 November 1999, the date on which Canada purports to have implemented the DSB's recommendations and rulings.

3. First, Canada argues that Brazil may not, in these proceedings, rely on any documents dated prior to 18 November, even though the facts addressed in those documents remain unchanged after 18 November. In its Rebuttal Submission, Brazil addressed this argument in considerable detail. I would simply note here that where facts remain unchanged by Canada's implementation measures, the publication date of documents supporting those facts is utterly irrelevant.

4. Second, Canada argues that its implementation measures are impervious to challenge under Article 21.5 of the DSU, since no TPC or Canada Account subsidies have been provided to the regional aircraft industry after 18 November. As noted in Brazil's Rebuttal Submission, I ask the Panel to consider the impact that Canada's argument, if accepted, would have on the broad question of implementation not just in this case, but in all cases. Canada's argument would reduce Article 21.5 to inutility.

5. As the Panel is aware, Brazil argues that the structure of TPC, as it applies to the regional aircraft industry, is tainted by *de facto* export contingency. The facts underlying that structure must be changed for Canada to claim that it has implemented the recommendations and rulings of the DSB. The changes made to TPC are merely cosmetic. In Brazil's view, in fact, the only way for Canada to rid TPC of the inference of *de facto* export contingency, as it applies to the regional aircraft industry, is to exclude that industry from TPC funding opportunities, or alternatively, to change radically the programme's eligibility and allocation requirements.

6. Canada argues, however, that Brazil cannot here challenge the amendments made to TPC, since no subsidy has actually been granted to the Canadian regional aircraft industry since 18 November 1999. The obvious implication of Canada's argument is that Brazil must wait until yet another prohibited TPC subsidy is granted to the regional aircraft industry, presumably after the Article 21.5 review has ended, and then begin dispute settlement proceedings anew. In the meantime, Canada demands

that Brazil - and this Panel - simply take Canada's word that it will not do wrong again.

7. This is not acceptable. Were the Panel to accept Canada's argument, the inescapable result would be to lock Brazil into a futile spiral of endless challenges to a continual string of TPC subsidies, identical to ones already judged by this Panel and the Appellate Body to be prohibited. There would be, in that case, no way for Brazil to vindicate its rights and force Canada to observe its obligations. This is not an effective remedy, and cannot be considered acceptable.

8. Canada's position presents this Panel with the same problem faced by the Panel in *Australia - Leather*. That Panel found that the approach urged by Australia, as recorded in paragraph 6.35 of the Report, was unacceptable. In paragraph 6.38 of its Report, the Panel stated that this approach "would grant full absolution to Members who grant export subsidies that are fully disbursed to the recipient before a recommendation to withdraw the subsidy is issued in dispute settlement, and for which the export contingency is entirely in the past." According to the Panel, the drafters of Article 3.1(a) of the Subsidies Agreement would not have included "the strict prohibition against subsidies contingent on export performance, including one-time subsidies contingent in fact on export performance, only to undermine that prohibition by providing a remedy which is ineffective in the case of such subsidies." To ensure an effective remedy, the Panel then required retroactive repayment of the subsidies granted.

9. This is precisely the situation with which this Panel is faced. Canada's proposal is to "withdraw the subsidy" prospectively only, but at the same time to make the measures constituting that withdrawal impervious to challenge.

10. Mr. Chairman, Brazil believes that the decision in *Australia - Leather* to require retroactive repayment was wrong, and that such a result is not required by the language of the Subsidies Agreement. However, Canada leaves the Panel in this case with no choice. If, under Canada's theory, Brazil is not permitted to challenge Canada's amendments to the TPC, the only remaining remedy is the retroactive repayment of TPC subsidies provided to the regional aircraft industry. Leaving Brazil without any effective remedy would negate completely the "strict prohibition against subsidies contingent on export performance" included in Article 3.1(a).

11. Brazil therefore requests, first and foremost, that the Panel reject Canada's argument that its implementation measures, in the form of amendments to the TPC, are impervious to challenge under Article 21.5. In the alternative - and although Brazil does not in general agree with the requirement of retroactive repayment of prohibited export subsidies - Brazil requests that should the Panel accept Canada's argument, it then recommend the retroactive repayment of TPC subsidies to the regional aircraft industry. Later in this statement, I will have more to say about the similarities between the facts of *Australia - Leather* and the facts of this case, should it be necessary for the Panel to reach the question of retroactive repayment of TPC subsidies to the regional aircraft industry.

TPC

12. I now turn to the substance of Canada's implementation measures regarding TPC. Brazil has demonstrated in detail that those measures make nothing more than

cosmetic changes to the documents underlying TPC. Canada's actions fail to meet its obligations to achieve effective implementation.

13. TPC subsidies to the Canadian regional aircraft industry were not held to be *de jure* export contingent. Rather, those subsidies were determined by this Panel and the Appellate Body to be contingent *in fact* upon export performance. In other words, this Panel, affirmed by the Appellate Body, determined that in providing subsidies to the regional aircraft industry *via* TPC, Canada *circumvented* the Subsidies Agreement. As the Appellate Body noted at paragraph 167 of its report in this case, "the Uruguay Round negotiators have, through the prohibition against export subsidies that are contingent *in fact* upon export performance, sought to prevent circumvention of the prohibition against subsidies contingent *in law* upon export performance."

14. Canada contends that merely removing the term "export" from TPC documents constitutes effective implementation. As I will discuss shortly, that would normally be true for subsidies that are contingent *in law* on export, but it is not true for subsidies that are contingent *in fact* on export. However, even if we accept, for the sake of argument, that Canada is correct, Brazil has shown in its submissions that Canada has failed to meet even its own measure of what constitutes effective implementation. Canada has failed to provide most of the documents associated with the "new" TPC to the Panel. As Canada itself admitted, in its Exhibit 9, it has failed to provide 68 percent of those documents. Canada cannot maintain that it has effectively implemented the DSB's recommendations and rulings by virtue of changes to TPC's documentation, without providing that documentation. Moreover, Brazil has demonstrated that those few documents Canada has provided still reveal a number of the factors considered by the Panel to support a finding of *de facto* export contingency.

15. But Canada's discussion of TPC *documents* is beside the point. As I have already noted, removing the term "export" from those documents might have been sufficient implementation had TPC been judged contingent *in law* on export performance. It is not, however, sufficient to remedy something determined to have *circumvented* the Subsidies Agreement; that is, something determined to be contingent *in fact* on export performance.

16. Remedying *de facto* export contingency requires more than merely going through a checklist of what Canada terms, at paragraph 21 of its First Submission, "the factual elements considered relevant by the Panel and Appellate Body in determining that contributions to the Canadian regional aircraft industry" were *de facto* export contingent. As stated in paragraph 6.21, footnote 24 of *Australia - Leather*, "the specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance ... and therefore prohibited do not, in our view, determine what is required in order to 'withdraw the subsidy' ..."

17. In other words, the task of remedying *de facto* export contingency is not a mere matter of formula. For implementation to be effective, more than "the specific details of the factual evidence underlying the conclusion that" TPC subsidies were *de facto* export contingent must change. However, the facts leading to the inevitable "*inference*" of TPC's *de facto* export contingency have not or cannot be changed. For this reason, Brazil has argued that TPC, as it applies to the regional aircraft industry, must be withdrawn in its entirety.

18. At a minimum, since Canada was judged to have circumvented the prohibitions of the Subsidies Agreement by providing TPC subsidies contingent in fact on export, its implementation measures must *ensure* that prohibited export subsidies *cannot* be granted to the regional aircraft industry in future, and not merely that they *might not* be granted.

19. Short of the retroactive repayment of subsidies already granted, requiring positive action by a Member to ensure that such subsidies will not be provided is the only means available to provide an effective remedy. Without such positive action, or in its place, without retroactive repayment, Members lodging successful "as applied" challenges to *de facto* export subsidies would be locked in an unending loop of litigation concerning something that had been already been found to violate the Subsidies Agreement.

20. The problem is that the facts of the "new" TPC do not ensure that prohibited export subsidies *cannot* be granted to the regional aircraft industry in future. Brazil describes those facts in detail in its submissions, and I will not repeat them here. The salient point, however, is that under the "new" TPC, the same, specifically-selected industries will receive even more TPC money than before for the same types of projects. I ask the Panel to note that on page 3 of the Industry Canada news release included as Brazil's Exhibit 18, Canada reports that it has even encouraged those companies whose TPC applications were closed on 18 November 1999 simply "to submit new proposals" under the TPC as amended.

21. In paragraph 22 of its First Submission, Canada claims that its sole motivation with the "new" TPC is "to promote technological innovation and enhance the technological capability of Canadian industry." But "Canadian industry" is not the beneficiary of the "new" TPC. Rather, specifically-selected sectors of Canadian industry are the beneficiaries. And, it is the overwhelmingly export-oriented aerospace industry that will continue to receive two-thirds of all TPC funds, as Canada itself states at paragraph 32 of its first submission.

22. The regional aircraft sector is, moreover, totally export-oriented. As you know, even Bombardier sales to Air Canada were structured as export sales to obtain export financing and to launch an export product. The Canadian government has consistently expressed something considerably short of casual indifference to the trading patterns of this industry, and has in fact explicitly said that it selected this industry to receive TPC funds *because* of its export orientation. Statements like this cannot now be "unsaid." They reveal the intent of the Canadian government in extending TPC funds to this industry. And according to Section 5.15.1.3 of Canada's Special Import Measures Handbook, cited by the United States at paragraph 5 of its submission, Canada considers the grantor's intent to be an important indication of export contingency where a government, rather than revealing a "direct linkage to export performance," instead circumvents the prohibition of export subsidies by establishing *de facto* export contingency.

23. Brazil has also demonstrated that, given the regional aircraft industry's virtually total export-orientation, any consideration of production or sales targets for applicants will, necessarily, be a reference to export performance. Additionally, the "strategic benefits," "selection criteria" and "assessment criteria" that must be demonstrated by regional aircraft industry applicants to receive TPC funds are, when applied to that industry, nothing more than euphemisms for export contingency.

Furthermore, Brazil has demonstrated that the "new" TPC retains its "near market" focus, and will continue to fund the same types of projects as it did before. Finally, Brazil has noted that Canada has not granted the Panel access to the majority of documents associated with the "new" TPC - documents that, under the "old" TPC, demonstrated facts from which the inference of *de facto* export contingency was drawn.

24. Under all of these circumstances - in the words of the Appellate Body at paragraph 167 of its Report, "the total configuration of the facts constituting and surrounding" TPC - the "inference" of *de facto* export contingency still exists. Canada's measures do not, therefore, constitute effective implementation. Brazil asks that the Panel so conclude.

Repayment of TPC Subsidies

25. Canada states that it has terminated \$16.4 million in TPC subsidies to the regional aircraft industry as part of what it calls "full and faithful implementation" of the DSB's recommendations and rulings. This \$16.4 million figure apparently represents the amount of outstanding disbursements not yet paid under the five TPC subsidies to the Canadian regional aircraft industry discussed in the original Panel proceedings. Those five large non-recurring grants, discussed in paragraph 9.285 of the Panel Report, totaled \$266.6 million.

26. Whether Canada's prospective termination of \$16.4 million in as-yet-unpaid TPC subsidies is sufficient to achieve effective implementation quite obviously raises the question of the applicability of the Article 21.5 decision in *Australia - Leather*. I have introduced that decision earlier, but allow me to expand somewhat upon it. In that case, the Panel determined that to "withdraw the subsidy" under Article 4.7 of the Subsidies Agreement means more than simply withholding any prospective, not-yet-paid portion of a subsidy. Rather, at paragraph 6.39 of its Report, the Panel determined that to "withdraw the subsidy" means to repay the subsidy.

27. As I have already stated, Brazil believes that the Panel in *Australia - Leather* reached a result that is not required by the language of the Subsidies Agreement. As long as an effective remedy is available apart from retroactive repayment, Brazil does not believe that repayment should, in general and as a matter of law, be recommended.

28. However, Brazil faces two unknowns. First, this Panel may consider itself, like the Panel in *Australia - Leather*, not to be bound by the arguments of the Parties or the Third Parties regarding the issue of retroactive repayment. In that case, it may decide to follow the reasoning in *Australia - Leather*.

29. Second, the Panel may accept Canada's argument that its amendments to the TPC are impervious to challenge under Article 21.5, leaving Brazil without any effective remedy. In that case, as I have already stated, the only way to achieve an effective remedy and uphold the "strict prohibition against subsidies contingent on export performance" is to follow the reasoning of the Panel in *Australia - Leather*.

30. Brazil hopes that neither of these situations comes to pass. But if they do, the Panel will find that the circumstances of *Australia - Leather* are similar to the facts surrounding the grant of TPC subsidies to the regional aircraft industry. Applying the reasoning in *Australia - Leather* to the facts of this case leads to the conclusion that

the TPC subsidies to the regional aircraft industry should be repaid in full and their impact eliminated.

31. First, the form in which TPC subsidies were provided is similar to the form in which the subsidies in *Australia - Leather* were provided. Both cases involve large "investment" grants enjoyed by recipients, and therefore allocable, over a period of time. Second, like the subsidies provided in *Australia - Leather*, TPC subsidies, which were first granted in 1996, were not notified by Canada, under Article 25.2 of the Subsidies Agreement, until 30 April 1999, after the Panel rendered its decision in this case.

32. Third, and again like Australia, Canada was held to have circumvented the Subsidies Agreement *via* the provision of subsidies contingent in fact on export performance. And like Australia, when faced with a determination that it had provided prohibited subsidies, Canada worked a second circumvention; in *Australia - Leather*, as described at paragraphs 6.13 and 6.50 of the Report, Australia simply replaced one *de facto* export contingent subsidy with another. Similarly, under the "new" TPC, the same, specifically-selected recipient industry is to receive even more TPC money to conduct the same types of projects funded by the "old" TPC. As I stated earlier, Canada has even encouraged companies whose TPC applications were closed on 18 November 1999 simply "to submit new proposals" under the "new" TPC.

33. Under these circumstances, the Panel in *Australia - Leather* determined, at paragraph 6.45 of its Report, that nothing less than "full repayment would suffice to satisfy the requirement to 'withdraw the subsidy' ..." Under that line of reasoning, Canada has not secured "full repayment" of the TPC subsidies provided to the regional aircraft industry, and has not therefore withdrawn the subsidy.

34. Once again, I reiterate that Brazil does not believe that this or any other Panel should follow *Australia - Leather*. However, if this Panel accepts the interpretation of Article 4.7 offered by the Panel in *Australia - Leather*, or if it accepts Canada's argument that its amendments to the TPC are not subject to challenge under Article 21.5, it should determine that Canada's failure to secure repayment means that it has not implemented the DSB's recommendations and rulings, and that the subsidies must be repaid.

Canada Account

35. In paragraph 2 of its First Submission, Canada states that its implementation of the DSB's recommendations and rulings regarding the Canada Account involves two steps: first, the completion of Canada Account transactions involving the regional aircraft industry; and second, the adoption of a policy to conform Canada Account financing to the terms of the OECD Arrangement.

36. Brazil has explained why these actions do not constitute effective implementation. The Canadian "policy statement" included as Canadian Exhibit 13 does not, as Canada claims at paragraph 10 of its Rebuttal Submission, state that Canada Account financing "must" comply with the OECD Arrangement. Nor does it state what "comply with the OECD Arrangement" means. Canada now asserts that it means that Canada Account financing will adhere to Item (k) of the Illustrative List of Export Subsidies and the "interest rates provisions" of the OECD Arrangement. The policy statement does *not* say this, but even if it did, neither the statement itself nor anything else

issued by Canada defines what are the "interest rates provisions" with which it intends to comply, or how it will apply those provisions.

37. Brazil has also noted that Canada already stated - on at least three occasions during the original Panel proceedings - that Canada Account financing already complied with the terms of the OECD Arrangement and, specifically, with the terms of Item (k). Extracts from the submissions in which Canada made this statement were included as Brazilian Exhibits 33-35. Contrary to Canada's claim, measures that were already in place at the time of the Panel's and the Appellate Body's ruling cannot credibly be touted as evidence of "full and faithful implementation."

38. Canada Account financing to the regional aircraft industry was determined by this Panel to constitute a prohibited export subsidy. Measures adopted by Canada to implement the Panel's ruling must ensure that the same thing will not happen again. In the absence of information regarding what "comply with the OECD Arrangement" means, or with which "interest rates provisions" Canada intends to comply, Canada will be able to continue to operate Canada Account as a prohibited export subsidy, undetected and undetectable. This is not effective implementation.

39. Several questions arise. For example, does "comply with the OECD Arrangement" mean that Canada Account financing will in every instance be issued at or above the OECD Arrangement's Commercial Interest Reference Rate, with an appropriate add-on for the risk factors associated with the particular transaction and the particular parties involved? Does it mean that all Canada Account financing will in every instance adhere to the 10-year maximum repayment term set by the OECD Arrangement? The Canadian "policy statement" fails to address these questions.

40. In the companion case against Brazil's PROEX, Brazil provided details regarding its implementation measures, and not just vague suggestions styled as government "policy." It offered specifics about how it had amended PROEX to comply with the DSB's recommendations and rulings. In light of Canada's implementation strategy with respect to the Canada Account, maybe Brazil should instead have issued a "policy statement" stating its intention to "comply with the OECD Arrangement." I hesitate to speak for Canada, but my guess is that it would not have found such a statement sufficient to implement effectively the recommendations and rulings of the DSB. I also presume that the Panel in the PROEX case would not have found such a change acceptable. Nor should this Panel, in consideration of Canada's "policy statement" regarding the Canada Account.

41. Brazil is not a Participant in the OECD Arrangement. Our understanding, however, is that it is unenforceable, not subject to dispute settlement, and subject, in its application, to often widely-varying interpretations by its various Participants. Under these circumstances, there is no way of knowing what Canada means when it says it will "comply with the OECD Arrangement" or the "interest rates provisions" included in the Arrangement.

42. Based on the information provided, Canada cannot possibly claim that it has put in place what it purports at paragraph 2 of its First Submission to be "new measures to ensure full and faithful implementation of the DSB rulings and recommendations." Canada has not offered anything "new" at all with regard to Canada Account, and has fallen well short of providing assurances that Canada Account cannot continue to provide prohibited export subsidies to the regional aircraft industry. The Panel should conclude that this is not effective implementation.

Conclusion

43. In conclusion, Brazil requests that the Panel determine that Canada has not implemented the recommendations and rulings of the DSB, with regard to both TPC and the Canada Account. Once again, Brazil thanks the Panel for this opportunity to present its views, and welcomes any questions the Panel might have.

ANNEX 1-4**CONCLUDING STATEMENT OF BRAZIL**

(6 February 2000)

Mr. Chairman and members of the Panel:

1. We heard a large number of arguments from the parties and the third parties today, some referring to technical details of the case, some to political considerations, some to procedural aspects of the case. I felt that, in the midst of all these arguments, we may lose the focus of what is really at stake before the Panel, and of what the essence of this case is. That is why I choose to make this brief summary of Brazil's views.

2. I guess the best way to start is to picture a scenario. I would ask the Members of the Panel to imagine a situation where a given country has a highly export-oriented industry. Some segments of this industry reach 100% export orientation. That country decides to support the export sales of that industry and builds a subsidy programme around it. The programme is *very carefully* designed to avoid a possible finding of *de jure* export contingency. At first 90% of all funds in the programme are directed to that industry, and in subsequent years, never less than 2/3 of the funds are allocated to that same highly export-oriented industry.

3. A Member who is directly affected by the exports of the beneficiary industry questions that programme in the WTO. A Panel constituted to examine the dispute understands that it is not facing a case where an industry that happens to be highly export oriented incidentally receives subsidies. That Panel finds that it is before a case where a highly export-oriented industry is specifically targeted to receive massive subsidies *because* it exports.

4. After the DSB recommends that the subsidizing country *withdraw* the prohibited subsidy - and not merely bring it into conformity with the WTO disciplines - that country completely ignores those recommendations and simply makes cosmetic alterations to the regulations of the original subsidizing programme. For example, they delete the word exports from all flyers and administrative documents.

5. The subsidizing country announces that it now has a "new" programme and that it has faithfully implemented the recommendations of the DSB. The fact, however, is that under this "new" programme the same companies will continue to receive subsidies to use in the same type of projects approved under the "old" programme. Actually, they will now receive even more money, since the results of the original programme have proven to be quite successful.

6. Such "implementation" is obviously challenged by the complaining country, which brings about Article 21.5 procedures. Under these procedures, the complainant shows unequivocally that the programme remains essentially the same and requests that the Panel make a finding of non-implementation. The subsidizing country nonetheless alleges that it has put in place a new programme, which cannot be deemed to be a *de facto* export subsidy. After all, it implemented the recommendations of the DSB in good faith and it could not possibly *prove*, after just a few weeks of implementation, that the *de facto* export contingency has disappeared. The complainant, it submits, is proposing a burden of proof that is **impossible** to be met. It

further argues that, quite on the contrary, it is the complainant who bears the burden of proof. It is the complainant that has to prove that the "new" programme is also *de facto* contingent on export subsidies. Furthermore, such proof would have to be based on "new" factual evidence, which could positively infer that the payments under the new subsidy programme are still *de facto* contingent on exports.

7. Mr. Chairman and members of the Panel, Brazil agrees that the complainant has the initial burden of proof, but since no payments were made under the new programme, it would be impossible for the complaining country to meet the standards suggested by this subsidizing country. The subsidizing country figures, therefore, that if it takes no actions during 60 or 90 days - or whatever the duration of the Article 21.5 Review Panel is - it will get away with its carefully planned circumvention of the Subsidies Agreement. The "impossible" burden of proof is now on the complainant.

8. Turning to the specific case of TPC payments, let me recall that the Appellate Body put before us a three-part test. First, one has to establish the "granting of a subsidy" - and Canada does not dispute that this occurs. The second part of the test concerns the expression "tied to". Finally, one should determine that exports are "anticipated" or "expected". Canada does not dispute that the regional aircraft industry in Canada is highly export-oriented, and even pointed out that this is a fact that will not change. Canada anticipates and expects export sales from that industry and this is not disputed either. What Canada does argue, is that Brazil failed to meet the second part of the test, the one concerning the "tied to" provision.

9. Mr. Chairman, Brazil has provided conclusive evidence that the targeted industries of the "old" TPC are the same recipients under the "new" TPC. Canada itself confirmed that when answering a follow-up question posed by you this morning. When it first examined this case, this Panel found that the way TPC was conceived and operated provided ample evidence that the subsidies granted to the targeted industries were "tied to" anticipated and expected export earnings. The Appellate Body unconditionally confirmed this finding. Under the "new" TPC the same three industries are targeted and Canada knows that whatever sales are made by those industries will be almost entirely directed to foreign markets. Nothing has changed, the granting of the subsidy is still firmly "tied to" anticipated and expected export earnings of the same industry.

10. Brazil showed that we still have the same answers to the three parts of the test the Appellate Body put before us. By doing this, Brazil has given the Panel ample evidence that Canada did not implement the recommendations of the DSB and has, therefore, met its burden of proof. On the other hand, Canada has given us nothing that would resemble a credible effort to implement those recommendations. It claims, nonetheless, that it must be *deemed* to be in compliance, since it has adopted the implementing measures in good faith and that Brazil is proposing a standard of proof that is *impossible* to meet. I will soon show that this is definitely not the case.

11. Mr. Chairman, Brazil admits that the task to implement recommendations to *withdraw a de facto* export subsidy is more complex than when we are dealing with a *de jure* export subsidy; but it is by no means impossible, as Canada claims.

12. One possible way to implement the findings on TPC could be, for example, the simple withdrawal of the 100 per cent export-oriented regional aircraft industry from the list of eligible recipients of the programme.

13. Nevertheless, if Canada still wanted to avoid such action, its changes to the regulations of the programme would have to *ensure* that the *de facto* contingency would not exist anymore. Let me recall that payments under the "old" TPC were not found to be *de jure* contingent on exports. However, Mr. Chairman, the regulatory changes made to TPC not only would *allow* the programme to be operated as before, it virtually *ensures that it will*. The representative from the EC said in the third party session that Canada must be given the "benefit of the doubt". There is no doubt here Mr. Chairman. TPC *will* operate as before, will benefit *exactly* the same companies - but, I forgot, now there will be even *more* money to be dispensed.

14. Canada claims that it could not possibly make changes to TPC that would ensure that the *de facto* contingency would disappear. This is an impossible task they say. Let me assure you Mr. Chairman that this is not true. It would not be particularly difficult to devise changes to the programme that would ensure the withdrawal of the export contingency. I could think of hundreds of alternatives.

The Chairman of the Panel asks if Mr. Azevêdo could provide examples of these alternatives.

15. Mr. Chairman, certainly the Canadian officials are aware of the concept of general availability of a subsidy. Canada could make TPC subsidies available to all industries. It did not do so. It maintained the programme resources limited to the same highly export oriented industries targeted by the "old" TPC. Canada could also make eligibility automatic and reduce the subjectivity of the criteria and conditions governing the approval of grants. Canada did not do so. Instead, Canada maintained highly subjective criteria and conditions, linking disbursements to vague goals such as "increasing economic growth, creating jobs, and supporting sustainable development", or to "strategic" concerns. I could go on providing examples of how Canada could reduce or eliminate the specificity of the programme, therefore eliminating the contingency on export earnings. But I do not wish to offer Canada an implementation roadmap. I wonder if later they would not simply characterize these examples as a sufficiency test proposed by Brazil.

16. The point is that Canada could have introduced changes that would ensure that, operating with a broader range of automatically eligible recipients (export oriented and otherwise), the granting authority had little or no room to arbitrarily make funds available based on the export propensity of the beneficiary. Canada *chose* not to do so. In fact Canada scrupulously tried to make sure that the programme would function just as it did before. The standard proposed by Brazil is by no means impossible to meet. It falls well within the boundaries of what is reasonable.

17. With regard to the Canada Account I believe that there's not a whole lot to be said. Before this Panel, during the original procedures of this case, Canada affirmed, in good faith I am sure, that Canada Account complied with the terms of the OECD Arrangement. Brazil pointed this out in its submissions in the current proceedings. Regardless of that good faith interpretation of the OECD Arrangement, this Panel found Canada Account to violate the SCM Agreement - a finding confirmed by the Appellate Body. Canada has now issued a "policy guideline" which, in effect, merely reproduces in writing what Canada had already said it was doing before the programme was found to grant prohibited subsidies.

18. If this is to be considered as effective implementation Mr. Chairman, the implications for the Multilateral Trading System would be grave indeed. Members could from then on feel obliged to merely state in writing, as a policy guideline or as part of a regulation, that the programmes found not to be in conformity with the WTO Agreement will henceforth operate in full compliance with the recommendations of the DSB; in compliance with the WTO Agreements; or any similar variation. In good faith, Mr. Chairman, they will then interpret the DSB recommendations, or the WTO Agreements, and implement the "new" programmes as they see fit. In the case of the Canada Account, the WTO Members not participants in the OECD Arrangement, as Canada itself asserts, would not even be able to verify such implementation.

19. I would further note that, regarding Canada Account, Canada itself acknowledges the issue of interpretation of the OECD Arrangement. Let me read a sentence found in the introductory paragraph of the document where Canada lists what it considers to be the relevant interest rate provisions of the OECD Arrangement: "within limits, variations of certain of these provisions are permitted under the terms of the Arrangement." Mr. Chairman, the DSB found that Canada Account subsidies were to be withdrawn, and Canada asks Brazil and the other WTO Members to believe that, from now on, they will interpret the OECD Arrangement, in good faith as before, but now in ways that would not be found to be in violation of the SCM Agreement.

20. Mr. Chairman, *nothing* has changed with regard to Canada Account. If Canada's policy guideline is found to be effective implementation, the multilateral trading system will have suffered a serious setback.

ANNEX 1-5**RESPONSES BY BRAZIL
TO QUESTIONS FROM THE PANEL
(14 February 2000)***Canada Account*

Q1. Could Brazil please elaborate regarding the basis on which it considers the Policy Guideline "purely hortatory" (Brazil's second submission at para. 69)? In Brazil's view, what changes would be necessary for it to become mandatory?

Response

The Policy Guideline adopted for Canada Account is hortatory because, according to Brazil's information, Policy Guidelines are not binding in Canadian law and cannot fetter Ministerial discretion. They provide guidance on how decision makers will exercise their discretion, but they are not binding and do not require a specific outcome. In *Maple Lodge Farms v. Canada* [1982] 2SCR 2 at 7, the Supreme Court of Canada held that Ministerial discretion cannot be fettered through the issuance of a Policy Guideline.

The Federal Court of Canada has also held that Policy Guidelines may be issued, but should not be drawn so narrowly that they "crystallize into binding and conclusive rules." See *Dawkins v. Canada* [1992] 1 FC 639 at 649. Similarly, decision-makers that issue Policy Guidelines may not construe those Policy Guidelines as binding obligations which restrict their ability to exercise discretion. *Saunders Farms v. B.C.* [1985] 32 Admin. L.R. (2d) 145 (BCCA).

Therefore, the Policy Guideline adopted by Canada for use with Canada Account cannot bind the Minister because that would fetter Ministerial discretion and violate Canadian law. Consequently, as the Policy Guideline is not binding but merely provides direction, it is merely hortatory.

In fact, Canada's actions demonstrate that its Policy Guideline does not remove Canada Account financing from the category of prohibited export subsidies; the policy was already in existence before the Panel determined that Canada provided prohibited export subsidies *via* the Canada Account. Despite the fact that Canada stated to the Panel in the original proceedings, on at least three different occasions, that Canada Account financing and loan guarantees for exports "have been consistent with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I," the Panel determined that Canada Account support constituted prohibited export subsidies.¹ If this policy did not provide a disincentive for Canada to maintain

¹ First Written Submission of Canada, 16 November 1998, para. 173 (Exhibit Bra-33). See also First Oral Submission of Canada, 26 November 1998, para. 101 ("Canada Account financing and

prohibited export subsidies *via* the Canada Account *before* the Panel's determination, why would it do so *after* the Panel's determination?

As to what changes would be necessary for the guideline to become mandatory under Canadian law, Brazil would note that it is not expert on Canadian law. However, it would seem that a minimum mandatory language should be used, and provision should be made for consequences in the event of non-compliance.

Q2. Does Brazil agree with Canada's identification of the "interest rate provisions" of the OECD Arrangement as set forth at paragraphs 69-80 of its oral statement and in the document provided by Canada entitled "Item (k): Interest Rates Provisions of the OECD Arrangement"? Are there other provisions of the OECD Arrangement that Canada has not mentioned but that in Brazil's view form part of the "interest rate provisions" of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies? Are there any provisions identified by Canada that in Brazil's view do not form part of the "interest rate provisions" of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies? Please explain in detail.

Response

Brazil, like most Members of the WTO, is not a Participant in the OECD Arrangement, and for that reason has limited knowledge of the Arrangement and its workings. Therefore, rather than questioning the specific list of "interest rates provisions" listed by Canada, Brazil has asked Canada a series of questions regarding the significance of the provisions it cites.

It should fall to Canada, as one of a minority of WTO Members that is a Participant in the Arrangement, to explain what those provisions are and how, precisely, it will apply them. As stated in its Statement to the Panel, Brazil's understanding is that in their *application* - and not merely in their *identification* - the provisions of the OECD Arrangement are subject to widely-varying interpretations by the various Participants. There is no dispute settlement mechanism in the Arrangement to regulate or constrain those different interpretations. There are no publicly-available documents recording the agreement of the Participants to abide by particular interpretations of particular provisions.

Brazil understands, however, that in applying the Arrangement, some Participants have adopted rather controversial interpretations of various provisions that affect the scope of financing subject to the disciplines of the Arrangement. Brazil's questions to Canada are posed in an attempt to discover whether Canada itself, as a

loan guarantees for exports committed since the entry into force of the SCM Agreement have complied with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I.") (Exhibit Bra-34); Second Written Submission of Canada, 4 December 1998, para. 77 ("Canada Account transactions are consistent with the interest rates provisions of the OECD Consensus.") (Exhibit Bra-35).

Participant in the Arrangement, has adopted some of these interpretations in its provision of export financing.

We begin, for example, with Article 2 of the Arrangement, which states that it applies to "official support for exports." The Arrangement contains no definition of the term "official support," and Brazil has confirmed with the OECD that the Participants have not reached agreement on a definition.² As a result, Brazil understands, some Participants take the position that "official support" consists only of the provision of support at rates below a government's cost of funds. According to those Participants, support extended at rates equal to or above the government's cost of funds constitutes so-called "market window" support. These Participants consider that, so long as support is granted through this "market window," it may be provided at rates below the minimum Commercial Interest Reference Rates ("CIRR") applicable to "official support" for exports. This interpretation of the "market window" exception may be perfectly acceptable, but it demonstrates why Brazil considers Canada's statement that it will "comply with the OECD Arrangement" ambiguous.

Further, there is an apparent discrepancy in the particular "interest rates provisions" identified by Canada, even under Canada's own standard. According to Canada, the "interest rates provisions" of the OECD Arrangement, incorporated into Item (k), include those provisions that "affect what the interest rate and the amount of interest payable will be in a given transaction."³ Brazil understands that the so-called "Knaepen Package," which took effect on 1 April 1999, requires Participants to adhere to certain sovereign and country risk premiums. These requirements may have been incorporated into the Arrangement, and may be incorporated *via* Canada's listing of Article 21(a). As a non-Participant, Brazil does not know whether this is the case. However, those requirements, which in Canada's words "affect what the interest rate and the amount of interest payable will be in a given transaction," should be included as "interest rates provisions" of the Arrangement, or Canada should explain why they are not. Thus far, Canada has been silent on this point.

Finally, Brazil has not knowingly asserted in this proceeding that Canada will not comply with the "non-derogation commitment," as Canada argues at paragraph 71 of its Oral Statement. Indeed, Brazil is not certain what that commitment is, and Canada has not specified which provisions compose the "non-derogation commitment set forth in the Arrangement." If Canada is referring to Article 27, however, titled "No Derogation for Export Credits," Brazil notes that Canada has not included this provision on its list.

Q3. Could Brazil describe in detail what it considers is required for full compliance with the interest rate provisions of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies. That is, what precisely would Canada have to do for Canada Account

² OECD Arrangement, Article 88. *See also* Correspondence with OECD Secretariat (Exhibit Bra-37).

³ Canadian document provided to the Panel on 6 February 2000, "Item (k): Interest Rates Provisions of the OECD Arrangement," pg. 1.

transactions in the regional aircraft sector to qualify for the safe haven of the second paragraph of item (k)? How if at all does this differ from what Canada has said would be necessary? If Canada Account transactions in the regional aircraft sector complied to the letter with all of the provisions of the OECD Arrangement that Canada identified in paragraphs 69-80 of its oral statement and in the Canadian document entitled "Item (k): Interest Rates Provisions of the OECD Arrangement", does Brazil believe that such transactions would qualify for the safe haven in the second paragraph of item (k)? Please explain in detail.

As discussed in its response to Question 2, Brazil considers that Canada has not fulfilled its implementation commitments by merely listing what it considers the "interest rates provisions" of the OECD Arrangement to be. Canada should state how it intends to apply those provisions, and what it means when it says it will "comply" with them.

Brazil has described above the ambiguities surrounding the application of the Arrangement regarding, for example, the definition of "official support" and the concept of "market windows." Without information from Canada regarding how it intends to *apply* each of the provisions included on its list, a non-Participant like Brazil will have no way of knowing what to "comply with" those provisions actually means. Only with this information could the Panel, or any WTO Member who is a non-Participant in the Arrangement, reasonably determine whether the Canada Account, as the Panel's question states, "complies to the letter with all of the provisions of the OECD Arrangement" included on Canada's list.

The Arrangement would appear to make the obtaining of information difficult for non-Participants. For example, it appears to Brazil that Article 52 of the Arrangement requires a Participant intending to match alleged non-conforming terms and conditions by another Participant to inform that Participant. However, Article 53 appears to permit a Participant to match the alleged non-conforming terms and conditions of a non-Participant by simply notifying other Participants of that fact, with no notice to the non-Participant. Thus, if the matching provisions of the OECD Arrangement were considered to be part of its "interest rates provisions," it would appear that a Participant would have to notify another WTO Member that is a Participant but not one that, like Brazil, is not a Participant. It is also unclear to Brazil what a non-Participant's obligations would be under these provisions. The point is, however, that it is up to Canada as the Member invoking the second paragraph of Item (k) to explain whether it intends to comply with these, and the other provisions, and if so, how it intends to do so. This is not a question of proof; it is a question of explanation.

Q4. Concerning Canada's proposal that the Panel endorse the verification mechanism suggested by Canada, Brazil states that it considers that resolution of the matter in the context of dispute settlement "is not clearly compatible with the spirit, if not the letter, of Article 19 of the DSU" (Brazil's second submission at para. 78). Could Brazil please elaborate on this point. In particular, in what specific sense might Canada's proposal be considered out of keeping with the

spirit and with the letter of Article 19? Are there any other provisions of the DSU or the SCM Agreement that would be relevant to Canada's proposal?

Response

Under Article 19.1 of the DSU, a Panel may make recommendations that a Member violating its commitments bring its measure into conformity with a particular agreement. Within the context of prohibited export subsidies, however, Panels are, more specifically, required by Article 4.7 of the Subsidies Agreement to recommend that a Member providing such a subsidy "withdraw the subsidy." Put simply, while a bilateral transparency and verification mechanism may be desirable, it is not a replacement for the requirement that Canada withdraw the prohibited export subsidies identified in the recommendations and rulings of the DSB. Canada is proposing that the Panel recommend verification, not implementation. Brazil would also note that Article 3.2 of the Dispute Settlement Understanding provides that recommendations and rulings of the Dispute Settlement Body cannot add to the obligations of the Members. A verification requirement would add to the obligations of the parties.

Bilateral discussions between Brazil and Canada regarding transparency and verification of programmes maintained for the support of their regional aircraft manufacturers are on-going. Whether those discussions succeed or fail will depend in part on Canada's willingness to submit a broader range of programmes than merely the Canada Account and TPC to the terms of any transparency and verification arrangement. Any such arrangement must be truly reciprocal to be acceptable to Brazil.

Further, the proposed bilateral agreement envisions the disclosure of extensive amounts of highly confidential commercial information. Confidentiality requirements, therefore, are vital in any bilateral arrangement. As the Panel is aware, confidentiality has been, and continues to be, an issue in these cases.

The Panel will recall that in Brazil - Export Financing Programme for Aircraft, WT/DS46, the interim report of the original Panel, containing its findings and conclusions, was prematurely released to the Parties, despite the understanding - otherwise adhered to in these proceedings - that all reports would be issued simultaneously. Late in the afternoon of the premature release, Northwest Airlines announced that it was awarding a contract for a large number of aircraft to the Canadian producer, Bombardier, rather than to Embraer of Brazil. Northwest had previously informed both manufacturers that it would await the results of the WTO proceedings before making its decision. Brazil is confident that it did not provide the interim report in DS46 to Northwest.

Likewise, in this Article 21.5 proceeding, the Panel will recall that Brazil's confidential Second Submission to this Panel somehow was obtained by the European Communities, despite the fact that it had not been provided to the EC by Brazil. While it has not been established exactly how the unauthorized disclosure to the EC occurred, the Panel will appreciate that incidents of this nature do not contribute to building confidence that unauthorized disclosure of highly sensitive commercial information under a transparency agreement will not occur.

Technology Partnerships Canada

Q1. At paras. 18 and 19 of its second submission, Brazil claims that "[a]t a minimum, Canada's implementation measures must ensure that prohibited export subsidies cannot be granted to the regional aircraft industry under the facts surrounding the operation of the TPC programme ..." (emphasis in original). Out of preference, Brazil would have Canada implement the Panel's findings on TPC assistance by eliminating the TPC programme altogether with respect to the regional aircraft sector.

- (a) *Please comment on Canada's assertion (para. 32 of oral submission of Canada) that, with regard to TPC assistance to the regional aircraft industry, Brazil has set Canada an "impossible burden of proof". Is it possible, in practice, for a panel to verify that a sovereign state has eliminated all discretionary authority to grant de facto export subsidies to a specific sector of its domestic industry? Is the elimination of all such discretionary authority required by Article 3.1(a) of the SCM Agreement?*

Response

Brazil does not agree that it suggested that a sovereign state must eliminate all of its discretionary authority. Obviously, a sovereign state cannot do that and remain a sovereign state. Nor does Brazil agree that it has set Canada "an impossible burden of proof." Brazil recognizes that it bears the burden of showing that Canada has failed to implement, and Brazil has done so. Brazil has shown that all the essential elements of the programme remain unchanged, and that many of these elements will never change. It then becomes Canada's burden to explain how Brazil was wrong and how Canada's purported changes actually constitute effective implementation. This Canada has not done. This is especially true here, where Canada has admitted that it has not in fact yet even completed its revisions of the programme.

The Panel will not, of course, be able to verify in these Article 21.5 proceedings that Canada never again will grant a subsidy *de facto* contingent on export to the regional aircraft industry. For the recommendations and rulings of the DSB in this case to have any meaning, however, withdrawal of the prohibited subsidy should consist of measures that make it clear to the Panel that Canada is not simply going to continue the same programme as before once these proceedings are completed. Otherwise, to obtain an effective remedy, Brazil would be required to engage in endless challenges to future generations of TPC subsidies issued under circumstances virtually identical to ones already judged to be prohibited by this Panel.

Brazil does not consider that the elimination of all discretionary authority is required by Article 3.1(a) of the Subsidies Agreement. For example, in Brazil's view, Article 3.1(a) does not prohibit the exercise of discretion in evaluating the financial or technical feasibility of a proposal. Rather, the specific question in this proceeding is whether Canada has "withdrawn the subsidy," under Article 4.7 of the Agreement. Under the "new" TPC, Canada has not withdrawn the subsidy; instead, the same, specifically-selected industries will receive even more TPC money than before for

the same types of projects. By any reasonable standard, this is not sufficient to achieve the effective remedy required by Article 4.7.

- (b) *Would elimination of the TPC programme have the effect desired by Brazil (i.e., elimination of discretionary authority to grant prohibited export subsidies to the Canadian regional aircraft industry) if Canada were subsequently able to introduce a new programme that could, in principle, lead to the grant of de facto export subsidies to the Canadian regional aircraft industry?*

Response

Brazil agrees that it is not possible to prevent all eventualities. However, the fact that a remedy could be subject to manipulation, does not mean that no remedy should be provided. Regardless of what new programmes are created in the future, the issue now before the Panel is whether Canada has fully implemented the DSB's recommendations and rulings.

Q2. Does Brazil consider that the provision of specific subsidies to export-oriented industries - in the absence of other factual considerations demonstrating de facto export contingency - necessarily violates Article 3.1(a) of the SCM Agreement? Please explain.

Response

When an industry is specifically targeted for a subsidy *because* of its undisputed export orientation, a violation of Article 3.1(a) of the SCM Agreement occurs. As the United States said, at paragraph 7 of its Third Party Submission, "there is a fundamental difference between a government granting a subsidy to an enterprise which happens to export and a government granting a subsidy to an enterprise *because* it exports."⁴

Moreover, Brazil has demonstrated that the export-orientation of the industry has not changed since the original Panel proceedings, and Canada has acknowledged that it maintains the same focus in the "new" TPC as it did in the "old" TPC - two-thirds of all funds will continue to go to the aerospace industry. Canada cannot maintain the identical focus on this industry, originally *selected because* of its exports, in the "new" TPC, with the export-orientation of the industry as evident as ever, and expect that the motivations underlying this focus in the "old" TPC are no longer relevant.

The Panel will recall that the Appellate Body concluded that a *de facto* export subsidy exists when it is "tied to" actual or anticipated exportation or export earnings. Brazil has shown that TPC subsidies were and, under the "new" TPC, will continue to be, provided to the aircraft sector *because* of its high export performance. As Can-

⁴ Emphasis in original.

ada has decided to provide subsidies to this industry *because* it exports, TPC subsidies clearly are "tied to" actual or anticipated exportation or export earnings.

Q3. At footnote 62 of its second submission, Brazil states that, "to reach sales forecasts", the Canadian regional aircraft industry must export. Is the grant of TPC assistance to the regional aircraft sector contingent on fulfillment of sales forecasts?

Response

Brazil noted in its submissions to the Panel that Canada has not yet provided 68 per cent of the documents associated with the "new" TPC. Therefore, Canada has made it impossible to determine whether this or other factors considered by the Panel in the original proceedings to constitute evidence demonstrating *de facto* export contingency are maintained in the "new" TPC. Canada has also admitted to the Panel that it has not yet completed the revision of many of these documents. For these reasons alone, the Panel may properly find that Canada has failed to implement the recommendations and rulings of the DSB.

Under the TPC Aerospace and Defence Sector Generic Model Agreement, applicants are required to report forecast and actual sales.⁵ Since Canada did not provide a new version of this document by the deadline for implementation of the recommendations and rulings of the DSB, the Panel should presume that the prior version still applies. Given its status as a generic form agreement, there is no reason why a new version of this document will not be created "until such time as the restructured programme approves and contracts new investments," as Canada suggests.

Brazil also notes that even after 18 November 1999, TPC's website states that TPC contributions, 65 per cent of which are allocated to the aerospace industry, "are forecasted to generate sales of more than \$89.6 billion ..."⁶ TPC therefore records and tracks sales forecasts.

Finally, Brazil notes that under the "new" TPC, one form of repayment of TPC contributions will be based upon "royalties on total company or division sales."⁷ To prepare a repayment schedule based upon royalties from sales, TPC must obtain information on and evaluate forecasted sales.

Q4. If, hypothetically (and as Brazil claims), the current measures taken by Canada to comply with the DSB recommendation are not a sufficient change in the factual situation which led to the initial conclusion that TPC assistance to the regional aircraft industry is de facto contingent on export, what alternative action(s) does Brazil consider Canada could take to implement the DSB

⁵ *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body, para. 9.340 (bullet point 10) ("Panel Report").

⁶ TPC Current Statistics, 6 December 1999 (Exhibit Bra-17).

⁷ Industry Canada News Release, 18 November 1999, pg. 4 (Exhibit Bra-18).

recommendation other than withdrawal of the TPC programme in respect of the Canadian regional aircraft industry?

Response

Alternatives available to Canada would include making TPC funds available to Canadian industry generally, and changing TPC so that its contributions do not confer benefits, and therefore do not constitute subsidies, within the meaning of Article 1.1 of the SCM Agreement.

Q5. At para. 37 of its first submission, Canada claims that "[t]he restructuring of TPC has removed all elements that had formed the basis for the Panel and Appellate Body finding of de facto export contingency, with the exception of one, namely that the Canadian regional aircraft industry has a high propensity to export its final products". Does Brazil agree that all other elements that had formed the basis of the Panel and Appellate Body rulings on export contingency - with the exception of the export orientation of the Canadian regional aircraft industry - were removed by Canada? If not, why not? If yes, and if the export orientation is the only element remaining, does it not then logically follow that the subsidies granted are no longer export contingent, especially in the light of the Appellate Body's statement in para. 173 of its report that the "export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding"?

Response

Brazil does not agree with Canada's claim that it has removed all elements forming the basis, in the original proceedings, for the determination that TPC contributions to the regional aircraft industry were *de facto* export contingent. In paragraph 15 of its Second Submission, Brazil describes the factors that in its view support a continued inference of *de facto* export contingency and a determination that Canada has not "withdrawn the subsidy":

- **First**, Brazil points to the export-orientation of the industry, along with the specificity of TPC, which maintains two-thirds of its contributions for the aerospace industry. That factor is discussed in the section beginning at paragraph 21 of Brazil's Second Submission (as well as in the section beginning at paragraph 18 of Brazil's First Submission).
- **Second**, Brazil notes that essentially the same projects continue to be eligible for contributions under the "new" TPC as were eligible under the "old" TPC. A discussion of this factor begins at paragraph 34 of Brazil's Second Submission (and is also included in Brazil's First Submission in the section commencing with paragraph 24).
- **Third**, Brazil shows that applicants for funds under the "new" TPC must demonstrate that their proposed project fulfills selection and assessment criteria, and programme goals and objectives, the achievement of which

requires a commitment to export performance. Brazil also demonstrates that the link between these criteria and export is particularly evident for aerospace and regional aircraft industry applicants, which are awarded two-thirds of TPC funds. This discussion begins at paragraph 37 of Brazil's Second Submission (as well as in Brazil's First Submission in the section beginning with paragraph 31).

- **Fourth**, Brazil demonstrates that Canada has not amended or provided documents that the Panel considered resulted in an inference of *de facto* export contingency. Brazil's discussion of this factor begins at paragraph 51 of its Second Submission (and is also included with the section beginning at paragraph 35 of Brazil's First Submission).

In this regard, we would recall the language of the Panel in *Australia - Leather*, at paragraph 6.21, note 24: "The specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement and therefore prohibited do not, in our view, determine what is required in order to 'withdraw the subsidy' within the meaning of Article 4.7 of the SCM Agreement.

Q6. At para. 11 of its oral statement, Brazil "requests that should the Panel accept Canada's argument, it then recommend the retroactive payment of TPC subsidies to the regional aircraft industry". Was this request contained in Brazil's first two written submissions to the Panel? If not, why not? Is Brazil seeking repayment of TPC subsidies to the Canadian regional aircraft industry? If so, what would be the basis for the Panel to recommend repayment?

Response

Brazil's First and Second Submissions did not contain a request for this retroactive repayment, which, as expressly stated in paragraph 11 of its Statement for the Meeting of the Panel, is an alternative, though not a preferred, remedy. Brazil's presentation of arguments regarding the retroactive repayment of TPC subsidies was in response to the circulation of the Article 21.5 decision in *Australia - Leather*, which was not circulated to the Members until 21 January 2000, four days after Brazil's Second Submission was filed on 17 January 2000.

Brazil submits that retroactive repayment may be appropriate only in the event that either or both of two scenarios materializes. First, if the Panel considers itself required to follow the reasoning of the Panel in *Australia - Leather*, Brazil has argued that the factual similarity between *Australia - Leather* and the case at hand make the reasoning of *Australia - Leather* applicable here. Second, if the Panel accepts Canada's argument that "in the absence of any such financial contribution and a full consideration of [the] facts, there can be no grounds to support Brazil's allegations of *de facto* export contingency under the restructured TPC programme,"⁸ Brazil will be left without recourse to Article 21.5 review of Canada's implementation

⁸ Canadian First Submission, para. 45.

measures. In that event, Brazil will be left with no effective remedy apart from the retroactive repayment of TPC subsidies granted to the Canadian regional aircraft industry.

Question to both parties

Please comment on the EC argument (para. 7 of the EC's oral statement) that, in light of the Panel's terms of reference set forth in document WT/DS70/9, "[t]he Panel may not ... in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two programmes at issue have not implemented the Report".

Response

This argument was raised by the European Communities and the parties before the Panel in *Australia - Leather* and was not accepted by that Panel. As Brazil stated in its oral presentation, Brazil believes the EC and the parties were correct in their positions in *Australia - Leather*, and that the case was wrongly decided. However, the fact remains that this Panel, like the Panel in *Australia - Leather*, might not find itself constrained by the positions of the parties. In its statement, Brazil attempted to allow for this fact and to point out the implications of *Australia - Leather* for this case, should the Panel decide to accept the reasoning of that case.

ANNEX 1-6

COMMENTS OF BRAZIL ON CANADA'S RESPONSES TO QUESTIONS FROM THE PANEL

(16 February 2000)

In Canada's answers to questions 1 and 2 posed by the Panel regarding TPC, Canada acknowledges (paras. 53-58) that it has actually completed very few changes to the TPC programme. Canada lists 24 documents pertaining to the TPC programme, but states that it has thus far in fact amended only three of these documents. There are drafts available for 13 documents. However, not even drafts are available for the remaining eight documents, including such potentially important materials as the "Statement of Work" and "Evaluation Framework". Canada's attempts to reform TPC are incomplete, leaving the Panel no basis on which to decide that TPC no longer retains its export contingency. For this simple reason alone, the Panel cannot conclude that Canada has implemented the rulings and recommendations of the DSB.

ANNEX 2-1
FIRST SUBMISSION OF CANADA
 (10 January 2000)
TABLE OF CONTENTS

	Page
I. INTRODUCTION	4434
II. TECHNOLOGY PARTNERSHIPS CANADA	4436
A. Findings of the Panel and the Appellate Body	4436
B. Measures Taken by Canada	4437
1. Termination of Activities under TPC	4437
(a) Canada has Cancelled Funding.....	4437
(b) Canada has Withdrawn Approvals-in-Principle.....	4437
(c) Canada has Closed all TPC Files in the Regional Aircraft Sector	4438
2. Canada has Restructured the TPC Programme	4438
(a) TPC Statements of it's Overall Objectives: The Restructured TPC's Objectives Focus on Innovation and not Export Promotion.....	4439
(b) The Types of Information Called for in Applications for TPC Funding: Information on Exports is not Called for or Accepted under the Restructured TPC.....	4440
(c) The Considerations, or Eligibility Criteria, Employed by TPC in Deciding Whether to Grant Assistance: Eligibility Criteria under the Restructured TPC do not Encompass Export Considerations	4440
(d) The Factors to be Identified by TPC Officials in Making Recommendations about Applications for Funding: under the Restructured TPC Administrators will not Consider Exports when Making Funding Recommendations	4441
(e) The Restructured TPC's Record of Funding in the Export Field Generally, and in the Aerospace and Defence Sector in Particular.....	4442
(f) The Nearness-to-the-Export-Market of Projects Funded: The Restructured TPC is Considerably less Near-Market.....	4442

	Page
(g) Significance of Projected Export Sales to Funding Decisions under the Restructured TPC: There will be no Recording of Projected Export Sales.....	4442
C. As Canada has Complied with the Recommendations and Rulings of the DSB, Brazil's Allegations are Unfounded.....	4442
III. CANADA ACCOUNT.....	4446
A. Findings of the Panel and the Appellate Body	4446
B. Measures Taken by Canada	4447
1. No Outstanding Contracts	4447
2. Canada has Taken Measures in Respect of Future Export Financing Transactions	4447
(a) The Minister has Adopted a Guideline	4447
(b) Canada Proposes the Establishment of Verification Procedures	4448
C. As Canada Has Complied with the Recommendations and Rulings of the DSB, Brazil's Allegations are Unfounded.....	4448
IV. REQUESTED FINDING.....	4450
Annex A.....	4451
LIST OF EXHIBITS	4454

I. INTRODUCTION

1. In *Canada - Measures Affecting the Export of Civilian Aircraft (Canada - Aircraft)*¹ the Panel and the Appellate Body found that contributions under Technology Partnerships Canada (TPC) to the Canadian regional aircraft industry were *de facto* contingent on export performance and thus such contributions were prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Duties* (SCM Agreement).² The Panel also concluded that Canada Account debt financing as applied to certain regional aircraft exports constituted subsidies, which were *de jure* contingent on exports, and thus inconsistent with Articles 3.1(a) and 3.2. Canada did not appeal this finding. On 20 August 1999, the Dispute Settlement Body (DSB) adopted the Reports of the Panel and the Appellate Body. It recommended that Canada bring assistance to the regional aircraft industry under TPC and Canada Account into conformity with its obligations under the SCM Agreement within 90 days, that is by 18 November 1999.

¹ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft")*, WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443 and Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft")*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.

² Unless otherwise stated, all Articles refer to the SCM Agreement.

2. In response, Canada has put in place new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement. In summary:

- with regard to TPC, Canada terminated all obligations for the disbursement of funds to the Canadian regional aircraft sector, and undertook a complete restructuring of the TPC programme to ensure that actual or anticipated exports will play no role whatsoever in eligibility or decision-making regarding future TPC assistance; and
- with respect to the Canada Account programme, transactions financed under this programme were all completed as of 18 November 1999. Further, to prevent prohibited export subsidies under this programme in the future, Canada adopted a policy requiring that any future Canada Account transactions comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits, thus bringing them within the exception of the second paragraph of Item (k) of the Illustrative List of Export Subsidies (Annex I to the SCM Agreement).

3. Described in detail below, these measures fully satisfy the requirement to withdraw the TPC and Canada Account assistance to the Canadian regional aircraft industry that was found to constitute prohibited export subsidies. In addition, these measures ensure - through programmatic changes - that any future assistance under either of these programmes with respect to regional aircraft will be consistent with the SCM Agreement. Canada has, therefore, fully implemented the DSB recommendations.

4. Brazil nonetheless challenges Canada's implementation measures pursuant to Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). It argues that Canada's measures are insufficient to constitute effective implementation of the recommendations and rulings of the DSB.

5. Brazil's contentions have no merit.

6. With regard to TPC, Brazil ignores the termination of ongoing assistance and the restructuring of TPC. It asks the Panel to find export contingency, not based on the three part test established by the Appellate Body, but rather on a combination of past statements made about the programme before restructuring and an argument that TPC objectives of economic growth and jobs should be regarded as legal surrogates for export contingency. Brazil's contentions amount to a request that the Panel find that TPC must cease all contributions under any conditions to the regional aircraft industry because of the export orientation of the sector. That request has no foundation in the SCM Agreement or the recommendations and rulings of the DSB.

7. With regard to the Canada Account programme, Brazil's contentions are equally unfounded. Transactions financed under this programme were all completed as of 18 November 1999. In addition, Canada has adopted measures to ensure that financing under the Canada Account for transactions after 18 November 1999 will have to conform with the exception in Item (k) of the Illustrative List of Export Subsidies.

8. Canada therefore respectfully requests that the Panel reject Brazil's allegations and arguments, and find that Canada's measures implement fully and faithfully the rulings and recommendations of the DSB.

II. TECHNOLOGY PARTNERSHIPS CANADA

A. Findings of the Panel and the Appellate Body

9. In *Canada Aircraft*, the Panel found that that TPC contributions to the regional aircraft sector were subsidies "contingent ... in fact ... upon export performance" within the meaning of Article 3.1(a). Brazil did not allege, and the Panel and Appellate Body did not find, that the TPC programme *per se* constituted an export subsidy under Articles 3.1(a) and 3.2. Rather Brazil challenged, in the words of the Panel "the actual application of the TPC ... programme ... in the Canadian regional aircraft sector".³

10. The Appellate Body upheld the Panel's findings, while further elaborating on the interpretation of "contingent ... in fact ... upon export performance" and modifying the analysis of the legal weight to be accorded to the nearness-to-the-market of a financed project.⁴ *De facto* export contingency, according to the Appellate Body, requires proof of three different substantive elements:

- (1) "the granting of a subsidy";
- (2) that "is tied to";
- (3) "actual or anticipated exportation or export earnings".⁵

11. In agreeing with the Panel that contributions to the regional aircraft industry under the TPC programme as then constituted were *de facto* contingent on export performance, the Appellate Body noted that the Panel considered sixteen factual elements covering a variety of matters, which the Appellate Body grouped into the following eight categories⁶:

- (a) TPC's statements of its overall objectives;
- (b) the types of information called for in applications for TPC funding;
- (c) the considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance;
- (d) the factors to be identified by TPC officials in making recommendations about applications for funding;
- (e) TPC's record of funding in the export field generally and in the aerospace and defence sector in particular;
- (f) the nearness-to-export-market of the projects funded;
- (g) the importance of the projected export sales by applicants to TPC's funding decisions; and
- (h) the export orientation of the firms or the industry supported.

12. The Panel and Appellate Body found that those factual elements *taken together* warranted a finding of a *prima facie* case of *de facto* export contingency. However, the Panel and the Appellate Body both affirmed that the export propensity

³ Panel Report, *supra*, footnote 1, para. 9.282

⁴ Appellate Body Report, *Canada - Aircraft, supra*, footnote 1, paras. 162-180; *see* Panel Report, *Canada - Aircraft, supra*, footnote 1, para. 9.339.

⁵ Appellate Body Report, *Canada - Aircraft, supra*, footnote 1, para. 169.

⁶ Appellate Body Report, *supra*, footnote 1, para. 175

of a recipient could not, by itself, form the basis for a finding of export contingency.⁷ Further, as the Appellate Body emphasised, "the facts must 'demonstrate' that the granting of a subsidy is *linked to* or *contingent upon* actual or anticipated exports. It does *not* suffice to demonstrate solely that a government granting a subsidy *anticipated* that exports would result."⁸

B. Measures Taken by Canada

13. Canada implemented the recommendations and rulings of the DSB by taking two sets of measures. First, Canada terminated all obligations for the disbursement of funds relating to the Canadian regional aircraft industry under TPC as it was previously constituted. Second, in order to ensure that any future transaction involving the Canadian regional aircraft industry would be compliant with the SCM Agreement, Canada comprehensively amended the structure and administration of TPC.

1. Termination of Activities under TPC

(a) Canada has Cancelled Funding

14. As of 18 November 1999, the Government of Canada terminated all obligations for the disbursement of funds pursuant to the five Canadian regional aircraft industry Contributions Agreement cited in *Canada - Aircraft*.

15. As shown in the amendments to the Contribution Agreements contained in Canada's Exhibit 1, the Government of Canada and the private party to each of the Contribution Agreements entered into irrevocable amendments providing that:

"Notwithstanding any other provisions of this Agreement, the Minister shall not, on or after 18 November 1999, disburse any part of the contribution provided for in the Contribution Agreement, whether or not the Claim on which such disbursement would otherwise be made, was submitted before or after 18 November 1999."

16. As a result of these cancellations, more than \$16.4 million of funding has been cancelled.

(b) Canada has Withdrawn Approvals-in-Principle

17. In 1998 TPC had approved-in-principle two projects in the regional aircraft sector, for which no Contribution Agreements had yet been concluded. As documented by letters in Canada Exhibit 2, on 5 November 1999, Industry Canada informed the applicants that it would not proceed with contracts for the projects in question, and the applicants acknowledged that the Minister of Industry has no obligations *vis-à-vis* the applicants pursuant to the prior approvals-in-principle. Conse-

⁷ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, paras. 9.336-9.337; Appellate Body Report, *Canada - Aircraft*, *supra*, footnote 1, para. 173 (stating that "[t]he second sentence of footnote 4 precludes a panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is 'granted to enterprises which export'. In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports.")

⁸ Appellate Body Report, *supra*, at footnote 1, para. 171 (emphasis in original; footnote omitted).

quently, as of 18 November 1999, TPC had no obligation whatsoever to disburse funds to the Canadian regional aircraft industry.

(c) Canada has Closed all TPC Files in the Regional Aircraft Sector

18. As described below, the Government of Canada undertook a thorough restructuring of the TPC programme. The restructuring applied not only to the regional aircraft sector, but to the programme as a whole. To bring all TPC activities under the restructured programme, all files relating to outstanding applications for financial assistance submitted prior to the restructuring were closed as of 18 November 1999. Letters so advising the applicants are contained in Canada Exhibit 3. In order to pursue funding under TPC, applicants must now submit applications under the new programme in accordance with the new Terms and Condition⁹ and the new Investment Application Guide.¹⁰

2. *Canada has Restructured the TPC Programme*

19. Following the Panel and Appellate Body rulings, Industry Canada undertook fundamental amendments to the structure and administration of TPC to ensure that TPC assistance is not contingent in law or in fact upon export performance. Indeed, export performance is not even a consideration in TPC activities.

20. The new restructured TPC came into effect on 18 November 1999. The specific elements of the TPC restructuring are set forth in a series of documents that are described below and appended as Exhibits. The most important of these are the TPC Terms and Condition¹¹, the Special Operating Agency Framework Document (SOA Framework)¹² the Investment Application Guide¹³ and the Investment Decision Document (IDD).¹⁴ These documents set out and reflect the key aspects of the programme, including its mandate, objectives and guiding principles, as well as eligibility and application and requirements and the required format for bringing recommendations forward for approval.

21. Canada has taken all the steps it can to address the factual elements considered relevant by the Panel and Appellate Body in determining that contributions to the Canadian regional aircraft industry under the previous version of the TPC programme were *de facto* export contingent. The following analysis uses the categories employed by the Appellate Body.

⁹ Exhibit Can - 4.

¹⁰ Exhibit Can - 5.

¹¹ *Supra*, note 9.

¹² Exhibit Can - 6.

¹³ *Supra* note 10.

¹⁴ Exhibit Can - 7.

(a) TPC Statements of its Overall Objectives: The Restructured TPC's Objectives Focus on Innovation and not Export Promotion

22. The restructured TPC's objectives, put simply, are to promote technological innovation and enhance the technological capability of Canadian industry. The mandate and overall programme objective of the restructured TPC are set out in the Terms and Conditions and the SOA Framework as follows:

"In a context in which innovation is essential in an increasingly knowledge-based economy, TPC is a technology investment fund established to contribute to the achievement of Canada's objectives of increasing economic growth, creating jobs and wealth, and supporting sustainable development. TPC will advance and support government initiatives by investing strategically in research, development and innovation in order to encourage private sector investment, and so maintain and grow the technology base and technological capabilities of Canadian industry. TPC will also encourage the development of SMEs in all regions of Canada.¹⁵

23. As set out in the SOA Framework, specific programme objectives indicate that contributions under TPC will be administered in a way that will contribute to:

- "increasing economic growth, jobs and wealth;
- supporting sustainable development;
- maintaining and building the industrial technology and skill base essential to a knowledge-based economy;
- encouraging the development of SMEs in all regions of Canada;
- encouraging private sector investment;
- managing the contributions so that all repayments are recycled into TPC, allowing potential for future growth;
- managing the sharing ratios on TPC contributions, with a target of an average TPC sharing ratio of no more than 33 per cent (with typical project sharing ratios between 25 per cent and 30 per cent); and
- taking an investment approach through sharing in rewards as well as risks.¹⁶

24. Consistent with these objectives, the Terms and Conditions stipulate that Aerospace and Defence component:

"...encourages and supports the development and application of those technologies essential for the development of these sectors. It involves projects that sustain and expand the technological capacity and capability of these sectors. Support is also available for defence conversion projects aimed at reducing the dependency of enterprises on military contracts.¹⁷

¹⁵ *Supra* note 12 at section 2.1 and *Supra* note 9 at section 2.

¹⁶ *Supra* note 12 at para. 2.2.

¹⁷ *Supra* note 9 at section 3.1.

25. In short, the restructured TPC's mandate and objectives clearly do not encompass the enhancement of exports or Canada's export base.

- (b) The Types of Information Called for in Applications for TPC Funding: Information on Exports is not Called for or Accepted under the Restructured TPC

26. The restructured TPC's application procedure has been reformed consistent with the new objectives of the programme. As such applicants must provide information on the proposed research and development initiative and its strategic benefit to Canada.¹⁸ The Investment Application Guide does not require the applicant to submit information regarding actual or anticipated exportation and explicitly states that: "*TPC will not accept or consider information concerning the extent to which your company does or may export*".¹⁹

- (c) The Considerations, or Eligibility Criteria, Employed by TPC in Deciding whether to Grant Assistance: Eligibility Criteria under the Restructured TPC do not Encompass Export Considerations

27. All investment proposals submitted for consideration will be evaluated against the revised assessment criteria as set out in the restructured programme's Terms and Conditions. Project assessment concentrates on the contribution that a project makes to improving the technological capability of a firm, rather than on the commercial viability and export potential of a specific product.

28. Applications for contributions are assessed in the context of the relevance of the project to the objectives of TPC and whether they fall within one of the eligible activities set out in section 3.3 of the Terms and Conditions. Specifically, proposals are assessed in terms of the extent to which they demonstrate:

- "a. that the that project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada;
- b. that the project is technologically feasible, and the applicant possesses, or can reasonably be expected to secure, the requisite technological and managerial capabilities, and financial resources, to achieve the stated objectives of the project;

¹⁸ *Supra*, note 10 at section 7. Applicants to the programme have been advised that the Minister of Industry reserves the right to release commercially confidential information, provided in the course of applying for assistance, for the purposes of the conduct of an international or internal trade dispute, in which Canada is a party or a third party intervenor (Investment Application Guide at page 7). Clauses similar to those used in the five contribution agreement amendments (See Exhibit Can - 1) will also now form part of all future contribution agreements. This permits Canada to release commercially confidential information contained in these agreements.

¹⁹ *Ibid.*

- c. that a contribution under TPC is necessary to ensure that the project (either individually or as part of a portfolio of related activities of the applicant) proceeds with the desired scope, timing or location; and
- d. that the contribution can be repaid.²⁰

29. In granting assistance in the aerospace and defence sector under TPC, *as previously constituted*, consideration was given to whether a project maintained and built "upon the technological capabilities and production, employment and export base."²¹ The focus under TPC is now squarely on the "development and application of technology" and the expansion of "technology capacity and capability". Indeed, under the restructured TPC, export performance is explicitly *not* a consideration. Section 6.1 of the Terms and Conditions mandate that:

"TPC will be administered in accordance with Canada's international agreements, and in particular, the granting of contributions will not be contingent, either in law or in fact, upon actual or anticipated export performance."

30. TPC has also taken a number of steps to enhance its transparency and will publicly announce all TPC investments identifying who the recipient is, the amount of funding provided, and the government's rationale for granting the assistance.

- (d) The Factors to be Identified by TPC Officials in Making Recommendations about Applications for Funding: under the Restructured TPC Administrators will not Consider Exports when Making Funding Recommendations

31. When making a funding recommendation under the restructured TPC, officials will base their decision on the information compiled in the course of the due diligence process and summarised in the Investment Decisions Document (IDD). This document, which is included as Canada Exhibit 7, draws out all of the information on a project that is relevant for the purposes of assessing it in relation to the mandate and objectives of TPC. The IDD is submitted to TPC Management Board, the Programmes and Services Board, the Deputy Minister of Industry Canada and the Minister of Industry Canada, as required for approval. The IDD contains all the necessary information to authorise TPC to enter into Contribution Agreements (i.e. the contribution amount, sharing ratio, and any special conditions). Decision-makers are explicitly directed that "TPC will not accept or consider information concerning the extent to which a company does or may export."²²

²⁰ *Supra* note 9 at section 4.

²¹ See Exhibit Can 8 at para. 3.2.3.

²² See Exhibit Can 7 at part 4.

(e) The Restructured TPC's Record of Funding in the Export Field Generally, and in the Aerospace and Defence Sector in Particular

32. While the aerospace and defence component of TPC will continue to receive two-thirds of the programme funds, it cannot be assumed that regional aircraft industry-related projects will receive the majority of the funds. In fact, no new regional aircraft-related projects have been approved or contracted since 14 November 1997.

(f) The Nearness-to-the-Export-Market of Projects Funded: the Restructured TPC is Considerably less Near-Market

33. TPC has been restructured to enable it to be less near-market. The programme's objectives themselves now focus on the contribution a project makes to improving the technological capability of the firm or sector, rather than on the commercial viability and export potential of supported products.

34. The programme now includes Industrial Research as an eligible category; this permits the restructured TPC to support earlier stage research and development that is further removed from the production and sale of specific products. The pre-competitive development category of eligible activity enables TPC to support the development of horizontal technologies that cut across the operations of recipient firms (e.g. measures to improve product quality, improve engineering efficiency, develop generic technologies with multiple applications, etc.) rather than the development of specific products.

(g) Significance of Projected Export Sales to Funding Decisions under the Restructured TPC: There will be no Recording of Projected Export Sales.

35. As noted above, TPC will no longer accept or gather, much less consider, any information whatsoever related to actual or anticipated exports or export sales. Accordingly, TPC Contribution Agreements will not record projections of export sales by recipients as was previously the case.

C. *As Canada has Complied with the Recommendations and Rulings of the DSB, Brazil's Allegations are Unfounded*

36. Canada has terminated all obligations for the disbursement of funds relating to Canadian regional aircraft industry under TPC as of 18 November 1999. It has, in addition, restructured the programme and its administration to de-link funding under TPC from any consideration of actual or anticipated exports or export earnings. Canada has, therefore, complied fully with the recommendations and rulings of the DSB.

37. The restructuring of TPC has removed all elements that had formed the basis for the Panel and Appellate Body finding of *de facto* export contingency, with the exception of one, namely that the Canadian regional aircraft industry has a high pro-

propensity to export its final products.²³ This element is clearly beyond the purview of the TPC. A company's or an industry's export orientation, or lack thereof, is not within the control of the Government of Canada. Moreover, as the Appellate Body has found, the SCM Agreement does not prohibit the granting of subsidies to firms or industries that are export oriented, including in circumstances where the government is aware of this export orientation:

"The second sentence of footnote 4 precludes a panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is 'granted to enterprises which export'. In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports...We agree with the Panel that...the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and *it is not the only fact supporting the finding*. [emphasis added]"²⁴

38. Despite the measures taken by Canada with respect to TPC, Brazil argues that nonetheless these measures fail to comply with the rulings and recommendations of the DSB. Brazil does not attempt to demonstrate, as it must, that contributions under the restructured TPC will be *de facto* export contingent by applying the three-part test established by the Appellate Body: that (1) there is granting of assistance by Canada under the restructured TPC that is (2) tied to (3) actual or anticipated exports. Rather, it makes the following three main arguments, none of which satisfies the standard for establishing *de facto* export contingency established by the Appellate Body.

39. First, Brazil makes the point that Canada's measures do not alter the status of TPC contributions as subsidies under Article 1 of the SCM Agreement. Canada's future assistance under TPC may or may not constitute subsidies. However, that is not the issue in this case. The issue of relevance to this proceeding is whether such assistance is contingent in fact upon export performance. Canada notes, in any event, that it has not made any contributions to the regional aircraft industry since 18 November 1999.

40. Second, Brazil asserts that *de facto* export contingency is still "inferred from the total configuration of facts constituting and surrounding any TPC contributions to the Canadian regional aircraft industry".²⁵ Brazil argues, therefore, that the withdrawal of the *de facto* export subsidy by Canada cannot be adequately achieved without a "complete and total abolition"²⁶ of the TPC programme as it relates to the Canadian regional aircraft industry.

41. Canada has undertaken a complete restructuring of the TPC programme in order to meet the concerns identified by the Panel and the Appellate Body and to

²³ The "export propensity" of the aerospace sector is a fact of the market. The world aircraft industry is one of the most globalized industries with few countries producing all the necessary technology domestically and relying on economics of scale for profitability. The Canadian aerospace sector is no different.

²⁴ Appellate Body Report, *Canada - Aircraft*, *supra*, at footnote 1, para. 173.

²⁵ First Written Submission by Brazil, Article 21.5 Panel at para. 5 - footnotes omitted.

²⁶ *Ibid.*, at para. 6.

comply with the recommendations and rulings of the DSB. Canada is not under any obligation to abolish the TPC programme. As was duly recognised by the Panel in *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*:

"WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, there by bringing themselves into compliance with their multilateral obligations under the SCM Agreement.²⁷

42. Third, Brazil tries to infer export contingency from a combination of past statements by Canadian government officials and industry groups endorsing exports; continued eligibility of aerospace and defence companies for TPC assistance; and allegations that objectives such as economic growth and jobs should be regarded as legal surrogates for export performance. This proposition is, however, untenable. By such logic, all subsidies are export subsidies and would be prohibited.

43. As set out in Annex A to this submission, Brazil's factual evidence suffers from a number of errors and distortions. Leaving these aside, however, virtually all of the evidence cited by Brazil relates not to the restructured TPC, but to TPC as it was previously constituted.²⁸ Indeed, in many cases Brazil uses the same quotations that it relied on in challenging TPC as it was previously structured and administered without acknowledging that such information is dated and superseded by the changes introduced by Canada.

44. The Appellate Body ruled that "Footnote 4 makes it clear that *de facto* export contingency must be *demonstrated* by the facts."²⁹ [emphasis original] Absent such a demonstration it cannot be assumed that assistance to the Canadian regional aircraft industry is *de facto* export contingent under the restructured TPC programme. In *Chile - Taxes on Alcoholic Beverages*³⁰ the Appellate Body held that where there has been a finding of non-compliance with WTO rules and a Member has adopted a replacement measure, that Member cannot be assumed to have continued the previous prohibited practice. The Appellate Body found:

"The final factor that the Panel relied upon in reaching the conclusion under the issue of 'so as to afford protection' was 'the way this new measure fits in a logical connection with existing and previous systems of *de jure* discrimination against imports.' In our view, the Panel has relied on the fact that previous Chilean measures, which are no longer applicable, involved some protection of domestic alcoholic beverages to show that the *new* tax system will also be applied 'so as to afford protection'. The Panel's reliance on this factor is wrong. *Members of the WTO should not be assumed, in any way, to have continued previous protection or discrimination through the adoption*

²⁷ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, para. 9.64.

²⁸ See Annex A, paras. 4 and 5.

²⁹ Appellate Body Report, *Canada – Aircraft*, *supra*, footnote 1, para. 169.

³⁰ Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* ("*Chile - Alcoholic Beverages*"), WT/DS/87/AB/R, WT/DS/110/AB/R, adopted 12 January 2000, DSR 2000:I, 281.

*of a new measure. This would come close to an assumption of bad faith.*³¹ [emphasis added, footnotes omitted]

45. The object of Canada's restructuring of TPC is to ensure that future TPC transactions with the Canadian regional aircraft industry will not be *de facto* contingent upon export performance. Establishing *de facto* export contingency requires a consideration of all the facts surrounding the granting of assistance. In the absence of any such financial contribution and a full consideration of those facts, there can be no grounds to support Brazil's allegations of *de facto* export contingency under the restructured TPC programme.

46. Finally, Brazil notes that Canada has not provided revised versions of the documents previously produced before the Panel in the original proceedings and certain other documents referenced in the SOA Framework, and argues that the Panel should draw a negative inference from this fact.

47. The restructuring of TPC involves a complete re-engineering of all of TPC's policies and procedures and related documents. While the Terms and Conditions have been modified, not all supporting documents have been finalised. Attached as Exhibit Can-9 is a list of TPC administrative documents currently being revised with an indication of the status of the revision. For the convenience of the Panel and Brazil, the table provides a mapping from old documents to new documents. Canada notes, once again, that no new contributions to the Canadian regional aircraft industry will be approved until the programme has been fully restructured.

48. Canada has provided the key restructuring documents, namely the new Terms and Conditions, the SOA Framework and the Investment Application Guide and the IDD. Copies of the documents identified in the above-referenced list that have been finalised are included in Exhibit Can-9. Moreover, Canada is prepared to provide additional documents, as they become available.

49. Attached, as Exhibit Can-10 is the Industry Sector - TPC Memorandum of Understanding, as requested by Brazil. This document sets out the respective roles and responsibilities of TPC and Industry Sector Branches.

50. Attached, as Exhibit Can-11 is the Treasury Board Policy on Repayable Contributions, as requested by Brazil. This document is not specific to TPC, but rather sets out the Government of Canada's policy in this area with which TPC must abide as indicated in its Terms and Conditions.³²

51. Moreover, Canada is unable to provide many of the documents requested by Brazil because they will not exist until such time as the restructured programme approves and contracts new investments. Specifically these documents include: completed Case Assessment or Project Summary Forms (now IDDs), completed Sector Branch Technical Assessments, Programme Forecasts and Progress Reports (as specified in the Contribution Agreement and which allow TPC to monitor progress). Moreover, the TPC Advisory Board, the Interdepartmental Advisory Committee, and the TPC Management Board have not met since 18 November 1999. As such there are no minutes, reports or records of decision available. While the Programmes and

³¹ Ibid. at para. 74.

³² Exhibit Can - 4 at section 5.

Services Board did meet on 8 December 1999, no minutes have yet been prepared. Canada also notes that the Board did not consider any project-specific items pertinent to the restructured programme at that meeting.

52. In summary, Canada has terminated all obligations for the disbursement of funds to the regional aircraft sector under TPC, as it was previously constituted. This included cancelling funding under existing Contribution Agreements, withdrawing the approvals-in-principle that had been granted for specific projects and closing all TPC files resulting to applications for financial assistance. Canada has also made fundamental and pervasive changes to the nature and administration of TPC that ensure that funding under the programme, if and when it occurs with respect to the regional aircraft industry, will in no way be tied to or contingent upon any consideration of actual or anticipated exports or export earnings. Canada therefore has withdrawn the subsidies found to be *de facto* export contingent by the Panel and Appellate Body, and has complied with its obligations under the SCM Agreement and with the recommendations and rulings of the DSU.

III. CANADA ACCOUNT

A. Findings of the Panel and the Appellate Body

53. In *Canada - Aircraft* the Panel rejected Brazil's claim the Canada Account programme as such is inconsistent with the SCM Agreement. The Panel also rejected Brazil's argument that the Canada Account programme mandates prohibited export subsidies. It found that:

"Brazil has failed to demonstrate that the Canada Account programme as such mandates subsidies that are contingent upon export performance. Rather, the Canada Account programme constitutes discretionary legislation. In light of the distinction that GATT/WTO panels have consistently drawn between discretionary legislation and mandatory legislation, *we find that we may not make any findings on the Canada Account programme per se. We therefore confine our analysis to Brazil's claims concerning the actual application of the Canada Account programme.*" [emphasis added].³³

54. The Panel found, however, that the application of the Canada Account debt financing in the two export transactions involving regional aircraft between 1 January 1995 and 30 June 1998 - covering deliveries to South African Express and LIAT - constituted subsidies that were contingent in law upon export performance within the meaning of Article 3.1(a). The Panel ruled that Brazil made a *prima facie* case that such debt financing was a subsidy contingent on export performance, and that Canada had not rebutted that case "nor sought to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies..."³⁴ The Panel concluded, as a result, that the debt financing in question constituted subsidies that were contingent in law upon export performance.

³³ Panel Report, *Canada - Aircraft*, *supra*, footnote 1, para. 9.213.

³⁴ Panel Report, *supra*, footnote 1, para. 9.225.

B. *Measures Taken by Canada*

1. *No Outstanding Contracts*

55. The Canada Account debt financing transactions with respect to South African Express and LIAT that were examined by the Panel in *Canada Aircraft* were completed in 1995 and 1998. Since 18 November 1999, there have been no new financing transactions in the regional aircraft sector under the Canada Account programme.

2. *Canada has Taken Measures in Respect of Future Export Financing Transactions*

56. While the Panel expressly did not find that the Canada Account programme *per se* was a prohibited export subsidy, Canada has taken further action to assure that the discretionary authority of the Export Development Corporation (EDC) in relation to financing under Canada Account will, in the future, be applied in a way consistent with the SCM Agreement. First, Canada has amended the guidance under which the Canada Account operates to require conformity with the OECD Arrangement on Guidelines for Officially Supported Export Credits (the OECD Arrangement). The second paragraph of item (k) of the Illustrative List of export subsidies permits export credit financing that abides by the interest rate provisions of the OECD Arrangement. Second, recognising the importance of verification of compliance, Canada is prepared to agree to procedures, discussed below, that will enable the disputing parties to verify that each is complying with the SCM Agreement in the way it administers export-finance related governmental programmes.

(a) *The Minister has Adopted a Guideline*

57. Under subsection 23(1) of the *Export Development Act*³⁵ Canada's Minister for International Trade, with the concurrence of the Minister of Finance, may authorise EDC to enter into any transaction or class of transactions which in the opinion of the Minister for International Trade is in the national interest, including Canada Account financing transactions. The Minister for International Trade adopted the policy that, with respect to financing under Canada Account, *only* those transactions that comply with the OECD Arrangement will be considered to be in the national interest.

"Policy Guideline - Canada Account

For the purposes of an authorisation under subsection 23(1) of the Export Development Act of a financing transaction or class of transactions, it is the policy of the Minister for International Trade to consider that any such transactions or class of transactions which does not comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits would not be in the national interest."

58. This policy, which is included as Exhibit Can - 13, was adopted by the Minister on 15 November 1999 and communicated officially to the President and Chief

³⁵ R.S.,c.E-20 Exhibit Can-12.

Executive Officer of EDC on 29 December 1999. By this policy, the Minister informs EDC and the world that he will not authorise any financing transaction under the Canada Account programme unless it complies with the OECD Arrangement. Under Canadian law, no Canada Account transaction may proceed without Ministerial authorisation and the Minister may not approve transactions that he does not find to be in the national interest. It should be noted that, while only regional aircraft financing was at issue in the dispute, the Minister has chosen to require that *all* financing transactions under the Canada Account, not only those in the regional aircraft sector, will be in conformity with the OECD Arrangement

(b) Canada Proposes the Establishment of Verification Procedures

59. To facilitate a definitive resolution of this dispute, Canada is prepared to agree to the establishment of verification procedures in respect of Canada's future arrangements to bring any subsidies in respect of Canada Account financing transactions for regional aircraft into compliance with the SCM Agreement, provided that such arrangements are also applicable to Brazil with respect to its implementation of the rulings and recommendations in *Brazil- Export Financing Programme for Aircraft* (PROEX).³⁶

60. Endorsement of this proposal for bilateral verification procedures would be consistent with the objectives of the DSU, and could be suggested by the Panel pursuant to Article 19.1 of the DSU. Canada also notes that in consultations with Brazil on 16 and 19 November 1999 concerning implementation of the Panels' recommendations and rulings in the two cases, Canada proposed that the Parties establish procedures that would enable each government to verify the compliance of the other with respect to specific future transactions under the pertinent measures to bring that Party into consistency with the SCM.

C. *As Canada has Complied with the Recommendations and Rulings of the DSB, Brazil's Allegations are Unfounded*

62. The financing transactions found by the Panel to be subsidies contingent in law upon export performance have been completed, i.e. all disbursements under the relevant loan agreements have been made. No new financing transactions in the regional aircraft sector have been entered into since 18 November 1999. To ensure complete implementation of the rulings and recommendations of the DSB and full compliance with the SCM Agreement, the Minister for International Trade has made a commitment not to authorise any financing transaction under Canada Account unless it complies with the OECD Arrangement. Canada is also prepared to enter into an agreement with Brazil to enable each to monitor compliance with the SCM Agreement in regard to financing of regional aircraft.

³⁶ Panel Report, *Brazil – Export Financing Programme for Aircraft* ("Brazil – Aircraft"), WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221 and Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("Brazil - Aircraft"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161,

63. Article 3.1(a) prohibits subsidies contingent in law or in fact upon export performance. Footnote 5 to that Article provides, in turn that "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provisions of this Agreement."

64. One such exception can be found in the second paragraph of Item (k) of Annex I. According to the Appellate Body in PROEX:

"The second paragraph applies when a Member is 'a party to an international undertaking on official export credits' which satisfies the conditions of the proviso, or when a Member 'applies the interest rate provisions of the relevant undertaking'. In such circumstances, an 'export credit practice' which is in conformity with the provisions of 'an international undertaking on official export credits' shall not be considered an export subsidy prohibited by the *SCM Agreement*. The OECD Arrangement is an 'international undertaking on official export credits' that satisfies the requirements of the proviso in the second paragraph in item (k).³⁷

65. An export credit practice that is in conformity with the interest rate provisions of the OECD Arrangement on Guidelines for Officially Supported Export Credits (OECD Arrangement) is not a prohibited export subsidy under the SCM Agreement.

66. Pursuant to the Ministerial Guideline discussed above, all future Canada Account financing transactions will abide by the OECD Arrangement. Therefore, to the extent that future financing transactions under the Canada Account programme are subsidies within the meaning of Article 1.1 and export subsidies within the meaning of Article 3.1, these transactions will benefit from the exception in Item (k).

67. In its submission Brazil has suggested that Canada must establish its entitlement to use Item (k) as an affirmative defence³⁸ Canada agrees that it is the Member claiming an exception that must demonstrate its entitlement to that exception. If, in the future, there is a financing transaction under Canada Account in relation to which Canada claims the exception in Item (k) and the claim to that exception is challenged, Canada will accordingly bear the burden of demonstrating compliance of the transaction with the exception in Item (k), to the extent Canada relies thereon.

68. Brazil has also asserted that Canada has not indicated which of the provisions of the OECD Arrangement it considers pertinent and in what way Canada intends to comply with them in respect to any future Canada Account activities. While that is true, Canada does not see why it would be obligated to provide such a delineation as to its future course, other than indicating, as Canada has, that it will meet the criteria to qualify for an exception under the second paragraph of Item (k). It is also far from clear what the legal consequence would be of attempting in this proceeding to delineate in the abstract, and before-the-fact, the various ways that Canada considers WTO members can act within the exception in the second paragraph of Item (k). As noted above, should Canada invoke the exception, in any possible future challenge it would have the burden of demonstrating compliance with second paragraph of Item

³⁷ Appellate Body Report, *Canada – Aircraft*, *supra*, footnote 1, para. 180.

³⁸ *Supra* note 25 at para. 46.

(k) at that time. Canada also notes that the Canada-Brazil verification procedure that it has proposed would facilitate monitoring of compliance on a reciprocal basis.

69. In summary, the Canada Account financing transactions that were found to be prohibited export subsidies were completed prior to 18 November 1999. Canada has therefore withdrawn the subsidies found to be export contingent by the Panel and complied with the recommendations and rulings of the DSB. Canada has also taken steps to ensure that all future Canada Account financing transactions will comply with the OECD Arrangement and benefit from the exception in Item (k). Finally, and perhaps most importantly, Canada suggests the development of a verification procedure under which Canada and Brazil would exchange relevant information regarding specific financing transactions in the regional aircraft sector so as to enable verification of their respective compliance with the SCM Agreement.

IV. REQUESTED FINDING

70. Canada requests that the Panel reject Brazil's claim.

Annex A

Factual Errors and Misrepresentations

Contained within the Submission by Brazil

1. On three occasions, Brazil asserts that funding for Technology Partnerships Canada (TPC) is rapidly increasing (e.g. 396 per cent). (Para. 13, 21, 23, citation: footnote 14 - TPC Annual Report, 1998-99, pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure)(Exhibit Bra-6).

This is a distortion of the actual programme funding situation. This schedule actually shows that TPC funding has been increased by 20 per cent. This increase in total programme funding (from \$250 million to \$300 million) was announced as part of the Government of Canada's February 1999 Budget Speech and as such pre-dates the *Canada- Measures* Report.

2. Brazil asserts (Para 20) that the Government of Canada admits that the export orientation of the regional aircraft industry "... drives the government's commitment to fund that industry...".

Brazil adduces no evidence to support this allegation. This is not the policy of the Government of Canada.

3. Brazil asserts (Para 21) that TPC is "captive" to the regional aircraft sector. In its use of statistics Brazil is not comparing like figures, but rather mixes apples and oranges.

As of 30 November 1999, TPC had approved \$972 million of *contributions* of which 65 per cent of total funding was for the Aerospace & Defence component of the programme. However, only 27 per cent or \$265 million of these contributions were provided in support of regional aircraft industry projects. Furthermore, no new regional aircraft projects have been approved or contracted since 14 November 1997.

During the 1998/99 fiscal year, 76 per cent of *disbursements* (i.e. \$152 million of a total of \$202 million) were from the Aerospace & Defence component of the programme while \$88.9 million (or 44 per cent of total disbursements) were paid to the sponsors of regional aircraft industry-related projects.

4. The Brazilian submission relies on extensive reference to documents and material from the period prior to the restructuring of TPC, many of which were previously submitted in the *Canada - Measures* case. These documents do not provide an accurate representation of the restructured programme.

<i>Footnote(s)</i>	<i>Citation</i>
21	TPC Annual Report, 1996-97, pg.5 (Exhibit Bra-8).
22 and 63	Industry Canada News Release, 10 January 1997 (Exhibit Bra-9).
23	Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

5. The Brazilian submission also introduces other evidence, not previously submitted in the *Canada - Measures* case. Again this information is from the period prior to the restructuring of TPC. Moreover, much of this information is either of a general nature or from non-governmental sources. As noted above, these documents do not provide an accurate representation of the restructured programme.

<i>Footnote(s)</i>	<i>Citation/Comments</i>
12	TPC Annual Report, 1998-99, pg.20 (Exhibit Bra-6).
13	<i>Id.</i> at pg. 21.
14	TPC Annual Report, 1998-99, pg.28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6).
34	TPC Annual Report, 1998-99, pg.27 (Exhibit Bra-6).
35	<i>Id.</i> at pg. 28 (row titled "Total funds available for new contributions in future years, " comparing 1999-2000 figure with 2002-2003 figure).
24	AThink Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999, pgs. 3,33 (Exhibit Bra-11).
25	<i>Id.</i> at pg.20 This general overview of the Canadian aerospace industry was published in October 1999, however most of the data used is from 1997.
26	Industry Canada, AResults of the 1998/99 Survey of the Canadian Aerospace and Defence Industry," 29 November 1999 (Exhibit Bra-12). This survey was published on 29 November, 1999, using 1998/99 survey data.
27	A Canadian Aerospace Suppliers Base Strategy for Change," 25 June 1999, pgs. 1, 16-17 (relevant excerpt included at Exhibit Bra-13).
28	<i>Id.</i> at pg.17. This was an independent assessment done by Price Waterhouse Coopers and commissioned by the Aerospace Industries Association of Canada, published on 25 June 1999, and does not represent the views of the Government of Canada. (Only 1 of 12 members of the study's Steering Committee was from Industry Canada. TPC representatives were not interviewed.)
29	Aerospace Industries Association of Canada, Annual Report, 1999, pg.4 Exhibit Bra-14).
30	<i>Id.</i> at pg.13.
31	<i>Id.</i> at pg.12. This report was published 20 September 1999 and is not a government publication.

- 33, 43 TPC Current Statistics, 6 December 1999 (Exhibit Bra-17).
Although published after the 18 November 1999 implementation deadline, all data relates to projects undertaken prior to the restructuring of TPC.
- 58 Industry Canada, CIBS Overview, "Executive Summary," pg.2 (Exhibit Bra-23).
- 59 Id. at pg.1.
- 60 Industry Canada, CIBS Strategic Overview, "International Business Development Priorities," pg. 1 (Exhibit Bra-24).
These documents published 7 March 1997, provide general sectoral information unrelated to TPC.
- 61 Industry Canada, CIBS Geographic Overview, pg.1 (Exhibit Bra-25).
This document, published 30 March, 1997, provides general sectoral information unrelated to TPC.
- 62 Industry Canada, CIBS - Aerospace and Defence, pg. 1 (Exhibit Bra-26).
This document published 10 March 1999, provides general sectoral information unrelated to TPC.
- 64 Conference Board of Canada, Performance and Potential 1999, "Working Smarter, Not Harder," pg. 107. (Exhibit Bra-27).
This report, published in October 1999, provides an independent assessment of Canada's economy. It is not a government publication and does not represent the views of the Government of Canada.

LIST OF EXHIBITS

Exhibit Can-1	Amendments to TPC Contribution Agreements terminating disbursement of funds
Exhibit Can-2	Letters withdrawing approvals-in-principle under TPC
Exhibit Can-3	Letters closing all files relating to outstanding applications under TPC
Exhibit Can-4	Revised TPC terms and conditions
Exhibit Can-5	TPC investment application guide
Exhibit Can-6	TPC special operating agency framework document
Exhibit Can-7	Investment decisions document
Exhibit Can-8	Original TPC terms and conditions
Exhibit Can-9	List of TPC administrative documents being revised as at 7 January 2000
Exhibit Can-10	Industry Sector-TPC memorandum of understanding
Exhibit Can-11	Treasury Board policy on repayable contributions
Exhibit Can-12	Export Development Act - R.S., c. E-20
Exhibit Can-13	Policy Guideline - Canada Account

ANNEX 2-2
REBUTTAL SUBMISSION OF CANADA
 (17 January 2000)
TABLE OF CONTENTS

	Page
I. INTRODUCTION	4455
II. CANADA HAS FULLY COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB	4456
A. Technology Partnerships Canada	4456
B. Canada Account	4457
III. brazil's allegations are unfounded	4457
A. Technology Partnerships Canada	4457
B. Canada Account	4458
IV. REQUESTED FINDING.....	4459

I. INTRODUCTION

1. In *Canada - Measures Affecting the Export of Civilian Aircraft (Canada - Aircraft)*¹ the Panel and the Appellate Body found that contributions under Technology Partnerships Canada (TPC) to the Canadian regional aircraft industry were *de facto* contingent on export performance and thus such contributions were prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Duties* (SCM Agreement). The Panel also concluded that Canada Account debt financing as applied to certain regional aircraft exports constituted subsidies, which were *de jure* contingent on exports, and thus inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement. Canada did not appeal this finding.

2. On 20 August 1999, the Dispute Settlement Body (DSB) adopted the Reports of the Panel and the Appellate Body. It recommended that Canada bring assistance to the regional aircraft industry under TPC and Canada Account into conformity with its obligations under the SCM Agreement within 90 days, that is by 18 November 1999.

3. In response, Canada has put in place new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement. Brazil nonetheless challenges Canada's implementation measures pursuant to Article 21.5 of the Understanding on Rules and Procedures Governing

¹ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft")*, WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, DSR 1999:IV, 1443 and Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft")*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.

the Settlement of Disputes (DSU) and argues that Canada's measures are insufficient to constitute effective implementation of the recommendations and rulings of the DSB.

4. In Canada's first written submission in these 21.5 proceedings², Canada established that it has fully implemented the DSB recommendations and rulings and that thus Brazil's allegations are unfounded. The purpose of this second submission is not to put forward any additional information or arguments but to provide a summarised version of Canada's position.

II. CANADA HAS FULLY COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB

A. Technology Partnerships Canada

5. As of 18 November 1999, Canada has terminated all obligations for the disbursements of funds pursuant to the five Canadian regional aircraft Contribution Agreements cited in *Canada-Aircraft*, and has withdrawn the approvals-in-principle that were issued under TPC for two other regional aircraft projects.³

6. In addition, taking full account of the factual elements which led the Panel and the Appellate Body to reach the finding of *de facto* export contingency, Canada has restructured the TPC programme and its administration to ensure that actual or anticipated exports or export earnings play no role in the goals, the application process, or decision-making under TPC. The key aspects of the restructured TPC are set out in the TPC Terms and Condition⁴, the Special Operating Agency Framework Document⁵, the Investment Application Guide⁶ and the Investment Decision Document⁷. Various secondary administrative documents are currently being finalised.⁸

7. Files relating to outstanding applications for financial assistance submitted prior to the restructuring were closed as of 18 November 1999. In order to pursue funding under TPC, applicants must submit applications in accordance with the new Terms and Conditions and Investment Application Guide. No transactions in relation to the Canadian regional aircraft industry will be approved until such time as the restructuring of the programme (including the finalisation of all secondary documentation) has been fully completed.

8. These measures fully and faithfully implement the DSB rulings and recommendations in *Canada-Aircraft* and are in compliance with the provisions of the SCM Agreement.

² Submitted on 10 January 2000.

³ Exhibits Can - 1 and Can - 2.

⁴ Exhibit Can - 4.

⁵ Exhibit Can - 6.

⁶ Exhibit Can - 5.

⁷ Exhibit Can - 7.

⁸ See Exhibit Can - 9 for a list of all the administrative documents currently being revised, with an indication of the status of the revision. Where not provided under another Exhibit to Canada's first 21.5 submission, copies of finalised documents are included in Exhibit Can - 9.

B. *Canada Account*

9. The Canada Account debt financing transactions that were examined by the Panel in *Canada-Aircraft* were completed in 1995 and 1998 and there have been no new financing transactions in the regional aircraft sector under the Canada Account programme since 18 November 1999.

10. Canada has taken further action to ensure that financing under the Canada Account will, in the future, be consistent with the SCM Agreement. First, Canada has confirmed in a Ministerial Guideline that all Canada Account financing transactions must comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits (the OECD Arrangement). Second, recognising the importance of verification of compliance, Canada is prepared to agree to procedures that will enable the disputing parties to verify that each is complying with the SCM Agreement in the way it administers export-finance related governmental programmes.

11. These measures fully and faithfully implement the DSB rulings and recommendations in *Canada-Aircraft* and are in compliance with the provisions of the SCM Agreement.

III. BRAZIL'S ALLEGATIONS ARE UNFOUNDED

A. *Technology Partnerships Canada*

12. Despite the measures taken by Canada with respect to TPC, Brazil argues that these measures fail to comply with the rulings and recommendations of the DSB.

13. Brazil does not attempt to demonstrate, as it must, that contributions under the restructured TPC will be *de facto* export contingent by applying the three-part test established by the Appellate Body. This test requires the proof of three substantive elements:

- (1) the granting of a subsidy by Canada under the restructured TPC;
- (2) that is tied to;
- (3) actual or anticipated exports.⁹

14. Rather than applying the three-part test set out by the Appellate Body, Brazil attempts to infer export contingency from evidence that suffers from a number of errors and distortions and relates, almost entirely, to TPC as previously constituted.¹⁰ The Appellate Body has clearly ruled that *de facto* export contingency must be *demonstrated* by the facts.¹¹ Brazil has failed to demonstrate, on the facts, that TPC as currently constituted will result in transactions that are *de facto* export contingent.

15. As fully set out in Canada's first submission in these 21.5 proceedings, and as noted above, Canada has terminated all obligations for the disbursement of funds to the regional aircraft sector under TPC, as it was previously constituted. No new transactions have been approved under the restructured TPC and therefore no new

⁹ Appellate Body Report, *supra*, footnote 1, para. 169.

¹⁰ Annex A to Canada's first Article 21.5 submission sets out these errors and distortions and the dated nature of the Brazilian evidence.

¹¹ *Supra*, note 8.

financial contributions have occurred. Canada has also made fundamental and pervasive changes to the nature and administration of TPC that ensure that funding under the programme, if and when it occurs with respect to the regional aircraft industry, will in no way be tied to or contingent upon any consideration of actual or anticipated exports or export earnings

16. By these actions, Canada has withdrawn the subsidies found by the Panel and Appellate Body to be *de facto* export contingent and thus has complied with the recommendations and rulings of the DSB and with its obligations under the SCM Agreement. Brazil's allegations are therefore unfounded.

B. *Canada Account*

17. Despite the measures taken by Canada with respect to Canada Account, Brazil argues that these measures fail to comply with the rulings and recommendations of the DSB.

18. The financing transactions found by the Panel to be subsidies contingent in law upon export performance have been completed, i.e. all disbursements under the relevant loan agreements have been made. Furthermore, no new financing transactions in the regional aircraft sector have been entered into since 18 November 1999.

19. To ensure complete implementation of the rulings and recommendations of the DSB and full compliance with the SCM Agreement, the Minister for International Trade has made a commitment not to authorise any financing transaction under Canada Account unless it complies with the OECD Arrangement. Pursuant to the second paragraph in Item (k) of Annex I to the SCM Agreement, an export credit practice that is in conformity with the interest rate provisions of the OECD Arrangement is not a prohibited export subsidy under the SCM Agreement. Therefore, to the extent that future financing transactions under the Canada Account programme are subsidies within the meaning of Article 1.1 and export subsidies within the meaning of Article 3.1, these transactions will benefit from the exception in Item (k).

20. Brazil has suggested that Canada must establish its entitlement to use Item (k) as an affirmative defence. Canada agrees that should Canada claim the exception under Item (k) in relation to any future financing transaction under Canada Account, and if the claim to that exception is challenged, Canada will accordingly bear the burden of demonstrating compliance with Item (k) at that time.

21. Recognising that it is in the interest of both Canada and Brazil to avoid such future challenges and in an attempt to reach a definitive solution to this dispute, Canada suggests that the Parties develop a verification procedure. Under this procedure the two governments would exchange relevant information regarding specific financing transactions in the regional aircraft sector so as to enable verification of their respective compliance with the SCM Agreement.

Canada has withdrawn the subsidies found by the Panel to be *de jure* contingent on exports and has thus complied with the recommendations and rulings of the DSB and with its obligations under the SCM Agreement. Brazil's allegations are therefore unfounded.

IV. REQUESTED FINDING

23. Canada requests that the Panel reject Brazil's claim and find that Canada's measures fully implement the rulings and recommendations of the DSB.

ANNEX 2-3

ORAL STATEMENT OF CANADA

(6 February 2000)

I. INTRODUCTION

Thank you, Mr. Chairman,

Mr. Chairman, distinguished members of the Panel, distinguished members of the delegation of Brazil, on behalf of Canada, let me first express our sincere appreciation to the Panel for agreeing to serve once more in this dispute, which we know has already been demanding of your time and attention. We will try to cooperate in every way possible to facilitate your task.

1. Mr. Chairman, in this proceeding under Article 21.5 of the DSU, Brazil has claimed that Canada has not complied with the rulings and recommendations of the DSB regarding Canada's TPC and EDC programmes. As the Panel knows well, it found that TPC contributions to the Canadian regional aircraft industry were subsidies contingent in fact upon export performance under the then applicable criteria and circumstances, and that two EDC Canada Account transactions were subsidies contingent in law upon export performance. The DSB recommended that Canada withdraw the subsidies within 90 days.

2. Canada has done so. Specifically, in response to those findings and recommendations, as of 18 November 1999, the date fixed for compliance, Canada has taken two types of actions.

3. First, Canada has terminated all subsidies and all obligations to provide subsidies to the Canadian regional aircraft industry that were outstanding under TPC as of the compliance date. The two Canada Account debt financing transactions addressed by the Panel have been completed and there have been no new Canadian regional aircraft financing transactions under Canada Account. Brazil does not dispute this.

4. Second, in response to the rulings and recommendations of the DSB, Canada has modified the rules and ministerial guidance under which these programmes operate so that any future assistance that Canada may provide to the regional aircraft industry under the TPC and the EDC Canada Account programmes will not conflict with the requirements of Article 3.1 (a) of the SCM Agreement.

5. In the case of TPC, Canada terminated all obligations to disperse funds related to the Canadian regional aircraft industry under the previous programme. Canada then completely restructured TPC to remove any consideration of export performance in the granting of assistance.

6. In the case of the EDC Canada Account Programme, Canada has taken a policy decision that future Canada Account financing of regional aircraft will be carried out in accordance with the OECD Arrangement. Thus, to the extent that future financing transactions under Canada Account may be prohibited export subsidies, they will benefit from the exception in the second paragraph of item (k) of the Illustrative List of Export Subsidies.

7. Thus, Canada has not only withdrawn the subsidies that were found to be prohibited, but has revised its programmes to be fully consistent with Canada's obligations under the SCM Agreement.

8. Furthermore, in response to the criticism directed at Canada by this Panel and the Appellate Body for failing to produce certain commercially confidential information in the earlier proceedings, Canada is revising the form of the confidentiality provisions contained in TPC contribution agreements and in EDC transactions, so as to facilitate, if requested, the disclosure of such information in the context of WTO dispute settlement proceedings. Finally, to facilitate a definitive resolution of this dispute Canada has proposed to Brazil the development of a bilateral compliance verification procedure.

9. In the face of Canada's actions, Brazil has not been able to base its claims in this proceeding on any currently pertinent evidence that even remotely suggests non-compliance- for there is none. Instead, Brazil bases its claims on (i) innuendo, (ii) a presumption of bad faith and (iii) a wholly unfounded legal theory that Canada, rather than Brazil, has the burden of proof in this case.

10. Ensuring compliance with the export subsidy rules is the goal of Canada's actions, and it is the effect that would be expected on the basis of the changes Canada has made. According to Brazil, Canada's burden is to prove that the restructured programmes could never possibly be applied so as to grant export contingent subsidies. But there is no basis in the DSU or the SCM Agreement, or international law for imputing to Canada an obligation to prove that discretionary laws could not possibly be used to grant export subsidies. Brazil presumably advances this novel theory because only by imposing that essentially impossible burden on the defending party could Brazil prevail in a complaint where neither the law nor the facts support Brazil's claim.

11. The remainder of Canada's opening statement is divided into two parts: My colleague, Ms. Kirsten Hillman, will first address the TPC programme, and I will then address the Canada Account. In each case, Mr. Chairman, we will briefly summarise the compliance measures that Canada has taken both to withdraw the subsidies found to be illegal and to prevent future illegal export subsidies. We will also respond to the various claims made by Brazil. With your permission, Sirs, I will now ask Ms. Hillman to address the Panel.

II. TPC COMPLIANCE

12. Thank you Mr. Chairman. It is an honour to have the opportunity to appear before this Panel to discuss Canada's implementation with respect to TPC. As you know, this Panel did not find that TPC was *per se* an export subsidy. Rather the Panel found that TPC assistance as applied to the Canadian regional aircraft industry was contingent in fact on export performance.

13. Canada has implemented the rulings and recommendations of the DSB as follows:

14. First, effective 18 November 1999 Canada terminated all obligations for the disbursement of funds to the Canadian regional aircraft industry under TPC. As a result more than \$16.4 million in funding to the sector has been cancelled.

15. Second, the Government of Canada withdrew two approvals in principle that had been issued under the old TPC programme to projects relating to the Canadian regional aircraft industry.

16. Third, the Government of Canada closed all application files under TPC as it was previously constituted. These three actions together mean that Canada has no obligations to disburse funds to the Canadian regional aircraft industry under the former TPC. In addition, under the restructured TPC no new investments have been approved and none will be approved until such time as all the necessary administrative documentation related to the restructured TPC has been finalized.

17. And the fourth implementation measure that the Government has taken to amend the very structure and administration of TPC in so as to address the factual elements that led the Panel and Appellate Body to find that contributions to the Canadian regional aircraft industry were *de facto* contingent upon export.

Restructuring of the TPC Programme

18. As of 18 November 1999, TPC, as it was previously constituted, no longer exists. The former TPC has been abolished and a new programme has been created with a new mandate from Cabinet. Under this new mandate exports or export performance will have absolutely no relevance to assistance to the Canadian regional aircraft industry - or to any other industry.

19. In undertaking the task of restructuring TPC, Canada was guided by the analysis and findings of the Panel and the Appellate Body. The Appellate Body concluded that there are three elements to a subsidy that is contingent in fact upon export performance. There must be (1) the granting of a subsidy (2) that is tied to (3) actual or anticipated exports. In reforming TPC, Canada focused on the second element of this three part test, and sought to eliminate those aspects of the TPC programme that led the Panel to conclude (and the Appellate Body to confirm) that the subsidies were "tied to" anticipated exports.

20. As to the first element - whether there is a subsidy - as Canada has noted, no new transactions have been approved under the restructured TPC. Future TPC assistance may or may not constitute subsidies under Article 1 of the SCM Agreement.

21. The third element of the Appellate Body test is "anticipated exports". Here we would note, Mr. Chairman, that the Canadian regional aircraft industry, like virtually every aircraft industry in the world, can be "anticipated" to export. Brazil suggests that the Government of Canada should take steps to alter the export orientation of the Canadian regional aircraft industry¹ and should even attempt to change the nature of the Canadian economy as a whole. Clearly an industry's export orientation, or lack thereof, is not within the control of the Government. In fact, the Brazilian, American and European regional aircraft industries, even though they exist in much larger domestic markets than that of Canada, are all also substantially export dependent. Furthermore, the SCM Agreement is very clear that subsidies to industries that export are not forbidden as such. The mere awareness or even anticipation of such exports does not preclude subsidization to such an industry. As the Appellate Body has

¹ See para. 47 of Brazil's second Submission.

clearly stated, and I quote "It does not suffice to demonstrate solely that a government granting a subsidy anticipated that exports would result".

22. According to the Appellate Body, a subsidy to an export oriented industry only becomes a prohibited subsidy when, the facts demonstrate that the granting of a subsidy is tied to or conditional on actual or anticipated exports. This is the second element of the Appellate Body's test, to which I will now turn.

23. In this case, the facts surrounding the administration of TPC led the Panel and the Appellate Body to conclude that TPC assistance was tied to or conditional upon anticipated exports. In response to this finding, Canada addressed the elements that the Panel and the Appellate Body determined were indicative of export contingency. We have reformed TPC so export performance is not even a *consideration* when funding is granted under TPC - let alone a *condition* for the granting of assistance.

24. The modifications made to the TPC programme in order to implement the rulings and recommendations of the DSB are fully set out in Canada's first submission and I will not reiterate them in detail here today. I would simply like briefly mention a few of the major changes, these include:

- First, the objectives of the restructured TPC focus on the promoting innovation and on improving the technological capability of Canadian industry;
- Second, information on exports will not be accepted from applicants under the restructured TPC; and
- Third, administrators will not in any way consider exports when making funding recommendations.

25. In addition, confidentiality clauses will be included in all future contribution agreements so as to permit the Government to release the pertinent information contained in these agreements in the context of WTO dispute settlement proceedings.

26. In summary, Mr. Chairman, the "total configuration of the facts" demonstrates that funding under the restructured TPC is not contingent in any sense on export performance. The European Communities are clearly of the same view and have stated in their third party submission that, and I quote: "The EC considers that Canada's actions with regard to TPC do *prima facie* amount to implementation of the Appellate Body's findings...there does not seem to be any basis on which continued *de facto* export contingency or some other violation of the SCM Agreement can be established."

27. Let me now turn to the arguments raised by Brazil.

Brazil's Arguments

28. As I have just set out, Canada has terminated all obligations to disburse funds to the Canadian regional aircraft industry under the former TPC programme. As Mr. Hankey noted, Brazil does not dispute this, and certainly does not offer any evidence to the contrary.

29. In addition, in order to achieve compliance, Canada has restructured TPC so that assistance to the regional aircraft industry under this programme will not run afoul of Article 3 of the SCM Agreement in the future. In its second submission, and again here this morning, Brazil presents a lengthy and rather inflamed critique of a position that Canada manifestly did not take; namely that until such time as there is a transaction under the restructured TPC, a Panel constituted under Article 21.5 of the

DSU cannot determine whether Canada has complied with the DSB's rulings and recommendations. That was not and is not Canada's view.

30. Lest we all be distracted by a jurisdictional argument not made, let me be very clear. Canada certainly believes that this Panel can - and indeed should - assess whether the restructured TPC programme implements the DSB's rulings and recommendations regarding de facto export contingency. In that regard, as we have demonstrated and as the restructured TPC's Terms and Conditions and Framework Document make explicit, export performance is in no way a consideration in the granting of assistance under the new TPC. Consequently, there is no evidence to support Brazil's claim that the restructured programme is de facto export contingent.

31. Beyond that, Canada's point was simply the obvious one that since there have been no transactions under the restructured TPC, it is naturally impossible at present, to look at facts relating to specific applications of the new programme. Canada is confident that when such transactions arise, they will be fully consistent with the SCM Agreement. At the same time, Canada recognises that, in the future, Brazil may want to examine the facts surrounding specific transactions to satisfy itself that the restructured TPC as applied in practice is not de facto export contingent.

32. Brazil, for its part, does not adduce evidence that the granting of funds under the restructured TPC programme would be de facto export contingent. Nor does Brazil attempt to apply the three part test set out by the Appellate Body for determining export contingency, namely that there must be (1) a subsidy that (2) is tied to (3) anticipated exports. Rather Brazil fabricates its own test based on an impossible burden of proof and a presumption of bad faith. In its second submission, Brazil states, and I quote, that:

"The implementation measures Canada has adopted, in the case of both TPC and Canada Account, merely suggest to Members that Canada might not continue to grant subsidies contingent in fact on export performance, rather than provide an assurance that it cannot do so."²

33. Brazil's proposed test imposes the burden of proof in this case on Canada, rather than Brazil. However, as we all know, it is the complaining party that bears the burden of proof.³ Brazil is arguing that Canada must prove that Canadian law prevents it from granting subsidies that are de facto contingent on exports. There is no basis in the findings of the Panel or the Appellate Body, the SCM Agreement, or international law for imputing to Canada an obligation to prove that discretionary laws could not possibly be used to grant export subsidies. Of course, the proper test in this case is the three part test set out by the Appellate Body that requires Brazil to demonstrate on the facts assistance under the restructured TPC is tied to, or contingent upon export performance. It is precisely because Brazil cannot meet the test of the Appellate Body that it tries to invent and impose its own test.

² See para. 79 of Brazil's second Submission.

³ While this principle is articulated in many decisions under the WTO, the one most often cited in support of this proposition is the Appellate Body's ruling in Appellate Body Report, *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India* ("US – Wool Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:1, 323.

34. According to Brazil's test, Canada's restructured TPC programme must always be tainted by the finding that some aspects of the former programme operated to create de facto export subsidies in some circumstances. At the heart of this test is the presumption that Members intend to circumvent their WTO obligations - hence the purported necessity for Canada to establish that its replacement programmes cannot grant de facto export contingent subsidies.

35. In effect, Brazil argues that TPC can never be restructured to comply with Canada's WTO obligations. This directly contradicts by the Appellate Body's rule in *Chile - Alcohol*, which is, and I quote, "[m]embers of the WTO should not be assumed, in any way, to have continued previous protection or discrimination through the adoption of a new measure." The Appellate Body has found that, and here again I quote, "This would come close to an assumption of bad faith."

36. Brazil argues that the rule in *Chile - Alcohol* does not apply in the case of de facto violations. However, Brazil offers no rationale to explain why de facto violations should be subject to a different legal standard than de jure violations. This is clearly unsupported by the text of the SCM Agreement, WTO rulings or indeed common sense. Indeed, Brazil's argument is contradicted by the Appellate Body in this very case where it held that the prohibition of de jure and de facto export subsidies are subject to the same legal standard, but are established through different evidence.

37. Brazil also argues that, in any event, its allegations of non-implementation are based solely on the new TPC programme⁴ and that therefore the rule in *Chile - Alcohol* does not apply. This is clearly at odds with the text of Brazil's submissions. While Brazil's submissions do make some reference to the restructured TPC programme, the evidence it puts forward as representing the "total configuration of the facts" from which de facto export contingency must be inferred consists almost exclusively of evidence relating to the old programme. This evidence is largely recycled from Brazil's submission to the Panel in the original proceedings. Here I refer you to Annex I of Canada's first submission where Canada reviews Brazil's evidence and reveals that it is dated and riddled with errors and misrepresentations.

38. In its second submission Brazil does acknowledge that its arguments rely heavily on dated evidence but argues that such evidence should be presumed to be equally applicable to the new TPC programme.⁵ This reasoning is directly at odds with the statement of the Appellate Body in *Chile - Alcohol* and amounts to an unsubstantiated allegation of bad faith.

39. Indeed, the only evidence that Brazil adduces regarding the restructured TPC relates to the objectives of the programme and its subsidiary documentation.

40. Brazil underlines that one of the objectives of TPC is the promotion of economic growth, and the creation of wealth and jobs, and notes that potential projects are assessed in relation to the extent to which they achieve these objectives. Brazil contends that the consideration of economic benefits of a project is equivalent to

⁴ See para. 30 of Brazil's second Submission.

⁵ See para. 28 of Brazil's second Submission.

making export performance a condition to granting funding. Brazil's reasoning goes something like this:

- In assessing a potential project, TPC considers the economic benefits of the project to Canada.
- Examples of economic benefits include economic growth, creating jobs and wealth.
- Economic growth and wealth are achieved in Canada, in part, through trade, which includes, of course, exports.
- Therefore, and here is where Brazil makes an untenable leap of logic, the consideration of the economic benefits of a project is equivalent to making export performance a condition of the granting of funding.

41. Brazil's assertion that economic objectives such as creating jobs, increasing Canadian wealth and spurring economic growth are surrogates for export conditionality is untenable. If this argument were to be accepted, and positive economic objectives were equated with exports, the scope of prohibited export subsidies would be radically expanded from that envisioned by the drafters of the SCM Agreement. Clearly, when governments give subsidies to industry, the intent is to make a positive contribution to the economy in one form or another. However, Brazil's reasoning would effectively prohibit all subsidies to any industry that exports, unless that subsidy has no benefit whatsoever to the economy. This is clearly not acceptable as it would preclude WTO Members from providing any subsidies to industries that export - a result directly contrary to the text of footnote 4 of the SCM Agreement.

42. Despite Brazil's spurious argument, Mr. Chairman, the fact remains that under the restructured TPC, the eligibility criteria reflect the overall objectives of the revised programme and do not include any consideration whatsoever of exportation or export earnings.

43. Finally, Mr. Chairman, Brazil has made much of the fact that Canada has not produced certain documents related to the restructured programme. However, the key documents that provide the restructured TPC with Cabinet authority to operate have been provided by Canada. These are the Terms and Conditions and the Special Operating Agency (SOA) Framework Document.⁶

44. The remaining documents are subsidiary documents that must respect the authority provided in the Terms and Conditions and the SOA Framework Document. This authority explicitly requires that TPC be administered in accordance with Canada's international obligations. Therefore all subsidiary documents must respect Canada's WTO obligations.

45. Canada would like to underline, once again, that the restructuring of TPC involves a complete re-engineering of all TPC's administrative documents. Consequently, no documents relating to TPC, as it was previously constituted, are valid under the new programme. To put it another way, those documents no longer exist for the purposes of TPC as it is now constituted.

⁶ See Exhibits Can-4 and Can-6.

46. Despite Canada's assurances - which I now reaffirm - that it will provide these documents as soon as they are finalized, Brazil has accused Canada of bad faith and alleged that Canada is "holding back" relevant documents.⁷ Canada takes exception to this baseless allegation.

47. Furthermore, Canada wishes once again to reiterate and make absolutely clear that no investments have been approved under the restructured TPC, and none will be approved until such time as all the supporting documents have been finalized. Despite Canada's assurance to this effect, Brazil, in its second submission, accuses Canada of having approved an investment under the revised TPC. Brazil refers to a press release made on 10 January 2000 regarding a TPC contribution to an Ontario company for the development of a robotics system. I have here a copy of the title and signature pages of the Contribution Agreement in question that I would like to submit to the Panel as Canada's Exhibit 14. As you will see this project was approved prior to November 18, 1999, under the former TPC.

48. To summarise, Mr. Chairman, the thrust of Brazil's submission is that it should be presumed that the restructured TPC programme will in practice violate the SCM Agreement, even though Brazil can point to nothing to substantiate its claim beyond evidence and innuendo regarding the predecessor programme and the regional aircraft industry's propensity to export.

49. Canada, for its part, has carefully noted the findings of the Panel and the Appellate Body and has made substantial and meaningful changes to the TPC programme so as to bring it into compliance with Canada's obligations under the SCM Agreement.

50. Accordingly, Mr. Chairman, Canada requests that the Panel find that Canada has fully and faithfully implemented the rulings and recommendations of the DSB by:

- Withdrawing assistance to the Canadian regional aircraft industry under TPC as previously constituted; and
- Amending the structure and administration of TPC so that assistance granted to the Canadian regional aircraft industry under this programme is not contingent in fact upon export performance.

51. Thank you for your attention. Mr. Hankey, will now address the measures taken by Canada in respect of the EDC Canada Account.

III. EXPORT DEVELOPMENT CORPORATION - CANADA ACCOUNT

52. Mr. Chairman, Members of the Panel, I would like to turn now to the measures that Canada has taken to bring the Canada Account programme into compliance with the recommendations and rulings of the DSB. Before doing so, however, I shall briefly review the findings of this Panel with respect to the Canada Account.

⁷ See para. 59 of Brazil's second Submission.

Appellate Body and Panel findings

53. In the original proceeding Brazil claimed that the Canada Account programme was inconsistent with the SCM Agreement and that it mandated export subsidies. The Panel rejected these claims. It found that the programme constituted discretionary legislation and did not mandate subsidies that are contingent on export performance. The Panel did not, as a result, make any findings on the Canada Account per se.

54. The Panel did find, however, that Canada Account debt financing in two transactions - one involving South African Express and the other LIAT - constituted export subsidies prohibited by Article 3.1(a). The Panel ruled that Brazil made a prima facie case that such debt financings were subsidies contingent on export performance, and that Canada had not rebutted that case, nor had Canada - and I quote - "sought to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies".⁸

55. These findings of the Panel - that the debt financing in the South African Express and LIAT transactions was contingent in law on export performance and that the Canada Account programme constituted discretionary legislation - were not appealed to the Appellate Body. The Panel's findings were limited, therefore, to Canada Account debt financing in two transactions.

EDC Compliance

56. Let me recall that the two Canada Account debt financing transactions that the Panel addressed were completed in 1995 and 1998. Since 18 November 1999, there have been no financing transactions in the regional aircraft sector. Canada has also taken action to ensure that, in the future, the discretionary authority under the Canada Account programme will be exercised in a way that is consistent with the SCM Agreement. Under Canadian law, no Canada Account transaction may proceed without the approval of the Minister for International Trade and no transaction may be approved unless the Minister determines that it is in the "national interest".

57. Canada adopted a Policy Guideline on 15 November 1999 that informs EDC and the world that the Minister for International Trade, from that date forward, will consider any Canada Account financing transaction that does not comply with the OECD Arrangement for Officially Supported Export Credits not to be "in the national interest".

58. The Minister is thereby saying that all future Canada Account financing transactions must comply with the OECD Arrangement if they are to receive the required Ministerial authorization. This is perfectly clear and unambiguous. A copy of the Guideline can be found at Tab 13 of Canada's Exhibits and is also publicly available and has been posted on the web site of the Department of Foreign Affairs. I have here a printout from the web site that I would like to present as Canada's Exhibit 15.

59. As the Appellate Body noted in the Brazil-Aircraft (PROEX) case, the OECD Arrangement is an international undertaking on official export credits that satisfies

⁸ Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("Canada – Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, para. 9.225.

the requirements of the proviso in the second paragraph of item (k). Pursuant to this paragraph of item (k), an export credit practice that is in conformity with the interest rates provisions of the Arrangement is not a prohibited subsidy under the SCM Agreement. Therefore, by conforming to the OECD Arrangement, future Canada Account financing transactions will conform with the requirements of the exception provided by the second paragraph of item (k).

60. Finally, Canada has indicated that it is prepared to agree to the establishment of verification procedures whereby Canada and Brazil would exchange relevant information regarding specific future financing transactions in the regional aircraft sector so as to allow both Canada and Brazil to verify compliance of such transactions with the SCM Agreement. Canada has proposed this procedure in the interest of avoiding future dispute settlement proceedings, believing that such a procedure would provide sufficient transparency to allow both Parties to satisfy themselves that the other is in compliance with its WTO obligations. Canada would like to make clear that it asks only that the Panel endorse the establishment of such an arrangement, and is not proposing an ongoing role for the Panel should a verification process be established. We also note, Mr. Chairman, that in the light of the rulings and recommendations of the Panel and Appellate Body concerning the provision of confidential information, EDC is revising the form of its confidentiality agreements entered into with its customers, to facilitate, if required, disclosure of such information in the context of the WTO dispute settlement proceedings.

61. In summary, the South African Express and LIAT transactions were completed before 18 November 1999. The implementation of the Policy Guideline will ensure that all future Canada Account financing transactions will comply with the OECD Arrangement, and thereby with the proviso in the second paragraph of item (k). Canada has, therefore, fully complied with the recommendations and rulings of the DSB.

Brazil's arguments

62. Mr. Chairman, Members of the Panel, Brazil has produced no evidence to call into question Canada's compliance in this case, because there is none.

63. Instead Brazil resorts to the same arguments it has advanced in the case of TPC. It argues that completion of the two transactions found to be *de jure* export contingent by this Panel is "simply not enough" and suggests that Canada must "do more" to bring itself into compliance with the DSB's recommendations and rulings. Canada has, of course, done "more" by adopting the Ministerial Policy Guideline. Brazil, however, dismisses this action on the basis that the Ministerial Guideline "does not ensure that prohibited export subsidies cannot be granted". This legal standard for compliance has no foundation in the WTO or international law.

64. Brazil's novel legal standard seeks not only to reverse the burden of proof onto Canada, but to create an extraordinary degree of burden: that Canada must prove that the Canada Account programme **cannot** be used to grant export subsidies. Brazil states this position in paragraph 71 of its second submission as follows: "...implementing the DSB's recommendations and rulings regarding the Canada Account should at a minimum ensure that prohibited export subsidies via the Canada Account **cannot** be granted, but **not merely that they might not** be granted".

65. Ms. Hillman has already noted that this standard finds no support whatsoever in the DSU, the SCM Agreement or international law. The Appellate Body has said that the complaining party bears the burden of proving a violation and there is nothing in Article 21.5 that suggests a different burden of proof in a proceeding under that Article.

66. In addition to seeking to reverse the burden of proof and to set it at an unreasonably high level, Brazil complains about Canada's compliance on two grounds. First, Brazil complains that the Guideline refers to the OECD Arrangement, and does not explicitly state that Canada will thereby meet the criteria to qualify for an exception under the second paragraph of Item (k). Second, it complains that Canada has not identified which of the articles in the Arrangement it believes constitute the "interest rates provisions" referred to in item (k).

67. With respect to Brazil's first point, Canada has already explained in its submissions why the Guideline does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the Arrangement and therefore the provisions referred to in the second paragraph of item (k). In requiring compliance with the OECD Arrangement, Canada requires compliance with the totality of the Arrangement, including all of its interest rates provisions. Canada has thereby required that all future Canada Account financing transactions will conform to the requirements of the exception provided in the second paragraph of item (k).

68. Regarding Brazil's second argument, Canada has already noted the reasons why Canada does not think it is necessary to set out all the provisions of the Arrangement with which Canada must comply. First, the Guideline ensures that Canada will comply with all provisions of the OECD Arrangement, which include the Arrangement's interest rates provisions. Second, it is far from clear what the legal consequence would be of attempting in this proceeding to delineate in the abstract, and before-the-fact, the various ways that Canada considers WTO members can act within the exception in the second paragraph of Item (k). Canada accepts that should it invoke the exception in the future, Canada would have the burden of demonstrating compliance with the second paragraph of Item (k) and is prepared to do so, should a transaction be challenged.

69. That said, Canada is willing to set forth its view as to which provisions of the current text of the OECD Arrangement would constitute interest rates provisions within the meaning of item (k) for the purposes of this dispute and in the context of regional aircraft transactions.

70. Canada considers that the most logical interpretation of the term "interest rates provisions" would include all provisions in the OECD Arrangement that affect what the interest rate and the amount of interest payable will be in a given regional aircraft transaction.

71. For the purposes of this dispute, the relevant "interest rates provisions" are generally contained in Chapter II of the Arrangement, which deals with the general rules governing the provision of officially supported export credits, and in Annex III, which contains the sector specific rules on Export Credits for Civil Aircraft. Canada notes that there may be other provisions of the Arrangement that are relevant to other sectors. Also, contrary to what Brazil has asserted, by complying with the OECD

Arrangement, Canada will also respect the non-derogation commitment set forth in the Arrangement.

72. For ease of understanding, we would group the most relevant provisions into two categories:

73. First, there are provisions that set the minimum interest rates for official financing support and that establish how these minimum rates are constructed and applied, and the terms by which they are offered. These include all the articles that cover the definition, construction and application of the minimum interest rates called the Commercial Interest Reference Rates, or CIRRs, such as Articles 15, 16 and 17 of Chapter II and Article 22 of Annex III.

74. In the second group of provisions are those that either directly or indirectly affect the amount of the interest charged and the timing of when it is paid, in a given transaction. These include provisions such as Article 7, which deals with cash payments, because the amount of the cash payment will affect the amount of interest charged; Article 10, which deals with the maximum repayment term, because the length of the term will determine the applicable minimum interest rates, as well as the overall amount of interest payable throughout the life of the loan; Article 14, which deals with payment of interest, because the payment profile will determine when an interest rate materializes in the form of an actual cash outlay; and Article 29, which deals with matching another government's terms and conditions that are outside of the Arrangement rules, because the terms and conditions that are being matched in such a case include interest rates. The requirements for a risk-based premium referred to in Article 21(a) and providing for higher effective interest rates for higher credit risks for direct lenders should also be included.

75. In Canada's view, this identification of interest rates provisions flows from the plain meaning of the words. The text of paragraph 2 of Item (k) refers to "interest rates provisions" and not simply to "interest rate". Thus, it must refer to more than the CIRR.

76. As this Panel and the Appellate Body have noted, pursuant to the second paragraph of Item (k), an export credit practice that is in conformity with the "interest rates provisions" of the Arrangement is not a prohibited subsidy under the SCM Agreement. If the term were applied only to the CIRR, the benefit of the exception would be extended to financing transactions that apply the CIRR, but do not abide by any of the other Arrangement rules, such as those relating to maximum terms and minimum risk premiums.

77. A financing transaction that applied a naked interest rate alone - one that is divorced from the other terms and conditions that affect the interest rate, and are generally part of any financing transaction - could very easily confer a benefit to the recipient that would be considered a subsidy under Article 1 of the Agreement and, if contingent on export, a prohibited export subsidy under Article 3.

78. Finally, one should bear in mind that the Illustrative List of the SCM Agreement was carried over from the Tokyo Round Subsidies Code. After more than ten years of negotiations, the OECD Arrangement was adopted in 1978. In 1979, the Tokyo Round Subsidies Code was agreed together with other Tokyo Round Agreements. It is inconceivable that the signatories of the GATT Subsidies Code, who were at the same time participants in the OECD Arrangement, would have agreed to

an item (k) that incorporated only a single, isolated provision of the Arrangement thus undermining the rest of the Arrangement less than one year after its adoption.

79. To assist the Panel, Canada has prepared a list of provisions that Canada considers to be "interest rates provisions" for the purposes of Item (k) in the context of this dispute. We are pleased to provide a copy of this list to the Panel, and to Brazil.

80. We would be happy to further discuss our rationale for this categorization of "interest rates provisions", if the Panel so wishes.

81. I will now briefly address the findings of the 21.5 Panel in *Australia - Leather*. In *Australia - Leather*, the factual circumstances of the "circumvention" are fundamentally different from the facts of this case. Brazil argued that the Panel decision was not correctly decided. But even if the Panel considers that the reasoning was not correct, the findings of the Panel in *Australia - Leather* are not in any way appropriate to this case. Let me explain.

82. In *Australia - Leather*, the Panel was faced with two, one-time financial contributions. The first of these financial contributions was found by the Panel to have been a subsidy contingent upon export performance. Australia purported to implement the Panel's findings, which had not been appealed, by placing the specific export subsidy found to have been prohibited, with another specific export subsidy. It was this second subsidy that was required to be removed. This, very clearly, is not the case here.

83. As you well know, it was the operation of TPC in the regional aircraft sector that was at issue. And it is the operation of TPC, as newly constituted, that is at issue in this proceeding. There is no evidence, and, indeed, no suggestion, that new subsidies have been granted to "circumvent" a Panel ruling. The claim here is that the restructuring of TPC has not gone far enough. In these circumstances, naturally, repayment of subsidies, even if such a remedy were available under the SCM Agreement, is not warranted.

84. Mr. Chairman, Brazil has made a valiant effort to bring the findings of the 21.5 panel in *Australia - Leather* into the discussion of this case. But, despite such effort, Brazil has failed to demonstrate the relevance of that decision in the context of the matter that is now before the Panel.

85. First, Brazil has not explained why the Panel should *now* entertain Brazil's argument for a retrospective application of Canada's obligation to withdraw, under Article 4.7 of the SCM Agreement, to subsidies that had already been granted before the recommendations of the DSB. Second, Brazil has not demonstrated how the specific findings of the panel report in *Australia - Leather* would be applicable to the facts of this case. I will address each issue in turn.

86. First, Mr. Chairman, Brazil is now in effect seeking to modify its original claim for a remedy. In fact, Brazil now asks the Panel to issue new recommendations as to what constitute Canada's obligation to withdraw subsidies found to have been contingent upon export performance. Brazil asks the Panel to use those new recommendations to assess Canada's compliance with those same recommendations.

87. Brazil does so, however, in the context of a procedure that is solely concerned with determining whether Canada has implemented the *original* rulings and recommendations of the DSB. Brazil is trying to get not only what it never got but, more

importantly, what it never sought. This can only be characterized as "trial by ambush", to borrow Lord Denning's famous phrase.

88. Brazil has known Canada's position on the interpretation and application of Article 4.7, in particular insofar as it applies to subsidies already granted. Canada's position on this issue was set out in Canada's second written Submission (para. 142 ss.) in the PROEX dispute running parallel to this case, where, of course, Canada is the complainant. In that submission, Canada indicated very clearly that its interpretation of the obligation to withdraw export subsidies under Article 4.7 of the Agreement does not allow for a retroactive withdrawal of subsidies that have already been granted. In that case, Brazil heartily supports Canada's view. In fact, in that case, Brazil has severely criticized the decision in *Australia - Leather* as bad policy and bad law.

89. In any event, Brazil could not have been unaware of Canada's interpretation of the scope and application of the obligation to "withdraw".

90. Nevertheless, during the various stages of the Panel process or even before the Appellate Body, Brazil has never taken exception with Canada's interpretation. It raises serious question of fairness and equity now for Brazil to ask the Panel to make a finding of non-compliance because Canada did not withdraw subsidies that had been granted before the recommendations of the DSB. Brazil never made that claim; in the course of implementing the rulings and recommendations of the DSB, Canada was not aware and could not have been aware of the nature of the obligation that Brazil now seeks to impose on Canada.

91. The role of the Panel under Article 21.5 of the DSU is to determine whether Canada's implementation measures are in conformity with the rulings and recommendations of the DSB. The ultimate role of the Panel is to settle the dispute between the parties. That dispute was framed by the parties in the course of their various submissions. The dispute, and therefore the rulings and recommendations of the DSB, do not include the withdrawal of subsidies that were granted before the recommendations of the DSB.

92. In conclusion on this point Mr. Chairman, Canada respectfully submits that in the light of the above considerations, it would not be an appropriate use of the Panel's jurisdiction under Article 21.5 to now grant Brazil a remedy that it never sought.

ATTACHMENT

Item (k): Interest Rates Provisions of the OECD Arrangement

This document sets out Canada's view of which provisions pertinent to regional aircraft financing in the current text of the OECD Arrangement would, for purposes of this dispute constitute "interest rates provisions" within the meaning of item (k) of Annex I of the SCM Agreement. The provisions described below affect what the interest rate and the amount of interest payable will be in a given transaction. Within limits, variations of certain of these provisions are permitted under the terms of the Arrangement. Canada notes that provisions in the Arrangement that are pertinent to sectors other than regional aircraft have not been listed. This list is thus without prejudice to Canada's position as far as other sectors are concerned. While Canada has not listed definitional provisions of the Arrangement, those provisions apply to the provisions listed below.

Article 2: Scope of Application

This article restricts the scope of the Arrangement to officially supported export credits with repayment terms of two years or more, and to official support in the form of tied aid.⁹

Article 3: Special Sectoral Applications and Exclusions

This article sets out the applicability of special guidelines to certain specific sectors. The guidelines applicable to the aircraft sector provide that in cases where provisions in the Sector Understanding on Export Credits for Civil Aircraft (Annex III) correspond with provisions in the Arrangement, the provisions of the Sector Understanding prevail.

The relevant provisions in the Sector Understanding are Articles 21, 22, 23, 24 and 25 of Annex III, Part 2, which covers new aircraft, and Articles 28, 29, 30 and 31 of Annex III, Part 3, which covers used aircraft, spare engines, spare parts, maintenance and service contracts.

Article 7: Cash Payments

This article requires providers of official support to require purchasers of goods and services to make cash payments of a minimum of 15 per cent of the export contract value of the goods or services, at or before the starting-point of a credit (defined in Article 9 of the Arrangement).

⁹ Tied aid support is not permitted for civilian aircraft, except for humanitarian purposes (Annex III, Article 24).

Article 9: Starting-point of Credit

This article requires that the repayment term begin by the actual date of delivery. However, depending on the complexity of the underlying export contract, other dates may be applicable.

Article 10: Maximum Repayment Term

This article sets out the maximum term for repayment of the export credit, which can be either five years (with a possible extension to eight and a half), or ten years, depending on whether the recipient country is classified as a Category I or Category II country. (The category of country is determined by world Bank data based on GNP per capita).

Article 13: Repayment of Principal

This article requires that the principal sum of the export credit is normally to be repaid in equal, and at least semi-annual instalments. It also permits equal, blended payments of principal and interest in the case of leases. Within limits, variations are allowed.

Article 14: Payment of Interest

This article requires payments of interest to be made in at least semi-annual instalments during the repayment term. Within limits, variations are allowed.

Article 15: Minimum Interest Rates

This article requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs), and sets out the principles by which CIRRs are established. These include the principle that CIRRs should closely correspond to the rate for first-class domestic borrowers and to the rate available to first-class foreign borrowers.

Article 16: Construction of CIRRs

This article requires CIRRs to be set at a fixed margin of 100 basis points above their respective base rates. For most OECD Participants, the base rates are the yields of government bonds with terms that roughly correspond to the average life of the loan.

Article 17: Application of CIRRs

This article provides that CIRRs can be held for 120 days at an additional cost of 20 basis points. When official financing support is provided for floating rate loans (rather than on a CIRR basis), the Participants must not grant the borrower the option of choosing the lower of CIRR or the short-term market rate throughout the life of the loan.

Article 19: Official Support for Cosmetic Interest Rates

This article forbids the offering of artificially reduced interest rates, which give the borrower the illusion of obtaining more favourable financing terms than are envisaged under the Arrangement.

Article 21(a): "Premium shall be risk-based."

Paragraph (a) of Article 21 requires that premiums be risk-based. This is understood to mean that premiums must "not [be] inadequate to cover long-term operating costs and losses" (as provided in Article 22(a)).

Article 26: Validity Period for Export Credits

This article imposes a limit of six months on the length of time offers can remain outstanding for acceptance by the buyer/borrower.

Article 29: Matching

This article permits the offering of terms and conditions that are outside of the Arrangement's rules, but only if such terms and conditions are matching another government's offer with terms and conditions that are outside of the Arrangement's rules.

ANNEX 2-4**ANSWERS TO QUESTIONS POSED TO CANADA BY THE PANEL
AND BY BRAZIL
(14 February 2000)****Questions Posed by the Panel Concerning Canada Account**

Q1. The Panel notes that the Policy Guidelines is worded in the negative, i.e., that a Canada Account financing transaction or class of financing transactions that does not comply with the OECD Arrangement would comply with the OECD Arrangement would not be considered to be in the national interest. This wording suggests that there may be transactions or classes of transactions that are outside the scope of, and therefore not subject to, the Arrangement. As a matter of logic, any such transactions could not "not comply with" the Arrangement, and therefore would neither be subject to, nor contrary to, the Guideline. Could Canada please explain why the Guideline was not worded in the affirmative, i.e., that only transactions that do comply with the Arrangement would be considered to be in the national interest? Could Canada please indicate whether all Canada Account transactions in the regional aircraft sector will be subject to the Arrangement and will comply therewith. Question 1:

Response

1. Under subsection 23(1) of Canada's Export Development Act, a prerequisite to authorization of a financing transaction under the Canada Account is a determination by the Minister for International Trade that the transaction is in the national interest. In making this determination, the Minister may reject a financing transaction for any number of reasons. The wording of the Policy Guideline in the negative is designed to preserve the Minister's ability to conclude that a proposed Canada Account financing transaction is not in the national interest based on other factors *even though* it complies with the OECD Arrangement. That is, if the Guideline were worded in the affirmative, as suggested in the Panel's query, it could be read to provide in effect that compliance with the OECD Arrangement means that a transaction, without more, would be in the national interest. This would leave no scope for other "national interest" considerations to be factored in by the responsible Minister.
2. As written, the Ministerial Guideline means that a transaction that does comply with the Arrangement may be in the "national interest", but that a transaction that does not comply with the OECD Arrangement will be considered, *ipso facto*, and without more, incapable of being in the "national interest". Compliance with the OECD Arrangement is therefore the one essential condition that must always be met in order for the transaction to be found to be in the national interest and authorized under the Canada Account.
3. All Canada Account transactions in the regional aircraft sector will be subject to and will comply with the OECD Arrangement.

Q2. Concerning Canada's apparent pledge, through the Policy Guideline, that "any future Canada Account financing transactions will be in conformity with the OECD Arrangement" (Canada's Oral Statement at para. 67.), the Panel notes, as acknowledged by Canada, that the "safe haven" in the second paragraph of item (k) of the Illustrative List makes specific reference to the "interest rate provisions" of the understanding in question, i.e., the OECD Arrangement. Canada has provided a paper ("Item (k): Interest Rates Provisions of the OECD Arrangement") and an oral statement concerning what it considers to be the interest rate provisions of the OECD Arrangement.

- (a) *Is it Canada's view that, in general, all of the substantive interest rate provisions that it has identified (i.e., all of the provisions other than matching) must both apply and be complied with for an export credit practice to be in conformity with the interest rate provisions of the OECD Arrangement? Please explain. If yes, does Canada consider that where this is not the case because of matching with non-complying terms and conditions, (i.e., where the transaction in question is matching the terms and conditions of a non-complying transaction), the transaction in question nevertheless is in conformity with the interest rate provisions of the Arrangement? Please explain.*

Response

1. All of the substantive interest rates provisions must be complied with to the extent that they are applicable. Not all substantive interest rates provisions are always applicable. For instance, for export credits in some sectors other than regional aircraft, Article 25 ("Local Costs") would, in Canada's view, represent a substantive interest rates provision; however, we did not retain Article 25 on our list because we decided to limit the list to those provisions that are relevant for the purpose of this case because they are generally applicable to regional aircraft. The local cost issue does not arise in the regional aircraft sector.
2. Also, some of the substantive interest rates provisions that are relevant for regional aircraft might not apply depending on the circumstances of the underlying export credit transaction. For example, Article 10 ("Maximum Repayment Term") has substantive rules that are significantly amended by the specific provisions stipulated in Annex III. We still found it important to list Article 10 because the concept of a maximum repayment term as set out in the main Arrangement text is directly related to the levels of the CIRRs (see Article 16), and CIRRs are applicable to regional aircraft.
3. The right to match is an intrinsic part of the disciplines of the Arrangement. It operates as a right to match financing by those countries which might provide financing pursuant to terms and conditions other than the standard terms and conditions. It works as a rather effective deterrent to those countries that might be tempted to not comply. Recent experience has shown that the total number of matching notifications has declined to less than 10 per year (all Participants combined). Because matching effectively amends some or all of the other interest rates provisions in their applicability to a particular transaction, matching is itself a substantive interest rates provision. Therefore, a

matching transaction undertaken in conformity with the Arrangement is also in conformity with the interest rates provisions of the Arrangement.

- (b) *If in answering (a) Canada indicates that it does not believe that all of the substantive provisions that it has identified must apply and be complied with for a transaction to be in conformity with the interest rate provisions of the Arrangement, does Canada consider that a transaction which complies with any one of these provisions or some subgroup of them is in conformity with the interest rate provisions of the Arrangement? Please explain, and identify the provision of provisions in questions. In particular, does Canada consider that export credits that are not CIRR-based (e.g., floating-rate financing), or export credit practices that do not involve an interest rate as such (e.g., export credit guarantees), can qualify for the safe haven of the second paragraph of Item(k)? Please provide a detailed explanation.*

Response

1. All the substantive interest rates provisions that are applicable and therefore can be complied with under the circumstances of the underlying export credit transaction, must be complied with for the transaction to be in conformity with the interest rates provisions of the Arrangement. Canada does not hold the view that any country should be allowed to not comply with an interest rates provision that is applicable to a transaction and still claim conformity with the interest rates provisions of the Arrangement.
2. Floating rates are a good example for illustrating this point. Clearly, floating rate financing is envisaged by the Arrangement, and the face value of the floating interest rate can be below the face rate of the CIRR; otherwise, the restriction imposed in Article 17.b) on choosing between the "lower of either the CIRR (...) or the short-term market rate" would be pointless. A floating rate transaction like the one described in Article 17.b) is in full conformity with the interest rates provisions of the Arrangement (indeed, Article 17 is itself an interest rates provision); CIRR is constructed on a fixed rate basis (Article 16) and therefore not applicable in a pure floating rate scenario. It is also clear from the plain wording of the Article 17.b) that the minimum floating interest rate is "the short-term market rate"; this is generally understood to refer to international market benchmarks such as LIBOR.
3. Canada wishes to clarify that export credit guarantees do involve an interest rate in respect of the underlying loans that are being guaranteed. A financial institution which receives an insurance policy or an unconditional guarantee (in either case, with or without interest rate support by government) from an export credit agency in respect of the financing of an export transaction may only provide a loan that respects the relevant interest rates provisions of the Arrangement.
4. While Article 17.b) confirms that official support can be provided on a floating rate basis at short-term market rates below CIRR, a narrow interpretation of the provision limits its application to cases of "pure cover" as described

above, i.e. loans insured or guaranteed by an export credit agency and extended at short-term market rates without interest rate support from the government. Canada holds the view that official support in the form of direct loans extended by export credit agencies at short-term market rates is equally legitimate under the Arrangement. Indeed, Canada believes that precluding direct lenders from undertaking floating rate transactions would give an undue advantage to those OECD Participants that operate insurance/guarantee systems. Moreover, short-term market rates such as LIBOR can be presumed to satisfy the principles for minimum interest rates set out in Article 15, insofar as they can be applied.

5. OECD Participants are fully aware of Canada's practice to offer floating rate financing under official support. While discussions on floating rate practices continue at the OECD, no Participant has alleged that Canada's floating rate practice represents a derogation from the Arrangement. Based on all of the above, Canada is of the firm view that official support provided in the form of direct loans at short-term market rates is fully compliant with the Arrangement and its interest rates provisions.
6. Notwithstanding that Canada believes that floating rates are encompassed within the OECD Arrangement, and should be included as "interest rates provisions" and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is clarified either under the OECD Arrangement or in the context of WTO proceedings that addresses this issue.

Q3. Would Canada please elaborate on how it intends to comply with the interest rate provisions of the Arrangement, as it has identified them, in respect of Canada Account transactions in the regional aircraft sector?

- (a) Please describe the form of forms that all Canada Account transactions in the regional aircraft sector will take. Please indicate, in particular, whether all such Canada Account transactions will take the form of official support for export credits with repayment terms of two years or more. In not please explain, and indicate how such transactions would be considered to be in conformity with the interest provisions of the Arrangement.*

Response

1. Any regional aircraft transaction entered into under the Canada Account will likely take the form of direct lending. While official support could be given by way of other means, for example guarantees, it is Canada's practice to provide support via direct lending. Because of the nature of the product, we do not expect any borrower to request repayment terms of less than two years. Accordingly, Canada would expect that all future Canada Account transactions in the regional aircraft sector will take the form of official support for

export credits with repayment terms of two years or more. Whether in the form of a direct loan or a guarantee, the interest rates provisions of the OECD Arrangement will be followed.

- (b) *Will all Canada Account transactions in the regional aircraft sector fall within, and comply with the terms of Articles 7, 9, 10, 13, 14, 17, and 26 of the Arrangement in respect of cash payments, starting point of credit, maximum repayment term, repayment of principal, payment of interest, application of CIRRs, and validity period for export credits, respectively? If not, how would any such transactions be considered to be in conformity with the interest rate provisions of the Arrangement?*

Response

1. Except in cases of matching or in cases of humanitarian aid, all Canada Account transactions in the regional aircraft sector will comply with Article 7 ("Cash Payments"), Article 9 ("Starting Point of Credit"), Article 13 ("Repayment of Principal"), Article 14 ("Payment of Interest"), Article 17 ("Application of CIRR"), and Article 26 ("Validity Period of Export Credits"). As for the maximum repayment term, Article 21 of Annex III effectively replaces Article 10 as the relevant interest rates provision for the purpose of compliance with regards to new regional aircraft
2. Canada Account transactions in the regional aircraft sector that are undertaken in full compliance with the matching provisions of the OECD Arrangement, will also be in compliance with the Arrangement and its interest rates provisions. This is because matching itself is an interest rates provision of the Arrangement as it specifically allows the offering of terms and conditions that are more favourable than otherwise allowed under the interest rates provisions of the Arrangement, provided they do not render the offer more favourable than the competing offer which is supported by another government and includes non-compliant terms and conditions for the same transaction (i.e., provided the terms do not "overmatch").

- (c) *Why does Canada not include Article 8 "repayment terms" in its list of relevant provisions?*

Response

1. Canada chose not to include definitional provisions in its list. Article 8 does not specify a rule; rather it provides a definition that is required for the purpose of setting rules in the subsequent articles. While the list of interest rates provisions provided to the Panel did not list definitional provisions of the Arrangement, as Canada noted in that document, those provisions apply.

- (d) *With all Canada Account transactions in the regional aircraft sector take the form of fixed rate financing at interest rates at or above the*

CIRR? If not, please explain in what sense any floating-rate financing and any below-CIRR fixed rate financing would be in conformity with the interest rate provisions of the Arrangement, given the requirement in Article 22 of the Sector Understanding that the CIRR shall be applied.

Response

1. As indicated in our answer to question 2 b: Notwithstanding that Canada believes that floating rates are encompassed within the OECD Arrangement, and should be included as "interest rate provisions" and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is clarified either under the OECD Arrangement or in the context of WTO proceedings that directly address this issue. Accordingly, except in cases of matching or humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed-rate financing at interest rates at or above the CIRR.
2. Also, if support were to be provided by way of "pure cover", i.e. a guarantee issued to a lending bank, the interest rates provision in Article 17.b) would be applicable. It is conceivable that the financing bank could price the loan on a floating rate basis and at a face rate below CIRR. The transaction would still be in full compliance with the interest rates provisions of the Arrangement. (Indeed, Article 17 is itself an interest rates provision.) Article 22 of the Sector Understanding simply reconfirms the applicability of the CIRR regime to regional aircraft; this is required because Article 6 of the Sector Understanding creates a different system of minimum interest rates for large aircraft. It is not the purpose of Article 22 of the Sector Understanding to invalidate Article 17.b) of the Arrangement.

(e) Will any so-called "market window" financing or other transactions be undertaken under the Canada Account in the regional aircraft sector? If so, please explain in detail the nature of any such transactions and the sense in which Canada considers they would be in conformity with the interest rate provisions of the Arrangement.

Response

1. Canada understands this question to ask whether Canada Account financing in the regional aircraft sector will be provided outside of the standard terms and conditions of the OECD Arrangement, notwithstanding whether such financing is consistent with the market. The answer is no. All Canada Account financing in the regional aircraft sector will be within the OECD Arrangement, whether or not the terms of a particular financing transaction are in fact market terms.

- (f) *Will any Canada Account transactions in the regional aircraft sector be provided in the form of export credit guarantees? If so, in what sense does Canada consider that such transaction would be in conformity with the interest rate provisions of the Arrangement.*

Response

1. Canada Account transactions in the regional aircraft sector will typically take the form of direct loans, although, for example, guarantees could also be envisaged. Guarantee transactions would also have to be in compliance with the relevant interest rates provisions of the Arrangement.
2. The package of disciplines reflected in the interest rates provisions is as important in a guarantee context as it is in the context of direct financing. See also Canada's response to question 2(b).
3. All future Canada Account transactions, whether undertaken on a direct lending basis or on a guarantee basis, will comply with the relevant interest rates provisions of the OECD Arrangement.

- (g) *How is it envisioned that the provision of official support for cosmetic interest rates with respect to the regional aircraft sector will be prevented (Article 19)?*

Response

1. Canada will simply not offer any cosmetic interest rates as defined in Article 18 when entering into regional aircraft transactions on Canada Account.
2. As a matter of clarification, interest rates below CIRR offered under the matching provisions of the Arrangement are not cosmetic interest rates because they do not involve compensatory measures (i.e. hidden measures) in the form of contractual adjustments. Matching is "open", not "cosmetic".

- (h) *Could Canada please describe how it will be ensured that appropriate risk-based premiums will be charged on Canada Account transactions in the regional aircraft sector. Why are the premium-related provisions of the Arrangement other than Article 22.a not, in Canada's view, part of the "interest rate provisions" of the Arrangement?*

Response

1. Canada selected only Article 21.a) because it articulates the principle of risk-based premiums and is the only premium-related provision that is available to WTO members that are not also OECD Participants. Clearly, the obligation to comply with the OECD Arrangement in its entirety imposes disciplines on Canada Account transactions in the regional aircraft sector that go beyond the obligation to adhere to the mere principle of Article 21.a). There are provisions in the Arrangement that add greater precision as to the nature of these premium-related disciplines.

2. Basically, OECD Participants have agreed on a common system for classifying countries into risk categories and setting minimum premiums in relation to the risk levels associated with each category that are expected to cover the Participants' long-term operating costs and losses. The actual country classifications and premium levels applicable to countries remain confidential because OECD Participants would like to avoid political interference with the country classification process. For an extensive description of the OECD premium system, we attach the OECD communications piece on premiums as a Canada's Exhibit 17.
3. Canada recognises that it would be unreasonable to expect a non-OECD WTO Member to charge a minimum premium level which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the Arrangement. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second paragraph of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants.
 - (i) *Please explain in detail how the matching provision will be applied with respect to Canada Account transactions in the regional aircraft sector. What, if any, are the limits on matching under the Arrangement? Does Canada consider that any Canada Account transaction in the regional aircraft sector that "matches", in the sense of the Arrangement, a non-complying transaction would be in conformity with the interest rate provisions of the Arrangement? Please explain.*

Response

1. Canada confirms that it considers any Canada Account transaction in the regional aircraft sector that is undertaken in full compliance with the matching provisions of the OECD Arrangement, to be in conformity with the Arrangement and its interest rates provisions.
2. This is because matching itself is an interest rates provision of the Arrangement as it specifically allows the offering of terms and conditions that are more favourable than otherwise allowed under the Arrangement, provided they do not render the offer more favourable than the competing offer that is officially supported by another government and includes non-compliant terms and conditions for the same transaction.
3. Clearly, "overmatching", i.e. offering more favourable terms and conditions than the competing, non-compliant offer, is not compliant with the Arrangement. Any case of matching by an OECD participant such as Canada must be notified to the other OECD Participants prior to the issuance of the commitment and will be scrutinised by them, particularly in cases of "non-identical matching" which are subject to a discussion procedure. "Non-identical matching" is still compliant provided it is not "overmatching". For instance, Canada would not have an issue with another Participant notifying a "non-identical matching" at CIRR over 12 years to match a non-compliant offer at CIRR minus 5 per cent over 10 years as there is no reason why a matching

Participant should be obliged to provide a cash subsidy if another tool is available to reduce the distortion created by the non-compliant offer to be matched.

4. For more details on the matching procedures of the Arrangement, we refer the Panel to Articles 50 through 53. We draw the Panel's attention to the high level of due diligence and disclosure required in the case of matching of a non-Participant. These cases are rare.
5. In Canada's view, the right to match is also available to WTO members that are not OECD Participants. If the matching transaction of a non-Participant were challenged at the WTO and found to provide a prohibited export subsidy, the "safe haven" of Item (k) would be available to that non-Participant, provided that the matching was undertaken in good faith and on the basis of reasonable due diligence.

(j) *Please describe in detail, including the nature of the differences, any particular provisions of the Sector Understanding on Export Credits for Civil Aircraft (Annex III of the Arrangement) that prevail over corresponding provisions of the Arrangement. To the extent that provisions of the Sector Understanding apply, will all Canada Account transactions in the regional aircraft sector fall within their scope and be in full compliance with them? Please explain in detail.*

Response

1. Annex III prohibits tied aid, except for humanitarian purposes (Article 24 of Annex III). This is an additional restriction applicable to the regional aircraft sector that Canada will obviously respect when entering into regional aircraft transactions on Canada Account.
2. Annex III also sets different maximum repayment terms. Rather than linking the repayment term to the wealth of the recipient country, the Sector Understanding ties it to the type (and effectively, the size) of the aircraft being exported. This rule can be more generous in one case (e.g. a Category A aircraft going into a Country I country) and more restrictive in another case (e.g. a Category B aircraft going into a Category II country).
3. As envisaged in Article 3, the sector-specific rule (i.e. Article 21 of Annex III) prevails over and effectively replaces the general Arrangement rule (i.e. Article 10).
4. Article 21 and Article 24 of Annex III are the interest rates provisions of the Sector Understanding that govern the repayment term and tied aid support. They are applicable to all Canada Account transactions in the regional aircraft sector, and all Canada Account transactions in the regional aircraft sector will comply with these two articles, except in cases of matching..

(k) *In the context of the responses to the above questions, would Canada please provide full details on all "variations" "allowed" under the relevant provisions of the Arrangement, referred to inter alia in the introductory paragraph of the Canada's paper ("Within limits, varia-*

tions of certain of these provisions are permitted under the terms of the Arrangement"). Will Canada Account transactions in the regional aircraft sector in all cases respect the applicable limits on any variations? Please explain in detail.

Response

1. Canada Account transactions in the regional aircraft sector will respect the applicable limits on allowed variations.
2. Allowed variations are called Permitted Exceptions under the Arrangement, and a comprehensive list can be found in Articles 48 and 49. The only Permitted Exception that is relevant for the purpose of regional aircraft transactions is the variation listed under Article 49 a) 2), which relates to irregular payment practices with respect to principal and interest.
3. One formal limitation on irregular payment practices is the no derogations engagement in relation to the repayment date of the first instalment of principal (Article 27). Generally speaking, and acknowledging that not all of the OECD Participants' conventions can be found written in the Arrangement text, the basic principle is that Permitted Exceptions are not supposed to make the offer more favourable than the most favourable terms and conditions that are allowed under the Arrangement. For instance, Canada would not have an issue with another Participant notifying a modest balloon payment after 7 years if the average life of the loan remained shorter than in the case of a standard repayment profile of 20 equal, semi-annual instalments.
4. The number of notifications of Permitted Exceptions generally exceeds 100 per year. Participants clearly consider Permitted Exceptions to be "permitted", i.e. in conformity with the Arrangement.

(1) Will Canada please elaborate on its apparent pledge, at para. 71 of its oral statement, that Canada "will also respect the non-derogation commitment set forth in the Arrangement".

Response

1. Article 27.a) of the Arrangement states that "(t)he Participants shall not derogate from maximum repayment terms, minimum interest rates, minimum premium benchmarks (...), the six-month limitation on the validity period for export credit terms and conditions, or extend the repayment term by extending the repayment date of the first instalment of principal (...)."
2. A derogating Participant is not in compliance with the Arrangement, nor in compliance with its interest rates provisions. As Canada Account transactions must comply with the Arrangement, Canada will not derogate from the Arrangement.
3. Canada notes that derogations are different from Permitted Exceptions and are also different from matching. Permitted Exceptions and matching are compliant; derogations are not.

Q4. Does Canada agree with the EC that Canada has "undertaken" to respect all of the provisions of the OECD Arrangement? If so, does Canada consider that this "undertaking" is legally binding on Canada Account transactions in the regional aircraft sector, and would Canada please elaborate on the specifics of this undertaking, making reference both to the interest rate provisions of the Arrangement as identified by Canada and to Canada's responses to questions 1-3, above.

Response

1. Canada has undertaken to respect all of the provisions of the OECD Arrangement with respect to financing transactions under the Canada Account. Through the Ministerial Policy Guideline the Minister for International Trade has undertaken not to authorise any financing transaction under Canada Account that does not comply with the OECD Arrangement. While the Ministerial Guideline is an administrative instrument and not a legislative one, for all practical purposes the effect is almost the same. This is because the exercise of discretion under the Canada Account programme is in the hands of the Minister and it is the Minister who has given the undertaking. In addition, officials administering the programme and/or referring financing transactions to the Minister for authorization will act in accordance with the Guideline. With respect to the difference between administrative guidelines and legislative instruments we refer the Panel to the comments made by the Panel in *United States - Sections 301 -310 of the Trade Act of 1974 (Sections 301-310)* where it stated:

"We recognize of course that an undertaking given by one Administration can be repealed by that Administration or by another Administration. But this is no different from the possibility that statutory language under examination by a panel be amended subsequently by the same or another Legislator."
2. The critical question, according to the Panel is whether the instrument in question is "lawful and effective." In this case, the Ministerial Guideline is effective in requiring that all Canada Account financing transactions in the regional aircraft sector comply with the OECD Arrangement and thereby comply with the interest rates provisions of the Arrangement.
3. Canada's view of which interest rates provisions are pertinent to this dispute is fully set out in Canada's exhibit - and a detailed explanation of how these would apply in practice can be found in Canada's responses to questions 1 and 2 from the Panel.

Q5. Would Canada please indicate the extent of and basis for its compliance obligations with respect to Canada Account. In this regard, we note that Brazil (at paragraph 66 of its second submission) characterizes Canada's position as being that the Panel's findings did not require Canada to take any action other than to ensure that the two Canada Account transactions identified in paragraph 54 of Canada's first submission were completed by 18 November 1999. Canada appears to disagree, as it stated at the meeting with the Panel that it does consider that the Panel's ruling imposes a legal obligation on Canada to take remedial action with respect to future Canada Account transactions in the regional aircraft. Does Canada confirm the

Panel's understanding of Canada's position? Could Canada please discuss the implications, if any, of Australia-Leather for Canada's arguments as to its obligations concerning Canada Accounts.

Response

1. Yes, Canada confirms the Panel's understanding of Canada's position.
2. In the original proceeding, the Panel found that the Canada Account was a discretionary programme that did not mandate subsidies contingent on export performance; the Panel therefore made no findings on the Canada Account programme per se. The Panel concluded, however, that Brazil had established a prima facie case, unrebutted by Canada, that applications of the Canada Account programme in the form of two debt financings involving regional aircraft were subsidies within the meaning of Article 1. (Because these financings were expressly for exports, the Panel also found them to be contingent in law upon export performance within the meaning of Article 3.1(a).) The Panel therefore concluded that "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement."
3. Although the Panel's conclusion concerned the programme as applied, it did not appear to be limited by its terms to the two transactions that had been before the Panel. Consequently, Canada understood the Panel ruling to mean that it was essential to take steps to ensure that any future financing transactions involving regional aircraft would be consistent with Canada's obligations under the SCM Agreement. Canada did so, by issuance of the Ministerial Policy Guideline making clear that any financing transaction not in compliance with the OECD Arrangement (necessarily including the interest rates provisions thereof) will not be approved for Canada Account financing.
4. Canada does not believe that the panel decision in Australia - Leather, which addressed whether the withdrawal of an individual subsidy might, in some factual circumstances, encompass the repayment of the subsidy, has any implications at all for the steps Canada it has taken to ensure that any future Canada Account financings involving regional aircraft are consistent with the SCM Agreement. Because the discretionary Canada Account programme was not per se found to mandate prohibited export subsidies, there can be no issue of withdrawing the Canada Account programme itself. Even Brazil has not argued for that result.
5. Nor does Canada believe that Australia - Leather has relevance for the Canada Account financings that formed the basis for this Panel's conclusion on the Canada Account as applied. Even assuming that Australia - Leather's controversial conclusion that repayment may be a required form of "withdrawal" in some circumstances were to be accepted, it could not, in Canada's view, apply here. The Australia - Leather case involved a one-time subsidy to a producer and its replacement measure which were contingent on a still ongoing stream of exports, which that Panel viewed as remediable only through repayment. In this dispute, by contrast, the two transactions before the Panel in the original proceeding were completed, including the export of all aircraft

that were "subsidized", in 1995 and 1998, long before the date for compliance.

Q6. Could Canada please elaborate on the legal basis for its argument that DSU Article 19.1 would allow the Panel to endorse, as part of its findings under DSU Article 21.5, the verification mechanism that it has proposed. Are there any other provisions of the DSU or the SCM Agreement that are relevant to this issue?

Response

1. Canada believes that reciprocal verification provisions would make both Brazil and Canada more confident of their respective compliance in the future. The second sentence of Article 19.1 authorizes a panel to "suggest" ways to implement a recommendation. Canada believes that endorsing the concept of reciprocal verification arrangements would be a useful suggestion, consistent with the spirit of Article 19.1.

Questions posed to Canada by the Panel regarding TPC

Q1. Please provide an up-dated version of Exhibit Cdn-9, and provide copies of all finalized "new" documents not already submitted to the Panel. Please provide the latest draft version of any "new" document still "under development". If no draft versions are available, please describe in detail the nature of the planned changes to the "new" document still under development".

Response

1. Exhibit Cdn-9 contains 35 serials of which 11 have already been provided to the Panel. Appended below are copies of all recently finalized "new" documents, as well as the latest draft versions of "new" documents still under development. Moreover, summary sheets describing in detail the nature of the planned changes to documents for which draft versions are not presently available are also included. Finally, a new serial, the Contribution Verification Checklist, is provided in draft form.
2. The draft documents submitted with this response are still under active consideration by TPC management and, therefore, are subject to change. Similarly, the planning assumptions underlying the summary sheets on documents not available in draft form could also change as the documents are developed. However, as all of these documents must respect TPC's Terms and Conditions, in their final form they will not be permitted to request or consider information concerning the extent to which applicant enterprises do or may export.
3. All of the documents identified in Exhibit Cdn-9 that remain to be finalized will be rolled out as they are completed and approved. It is reiterated that TPC will not approve contributions to the Canadian regional aircraft industry until the programme has been fully restructured. Therefore, TPC has a vested interest in completing this important task in a timely manner. But while time may be important, it is far more critical that TPC's policy and procedural documents be revised through a detailed review process that ensures that Canada is honouring its international obligations.

4. The current status of TPC documents are identified below under the three categories solicited by the Panel, namely:
- finalized "new" documents not already submitted to the Panel;
 - "new" documents still "under development"; and
 - documents for which draft versions are not available at this time.

Exhibit Cdn-9 Serial No.	Document
Finalised "new" documents not already submitted to the Panel (copies provided)	
5	Financial Data Outline (retitled)
6	Contribution Agreement Repayment Terms (retitled)
30	Environmental Assessment and Review Process
"New" documents still "under development"(latest draft versions provided)	
2	TPC Repayment Policy
3	Assessment Guidelines for Due Diligence
20	TPC Review Procedures (including Standard Letters)
21	Special Purpose Equipment List
24	TPC Project File Structure
25	TPC Policies and Procedures on Incrementally, Irreversibility and Retroactivity
28	Claims Package for Clients
29	PSB Integrity Review Checklist
31	Procedures for Project Amendments (retitled)
32	Claims Verification Checklist
33	Policy on Eligible Overhead Costs
34	Policy Guideline for Treatment of Eligible Equipment costs and Project Assets (retitled)
New	Contribution Verification Checklist
Documents for which draft versions are not available at this time (summary sheets provided)	
7	Statement of Work
8 & 9	TPC Standard Contribution Agreement (merged)
16	Framework Investment Proposals: <ul style="list-style-type: none"> - Industrial Research - Pre-competitive Development - Studies
18	TPC Business Plan (2000/2001-2001/2002)
22	Schedules of Estimated and Actual Project Benefits (retitled)
23	Performance Measures - Project Data Sheet
26	Evaluation Framework
35	Quality Assurance Checklist

Q2. Does Canada agree with Brazil's argument (para. 5 of its oral submission) that the only way for Canada to remove de facto export contingency is to "exclude [the regional aircraft industry] from TPC funding opportunities, or alternatively, to change radically the programme's eligibility and allocation requirements", and that (para. 17 of Brazil's oral submission)"TPC, as it applies to the regional aircraft industry, must be withdrawn in its entirety"? If not, what other ways of implementing the DSB recommendation would be possible in Canada's view if, hypothetically (and as Brazil claims), the current measures taken by Canada to comply with the DSB recommendation are not considered a sufficient change in the factual situation

which led to the initial conclusion that TPC assistance to the regional aircraft industry is de facto contingent on export?

Response

1. Canada rejects Brazil's argument and considers that it is not required to cease all TPC assistance to the Canadian regional aircraft industry. As noted previously, based on guidance provided by the Panel and the Appellate Body and in accordance with the test for de facto export contingency developed therein, Canada has taken the steps within Canada's control to ensure that any assistance that TPC may provide in the future to the Canadian regional aircraft industry will not be contingent on export performance in law or in fact. To go further and require Canada to "exclude [the regional aircraft industry] from TPC funding" would go beyond the rulings and recommendations of the DSB and be contrary to footnote 4 of the SCM Agreement.
2. Given the substantial steps already taken, we are aware of no other steps that Canada could take or needs to take, other than ensuring that future subsidiary documents and implementing measures as they are adopted conform with the changes already implemented.

Question to both Parties

Please comment on the EC argument (para. 7 of the EC's oral statement) that, in light of the Panel's terms of reference set forth in document WT/DS70/9, "[t]he Panel may not... in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two programmes at issue have not implemented the Report."

Response

1. We believe that the EC is correct. Brazil did not request the Panel to examine the sufficiency of Canada's withdrawal of previous subsidies, but has only questioned whether the changes to the two programmes are sufficient to conform with the SCM Agreement. This is in stark contrast to the situation in the *Australia - Leather 21.5* hearing where the Panel found repayment of the subsidy in question to be required. In that case, the issue of repayment was already before the Panel as the United States was seeking repayment of a portion of the monies already paid out. In deciding how much repayment was necessary, the Panel may have gone further than any Party desired, but the issue of repayment had been placed before the Panel.
2. Canada notes that Canada has fully complied with its WTO obligations in terminating, by the required date, all assistance found to have been export subsidies.

Questions by Brazil to Canada in the Canada Case Re Canada Account

Q1. Please identify any publicly-available sources from which information regarding particular Canada Account transactions could be obtained.

Response

1. As Canada noted at the hearing, information on specific Canada Account transactions is not made publicly available due to commercial confidentiality. It is for this reason that Canada proposed a reciprocal verification procedure so that Brazil could have access to that information.
2. Information on the Canada Account *in general* can be found from the following publicly available sources:
 - EDC's Annual Report
 - The Summary Report of the Canada Account Report to the Treasury Board. (This summary report can be found on EDC's website.)
 - The Government Expenditure Plan and Main Estimates

Q2. Is there any information available to WTO Members that are not Participants in the OECD Arrangement of that have not negotiated bilateral transparency or verification arrangements with Canada that would allow those Members to determine whether particular Canada Account transactions constitute prohibited export subsidies?

Response

1. Canada is not aware of any sources of information that would allow WTO members that are not OECD members and that are not party to bilateral verification procedures to determine whether particular Canada Account transactions constitute prohibited export subsidies.

Q3. In a document provided to the Panel during its meeting of 6 February, Canada states that Article 15 of the OECD Arrangement, which "requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs), " is amongst the "interest rates provisions" referred in the second paragraph of Item (k) to Annex 1 to the Subsidies Agreement¹⁰ Brazil poses the following questions:

- (a) *Please define the term "official financing support."*

¹⁰ "Item (k): Interest Rates Provisions of the OECD Arrangement," Canadian document provided to the Panel on 6 February 2000, pg. 2

Response

1. "Official financing support" is referred to in the fourth paragraph of the Introduction to the OECD Arrangement: "Direct credits/financing, refinancing and interest rate support are referred to as official financing support."
 - (b) *Is Canada's term "official financing support" the same as the term "official support," form the OECD Arrangement? If not, what is the difference between the two terms?*

Response

1. All "official financing support" is "official support", but not all "official support" is "official financing support". The fourth paragraph of the Introduction is clear in that regard. Aid financing (credits and grants) as well as export credit insurance and guarantees (without interest rate support, i.e. "pure cover") are listed as possible forms of "official support", but they do not represent "official financing support".
 - (c) *As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft constitute "official financing support"? If so, why? If not, why not?*

Response

1. All Canada Account financing transactions involving regional aircraft will comply with the Arrangement. If Canada Account were used to provide loan guarantees, the transactions would, as a matter of definition, not constitute "official financing support"; however, they would still comply with the Arrangement rules on "official support". In the more typical cases of direct financing offered under Canada Account, the transactions will, of course, comply with the Arrangement rules on "official financing support". Whether a transaction is undertaken in the form of a direct loan or a guarantee, it will be structured in a way to be in full compliance with the relevant interest rates provisions of the Arrangement.

Q4. As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft always be extended at interest rates equal to of above the OECD Arrangement's CIRR?

Response

1. Notwithstanding that Canada believes that floating rates are encompassed within the OECD, and should be included as "interest rate provisions" and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution

of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is clarified either under the OECD Arrangement or in the context of WTO proceedings that directly address this issue. Accordingly, except in the cases of matching and humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed rate financing at interest rates at or above the CIRR.

- (a) *If Canada responds in the negative, under what circumstances would such financing not be extended at interest rates equal to or above the OECD Arrangement's CIRR?*

Response

1. If official support were provided by way of "pure cover", i.e. a guarantee issued to a lending bank, the interest rates provision in Article 17.b) would be applicable. It is conceivable that the financing bank could price the loan on a floating rate basis and at a face rate below CIRR. The transaction would still be in full compliance with the interest rates provisions of the Arrangement. (Indeed, Article 17 is itself an interest rates provision.)

- (b) *If Canada responds in the affirmative, please reconcile this response with the following: first, Canada's statement, reported at paragraph of the Panel Report, that Canada Account financing is used where support under EDC's Corporate Account cannot be extended, i.e., where a particular transaction involves risk factors or requires financing terms in excess of those which EDC's Corporate Account would normally undertake; and second, Canada's statement, in the 3-4 February Panel meeting in the companion Article 21.5 case against PROEX, that EDC's Corporate Account does sometimes lend at rates below the CIRR.*

Response

1. Support under Canada Account will continue to be offered in circumstances where for risk, size or capacity reasons, EDC cannot provide support under the Corporate Account. In such cases, the risks will be assessed and the borrower offered terms and conditions commensurate with the risk, but in accordance with the interest rates provisions of the Arrangement. A risk premium would be applied to compensate Canada for the risk incurred. Canada's statement, in the 3-4 February Panel meeting in the companion Article 21.5 case against PROEX, that EDC's Corporate Account has sometimes lent at rates below the CIRR, is correct. In such a case the terms and conditions are not only commensurate with the risk, but are also consistent with the terms and conditions that would be available to the borrower from commercial banks/lenders.

*Q5. As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft always comply with the 10-year maximum repayment term applicable to regional aircraft transactions under the OECD Arrangement?*¹¹

- (a) *If Canada responds in the negative, under what circumstances would such financing not comply with the 10-year maximum repayment term?*

Response

1. Canada confirms that Canada Account transactions in the regional aircraft sector will always comply with the maximum repayment terms of Article 21 of Annex III of the Arrangement, except in those cases where Canada might exercise its right to match non-compliant terms and conditions in accordance with Article 29 of the Arrangement, as confirmed by Article 25 of Annex III.

- (b) *If Canada responds in the affirmative, please reconcile this response with the following: first, Canada's statement, at paragraphs 6.159-6.160 of the Panel Report, that Canada Account financing is used where support under EDC's Corporate Account cannot be extended, i.e., where a particular transaction involves risk factors or requires financing terms in excess of those which EDC's Corporate Account would normally undertake; and second, the fact that EDC's Corporate Account provides repayment terms (specifically, 16.5 -year terms)¹² beyond the maximum 10-year term identified for regional aircraft transactions in the OECD Arrangement*

Response

1. The circumstances that would give rise to 16.5 year terms under Corporate Account would not be such that Canada Account support would be required. Canada Account continues to be used in circumstances where Corporate Account can not be extended, for reason of risk, size of transaction, or country concentration reasons. In other words, such a term would be granted because it would be consistent with the terms and conditions available to that particular borrower from commercial banks/lenders. Canada could not, under Canada Account, support terms in excess of the ten-year repayment term identified for regional aircraft transactions in the OECD Arrangement, unless it was doing so in order to match another country's financing offer on other than the standard terms and conditions of the OECD Arrangement.

¹¹ OECD Arrangement, Annex III, Part 2, Chapter V, Article 21(a).

¹² Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 65.

Q6. In a document provided to the Panel during its meeting on 6 February, Canada states that Article 29 of the OECD Arrangement, which "permits the offering of terms and condition that are outside of the Arrangement's rules, but only if such terms and conditions are matching another government's offer with terms and conditions that are outside of the Arrangement's rules" is amongst the "interest rates provisions" referred to in the second paragraph of Item (k) to Annex 1 to the Subsidies Agreement.¹³

- (a) *When Canada states that in the circumstances detailed in Article 29, it may provide "terms and conditions that are outside of the Arrangement's rules" would the provision of those "terms and conditions" still constitute "official financing support", as that term is defined by Canada?*

Response

1. Whether or not a transaction is undertaken on a matching basis, if it falls under the Arrangement's definition of "official financing support" (i.e., official support offered by way of direct credits/financing, refinancing and/or interest rate support), it remains "official financing support". Canada notes that the definition is the OECD Arrangement definition, not a definition devised by Canada.

- (b) *Does Canada consider it to be consistent with the interest rates provisions OECD Arrangement to offer terms that are "outside of the Arrangement's rules" where it is "matching another government's offer with terms and conditions that are outside of the Arrangement's rules"?*

Response

1. Yes. Article 29 grants a positive right. As a result, matching (unlike unilateral derogations) is compliant with the Arrangement. It is an interest rates provision because it allows Participants to offer terms and conditions affecting the interest rate and the amount of interest payable that are more favourable than the terms and conditions envisaged in the other interest rates provisions of the Arrangement.

- (c) *Does Canada consider it to be consistent with the Subsidies Agreement to offer terms that are "outside to the Arrangement's rules", where it is "matching another government's offer with terms and conditions that are outside of the Arrangement's rules"? If Canada's re-*

¹³ "Item (k): Interest Rates Provisions of the OECD Arrangement," Canadian document provided to the Panel on 6 February 2000, pg. 3

sponse is in the affirmative, please identify which provision of the Subsidies Agreement permits "matching" in these circumstances.

Response

1. Matching involves the provision of an export subsidy. An export subsidy is, as a rule, prohibited under the SCM Agreement. Matching is, however, permitted under the second paragraph of Item (k) as an export credit practice that complies with the interest rates provisions of the OECD Arrangement.

Q7. In paragraph 71 of its Statement for the Meeting of the Panel, dated 6 February 2000, Canada stated that the "interest rates provisions" of the OECD Arrangement relevant to this dispute are "generally" contained in Chapter 11 and Annex III to the Arrangement. Please identify any exceptions.

Response

1. In its list of "interest rates provisions", Canada also identified Article 2 ("Scope of Application") and Article 3 ("Special Sectoral Applications and Exclusions"). These two articles can be found in Chapter I of the Arrangement.
2. Canada listed Article 2 because the scope of the Arrangement naturally determines the scope of the interest rates provisions of the Arrangement. Article 3 is of particular relevance in the context of export credits for regional aircraft because it effectively establishes how the interest rates provisions of the Annexes are related to the interest rates provisions of the Arrangement.

Canada wishes to note that it limited its list to those interest rates provisions that are relevant for regional aircraft transactions. Other interest rates provisions might be relevant in other sectors. For illustrative purposes only, Article 25 ("Local Cost") would, in Canada's view, be among the interest rates provisions that are relevant for export credits in support of power projects.

ANNEX 2-5

COMMENTS OF CANADA ON BRAZIL'S RESPONSES TO THE QUESTIONS FROM THE PANEL

(17 February 2000)

CANADA ACCOUNT

Question 1

1. Canada confirms the statements made in its written submissions and in its response to question 4 from the Panel regarding the serious and effective nature of the Ministerial Policy Guideline. The Guideline is not at all hortatory.

Question 4

2. Canada would like to re-confirm that Canada is committed to complying with the rulings and recommendations of the Panel and Appellate Body on an on-going basis. Accordingly, and in response to the criticism directed at Canada by the Panel and the Appellate Body for failing to produce certain commercially confidential information in the earlier proceedings, Canada is revising the form of the confidentiality provisions to be contained in future TPC contribution agreements and in future EDC transactions, so as to facilitate, if requested, the disclosure of such information in the context of WTO dispute settlement proceedings.

TECHNOLOGY PARTNERSHIPS CANADA

Question 2

3. The Panel has asked Brazil whether the provision of specific subsidies to export-oriented industries, for that reason alone, necessarily violates Article 3.1(a) of the SCM Agreement. While it is not stated directly, Brazil's answer, and in particular Brazil's quotation of the United States third party submission, implies that in Brazil's opinion, granting a subsidy to an industry that exports is not, in and of itself a violation of Article 3.1(a).

4. Canada has two comments regarding Brazil's response.

5. First, Brazil's assertion that "two-thirds of all funds [under TPC] will go to the aerospace industry", and its implication that "aerospace" and "regional aircraft" mean the same thing, are incorrect. Regional aircraft is but one part of the aerospace industry, which is one component of the A&D sector. The sector includes 800 establishments and encompasses everything from satellites to combat boots. This sector is, in turn, only one of the areas designated for funding under TPC. Indeed, it is in an effort to focus on Enabling and Environmental technology projects, and recognizing that projects in the A&D sector are significantly more costly than those in other eligible areas, that TPC has placed a limit on the share of funds that can be allocated to A&D.

6. In any event, as Brazil rightly notes in its Second Submission, the issue is not whether Canadian regional aircraft related projects receive the majority of TPC funds

(which they clearly do not) or \$1 of those funds, but whether TPC funding is export contingent. The facts demonstrate that it is not.

7. Second, TPC provides funding for R&D in the A&D sector because it is a sector with significant potential for important industrial research and development.

8. The OECD Economic Survey of Canada noted the widely held view that Canadian industry suffers from an innovation gap compared with other developed countries, ranking 9th out of 10 countries in industrial research. This innovation gap has contributed to weak productivity performance over the past two decades, resulting in sub-optimal employment growth and contributing to high government deficits.

9. In exploring ways of increasing industrial R&D, it is natural for the Government to look for sectors or technologies that are already or potentially positioned to conduct R&D on a large scale and at the leading edge of the technology spectrum.

10. Canada's A&D sector is one such sector. It is one of the country's largest investors in R&D and a source of high-paying jobs employing some 800,000 Canadians. R&D expenditures in the A&D sector total more than \$1 billion annually. The R&D intensity (R&D/sales) of the A&D sector was 7.28 per cent in 1998, well in excess of the average of 1.2 per cent for all Canadian manufacturing enterprises.

Question 3

11. Brazil did not answer the Panel's question; namely, whether the granting of TPC assistance to the regional aircraft sector is contingent on the fulfilment of sales forecasts. The answer is no, and Canada notes that Brazil has offered no evidence to the contrary.

Question 4

12. Brazil proposes two alternatives for reforming TPC: (1) "making funds available to Canadian industry generally", and (2) "changing TPC so that its contributions do not confer benefits, and therefore do not constitute subsidies within the meaning of Article 1.1 of the SCM Agreement".

13. The first proposal - making TPC generally available - would be legally irrelevant to remedying a practice found to be an export subsidy, since export subsidies are deemed to be specific under Article 2, regardless of general availability. Brazil is also wrong on the facts, since TPC contributions are available to Canadian industry generally. Funds are available to two technologies (enabling and environmental) that cut across all industrial, agricultural and service sectors, and a group of industrial sectors broadly termed aerospace and defence that encompass a vast area of the Canadian economy.

14. Regarding Brazil's second alternative - eliminating any benefit from TPC contributions, Canada notes that Canada is not required to refrain from subsidizing the regional aircraft industry, provided Canada has taken steps so that any such subsidization will not be contingent on export performance. Canada has done so.

ANNEX 3-1

SUBMISSION OF THE EUROPEAN COMMUNITIES

(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	4500
II. BUSINESS CONFIDENTIAL INFORMATION.....	4500
III. TECHNOLOGY PARTNERSHIPS CANADA.....	4501
1. Introduction.....	4501
2. Assessment by the EC.....	4501
IV. THE CANADA ACCOUNT SUBSIDIES.....	4503
1. Introduction.....	4503
2. Assessment by the EC.....	4504
V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL.....	4505
VI. CONCLUSION.....	4505

I. INTRODUCTION

1. The European Communities (hereafter "the EC") makes this third party submission because of its systemic interest in the correct interpretation of the *SCM Agreement* and the of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").

2. It will comment on the facts and arguments of the parties as they appear from the Reports and the first written submissions of the parties. The arguments presently before the Panel are not however as yet fully developed and the EC anticipates that it will have more to say at the third party session of the meeting with the Panel. The EC does not consider that it is appropriate for it at this stage to discuss arguments that have not yet been developed by the parties.

3. Section III will discuss the Technology Partnerships Canada programme ("TPC") and Section IV the Canada Account subsidies.

II. BUSINESS CONFIDENTIAL INFORMATION

4. The EC must first recall its position on the special procedures for the protection of "Business Confidential Information."

5. The EC recognises that certain information used in panel proceedings may be of such a nature that particular care is called for to protect it. The EC cannot accept however that protective procedures are adopted which it is impossible for the EC to follow. As the EC explained before the Appellate Body, EC officials are not allowed to enter into personal commitments to third country governments concerning the conduct of dispute settlement proceedings. Such obligations may only be undertaken

by the EC, which is bound vis-à-vis other WTO Members by Article 18.2 DSU to ensure that confidential information is protected. In the case of the EC, the effectiveness of this obligation is ensured by the fact that EC officials are all bound by the EC Treaty and their terms of employment not to disclose confidential information, including business confidential information.

III. TECHNOLOGY PARTNERSHIPS CANADA

1. Introduction

6. The Panel has found and the Appellate Body has affirmed that the TPC programme as applied to the regional aircraft industry constituted a *de facto* export subsidy, and was therefore inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement. The Panel recommended that Canada bring these subsidies into conformity of the *SCM Agreement* within 90 days.

7. Canada claims to have implemented the Appellate Body's findings in the following way:

- (a) *Canada has terminated all obligations to regional aircraft projects under the TPC programme*, with effect from 18 November 1999. It has cancelled all outstanding funding for regional aircraft projects. It has also withdrawn approvals-in-principle and has closed all files relating to outstanding applications. Canada claims that it now has no further obligation to disburse funds or consider applications with regard to regional aircraft under the TPC programme as previously constituted.
- (b) *Canada has also restructured the TPC programme*, with a view to eliminating the inconsistencies identified by the Panel and the Appellate Body. In particular, in the framework of the new TPC, it has restructured the TPC's objectives to remove the references to export promotion, it has removed export considerations from the eligibility and approval criteria and it has opened up the programme to activities which are further from the market (e.g. industrial research), although certain elements of the documentation have not yet been finalised. Significantly, Canada states that under the new TPC information on export sales will no longer be gathered or recorded.

8. Canada claims that these actions amount to implementation of the Panel's and Appellate Body's findings.

2. Assessment by the EC

9. The Panel found TPC to be *de facto* export contingent. Establishing whether *de facto* export contingency has ceased (and not been re-introduced in some way) obviously involves difficult questions of fact.

10. The EC considers that Canada's actions with regard to the TPC do *prima facie* amount to implementation of the Appellate Body's findings. In addition since no disbursements have been made since 18 November and no new applications for assistance have been approved since that date, there does not seem to be any basis on

which continued *de facto* export contingency or some other violation of the *SCM Agreement* can be established.

11. The TPC was found to constitute an export subsidy in fact, not in law. Therefore Canada is not required to change the law in order to bring the TPC into conformity with the *SCM Agreement*, but it must satisfactorily address the elements which have been found by the Appellate Body to justify a conclusion of *de facto* export contingency. The Panel and the Appellate Body held that a number of facts relating to the TPC, when considered together, demonstrated that the granting of TPC subsidies was tied to actual or anticipated export¹ and that export contingency could be "... *inferred* from the total configuration of the facts."²

12. It should be noted that Canada is required to remove the export *contingency*, it is not required to stop subsidising the aircraft industry. In order to meet the 'but for' test established by the Panel in paragraph 9.332 of its Report, Canada must satisfy the Panel that TPC assistance will in future be granted without reference to actual or anticipated export earnings, in order to avoid a finding of *de facto* export contingency as defined by Article 3.1(a) and footnote 4 of the *SCM Agreement*. Put another way, Canada must ensure that the freedom of choice of applicants to decide between selling on the domestic or export markets is not limited in any way by the conditions attached to the receipt of the subsidy.

13. The EC notes that the amendments to the TPC programme introduced by Canada are designed to address each of the groups of facts found to warrant the conclusion of *de facto* export contingency. In the restructured TPC programme export performance is no longer referred to as an objective, export considerations have been removed as a criterion for eligibility or approval, and the scope of eligible activities under TPC have been expanded to include industrial research, thus shifting the focus of support further away from the market. The systematic gathering of information on export performance has also been stopped. Therefore it seems that export contingency can no longer be inferred from the total configuration of the facts, the balance of which has clearly been changed by the amendments to the TPC, and in this way Canada has *prima facie* removed the basis for a finding of *de facto* export contingency.

14. Brazil claims in its First Written Submission that Canada's amendments to the TPC are "cosmetic" and do not change the fact that the programme is export contingent. In particular, it argues that the sectoral coverage of the TPC has not changed, that the aerospace sector (including regional aircraft) will continue to receive the largest share of funds and that the regional aircraft industry remains export-oriented.

15. The EC considers that Canada is not prevented by the *SCM Agreement* from limiting eligibility for a subsidy to certain sectors or from concentrating funding on certain industries. As for the export-oriented nature of the regional aircraft industry, while the Appellate Body found that it was legitimate for the Panel to consider it as a

¹ Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, paras. 9.316 to 9.348. Sixteen factual elements were identified.

² Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 167.

relevant fact in its assessment of export contingency, it cannot *by itself* justify such a finding, in view of the provisions of footnote 4 of the *SCM Agreement*. However, Brazil has not produced any other relevant arguments to support its contention that the restructured TPC is still export-contingent; most of its other argument³ seem to relate the operation of the previous TPC programme.

16. In the view of the EC, the requirements imposed on a WTO Member to remove *de facto* export contingency cannot be so onerous as to effectively prevent a Member from exercising its basic right to grant subsidies which are not prohibited. In this regard, the fact that a Member continues to subsidise the same firms or sectors under a modified scheme is not by itself sufficient to conclude that the status of the scheme has not changed.

17. It is of course possible that in the future the restructured TPC programme may, in the light of evidence on its actual operation, be found to provide export subsidies to regional aircraft. For instance, if the stated eligibility criteria were not adhered to and/or funding was found to be disproportionately granted to export projects, such a situation may arise. In such a case, the amendments to the restructured TPC prove not to have been sufficient to prevent a finding of export contingency. However, at the moment, there are no facts before the Panel, with regard to the restructured TPC, to indicate that this is likely happen. The Panel can only take its decision on the basis of the information currently available; the implementing party must be assumed to be acting in good faith unless there are good reasons to believe the contrary.

IV. THE CANADA ACCOUNT SUBSIDIES

1. Introduction

18. In the original proceeding, the Panel found that the Canada Account programme provided debt financing (export credits on projects which are deemed to be in the national interest, but which the EDC cannot support for reasons of size or risk) which constituted *de jure* export subsidies prohibited by Article 3.1(a) of the *SCM Agreement*. Canada did not seek to rebut the *prima facie* evidence of an export subsidy provided under this programme, nor did it appeal the Panel's finding to the Appellate Body.

19. The Panel also held that since Canada Account financing was *discretionary*, it could only rule on the particular cases of support.⁴ This finding was not challenged on appeal. As a result, the Panel merely found a number of *transactions* to have been *de jure* export contingent.

20. Canada has however accepted that the Canada Account programme was inconsistent with the *SCM Agreement*, and has taken steps to rectify this inconsistency and make the programme compatible with the Agreement.

³ Section D.3 of Brazil's submission.

⁴ Panel Report, *supra*, footnote 1, para. 9.213.

21. First Canada points out that the cases of Canada Account debt financing transactions on which the Panel ruled had been *completed* in 1995 and 1998⁵ and that there had been no transactions financed under Canada Account since 18 November 1999. Secondly, it has, for future transactions, adopted a policy that the Minister of Finance will not consider Canada Account financing which does not conform to the OECD Arrangement on Export Credits to be in the national interest.

2. *Assessment by the EC*

22. Since, according to Canada, the Minister is required to approve all such transactions and may not approve financing transactions which are not in the national interest, it would seem that all Canada Account transactions (not only those concerning regional aircraft) will in future comply with the OECD Arrangement. Under the second paragraph of item (k) of Annex 1 of the *SCM Agreement*, in conjunction with footnote 5, any Member which respects the provisions of the OECD Arrangement (Canada is a party to it) is not considered to be granting a prohibited export subsidy. Therefore, since Canada has undertaken to respect all the provisions of the OECD Arrangement (including presumably the interest rate provisions), it appears to the EC that Canada has *prima facie* correctly implemented the Panel's findings by amending the Canada Account programme to eliminate those elements which the Panel found be inconsistent with the *SCM Agreement*.

23. Brazil has not produced any evidence to call into question Canada's implementation. It merely suggests that Canada could have opted to assert the affirmative defence under the second paragraph of item (k) before the original panel, and argues that Canada still bears the burden of proving this affirmative defence in the implementation Panel.

24. This is clearly correct (and would also be correct if Canada had invoked the defence and it had been rejected). The EC presumes that Canada did not invoke item (k) in the original panel proceeding because the Canada Account financing did not meet the requirements of the OECD Arrangement at that time.

25. Now that the programme has been amended by Canada's undertaking to comply with the OECD Arrangement, it must, in accordance with the presumption of good faith to which WTO Members are entitled, be considered to no longer constitute a prohibited export subsidy.

26. Unless Brazil can show reasons which lead to Panel to conclude that the programme will not be applied according to the rules, the Panel must conclude that the implementation is sufficient.

⁵ It appears from the Panel Report (para. 6.171) that *deliveries* were also completed by 1998.

V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL

27. Canada proposes to enter into a transparency agreement with Brazil to ensure financing complies with the *SCM Agreement* and asks the Panel to suggest this in its recommendations.

28. Canada and Brazil are of course free to settle their dispute in whatever way they wish so long as the settlement complies with the WTO Agreement.

29. The EC does not however consider that it would be appropriate for the Panel to suggest a transparency agreement. Canada and Brazil already have an obligation to notify all their subsidies, including the ones found by the Panel in this case. They do not seem to have fully complied with this obligation.. It would appear more appropriate for the Panel to insist that Canada and Brazil fulfil their WTO commitments than to make the suggestion requested by Canada.

VI. CONCLUSION

30. The EC is conscious that the case before the Panel today poses a number of important issues concerning the interpretation of the *SCM Agreement*.

31. The state of the arguments presented by the parties and the information and time for reflection available to the EC has not allowed it to make as full a contribution to the reflections of the Panel as it might have liked. It will therefore supplement its arguments at the Third Party Session in the light of the other submissions to be presented to the Panel before that meeting.

ANNEX 3-2

SUBMISSION OF THE UNITED STATES

(17 January 2000)

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4506
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME AND THE CANADA ACCOUNT	4506
A. The Determination of Whether a Subsidy is Contingent in Fact Upon Export Requires a Panel to Examine All of the Facts Surrounding the Granting of the Subsidy.....	4507
B. The United States Disagrees with Brazil's and Canada's Characteriza- tions of Item (k) of the Illustrative List	4509
III. CANADA'S PROPOSAL FOR "VERIFICATION PROCEDURES"	4510
IV. CONCLUSION	4511

I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the Article 21.5 proceeding that Brazil has requested to review Canada's implementation of the recommendations and rulings of the Dispute Settlement Body ("DSB") in *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, 14 April 1999 ("Panel Report"); WT/DS70/AB/R, 2 August 1999 ("Appellate Body Report"). As was the case before the Panel and the Appellate Body, the United States does not intend to comment upon the specific factual matters at issue in this dispute. Rather, the United States intends to limit its comments to certain fundamental interpretive issues relating to the proper legal interpretation of what constitutes a subsidy that is "contingent in fact" upon export performance and the proper approach for addressing claims involving item (k) of the Illustrative List. The United States will also comment briefly on Canada's proposal to establish "verification procedures" that it claims will "facilitate a definitive resolution of this dispute."¹ The United States does not comment at this time upon the other issues raised in this proceeding.

II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME AND THE CANADA ACCOUNT

2. Brazil claims that Canada's amendments to the TPC programme and the Canada Account do not make the programmes consistent with the WTO Agreement on Subsidies and Countervailing Measures ("the SCM Agreement"), and do not consti-

¹ Canada Submission, paras. 59-61.

tute effective implementation of the DSB's recommendations and rulings. The United States takes no position on these issues. The United States does, however, wish to make certain brief observations that it hopes will assist the Panel in reaching its own determinations.

A. *The Determination of whether a Subsidy is Contingent in Fact upon Export Requires a Panel to Examine all of the Facts Surrounding the Granting of the Subsidy*

3. Brazil properly notes in its submission that the Panel and the Appellate Body each concluded that TPC assistance to the Canadian regional aircraft industry was contingent "in fact" (or "*de facto*") upon export performance.² As the Appellate Body explained, the purpose of the prohibition on export subsidies that are contingent in fact upon export performance is to prevent circumvention of the prohibition against export subsidies contingent in law upon export performance.³ Moreover, although the legal standard for demonstrating such contingency is the same for the two types of export subsidy, the types of evidence that may be employed to meet the legal standard may differ. The Appellate Body explained that proving *de facto* export contingency is much more difficult than proving *de jure* export contingency because:

There is no single legal document which will demonstrate, on its face, that a subsidy is "contingent ... in fact ... upon export performance". Instead, the existence of this relationship of contingency, between the subsidy and export performance, must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.⁴

4. Thus, it is not enough merely to examine the legal criteria controlling an alleged *de facto* export subsidy. Nor is it enough simply to examine the formal, non-legal criteria that a Government considers in determining whether to grant the subsidy. Rather, a Panel must look at all of the facts surrounding the granting of the subsidy to determine whether - despite the absence of any formal requirements - the granting of the subsidy was in fact tied to actual or anticipated exportation.

5. In this sense, the United States noted before the Appellate Body that Canada's own approach for identifying *de facto* export subsidies under its domestic countervailing duty law views the intent of the subsidizing government as a primary consideration. Section 5.15.1.3 of the "Special Import Measures Act ("SIMA") Handbook⁵

² See Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, para. 9.347; Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 180.

³ Appellate Body Report, *supra*, footnote 2, para. 167.

⁴ Appellate Body Report, *supra*, footnote 2, para. 167.

⁵ The Special Import Measures Act ("SIMA") is the Canadian antidumping and countervailing duty law. The SIMA Handbook is the working manual of the Revenue Canada Anti-Dumping and Countervailing Directorate. It can be accessed online at <http://www.rc.gc.ca/sima>.

contains the following discussion on "Guidelines on What Constitutes an Export Subsidy":

Sometimes ... a subsidy may not be explicitly contingent on export performance but may have the same effect. For example, where a grant or concessional loan is provided to aid the establishment of an industry which will produce largely for export markets, the subsidy may be a "de-facto" export subsidy.

If the subsidy cannot be readily identified as an export subsidy, on the basis of a direct linkage to export performance, then it may be useful to examine other factors to determine whether there is an export linkage. *These factors could include the granting authority's intention in establishing the programme gleaned from government statements or publications which announced or publicized the programme.* The enabling legislation should also be reviewed to determine whether it indicates a linkage to export performance. However, if increased external trade and balance-of-payments considerations are incidental to national industrial or regional objectives, then the subsidy may not be *intended* as an export subsidy. Accordingly, the *intention* may be difficult to distinguish in practice. ...

Trade impact is another factor in making the distinction. Domestic subsidies are introduced to relieve distortions in the domestic economic scene, whereas export subsidies are *intended* to have a major trade impact. Of course, any domestic subsidy will often have some indirect trade impact, however minor, and subsidies which lower the costs of industries producing tradeable goods are properly a matter for concern. Also, subsidies are rarely provided with one purpose in mind. Objectives such as sectoral, structural, scientific, or regional policies are also bound up in subsidy decisions.⁶

Thus, the SIMA Handbook recognizes the intent and objectives of the subsidizing government as relevant factors for determining whether a particular subsidy is a *de facto* export subsidy.

6. Moreover, the EC argued before the Appellate Body that "[o]ne circumstance in which an indication of *de facto* export contingency might arise is where the recipient is required to achieve certain minimum production and sales targets which in the light of the facts of the case can only be achieved through increased export effort and not from sales on the domestic market." The United States agrees wholeheartedly with the EC's statement. If there is something about the product itself, or the nature of the market for that product, which indicates that a recipient will have to export to fulfill the conditions of the subsidy, that would be persuasive evidence of *de facto* export contingency. This is not to say, however, that such a circumstance is the *only* circumstance that would indicate the existence of a *de facto* export subsidy.

7. Finally, Canada quotes the Appellate Body's statement that:

⁶ SIMA Handbook, para. 5.15.1.3 (Nov. 27, 1998) (emphasis added).

The second sentence of footnote 4 precludes a panel from making a finding of de facto export contingency for the sole reason that the subsidy "is granted to enterprises which export". In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports. ... We agree with the Panel that, under the second sentence of footnote 4, the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding.⁷

Canada views the Appellate Body's statement as support for the proposition that the SCM Agreement does not prohibit the granting of subsidies to firms or industries that are export oriented, "including in circumstances where the government is aware of this export orientation."⁸ In the view of the United States, this statement is not quite accurate. As the above excerpt demonstrates, the Appellate Body in fact stated that the export orientation of a firm is not enough *standing alone* to support a finding of *de facto* export contingency. In the view of the United States, there is a fundamental difference between a government granting a subsidy to an enterprise which happens to export and a government granting a subsidy to an enterprise *because* it exports.

8. As noted at the beginning of this discussion, the United States takes no position on the issue of whether the amendments that Canada has made to the TPC programme comply with the rulings and recommendations of the DSB. The United States hopes, nonetheless, that its comments on the need to examine all of the facts surrounding the decision to grant the subsidy will prove useful to the Panel as it evaluates the complex issue at hand.

B. The United States Disagrees with Brazil's and Canada's Characterizations of Item (k) of the Illustrative List

9. The second type of financing at issue in this proceeding is the "Canada Account." In challenging Canada's amendments to the Canada Account, Brazil notes Canada's statement that future transactions under the Account will be authorized only if they comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits.⁹ The relevance of the OECD Arrangement to this issue is that the second paragraph of item (k) of the SCM Agreement's Illustrative List states that:

if a Member is a party to an international understanding on official export credits ... or if in practice a Member applies the interest rates of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.¹⁰

⁷ Canada Submission, para. 37, citing Appellate Body Report, *supra*, footnote 2, para. 173.

⁸ Canada Submission, para. 37.

⁹ Brazil Submission, para. 45.

¹⁰ SCM Agreement, Annex I (Illustrative List), item (k).

Brazil characterizes this language as an "affirmative defense" and argues that it is "not sufficient" for Canada merely to assert the defense in this proceeding.¹¹ While disputing whether it has an obligation to "do more" at the present time, Canada does not dispute Brazil's description of the cited language as an affirmative defense and, in fact, "agrees that it is the Member claiming an exception that must demonstrate its entitlement to that exception."¹²

10. The United States disagrees with Brazil's and Canada's characterization of the second paragraph of item (k) as an "affirmative defense" or an "exception" to the SCM Agreement. In the view of the United States, a complainant that challenges a practice contained in the Illustrative List has the burden of establishing that the practice constitutes an export subsidy. If the complainant establishes a *prima facie* case, the burden then shifts to the defendant to rebut the *prima facie* case. In the view of the United States, the items contained in the Illustrative List are not "exceptions" to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices.

11. The United States has no further comments to make on the issue of Canada's amendments to the Canada Account.

III. CANADA'S PROPOSAL FOR "VERIFICATION PROCEDURES"

12. Finally, the United States wishes to comment briefly on Canada's proposal to establish "verification procedures," which it asserts will "facilitate a definitive resolution of this dispute."¹³ Canada's willingness to accept these procedures is conditioned on Brazil's willingness to accept similar procedures with respect to the rulings and recommendations in *Brazil - Export Financing Programme for Aircraft* (PROEX).¹⁴ Canada claims that the "[e]ndorsement of this proposal for bilateral verification procedures would be consistent with the objectives of the DSU, and could be suggested by the Panel pursuant to Article 19.1 of the DSU."

13. In the view of the United States, if they so desire, Canada and Brazil certainly may agree to establish procedures that would enable each party to monitor the other's compliance with the rulings and recommendations applicable to the programmes at issue. However, the United States disagrees that Article 19.1 of the DSU would permit the Panel to suggest such procedures. By its plain terms, Article 19.1 permits a panel to suggest ways to implement the recommendations that it makes after concluding that a measure is inconsistent with a covered agreement. It does not permit - or even contemplate - that a panel may take further steps and play some role in monitoring the implementation process itself. As the Appellate Body stated in *India - Patent Protection for Pharmaceutical and Agricultural Products*:

¹¹ Brazil Submission, para. 46.

¹² Canada Submission, para. 67.

¹³ Canada Submission, paras. 59-61.

¹⁴ Panel Report, *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*"), WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221 and Appellate Body Report, *Brazil - Export Financing Programme for Aircraft* ("*Brazil - Aircraft*"), adopted 20 August 1999, WT/DS46/AB/R, DSR 1999:III, 1161.

[a]lthough panels enjoy some discretion in establishing their own working procedures, this discretion does not extend to modifying the substantive provisions of the DSU. ... Nothing in the DSU gives a panel the authority to disregard or to modify other explicit provisions of the DSU.¹⁵

14. Furthermore, the United States observes that nothing would prevent Canada and Brazil from agreeing on "transparency" procedures under Article 25 of the DSU, which permits parties by mutual agreement to resort to arbitration as an alternative to dispute settlement. Article 25.2 of the DSU explicitly permits parties to agree on the procedures to be followed in that context.¹⁶

15. Lacking additional details, the United States is not in a position to comment upon the actual structure that the verification procedures would take. Once again, this presumably would be an issue for the parties to decide among themselves.

IV. CONCLUSION

16. In conclusion, the United States thanks the Panel for providing an opportunity to comment on the important issues at stake in this proceeding, and hopes that its comments will be useful.

¹⁵ Appellate Body Report, *India - Patent Protection for Pharmaceutical and Agricultural Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, para. 92.

¹⁶ DSU, art. 25.2.

ANNEX 3-3

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(6 February 2000)

1. Introduction

1. The European Communities makes this third party submission because of its systemic interest in the correct interpretation of the *SCM Agreement* and the correct application of the DSU.

2. The EC is in particular most concerned by the fact that the recent Article 21.5 panel on *Australia - Automotive Leather*¹ has considered itself entitled to interpret the WTO Agreement as allowing retroactive remedies. Since similar issues may be involved in this case and the present Panel may have to confront the question, the EC feels it must devote some time today to explaining why the approach of the Article 21.5 panel on *Australia - Automotive Leather* is a serious error.

2. Panels may not decide *ultra petitem*

3. The Panel in this case ought not to reach the issue of retroactivity of remedies which proved so problematic in the Article 21.5 report by the *Australia - Automotive Leather* since the terms of reference of this Panel are carefully circumscribed² as covering only the measures that Canada has taken (or not taken) to amend the two *programmes* at issue - the Canada Account export credit financing and the operation of the TPC programme.

4. WTO dispute settlement is a *member-driven* process that can only be initiated by members and is continuously under the control of the parties who are free to choose the panellists they desire and to terminate the process when they wish. The DSU expressly states that the purpose of dispute settlement is to *preserve* the rights and obligations of Members, that it cannot add to or diminish those rights and that it should encourage amicable settlements and aim at a satisfactory resolution of disputes.

5. The Appellate Body made clear in *India - Patent Protection*³ that a claim that has not been made in the request for the establishment of the panel cannot be the subject of a finding by a panel and explained this *inter alia* on the grounds of procedural fairness.⁴

6. Although there is in principle no bar to the parties or the panel developing new *arguments* during the process, the EC considers that this does not allow new arguments to be developed by a panel which declare or assume the existence of rights

¹ Panel Report *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States*, ("Australia - Automotive Leather II (Article 21.5 - US)"), WT/DS126/RW, adopted 11 February 2000, DSR 2000:III,1189

² WT/DS70/9 of 23 November 1999.

³ Report by the Panel on *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products - Complaint by the European Communities and their Member States*, WT/DS79/R, adopted 22 September 1998, DSR 1998:VI, 2661, paras. 85 - 90.

⁴ See esp. para. 88.

that the parties have not claimed. Such action raises the same systemic and procedural fairness concerns as arise when a panel makes findings on a new claim.

7. The Panel may not therefore find in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two *programmes* at issue have not implemented the Report.

3. The requirement to withdraw subsidies can only be prospective

8. However, since it cannot be excluded that arguments about retroactive remedies under the *SCM Agreement* may arise in this case and in view of the unacceptability of retroactive remedies for the EC, and we are sure for other Members, the EC will now set out its view and comment on the *Australia - Automotive Leather* report.

9. The EC agrees with the parties to this dispute and the other third party that the remedy under Article 4 *SCM Agreement*, like all other remedies under the WTO dispute settlement system, can only be, and were only intended by the Members to be, *prospective* in nature. They are not intended to and indeed cannot remove the effects of a trade distortion or restriction situated in the past.

3.1 The text and context of the relevant provisions

10. The terms "withdraw the measure" or "withdraw the subsidy" in Article 4.7 *SCM Agreement* do not require retroactive implementation any more than the term "bring the measure into conformity" in Article 19.1 DSU.

11. The term "withdraw" is a general term which may cover many different concepts including revocation, repeal, repayment of money, liquidation of an interest or a neutralisation of an effect. The definitions in the New Shorter Oxford Dictionary include⁵:

Take back or away (something bestowed or enjoyed). Cause to decrease or disappear. Remove (money) from a place of deposit.

12. The term "withdraw" is used in Article 4.7 precisely because there may be many ways of implementing a panel report concerning export subsidies - as the EC will discuss in more detail below.

13. "Withdraw" does not imply a *retroactive* remedy but rather in the context a *prospective* remedy. If an investment is withdrawn the investor may receive more or much less than he put in. A right, or even an obligation, to withdraw does not imply recovering exactly the sum originally invested. Indeed Articles 3.7 and 26.1(b) DSU also use the term "withdrawal of the measure" when referring to implementation in the sense of Article 19.1 DSU and this has been held to mean only prospective implementation in the report of the Article 21.5 panel in *European Communities - Bananas - Recourse by Ecuador*,⁶ where the panel held that:

In framing this issue for consideration, we do not imply that the European Communities is under an obligation to remedy past discrimina-

⁵ New Shorter English Oxford Dictionary - CD - January 1997.

⁶ Report by the Panel on *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Article 21.5 by Ecuador*, WT/DS27/RW/ECU, 12 April 1999, DSR 1999:II, 803, para. 6.105.

tion. Article 3.7 of the DSU provides that "... the first objective of the dispute settlement is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements." This principle requires compliance *ex nunc* as of the expiry of the reasonable period of time for compliance with the recommendations and rulings adopted by the DSB. If we were to rule that the licence allocation to service suppliers of third-country origin were to be "corrected" for the years 1994 to 1996, we would create a retroactive effect of remedies *ex tunc*. However, in our view, what the EC is required to ensure is to terminate discriminatory patterns of licence allocation with *prospective* effect as of the beginning of the year 1999.

14. In the same way, the Article 22.6 Report on the recourse to Article 22 DSU by the US in *EC -Bananas*,⁷ considered that the level of nullification and impairment had to be assessed as it existed at the end of the reasonable period of time (which may, for a number of reasons, be different from that which existed before). This supports the view that the obligation to implement only relates to the future, not the past.

15. An additional element of context supporting the non-retroactivity of remedies in the WTO is the fact that both Articles 19.1 DSU and 4.7 *SCM Agreement* allow Members a period of time in which to implement panel reports. Since these provisions do not require *immediate* implementation, why should they be interpreted to require *retroactive* implementation?

3.2 The object and purpose of the WTO Agreement

16. The above interpretation is fully supported by a consideration of the object and purpose of the WTO Agreement.

17. The fundamental reason why WTO remedies are not retroactive is that the objective of the WTO Agreement is the removal of restrictions on trade, not compensation for past restrictions or the creation of rights to restrict trade in the future. This objective can only be achieved by ensuring that trade-restricting or trade distorting measures are removed for the future. Past trade restrictions or distortions *cannot* be remedied. In particular, creating new restrictions and distortions in the future cannot eliminate the fact that trade was distorted or restricted in the past but in fact only frustrate the object and purpose of the WTO Agreement. The situation is very different from legal procedures that seek to provide monetary compensation.

18. Specifically, in the case of subsidies, a benefit and a corresponding trade advantage that has been enjoyed in the past cannot be removed. All that can be removed is the benefit that is yet to be enjoyed. A requirement to remove more than the prospective benefit in an effort to "punish" or "deter" or "compensate" would logically mean that the company concerned suffers a *disadvantage* for the future. This would not remove the earlier benefit and the resulting restrictions or distortions of

⁷ Decision by the Arbitrators, *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS27/ARB, 9 April, DSR 1999:II, 725, para. 4.8.

trade but merely create new ones contrary to the fundamental objectives of the WTO Agreement.

19. Indeed, the *Australia - Automotive Leather* panel did itself recognise that there was no intent in the *SCM Agreement* that the remedy attempt to restore the *status quo ante* or to provide reparation or compensation when it ruled that there was no basis on which to add interest to the amount to be repaid.

20. An additional purpose of the WTO Agreement and in particular its dispute settlement system is to provide "security and predictability to the multilateral trading system" (Article 3.2 DSU). This purpose is also frustrated by retroactive remedies.

21. It is clear that the operation of the WTO Agreement can *affect* the rights and obligations of private operators even though, as international law, it cannot *create* rights and obligations for private operators except where this expressly provided for. The EC is firmly of the view that the WTO Agreement and the *SCM Agreement* in particular do not have direct effect in municipal legal systems - that is they are not "self-executing".⁸ This fact has consequences for the degree of interference in private rights that the WTO Agreement was intended to give rise.

22. The EC would observe more generally that under the *SCM Agreement* there is a distinction to be drawn between the interest of private parties in the continuation of a law or other general measure and the individual rights arising out of a particular act of a government, such as the grant of a subsidy. The former can be withdrawn, the latter cannot be simply be revoked under the constitutional systems of most WTO Members.

23. Consequently, the EC considers that the obligation to "withdraw" the prohibited export subsidy in Article 4.7 *SCM Agreement* can only be to withdraw the general measure or programme to the extent that it is contrary to the *SCM Agreement* and, as regard individual or "one-off" subsidies to withdraw that portion of it that corresponds to the future effects, that is the prospective benefit, and not that which corresponds to effects which have occurred in the past.

24. The panel in *Australia - Automotive Leather* relied in fact heavily on a different "object and purpose" argument to support its interpretation. This was that a retroactive remedy was necessary in order to allow an effective remedy.⁹

25. The *Australia - Automotive Leather* panel expressly states in paragraph 6.37: "we decline to read 'withdraw the subsidy' in a manner that does not give it effective meaning." Its motivation is explained in paragraph 6.35 as follows:

In our view, terminating a programme found to be a prohibited export subsidy, or not providing, in the future, a prohibited subsidy, may constitute withdrawal in some cases. However such actions have no

⁸ This view is confirmed by the Report by the Panel Report, *United States - Sections 301-310 of the Trade Act of 1974 ("US - Section 301 Trade Act")*, WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815, para. 7.72. The absence of direct effect of WTO provisions in the EC has recently been confirmed by the court of Justice in case-149/96, *Portugal v. Council*. Judgment of the Full Court of 23 November 1999. See also annotation by Rosas in *Common Market Law Review* [2000].

⁹ Paras. 6.35 to 6.38 of the report.

impact and consequently no enforcement effect, in the case of prohibited subsidies granted in the past.¹⁰

26. The *Australia - Automotive Leather* panel seems to be saying that its rigorous interpretation of the terms of the *SCM Agreement* would lead to a different conclusion to that it arrives at in that case where the defending party would have to take some other unpalatable action. It seems therefore that the basis for the Panel's finding is that the need for a *deterrent effect* in the *SCM Agreement*.

27. The EC would observe that this approach based on requiring an effective remedy or a deterrent effect might mean that a subsidy which is paid in regular instalments over, say, 10 years would be treated differently to a subsidy of equivalent value paid immediately in one lump sum. In the former case, if the *Australia - Automotive Leather* panel had been confronted with the former subsidy it might have considered that that cessation of future payments was sufficient withdrawal (on the basis that there would have been an "effective remedy"). In the latter case, it would have required repayment of the whole amount. This would treat equivalent subsidies differently for no good reason and elevate form over substance. The approach advocated by the EC and the parties in that case would allow the two cases to be treated consistently.

28. The EC contests that the *SCM Agreement* or any other part of the WTO Agreement is intended to have any deterrent effect. This is not only apparent from the object and purpose of the WTO Agreement, described above, but also from the fact that in the event of non-compliance, suspension of concessions under Article 22 DSU must be "equivalent" to the level of the nullification and impairment caused by the measure found to be WTO-incompatible and countermeasures under Article 4.10 *SCM Agreement* must be appropriate and not disproportionate. As the Arbitrators in *EC - Bananas* explained:

... the purpose of countermeasures to *induce compliance*. But this purpose does not mean that the DSB should grant authorisation to suspend concessions beyond what is *equivalent* to the level of nullification or impairment. In our view, there is nothing in Article 22.1 of the DSU, let alone in paragraphs 4 and 7 of Article 22, that could be read as a justification for counter-measures of a *punitive* nature.

29. If countermeasures are not to have a punitive or deterrent element, then nor should the voluntary compliance. Otherwise, voluntary compliance would be discouraged.

30. In any event, the "need for an effective remedy" argument of the *Australia - Automotive Leather* panel is misguided since the correct approach of withdrawing the prospective portion of the benefit of the financial contribution does provide an effective remedy. The *Australia - Automotive Leather* panel's reason for rejecting this approach was, apart from its wrong interpretation of the word "withdraw", simply that "the valuation of the benefit of a subsidy, its allocation over time, and the calcu-

¹⁰ Para. 6.34.

lation of the "prospective portion" thereof, are complicated questions, for which there are no guidelines in the SCM Agreement."¹¹

31. This is not acceptable. WTO dispute settlement generally, and subsidy proceedings in particular, will often involve complex issues of fact but this is no reason for a panel to abandon its mission and require, for example, the repayment of the whole of the financial contribution rather than just a part. This is just as unacceptable as saying that since it is difficult to calculate a precise amount, no amount need be repaid.

3.3 Past practice

32. The absence of a remedy for past and consummated violations has always been a well-known feature of the GATT/WTO system. It is established and accepted that it can lead in some cases to there being no remedy at all for the complaining party. The EC considers that this established practice confirms the conclusions it reaches above.

33. A useful discussion of the practice of the GATT Contracting Parties is contained in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*.¹² In the WTO, panels have also always operated on the basis that remedies cannot be retroactive and the EC has already referred the Panel to the reports in the banana litigation.

3.4 Application to subsidies and the present case

34. There may be several ways of withdrawing a prohibited export subsidy in a particular case. The application of the above principles to the case of prohibited export subsidies must bear in mind that such subsidies are made up of three elements. First there must be a financial contribution. Second, for there to be a subsidy, the financial contribution must give rise to a benefit to the recipient. Third the subsidy is only prohibited if it is contingent upon export performance. Each of these elements may have components that are past and components that only arise in the future.

35. Withdrawing the measure or prohibited export subsidy may be achieved by effectively withdrawing any of these elements.

36. In some cases the choice may be constrained by the practical impossibility of withdrawing one or other of these elements. Thus the *Australia - Automotive Leather* panel noted that removal of the export contingency was not possible in that case since the contingency was found to exist at the date of grant which was in the past. But equally, withdrawal of effects that have already been manifested, including a benefit which has been enjoyed in the past, is also not possible. The only effects that can be prevented, that is the only benefit that can be withdrawn, is the benefit that is yet to be enjoyed in the future. Attempting to withdraw a benefit enjoyed in the past

¹¹ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, para. 6.44.

¹² See e.g. the discussion in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*. GPR/DS.2/R, adopted on 13 May 1992, paras. 4.21, 4.24 and 4.26.

by ordering the repayment of the whole of the financial contribution paid simply imposes a penalty on the company (even though the panel attempts to deny this) for the future which may even create a new and additional distortion of trade contrary to the object and purpose of the WTO Agreement.

4. Is the TPC now in conformity with the WTO Agreements?

37. The question of whether the TPC has now been brought into conformity with the *SCM Agreement* depends evidently on the facts which the Panel will verify but on which the EC is ill-equipped to comment - especially since it has not been provided with all the facts. The EC can agree with US that it is not sufficient to establish that there is a *de facto* export subsidy to show that subsidies are provided to companies *which export*. It must at a minimum be established that they have been provided to companies *because they export*. Establishing the legal rule does not however help to resolve the case since there does not appear to be any basis on which to decide that subsidies are still being provided to companies "because they export".

38. In fact, it would appear logically impossible to establish that companies are in fact receiving subsidies "because they export" where there are no exports. Brazil is complaining that the TPC *programme* is still *de facto* export contingent. The EC makes the following comments on the legal constructions that are used by Brazil in its second written submission in an attempt to establish *de facto* export contingency of a programme - the new TPC - of which the details are not known and under which no subsidies have been paid.

39. The original panel report in conjunction with Article 4.7 *SCM Agreement* obliges Canada to take positive action to remove the inconsistency found. But it does not create any *additional obligation* to that which applies generally with respect to export subsidies. For the EC this follows from general principles and is confirmed by Article 3.2 DSU which states that:

Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

40. Thus the Panel Recommendation cannot diminish a Member's rights or increase its obligations under the *SCM Agreement*. As the EC has already submitted, Canada is not required to abolish the TPC, nor is it prevented from subsidising the regional aircraft sector, provided that it does so in a manner consistent with the *SCM Agreement*.

41. Similarly, Canada is not prevented from increasing the TPC budget; this is not inconsistent with the *SCM Agreement*. It should be remembered that WTO Members still have adequate redress against the injurious use of subsidies under Part III of the *SCM Agreement*, even if they are not prohibited.

42. Thus Brazil is wrong to argue that Canada must now take measures to *ensure* that TPC cannot in the future give rise to export subsidies. As the Community has already submitted, Canada, in restructuring the TPC, is simply required to do two things. Firstly, to remove those features of the regime that gave rise to the original finding, and secondly, not to introduce any new elements into the restructured programme which can already be demonstrated to give rise to export contingency. In this respect, the restructured TPC has to be judged on its merits and on the extent to which it has addressed the inconsistencies identified by the Appellate Body. To the extent that Canada has remedied such inconsistencies, it must be given the benefit of

the doubt. It is not sufficient for Brazil to make assumptions about the new programme on the basis of statements made in relation to the old TPC.

43. On this point, the EC notes Brazil's allegation that the restructured TPC has "retained its focus" on the same recipient industries funded by the old TPC. The Appellate Body did not identify the apportioning of TPC funds by sector as a factor leading to *de facto* export contingency. Consequently, Canada is not required to change the distribution of funding by sector in order to remedy *de facto* contingency.

44. In view of the measures that have been taken and the fact that no new support has been granted, the EC maintains its view that the inconsistency must be considered to have been removed, or at least that the contrary cannot yet be proved. Brazil is right to point out that absence of any financial contribution is not by itself sufficient to ensure implementation,¹³ but in this case changes that have been made to the restructured TPC must create a presumption that any such contribution will not lead to the granting of an export subsidy. In this regard, implementation of a panel report does not require an absolute guarantee of future good behaviour, especially in the case of *de facto* export subsidies, where the Government may not even know that it is granting such a subsidy.

45. Brazil argues that the Article 21.5 DSU proceeding will be ineffective and therefore reduced to "inutility" (referring to the case law of the Appellate Body) if the measures taken by Canada are judged sufficient. The EC does not consider that this is a reason for the Panel to create new rights and obligations in violations of Article 3.2 DSU for three reasons:

- First the WTO Agreement, as international law, cannot be expected to guarantee "effective remedies" in all cases.
- Second, there is an available remedy in the possibility of bringing new panel proceedings.
- Third, the alleged "ineffectiveness" of a remedy does not mean that the corresponding provision of the Agreement is reduced to inutility. As the panel in *US - Foreign Sales Corporations* held, inutility in the sense used by the Appellate Body means "without meaning" or "redundant" and refers to the "principle of effective treaty interpretation" which requires that a treaty be interpreted so as to give meaning to all its terms. This does not mean that there must be a satisfactory sanction for the violation of every provision.¹⁴

46. The EC also takes issue with Brazil's statement¹⁵ that "When it comes to enforcement of the most egregious of export subsidies - those subsidies determined by a Panel or the Appellate Body to be levied in a manner designed to circumvent the prohibition of *de jure* export contingency - Members would be left without an effective remedy."

¹³ Paras. 6 and 13 of Brazil's second submission.

¹⁴ See Panel Report, *United States - Tax Treatment for "Foreign Sales Corporations"* ("US - FSC"), WT/DS108/R, adopted 20 March 2000, DSR 2000:IV, 1677, para. 7.9.

¹⁵ Paras. 13 (and 53) of Brazil's second submission.

47. The EC does not consider it appropriate for WTO remedies to depend on the presumed intent or "design" of Members, a matter that is notoriously difficult to establish.

48. While it is true that the Uruguay Round negotiators sought to prevent circumvention of the *de jure* prohibition¹⁶, it does not follow that all *de facto* export subsidies are motivated by circumvention. *De facto* export subsidies can be determined to exist in many other circumstances, depending on the panel's appreciation of the totality of the facts in question, which do not involve any notion of circumvention. Indeed, there is arguably no need to demonstrate that a Government originally *intended* to grant an export subsidy at all; Footnote 4 of the SCM Agreement merely requires that the subsidy "...is in fact tied to actual or anticipated exportation....". The Appellate Body did not conclude that Canada intended to circumvent any provisions of the SCM Agreement. There is no basis for Brazil's claim that *de facto* export subsidies are the "most egregious form of export subsidies", since all export subsidies are subject to the same remedy under Part II of the SCM Agreement.

5. Item (k) of the Illustrative List

49. The EC now comes to the issue of item (k) of the Illustrative List. Canada has declared that it will not in future approve Canada Account financing "which does not comply with the OECD Arrangement."¹⁷ If it respects this commitment (and in the view of the EC Canada is entitled to a presumption of good faith), there can be no prohibited export subsidy because of footnote 5 to the *SCM Agreement* and the second paragraph of item (k). Much has already been written on this matter and the EC will confine its remarks to the argument made by the US that item (k) is part of the definition of a subsidy rather than being in the nature of an "affirmative defence," which is the position of all the parties and of the EC.

50. The US position is that:

... the items contained in the Illustrative List are not "exceptions" to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices.¹⁸

51. This cannot be right and the US does seek to justify its self-serving¹⁹ contention. But the EC will briefly examine the relevant provisions. The Illustrative List is incorporated into Article 3.1(a) in two ways. First the prohibition in Article 3.1(a) is stated to *include* the subsidies *illustrated* in Annex I. Second, footnote 5 states that that:

"Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement".

52. Let us consider these two sources of incorporation in turn:

¹⁶ Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 167.

¹⁷ Para. 57 of Canada's First Written Submission.

¹⁸ Para. 10 of the US Third Party Statement.

¹⁹ Its position is motivated by its desire to defend its own export subsidy programme.

53. It seems absolutely clear that the word "including" means that in principle the Annex does not diminish the generality of the prohibition in Article 31.(a). The word "illustrated" does not do so either. This is particularly clear from the explanation given by the 1960 GATT Working Party Report that originally proposed the list:²⁰

"The Working Party agreed that this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI."²¹

54. It is the fact that the Illustrative List in Annex I is incorporated into Article 3.1(a) without restricting the generality of the prohibition that renders footnote 5 necessary. The drafters realised that Annex I contained certain exceptions and they wanted to preserve these in the *SCM Agreement*. However what they clearly did not intend was that the Illustrative List should be exhaustive of the disciplines applying to the measures it described. If it were, there would be no need for Article 3.1(a) but simply a reference to the Annex and a statement prohibiting "any other subsidies contingent upon export performance". The fact that the drafters did otherwise must have some meaning.

55. That the US position is erroneousness is also clear from the consequences that it would entail:

- The first consequence of the US position would seem to be that Brazil has to prove that the new Canada Account export credits are inconsistent with the second paragraph of item (k). If that were true, the Panel could never have found a violation in the original proceeding where Brazil left it to Canada to raise this defence and Canada declined to do so. Accordingly, if there was no established violation, there can be no obligation to implement and, also, Brazil would have to prove that the existing practice does not comply with the Arrangement.
- Second, the US approach of making the Illustrative List exhaustive for those matters addressed by it, would mean that stricter disciplines only exist for those rare measures *not included* in the Illustrative List. This also cannot have been the intention. The intent of the parties in incorporating Annex I was not to ensure that everything that was previously not prohibited would now be exempted (which would mean *no progress*). It was to ensure that what was previously prohibited would remain prohibited (which means *no backtracking*). If the Illustrative List exempted measures that are simply not identified as export subsidies, the general words of Article 3.1(a) would fail in their basic task of introducing stricter disciplines.
- Finally, the US approach by making the Illustrative List relevant to the definition of subsidy in Article 1, would make the Illustrative List a rich source of exceptions to all the disciplines of the *SCM Agreement*. Where the drafters wanted the Illustrative List to be relevant for the purpose of the definition of subsidy, they said so. Footnote 1 to the *SCM Agreement* is a clear example.

²⁰ See the EC submissions reported at 4.940 and 4.941 of the Report.

²¹ BISD 9S/187, immediately following the list.

6. Conclusion

56. The EC is conscious that the case before the Panel today is complex and poses a number of important issues concerning the interpretation of the *SCM Agreement*. The EC has sought to provide arguments that it thinks may assist the Panel in coming to the correct conclusion on a number of these issues. The EC has not however commented on all the issues which the Panel may potentially decide are relevant to a resolution of this case. It would be happy to respond to any questions that the Panel may have on such issues, just as it is ready, if requested, to clarify and develop the comments that it has made today.

ANNEX 3-4

ORAL STATEMENT OF THE UNITED STATES

(6 February 2000)

1. Mr. Chairman and Members of the Panel, it is my honour to appear before you today to present the views of the United States as a third party in this Article 21.5 proceeding. It is not my intent today simply to repeat the comments already stated in our written submission. Instead, I will first comment briefly on certain statements made by the EC in its written submission, and then make a few broader observations on the overall purpose of the SCM Agreement, which the United States believes should inform the Panel as it considers the difficult issues at hand. Finally, although I had not intended to do so, I will also make a few brief comments on the *Australia - Leather* decision in light of the EC's comments this afternoon.

2. Turning first to the comments of the EC in its written submission, in paragraph 12 of its 17 January submission, the EC claims that Canada will be able to avoid a finding of *de facto* export contingency for the TPC programme if it is able to satisfy the Panel that future assistance is being granted without reference to actual or anticipated export earnings. To quote the EC's submission, "Canada must ensure that the freedom of choice of applicants to decide between selling on the domestic or export markets is not limited in any way by the conditions attached to the receipt of the subsidy".

3. The EC's argument before the Panel is similar to the arguments that it raised without success before the Appellate Body. There, the EC argued that there are various tests that the Panel should have applied in determining the export contingency of the TPC programme. For example, the EC argued that the panel could have considered "whether the recipient's freedom to direct his sales effort to the domestic or the export market is somehow restricted".¹ This is essentially what the EC is arguing here.

4. The Appellate Body rejected this kind of rigid approach. To quote its opinion (at para. 169):

We agree with the Panel that what facts *should* be taken into account in a particular case will depend on the circumstances of that case. We also agree with the Panel that there *can be no general rule* as to what facts or what kinds of facts *must* be taken into account.²

The Appellate Body's statement reflects the simple truth that the determination whether a subsidy is contingent in fact upon export is a complicated task. Again quoting the Appellate Body (this time at para. 167), proving *de facto* export contingency is "much more difficult" than proving *de jure* export contingency because the existence of the contingency must be "inferred" from *all* of the facts surrounding the granting of the subsidy.

¹ Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 104.

² *Id.*, para. 169 (partial emphasis added).

5. Therefore, addressing the EC's suggested test, it may well be that the recipients of a particular subsidy have complete freedom of choice to decide between selling in the domestic market and selling in the export market. The subsidy may still be a prohibited export subsidy. In the *Australian Leather* case, for example, the subsidy recipient was free as a legal matter to choose its own markets; it just happened that the nature of the market for its products meant that it had to export to meet the relevant sales targets. In this manner, the sales targets in essence became *de facto* export targets.³ The EC acknowledged the possibility of this type of scenario in its comments before the Appellate Body. The facts will vary from case to case.

6. Finally, in approaching this issue, it is important to keep in mind the Appellate Body's observation (at para. 167) that the Uruguay Round negotiators sought to prevent the circumvention of the prohibition on *de jure* export subsidies when they included the prohibition on *de facto* export subsidies. A clever government that wishes to provide export subsidies to its exporters may be able to do so in a way that leaves its reasons unclear. However, a subsidy that is neutral on its face may still be prohibited. The task for a panel is to determine whether, in spite of this facial neutrality, the surrounding facts lead to the inference that the grant of the subsidy was contingent upon export, that is, that it was tied to actual or anticipated exportation or export earnings. To quote this panel (at para. 9.332), "do the facts demonstrate" that the subsidy would not have been granted "but for" anticipated exportation or export earnings?

7. The United States would now like to comment briefly on certain broader points that we hope will influence the spirit in which the Panel evaluates this dispute.

8. This proceeding, as well as the companion proceeding brought by Canada against Brazil, is extremely important, for it revolves around the critical issue of compliance with DSB rulings and recommendations and the resultant effect on the SCM Agreement's ability to discipline injurious and prohibited subsidies.

9. As this Panel noted in its original opinion, subsidies by their very nature involve situations where governments insert themselves into the marketplace by providing benefits to favored companies, that is, financial contributions on better than market terms. While the SCM Agreement allows certain, non-injurious subsidies, it flatly prohibits export subsidies. These two cases are a good example of why this is so.

10. When a government chooses to provide an export subsidy, it effectively is deciding to interfere in the marketplace to provide its producers with an unjustified advantage over their foreign competitors *in their competitors' home markets and in third country markets*. Inevitably, this provokes a response from the affected countries and their producers. For example, in the companion case to this dispute, Brazil argued before the Appellate Body that PROEX subsidies were intended to match the subsidies provided by the Government of Canada to its producer. The result is a ruinous subsidy competition that distorts the world trading system, punishes taxpayers, and bleeds off resources that might better be used for other purposes. The govern-

³ Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, ("Australia Automotive Leather II"), WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951, para. 9.67.

ments concerned may well want to call off this competition; effective rules on export subsidies, effectively enforced, can make this possible.

11. Finally, I would like to comment briefly on the Panel's decision in the *Australian Leather* Article 21.5 proceeding. If the Panel would like detailed comments on this issue, I would prefer to provide them in writing. However, I am happy to provide some initial oral comments.

12. As an initial matter, the United States feels that the Panel's decision in the *Leather* case is not directly relevant to this dispute, because Brazil is not seeking the repayment of past TPC and Canada Account subsidies. For this reason, this Panel does not need to reach the issue addressed by the *Leather* panel.

13. If the Panel is nonetheless interested in our views, then I would simply observe that the *Leather* panel has spoken, so it is appropriate to conclude that its determination is definitive with regard to that case. The United States intends to support adoption of the report at the next meeting of the Dispute Settlement Body.

14. The United States notes that the *Leather* Panel itself acknowledged that the proper manner of withdrawing a prohibited export subsidy may differ from case to case.

15. While the Panel's conclusion in *Leather* went beyond the position that we took, we can't fault the logic of that conclusion.

16. As I noted at the beginning of my comments, the United States would be pleased to provide a more detailed response in writing if the Panel so desires.

17. As the United States noted in its written submission, we take no position on the issue of whether the amendments that Canada has made to the TPC programme and the Canada Account comply with the rulings and recommendations of the DSB. The United States hopes, nonetheless, that our comments today will prove useful to the Panel as it evaluates the complex issues at hand.

18. This concludes my comments. On behalf of the United States, I thank you again for providing us with this opportunity to present our views.

ANNEX 3-5

ANSWER OF THE UNITED STATES TO QUESTION POSED BY BRAZIL

(14 February 2000)

Q1. Please confirm the United States' statement, at the 6 February Meeting of the Panel, that it did not receive Brazil's Rebuttal Submission, dated 17 January 2000.

Response

The United States confirms the referenced statement.

ANNEX 3-6**ANSWERS OF THE UNITED STATES TO QUESTIONS
POSED BY THE PANEL**

(14 February 2000)

Questions to third parties

US

Q1. The US argues that the items contained in the Illustrative List are not, in Canada's words, 'exceptions' to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices. Would the US please elaborate on this statement. In particular, is the US suggesting that Canada's view is that the entire Illustrative List consists of exceptions to the rest of the SCM Agreement? Whatever the response to the preceding question, would the US disagree with a statement that the second paragraph of item (k) might at least in some circumstances be characterized as an "exception" to the first paragraph, in the sense that measures defined in the first paragraph of item (k) are prohibited export subsidies except if nevertheless they conform to the provisions of the second paragraph?

Response

1. With respect to the Panel's request that the United States elaborate on its statement, the question of the status of the items contained in the Illustrative List is connected to the so-called "*a contrario*" issue". Because the US position regarding the latter issue has been set out more fully in its written submissions in other dispute settlement proceedings, the United States will restate this position below for the benefit of this Panel, and hopes that this more detailed treatment of the issue will assist the Panel in its resolution of the matter before it. Following that discussion, the United States will address the other questions posed by the Panel in Question #1.

The "A Contrario" Issue

2. The basic question underlying the *a contrario* issue is this: In the case of a measure that is described by a particular item of the Illustrative List, is the measure's status as a prohibited or non-prohibited export subsidy governed by the standards contained in the item itself or by the general standards set forth in Article 1 and Article 3.1(a) of the SCM Agreement? For example, in the case of Canadian export financing under the Canada Account, if one assumes that the type of financing in question is of a type dealt with by item (k), is the prohibited/non-prohibited status of such financing controlled by item (k) or by Article 1 and Article 3.1(a)?

3. In the view of the United States, as a general matter of public international law, it is item (k) which is controlling. The principle of *generalia specialibus non derogant* holds that "a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of the general provision dealing with the category of subject to which that matter belongs, and which otherwise might govern it as

part of that category."¹ While the Appellate Body has not necessarily invoked this principle by name, it repeatedly has emphasized the importance of analyzing a measure based on the provision of the WTO agreements that most specifically addresses the measure.² Of all the provisions in the SCM Agreement, item (k) clearly is the provision that most specifically addresses export credit practices.

4. In addition to general principles of public international law, the items of the Illustrative List are controlling - where they apply - by virtue of footnote 5 of the SCM Agreement. Specifically, while Article 3.1(a) prohibits export subsidies, including those described in the Illustrative List, footnote 5 to Article 3.1(a) provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." Footnote 5 makes clear that a practice identified by the Illustrative List as *not* constituting an export subsidy is not prohibited by Article 3.1(a) or any other provision of the SCM Agreement. Thus, if, for example, an export credit practice is permitted under item (k) - rather than prohibited - that is the end of the matter; no further analysis is needed. As such, footnote 5 constitutes an express incorporation into the SCM Agreement of the *generalia* principle.³

5. The disagreement as to whether an item of the Illustrative List is controlling appears to focus on the word "illustrative". While all of the parties and third parties involved in this dispute agree that the Illustrative List is "illustrative", they disagree on the manner in which it is illustrative. Canada and the EC appear to argue that if a particular type of financial contribution is described by a particular item in the Illustrative List, but cannot be considered as an export subsidy under the standard contained in the particular item, that financial contribution nonetheless can be found to be an export subsidy under some other standard.

6. In the view of the United States, this is not what the drafters intended when they used the term "illustrative" to refer to Annex I of the SCM Agreement. Instead, a more reasonable interpretation is that the drafters used the term "illustrative" simply to signify that not all types of financial contributions are covered by the Illustrative List.⁴ However, where an item of the Illustrative List does address a particular type of

¹ Gerald Fitzmaurice, *The Law and Procedure of the Court of International Justice, 1951-4: Treaty Interpretation and Other Treaty Points*, 1957 British Y.B. Int'l L. 236; see also *Case Concerning Payment of Serbian Loans*, P.C.I.J. Ser. A, No. 20/21, page 30; and Grotius, *De Iure Belli Ac Pacis*, Lib. II, Cap. XVI, XXIX (Classics, 3, 1929).

² Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("Bananas"), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 204 (where the issues before a panel implicate two provisions, a panel should examine the more specific provision first); and Appellate Body Report, *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998, DSR 1998:III, 1003, para. 45 ("Because the language of Article II:1(b), first sentence, is more specific and germane to the case at hand, our interpretive analysis begins with, and focuses on, that provision.").

³ Footnote 5 is not unique in this regard. Article 1.2 of the DSU, which provides that special or additional rules and procedures prevail over the general rules of the DSU, constitutes a very significant application of the *generalia* principle.

⁴ For example, with the exception of export credits, which are dealt with in item (k) and which relate to the sale of goods, the Illustrative List does not address export-contingent loans, such as government loans provided solely to exporters for purposes of capacity expansion. Indeed, debt

financial contribution - as is the case with respect to item (k) and export credits - that item sets forth the standard for determining whether the financial contribution is or is not an export subsidy.

7. Consider, for example, item (j) of the Illustrative List, which deals with export guarantee and insurance programmes. Looking just at the standard for premium rates, premium rates give rise to an export subsidy if they are "inadequate to cover the long-term operating costs and losses of the programmes." Implicit in item (j), however, is the notion that premium rates do not give rise to an export subsidy if they are "adequate" to cover long-term operating costs and losses. Thus, on its face, item (j) provides Members with a predictable standard to use in establishing and administering export guarantee and insurance programmes.

8. Under the approach to the Illustrative List taken by Canada and the EC, however, any predictability is lost. For example, if item (j) was only "illustrative", there would be numerous ways in which an export insurance or guarantee programme could be considered to be an export subsidy even though the premium rates conform to the standard in item (j). If premium rates were inadequate to cover *short-term* operating costs *or* losses, a programme could be considered to be an export subsidy. If premium rates were inadequate to cover short- or long-term *non-operating* costs, a programme could be considered to be an export subsidy. If premium rates were less than what an exporter might pay for comparable coverage in the marketplace, there could be an export subsidy under a "benefit to recipient" approach. This would be particularly true in a situation where a specific export transaction involves an unusually severe risk of nonpayment or currency fluctuation.⁵

9. It is extremely unlikely that the drafters of the SCM Agreement went to the trouble of crafting in the Illustrative List specific and detailed rules for particular types of financial contributions, such as the rules in item (j) and item (k), with the intent that those rules could be readily ignored in favor of more general standards found elsewhere in the SCM Agreement. Instead, a more plausible reading is that the drafters intended to use the Illustrative List as a vehicle for establishing detailed rules for certain types of financial contributions, rules that elaborate on the general principles contained in Article 1 but that cannot be ignored in favor of those more general principles.

financing provided under Canada's TPC programme does not fall under item (k). Similarly, with the exception of export credit-related guarantees, which are dealt with in item (j), the List does not address loan guarantees to producers that are contingent on export performance. Likewise, the List does not address forgiveness of government-held debt which may be contingent upon export performance. Finally, the List does not address export-oriented equity infusions, a practice alleged in this very case. Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("*Canada - Aircraft*"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, paras. 217-219.

⁵ Similarly, the approach taken by Canada and the EC would render irrelevant the "material advantage" clause in the first para. of item (k), a clause which the Appellate Body already has acknowledged must be given meaning. Appellate Body Report, *Brazil - Export Financing Programme for Civil Aircraft* ("*Brazil - Aircraft*"), WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 179. Under the Canadian and EC interpretation, export credits that otherwise fall under the first para. could constitute prohibited export subsidies regardless of whether they "are used to secure a material advantage."

10. The counter-arguments that have been made against this interpretation are not persuasive. For example, the EC has argued that in order for footnote 5 to exclude a measure from the prohibitions of the SCM Agreement, there has to be "a clear statement in Annex I that a measure *does not constitute* an export subsidy."⁶ In its prior submissions to the Appellate Body on this issue, the EC stated that "footnote 5 requires an 'affirmative statement' in the Illustrative List to the effect that a measure does not constitute an export subsidy."⁷ Under either standard, the EC has identified only the second paragraph of item (k) as falling within the purview of footnote 5.⁸

11. However, the text of footnote 5 does not require such a "clear" or "affirmative" statement, and there is a reason for this: the drafters had a different intent. Footnote 5 first appeared in the third draft agreement prepared by the Chairman of the Negotiating Group on Subsidies.⁹ In this draft, footnote 5 appeared for the first time - as footnote 4 to Article 3.1(a). Footnote 4 read as follows: "Measures *expressly* referred to in the Illustrative List as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." (Emphasis added). Thus, the original version of footnote 5 had an additional word - "expressly" - which, had it been retained, might have supported the EC interpretation.

12. The word "expressly" was not retained, however. In the very next draft, the word was deleted from the footnote (still numbered as footnote 4).¹⁰ This change demonstrates that the drafters intended to expand, rather than restrict, the scope of footnote 5.¹¹ The change also demonstrates that the drafters did not intend the sort of narrow construction of footnote 5 advanced by the EC.

⁶ Panel Report, *United States - Tax Treatment for "Foreign Sales Corporations" ("FSC")*, WT/DS108/R, adopted 20 March 2000, DSR 2000:IV, 1677, para. 4.932 (emphasis in original).

⁷ *Brazil - Aircraft*, supra, footnote 5, para. 77.

⁸ *Id.*; and *FSC*, para. 4.932. If the drafters truly intended that footnote 5 apply only to the second para. of item (k), presumably they would have articulated this intent more directly by expressly referring to that para..

⁹ MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990). In the prior two drafts, the prohibition against certain subsidies was contained in Article 1.1, which referred to three categories of subsidies: (a) subsidies contingent upon export performance; (b) subsidies listed in the Illustrative List; and (c) subsidies contingent upon the use of domestic over imported goods. MTN.GNG/NG10/W/38 (18 July 1990); and MTN.GNG/NG10/W/38/Rev. 1 (4 September 1990). In the third draft, Article 1.1 was redesignated as Article 3.1, and the first two categories were combined into a single subparagraph (a).

¹⁰ MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

¹¹ *Cf.*, *Bananas*, para. 186, in which the Appellate Body found that where the negotiating history of the Lomé Waiver demonstrated that the word "foreseen" was replaced by "required", the "change clearly suggests that the CONTRACTING PARTIES wanted to restrict the scope of the Lomé Waiver." In the case of footnote 5, the change runs in the opposite direction; the drafters clearly wanted to expand the scope of footnote 5.

Likewise, one is "not entitled to assume that the disappearance [of "expressly"] was merely accidental or an inadvertent oversight on the part of either harassed negotiators or inattentive draftsmen." Appellate Body Report, *United States - Restrictions on Imports of Cotton and Man-Made Fibre Underwear*, WT/DS24/AB/R, adopted 25 February 1997, DSR 1997:1, 11, page 17. The negotiating record demonstrates that after the word "expressly" was deleted from the text, footnote 5 - then footnote 4 - continued to be the subject of discussion, including an unsuccessful attempt to delete the footnote altogether. *Negotiating Group on Subsidies and Countervailing Measures*;

13. The second principal argument - advanced by both Canada and the EC - is that the US interpretation somehow would transform the Illustrative List into an exhaustive list that allegedly would allow "all sorts of measures" to escape the export subsidy prohibition.¹² Both Canada and the EC have offered as an example item (a) of the Illustrative List, which prohibits "direct subsidies," claiming that under the US approach, *indirect* export subsidies would escape item (a) and, thus, prohibition under Article 3.1(a).¹³

14. However, this is a mischaracterization of the US position. First, as noted above, the US position is *not* that the Illustrative List is exhaustive. Instead, the US position is that the Illustrative List does not deal with all possible financial contributions, but for those that it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned. Second, in the case of the EC's item (a) example, the US position is that item (a) simply does not address "indirect" subsidies. Thus, indirect subsidies do not "escape" any prohibition. Instead, the standard for a prohibited *indirect* subsidy must either be found elsewhere in the Illustrative List or, if the specific provisions of the Illustrative List are silent, in the general principles of Articles 1 and 3.1(a) of the SCM Agreement.

15. Finally, the opponents of the *a contrario* interpretation have never been able to explain how their approach to footnote 5 and the Illustrative List does not render various portions of the Illustrative List ineffective. For example, they have been unable to explain how their approach does not render the "material advantage" clause of item (k) superfluous. Because such an outcome is incorrect under public international law,¹⁴ a correct interpretation of footnote 5 and the Illustrative List is that the provisions of the Illustrative List are controlling with respect to the measures addressed therein.

Canada's View

16. Canada's view appears to be that footnote 5, as well as any item in the Illustrative List that - in Canada's view - is encompassed by footnote 5, is an exception to Article 3.¹⁵ In the view of the United States, neither footnote 5 nor the items in the Illustrative List constitute "exceptions". To the contrary, footnote 5 and the Illustrative List are part of Article 3, not exceptions to it.

Meeting of 6 November 1990: Note by the Secretariat, MTN.GNG/NG10/24 (29 November 1990), page 2.

¹² Panel Report, *United States - Tax Treatment for "Foreign Sales Corporations"*, ("FSC"), WT/DS108/R, adopted 20 March 2000, DSR 2000:IV, 1677, para. 4.933.

¹³ Panel Report, *Brazil - Export Financing Programme for Aircraft ("Brazil - Aircraft")*, WT/DS46/R, adopted 20 August 1999, DSR 1999:III, 1221, para. 4.64; Panel Report, *FSC, supra*, footnote 12, para. 4.933-4.934.

¹⁴ See, e.g., Appellate Body Report, *Japan - Taxes on Alcoholic Beverages*, ("Japan Alcoholic Beverages"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 105.

¹⁵ Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft")*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, para. 5.81.

The Second Paragraph of Item (k)

17. Whether one considers the second paragraph of item (k) to be an "exception to", a "qualification of", or a "refinement of" the first paragraph is, in the view of the United States, essentially a semantic exercise with no legal significance. The Appellate Body has stated that the assignment of the burden of proof is not affected by describing a particular provision as an "exception" to something else.¹⁶ Likewise, characterizing a provision as an "exception" does not affect the interpretation of the provision. As the Appellate Body has stated:

[M]erely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation.¹⁷

18. Thus, whether or not one characterizes the second paragraph of item (k) as an exception to the first paragraph, the complainant in a dispute - in this case, Brazil - has the burden of proving that the alleged offending practice fails to satisfy the terms of the second paragraph.

Q2. In any case, what are the practical implications, if any, for the issues before the Panel (and for the parties' arguments) of the US argument concerning the parties' characterizations of the Illustrative List (or at least of the second paragraph of item (k) thereof)? That is, the parties seem to agree that it would be for Canada eventually to choose whether to invoke that provision as a defense, and if it did so, to provide evidence to demonstrate its compliance therewith. Does the US agree or disagree with this? Please explain.

Response

1. The practical implications of the US argument depend upon whether the Panel considers itself bound by an agreement between the two parties as to how the SCM Agreement should be interpreted; *i.e.*, the parties' agreement that Canada bears the burden of proving that Canada Account financing now conforms to the second paragraph of item (k). If the Panel simply decides that it will accept the parties' interpretation because it happens to be something on which they agree, then the US argument is irrelevant.

2. However, in the view of the United States, a panel is not obliged to accept the interpretation of an agreement that happens to be shared by the two litigants present before it. Although it is true that WTO dispute settlement is a Member-driven process, that does not mean that a panel can ignore its mandate under Article 11 of the DSU to "make an objective assessment of the matter before it"

¹⁶ Appellate Body Report, *EC - Measures Affecting Meat and Meat Products, (Hormones)* ("EC - Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135, para. 104.

¹⁷ *Id.*

3. Thus, the United States believes that the Panel must interpret the SCM Agreement objectively and independently of any agreement between the parties. When it does so, the United States believes that it should interpret the SCM Agreement - and, in particular, item (k) - in the manner described by the United States in its response to Question #1. Such an interpretation leads to the conclusion that the burden is on Brazil to demonstrate that the Canada Account does not conform to the second paragraph of item (k).

Q3. Concerning the verification mechanism proposed by Canada, the US argument seems to be that were the Panel to endorse any such mechanism, this would constitute a violation of Article 19.1 of the DSU, in that it would constitute a "modification" thereof which the Appellate Body has ruled is impermissible. Is this a correct understanding of the US argument. Please elaborate.

Response

1. The Panel's understanding is correct. Under the DSU, panels may suggest methods of implementation, not methods of monitoring implementation. Surveillance of implementation is the subject of other provisions of the DSU, not Article 19.

ANNEX 3-7

RESPONSES BY THE EUROPEAN COMMUNITIES TO THE QUESTIONS FROM THE PANEL AND FROM BRAZIL (14 February 2000)

Question 1 to the EC

The EC takes the view that because Canada has "undertaken" to respect all the provisions of the OECD Arrangement, Canada has prima facie correctly implemented the Panel's findings. Would the EC please elaborate on what it means by "undertaken". That is, is the EC's position dependent on the specific nature of characteristics of that undertaking, and if so, what are the elements that persuade the EC that the undertaking does constitute prima facie correct implementation? Under what circumstances, if any, would the EC consider that a statement issued by a government body, or made by a government employee acting in an official capacity, did not have the status of an undertaking constituting prima facie evidence of compliance with a ruling by the DSB?

Response

1. The EC did not use the term "undertaken" to suggest that Canada had entered into a binding commitment. Canada has rather declared that it will not in future approve Canada Account financing "which does not comply with the OECD Arrangement."¹
2. In the original proceeding, the Panel took the view that since Canada Account financing was *discretionary*, it could only rule on particular cases of support.² This finding was not challenged on appeal. As a result, the Panel merely found a number of *transactions* to have been *de jure* export contingent.
3. There is not therefore any finding of an export subsidy programme to implement although Canada has taken some steps to ensure that the programme will not in future give rise to the same problems.
4. There is a change in Canada's practice on Canada Account financing since before the declaration it claimed that this financing was "consistent" with the OECD Arrangement, which can be taken simply to mean that Canada did not consider that Canada Account financing fell under the OECD Arrangement. Now, it positively declares that future Canada Account financing will *comply* with the Arrangement.
5. But this is not really the question before the Panel. If it was not possible in the original proceeding to declare the Canada Account financing incompatible with the *SCM Agreement* as a *programme*, that is in general, because it was discretionary,

¹ Para. 57 of Canada's First Written Submission.

² Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft* ("Canada - Aircraft"), WT/DS70/R, adopted 20 August 1999, DSR 1999:IV, 1443, para. 9.213.

then it is still not possible now. The existence of the Panel Report cannot add to or diminish the rights and obligations of Members (Article 3.2 DSU).

Question 2 to the EC

Would the EC please elaborate on the specific reasons why it does not believe that it would be appropriate for the Panel to suggest a transparency agreement, as proposed by Canada. In particular, does the EC consider that such a suggestion by the Panel would be impermissible under the DSU and/or the SCM Agreement, or simply inadvisable for other reason? Please explain.

Response

1. The EC finds itself in agreement with the statement of the US that Article 19.1 DSU, by its plain terms, allows a panel to suggest ways of implementing the recommendations that it makes after concluding that a measure is inconsistent with the covered agreement. A transparency agreement is not capable in itself to achieve the result of bringing Canada's subsidies into conformity. It is rather a means of verifying compliance, which is not a matter in which panels should become involved.
2. Accordingly, Article 19.1 DSU does not give to the Panel the necessary authority to make the suggestion and it is therefore impermissible.

QUESTION FROM BRAZIL

Brazil notes several references to its Rebuttal Submission, dated 17 January 2000, in the European Communities' Statement for the Meeting of the Panel on 6 February 2000. Please identify from whom the European Communities received this document.

Response

1. The European Communities received Brazil's second written submission by e-mail. No record of the origin of the transmission was kept. It expected to have received the text from Brazil.
2. The European Communities is concerned that Brazil contests its right of have received the second submission and states that it did declined to send a copy to the EC as required by the Working Procedures of the Panel. How can the EC usefully contribute to the consideration of this matter by the Panel if it is not aware of all the arguments that have been presented to the Panel prior to the meeting?
3. Article 10:3 of the Understanding on Rules and procedures governing the settlement of disputes (DSU) states that
4. Third parties shall receive the submissions of the Parties to the dispute to the first meeting of the Panel. (emphasis added).
5. Furthermore, the DSU does not foresee any specificity in the application of this rule to panels reconvened pursuant to Article 21.5.

6. As the meeting of 6 February 2000 was the **first** and **only** meeting of the Panel in this case, the EC was entitled to receive all submissions made to that meeting.
7. A refusal by Brazil to allow the EC to have its second written submission would be a breach of the DSU and the Working Procedures and undermine the validity of the procedure.
8. The European Communities can assure Brazil that there has been no breach of confidentiality since its second written submission has only been made available to Members participating in the proceeding and for that purpose, as required by the DSU.

CANADA - TERM OF PATENT PROTECTION

Arbitration under Article 21.3(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes

WT/DS170/10

Circulated to Members on 18 August 2000

I. INTRODUCTION

1. On 12 October 2000, the Dispute Settlement Body (the "DSB") adopted the Panel Report¹ as upheld by the Appellate Body Report² in *Canada - Term of Patent Protection* ("*Canada - Patent Term*").³ At the DSB meeting of 23 October 2000, Canada informed the DSB, pursuant to Article 21.3 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), that it would implement the recommendations and rulings of the DSB in this dispute and that it would require a "reasonable period of time" to do so, under the terms of Article 21.3 of the DSU.

2. In view of the impossibility of reaching an agreement with Canada on the period of time required for the implementation of those recommendations and rulings, the United States requested that such period be determined by binding arbitration pursuant to Article 21.3(c) of the DSU.⁴

3. By joint letter of 10 January 2001, Canada and the United States notified the DSB that they had agreed that the duration of the "reasonable period of time" for implementation should be determined through binding arbitration, under the terms of Article 21.3(c) of the DSU, and that I should act as Arbitrator.⁵ The parties also indicated in that letter that they had agreed to extend the time-period for the arbitration, fixed at 90 days from the date of adoption of the Panel and Appellate Body Reports by the DSB, until 28 February 2001.⁶ Notwithstanding this extension of the time-period, the parties stated that the arbitration award would be deemed to be an award made under Article 21.3(c) of the DSU. My acceptance of this designation as Arbitrator was conveyed to the parties by letter of 11 January 2001.

4. Written submissions were received from Canada and the United States on 22 January 2001, and an oral hearing was held on 5 February 2001.

¹ Panel Report, *Canada, Term of Patent Protection* ("*Canada - Patent Term*"), WT/DS170/R, adopted 12 October, 2000, as upheld by the Appellate Body Report, WT/DS170/AB/R.

² Appellate Body Report, *Canada, Term of Patent Protection* ("*Canada - Patent Term*"), WT/DS170/AB/R, adopted 12 October, 2000.

³ WT/DS170/7, IP/D/17/Add.1.

⁴ WT/DS170/8, IP/D/17/Add.2.

⁵ WT/DS170/9, 10 January 2001.

⁶ Ibid.

II. ARGUMENTS OF THE PARTIES

A. Canada

5. Canada requests the Arbitrator to fix the "reasonable period of time" at 14 months and two days, so that the "reasonable period of time" will expire on 14 December 2001, that is, the last day the Canadian Parliament is scheduled to sit before its Christmas recess in 2001.

6. Canada submits that compliance will require amending its *Patent Act*.⁷ Past arbitrations have established that a legislative change is likely to be more time-consuming than an administrative change. Canada also submits that, to comply with the WTO ruling in this dispute, it needs to amend not only Section 45, but also Sections 78.1, 78.2 and 78.5 of its *Patent Act*, as well as Section 46 of the "Old Act", that is, Section 46 as it read before 1 October 1989.

7. Canada notes that there have been relatively few arbitrations to date under Article 21.3(c) of the DSU in which implementation of the recommendations and rulings of the DSB required legislative change. In the arbitration award in *Japan - Taxes on Alcoholic Beverages* ("*Japan - Alcoholic Beverages*"), the arbitrator referred to the guideline of 15 months in Article 21.3(c) of the DSU and stated that he had not been persuaded by the particular circumstances cited by the parties, to justify a departure of the 15-month guideline either way.⁸ In *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("*European Communities - Bananas*"), the arbitrator ruled in a similar manner as in the previous case and awarded the European Communities a period of 15 months and five days to implement the recommendations and rulings of the DSB.⁹ The arbitrator did not find any particular circumstances that justified deviation from the guideline. In *EC Measures Concerning Meat and Meat Products (Hormones)* ("*European Communities - Hormones*"), the arbitrator arrived at a similar result and awarded the European Communities 15 months.¹⁰ Again, the arbitrator did not find any circumstances that justified deviation from the guideline.

8. Canada notes that in *Korea - Taxes on Alcoholic Beverages* ("*Korea - Alcoholic Beverages*"), the arbitrator granted Korea 11 months and two weeks.¹¹ According to Canada, Korea had claimed a relatively short period for the completion of its legislative process. The arbitrator granted Korea the period it had requested to pass the required legislation, but ruled that the required regulatory change could be com-

⁷ Canadian *Patent Act*, R.S.C., 1985, c.P-4, s.45.

⁸ Award of the Arbitrator, *Japan - Taxes on Alcoholic Beverages - Arbitration under Article 21.3(c) of the DSU*, WT/DS8/15, WT/DS10/15, WT/DS11/13, 14 February 1997, DSR 1997:I, 3, para. 27.

⁹ Award of the Arbitrator, *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Arbitration under Article 21.3(c) of the DSU*, WT/DS27/15, 7 January 1998, DSR 1998:I, 3, para. 19.

¹⁰ Award of the Arbitrator, *EC Measures Concerning Meat and Meat Products (Hormones) - Arbitration under Article 21.3(c) of the DSU*, ("*European Communities - Hormones*"), WT/DS26/15, WT/DS48/13, 29 May 1998, DSR 1998:V, 1833, para. 48.

¹¹ Award of the Arbitrator, *Korea - Taxes on Alcoholic Beverages - Arbitration under Article 21.3(c) of the DSU*, WT/DS75/16, WT/DS84/14, 4 June 1999, DSR 1999:II, 937, para. 48.

pleted at the same time as the legislation.¹² Canada notes that, according to the arbitrator, "[a]lthough the reasonable period of time should be the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB, this [did] not require a Member, in [his] view, to utilize an *extraordinary* legislative procedure, rather than the *normal* legislative procedure, in every case."¹³

9. Canada recalls that in *Chile - Taxes on Alcoholic Beverages* ("*Chile - Alcoholic Beverages*"), the arbitrator fixed the "reasonable period of time" at 14 months and nine days.¹⁴ According to Canada, the arbitrator recognized that the management of legislation before it is introduced in the legislature is important, particularly when the legislation is politically sensitive, and held that this should be taken into account.¹⁵

10. Canada also submits that in *United States - Section 110(5) of the US Copyright Act* ("*United States - Section 110(5)*") the arbitrator set the "reasonable period of time" at 12 months, without explaining his rationale.¹⁶ According to Canada, the arbitrator dismissed the relevance of "controversy", in the sense of domestic "contentiousness", as a relevant consideration in determining the "reasonable period of time". Canada submits that the arbitrator erroneously relied on a statement of the arbitrator in *Canada - Patent Protection of Pharmaceutical Patents* ("*Canada - Pharmaceutical Patents*").¹⁷ In Canada's view, the arbitrator should have taken into account that the legislative process in a democratic state inevitably involves debate. Such legislative debate will be more intense and longer when there are competing legislative approaches for the implementation of the recommendations and rulings of the DSB. Canada adds that it is important to emphasize that it is not so much the "controversy" or the "contentiousness" of the measure as such that should justify allowing more time than would otherwise be the case, but rather the inherent necessity of providing adequate time for debate when legislative choices need to be made in a democratic system of government.

11. Canada further recalls that in the *Canada - Certain Measures Concerning Periodicals* dispute, the United States and Canada agreed on an implementation pe-

¹² Award of the Arbitrator, *Korea - Alcoholic Beverages*, *supra*, footnote 11, para. 46.

¹³ *Ibid.*, para. 42.

¹⁴ Award of the Arbitrator, *Chile - Taxes on Alcoholic Beverages - Arbitration under Article 21.3 (c) of the DSU* ("*Chile - Alcoholic Beverages*"), WT/DS/87/15, WT/DS/14, 23 May 2000, DSR 2000:V, 2589, para. 46.

¹⁵ *Ibid.*, para. 43.

¹⁶ Award of the Arbitrator, *United States - Section 110(5) of the US Copyright Act - Arbitration under Article 21.3(c) of the DSU* ("*United States - Section 110(5)*"), WT/DS160/12, 15 January 2001, para. 47.

¹⁷ The arbitrator stated:

I see nothing in Article 21.3 to indicate that the supposed domestic "contentiousness" of a measure taken to comply with a WTO ruling should in any way be a factor to be considered in determining a "reasonable period of time" for implementation.

Award of the Arbitrator, *Canada - Patent protection of Pharmaceutical Products, Arbitration under Article 21.3(c) of the DSU* ("*Canada - Pharmaceutical Patents*"), WT/DS114/13, 18 August 2000, para. 60.

riod of 15 months.¹⁸ The legislation was relatively non-complex from a technical point of view, but it was politically contentious. The agreement between the parties in that dispute recognized this political reality.

12. Canada justifies its request for an implementation period of 14 months and two days by reference to its normal legislative process. In accordance with normal procedure, officials of the Department of Industry have informed the new Minister of Industry (who is responsible for the *Patent Act*) of the obligations resulting from the recommendations and rulings of the DSB in this case. As part of the preparatory process, a draft Memorandum to Cabinet ("MC") is being prepared. The MC is the formal document that sets out the government's policy intent and, upon Cabinet approval, provides the authority and instructions for the Department of Justice to draft the bill.

13. Canada notes that due to the recent elections in Canada, and the convening of the new Parliament on 29 January 2001, the timing of consideration of the MC in Cabinet Committee and full Cabinet is uncertain.¹⁹ Once the MC has been approved by the Cabinet, the Department of Justice will be instructed to complete the drafting of the bill and put it in final form. It is expected that once Cabinet has given its policy approval, the finalization of the drafting of the bill will take approximately one month. Once the drafting of the bill has been completed, the Government House Leader will review the bill, determine its priority in the government's legislative calendar, and report back to Cabinet so as to seek the delegated authority of the full Cabinet to schedule the introduction of the bill.²⁰

14. According to Canada, the setting of the legislative agenda is the prerogative of the Government House Leader. This will have an impact on the priority that can be given to the introduction of new business, and when such new business can be included in the schedule of the House of Commons for debate. Canada outlines the legislative process in Canada as follows. The first stage is the introduction, and the first reading of the bill in Parliament. At this stage, the Minister of Industry will inform the House of his intention to proceed with the tabling of the bill. The purpose of the first reading is for the bill to be introduced so that it can be printed and distributed to all Members of the House. During the second reading, Members debate and vote on the principle of the bill. The bill is then referred to Committee. The Committee undertakes a clause-by-clause review and study of the bill. The timetable associated with consideration of the bill by the Committee is difficult to predict, and depends on the number of witnesses and experts that are summoned or interested in testifying. Once the bill has been approved, including any amendments, the Committee refers the bill to the House clearly indicating any amendments proposed.

15. The full House considers any amendments and votes for or against them. If amendments to the bill are made, the bill must be re-drafted and reviewed by the Legislation Section of the Department of Justice. The bill can then be scheduled for a

¹⁸ Pursuant to Article 21.3(b) of the DSU. See Canada's statement at the DSB meeting of 25 September 1997, WT/DSB/M37, 4 November 1997.

¹⁹ In response to questioning from the Arbitrator, Canada clarified that the MC would be considered by the Cabinet Committee during the week of the oral hearing.

²⁰ At the oral hearing, Canada declared that the Government of Canada's aim is to introduce the bill for the first reading in early March 2001.

third reading. During the third reading, the Members debate and vote on the bill as amended. Although unusual, it is possible for amendments to be introduced at this stage. Once the bill has gone through a third reading in the House, it will be sent to the Senate for consideration.

16. Consideration of the bill in the Senate follows a similar process to that of the House, including the first reading, second reading, consideration in Committee, and third reading. The Senate may propose amendments to the bill, which will then have to be sent back and considered by the House of Commons.

17. Following passage by both the House of Commons and the Senate, the bill is prepared for the Governor General for Royal Assent. Generally, an act will come into force on the date on which it receives Royal Assent unless another date of entry into force is specified in the statute, or the date may be left by the statute to be determined by order of the Governor-in-Council.

18. Canada explains that the House of Commons is scheduled to sit for 135 days in 2001. Of the 135 scheduled sitting days, certain days are allotted for certain specific debates and other emergency and special debates, leaving a maximum of 104 days for government business. Of the 80 sitting days between February and June 2001, five days are reserved for specific debates. This leaves a maximum of 61 days for consideration of legislative business during this period. The bill would likely be in committee phase when the House adjourns for its summer recess. Unlike the House, the Senate does not have a set calendar.

19. Canada submits that the required amendment to its *Patent Act* will have an impact on Canada's health care system. Therefore, it can be expected that there will be significant debate on the amendments that the government will propose. The debate, which is likely to be divisive, will affect the amount of time required by Parliament to process the legislative proposal. Any attempt by the government to use extraordinary procedures to limit debate could cause political reactions jeopardizing the chances of early enactment of the legislation and may result in more time being required to complete the legislative process than would otherwise be the case. Therefore, the government will have to carefully manage the legislative process and engage in consultations with stakeholders and the provinces, both before and during the debate in Parliament.

B. *The United States*

20. The United States asks the Arbitrator to determine that the "reasonable period of time" is six months from the date of the adoption of the Panel and Appellate Body Reports by the DSB in this dispute.

21. The United States submits that if Canada is permitted to delay its implementation of the recommendations and rulings of the DSB in this dispute, thousands of patents will continue to expire "prematurely", causing irreparable harm to patent owners that are United States nationals. For the United States, this is an issue of extreme urgency "in which every day counts".²¹ According to the United States, on average, 1,149 patents will "prematurely" fall into the public domain every month of 2001.

²¹ United States' submission, para. 3.

22. The United States agrees that a legislative amendment is the most appropriate means of implementing the recommendations and rulings of the DSB. The United States is not, however, persuaded by the implementation schedule proposed by Canada. The United States considers that this implementation schedule does not properly reflect the objective of prompt compliance, nor does it take sufficient account of the flexibility Canada has in its parliamentary system.

23. The United States submits that the awards issued in previous arbitrations have made it clear that the "reasonable period of time" determination shall be based on the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB. The clearest guidance for any arbitrator in making this determination is the text of Article 21.3(c), which provides that the "reasonable period of time" should not exceed 15 months from the date of the adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.

24. The United States argues that the context of Article 21.3(c) makes clear the overriding purpose of prompt compliance. Not only does this Article emphasize that a "reasonable period of time" is available only "[i]f it is impracticable to comply immediately with the recommendations and rulings", but Article 21.1 affirms that "[p]rompt compliance with recommendations and rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members". Similarly, Article 3.3 of the DSU cites the "prompt settlement" of disputes as "essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members".

25. Referring to the award in *Canada - Pharmaceutical Patents*, the United States submits that Canada carries the burden of establishing that the "reasonable period of time" it seeks is in fact the shortest period possible for compliance within its legal system.²²

26. According to the United States, while "particular circumstances" considered in previous arbitrations include the form of implementation, the complexity of the steps necessary for implementation, the legally binding nature of these steps for implementation and their timing, the existence of domestic controversy or "contentiousness" is not a relevant factor.²³

27. The United States asserts that an examination of the form of Canada's implementation, the lack of complexity in the steps involved in that implementation, and the discretion built into Canada's parliamentary system shows that the shortest period of time possible for implementation under Canada's legal system is six months from the date the recommendations and rulings of the DSB were adopted.

28. The United States submits that the bureaucratic process of drafting the bill and obtaining Cabinet approval under the Canadian parliamentary system is highly flexible, and can be completed quickly if desired or necessary. The United States is of the view that even approval through Cabinet committees and the full Cabinet can be, and often is, expedited. There are no mandatory procedural rules or time requirements for such a process.

²² Award of the Arbitrator, *Canada - Pharmaceutical Patents*, *supra*, footnote 17, para. 47.

²³ *Ibid.*, para. 60.

29. According to the United States, to ensure that all patents filed before 1 October 1989 obtain the term of at least 20 years from the date of filing, as established by the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (the "*TRIPS Agreement*"), requires only a simple, narrow amendment of Section 45 of Canada's *Patent Act*. Furthermore, any conforming amendments to other sections of this Act, if they are required, can only be technical and non-substantive in nature.²⁴ Thus as, an amendment to Section 45 would be narrow, any conforming amendment must also be narrow.

30. The United States contends that the process for approving a legislative amendment at the Cabinet level prior to its submission to the Parliament is neither complicated nor time-consuming. The Cabinet and its Committee typically meets weekly. Cabinet consideration is often *pro forma* after a proposal has been approved through Committee. As the required amendment to Canada's *Patent Act* is straightforward and is merely conforming Canada's law to an obligation under the *TRIPS Agreement* that Canada has already assumed, there is no policy issue to debate and no complexities in terms of legal drafting.

31. The United States submits that Canada has a parliamentary system, which means the government with its parliamentary majority can effectively ensure that whatever legislation it wants to pass will be passed in as short a time-period as it likes. Thus, if Canada is committed to passing the bill promptly, there is ample scope to do so using the legislative steps outlined by Canada, particularly given the controlling majority of the Liberal Party in the Parliament following the recent election, and the fact that the legislative procedural rules only require an average of one mandatory sitting day each for the first reading, the second reading, the committee stage, and the report stage and third reading taken together.

32. The United States asserts, as past practice illustrates, many bills have been swiftly passed by this government. For instance, in the 36th Parliament (1997-2000), of the 78 government bills that received Royal Assent, 40 were passed in four months or less. Indeed, bills have been enacted in as short a time-period as one week.

33. According to the United States, with Canada's ability to promptly pass legislation, the underlying question is whether Canada will make the passage of the bill a priority in its legislative agenda. For the United States, the answer must be a resounding "yes". Canada must make the compliance of its obligations under the *TRIPS Agreement* a priority in its legislative proceedings.

34. The United States concludes that there are no compelling reasons why Canada needs more than six months to implement the recommendations and rulings of the DSB in this case.

III. "REASONABLE PERIOD OF TIME"

35. Canada has said that it will comply with the recommendations and rulings of the DSB in *Canada - Patent Term*, but has requested a "reasonable period of time"

²⁴ At the oral hearing, the United States stated that while a technical correction to Section 78.1 of Canada's *Patent Act* might be needed, it would appear that no additional changes to the *Patent Act* will be necessary.

under Article 21.3 of the DSU in which to do so.²⁵ As the duration of the "reasonable period of time" in this case has not been agreed by the parties, they have requested that I determine this period of time through binding arbitration under Article 21.3(c) of the DSU.²⁶

36. Article 21.3(c) of the DSU provides that when the "reasonable period of time" is determined through arbitration:

... a guideline for the arbitrator should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.

Thus, when the "reasonable period of time" is determined through arbitration, the guideline for the arbitrator is that this period should not exceed 15 months from the date of adoption of the panel report and/or the Appellate Body report. This does not mean, however, that the arbitrator is obliged to grant 15 months in all cases. Article 21.3(c) makes clear that the "reasonable period of time" may be shorter or longer, depending upon the "particular circumstances". The applicable "particular circumstances" thus influence the determination of what is a "reasonable period of time" for implementation, as has been stated by previous arbitrators.²⁷

37. The meaning of Article 21.3(c) is elucidated by its context. This context includes the introductory language of Article 21.3, which recognizes that the question of a "reasonable period of time" for implementation only comes into play if "it is impracticable to comply immediately"; Article 21.1, which stresses that "[p]rompt compliance ... is essential in order to ensure effective resolution of disputes to the benefit of all Members"; and Article 3.3, which also recognizes that the "prompt settlement of situations ... is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

38. Thus, the DSU explicitly emphasizes the importance of "prompt" compliance. In recognition of this principle, previous arbitrators have established that the most important factor in establishing the length of the "reasonable period of time" is the following:

... it is clear that the reasonable period of time, as determined under Article 21.3(c), should be the *shortest period possible within the legal system of the Member* to implement the recommendations and rulings of the DSB.²⁸ (emphasis added)

²⁵ Canada's statement at the DSB meeting of 23 October 2000. See, *supra*, para. 1.

²⁶ WT/DS170/9, 10 January 2001.

²⁷ See, for example, Award of the Arbitrator, *Chile - Alcoholic Beverages*, *supra*, footnote 14, paras. 39, 41-45; Award of the Arbitrator, *Canada - Certain Measures Affecting the Automotive Industry - Arbitration under Article 21.3 (c) of the DSU ("Canada - Automotive Industry")*, WT/DS139/12, WT/DS142/12, 4 October 2000, para. 39; and Award of the Arbitrator, *Canada - Pharmaceutical Patents*, *supra*, footnote 17, para. 48.

²⁸ Award of the Arbitrator, *European Communities - Hormones*, *supra*, footnote 10, para. 26; quoted with approval in Award of the Arbitrator, *Korea - Alcoholic Beverages*, *supra*, footnote 11, para. 37. See, also, Award of the Arbitrator, *Indonesia - Certain Measures Affecting the Automobile*

39. Although the "reasonable period of time" should be the "shortest period possible within the legal system of the Member" this does not require a Member to utilize an "extraordinary legislative procedure" in every case.²⁹

40. I now turn to an examination of the arguments made by Canada and the United States in order to determine what would be a "reasonable period of time" in the "particular circumstances" of this dispute.

41. At the outset, I note that the parties agree that the means of implementation in this dispute is legislative, rather than administrative. I recall the statement of a past arbitrator that a legislative change is likely, absent evidence to the contrary, to be more time-consuming than an administrative change.³⁰

42. Canada proposes that I set the "reasonable period of time" at 14 months and two days from the date of adoption of the Panel and Appellate Body Reports by the DSB, so that the "reasonable period of time" will expire on 14 December 2001, that is, the last day the Parliament of Canada is scheduled to sit before its Christmas recess in 2001. Canada justifies this request by reference to its usual legislative process. In support of its position, Canada invokes two factors: the limited number of available sitting days of the House of Commons; and the character of the debate, which is likely to be "divisive".³¹ According to Canada, any attempt by the government to use extraordinary procedures to limit debate could cause political reactions jeopardizing the chances of early enactment of the legislation. Therefore, the Government of Canada will have to manage carefully the legislative process and engage in consultations with stakeholders and the provinces, both before and during the debate in Parliament.

43. The United States requests that I set the "reasonable period of time" at six months from the date of adoption of the Panel and Appellate Body Reports by the DSB. According to the United States, the process of drafting a bill, gaining Cabinet approval and passing legislation is highly discretionary and can be completed quickly; Canada has a parliamentary system in which the government with its parliamentary majority can ensure that legislation will be passed in as short a time as it likes. The United States considers that Canada must make compliance with its obligations under the *TRIPS Agreement* a priority in the legislative proceedings.

44. Before I turn to the essence of this dispute, it is useful to first address two points on which the parties generally agree. The first concerns the "complexity", or rather the absence of "complexity", of the implementing measure in this case. In two previous arbitration awards, it has been expressly recognized that the complexity of the proposed implementation can be one of the "particular circumstances" which may influence the length of the "reasonable period of time".³²

Industry, under Article 21.3(c) of the DSU ("Indonesia Autos "), WT/DS54/15, WT/DS55/14, WT/DS59/13, WT/DS64/12, 7 December 1998, DSR 1998:IX, 4029, para. 22; and Award of the Arbitrator, *Canada - Pharmaceutical Patents, supra*, footnote 17, para. 47.

²⁹ Award of the Arbitrator, *Korea - Alcoholic Beverages, supra*, footnote 11, para. 42. See, also, Award of the Arbitrator, *United States - Section 110(5), supra*, footnote 16, para. 32.

³⁰ Award of the Arbitrator, *Canada - Pharmaceutical Patents, supra*, footnote 17, para. 49, quoted with approval by the arbitrator in *United States - Section 110(5), supra*, footnote 16, para. 34.

³¹ Canada's submission, paras. 29 and 32.

³² Award of the Arbitrator, *Canada - Pharmaceutical Patents, supra* footnote 17, para. 50. See, also, Award of the Arbitrator, *European Communities - Bananas, supra*, footnote 9, para. 19.

45. The parties in this dispute hold different views on the exact number of provisions of the Canadian *Patent Act* which need to be amended.³³ The parties do agree, however, on the nature of these amendments. In response to questioning at the oral hearing, Canada accepted that the proposed bill addresses narrow technical issues. Thus, Canada recognizes that its request for a "reasonable period of time" of 14 months and two days is not justified by the "complexity" of the envisaged implementing legislation. Canada, rather, seems to admit the position of the United States that the required legislative change is "simple".³⁴

46. A second point of convergence between the parties concerns the significance, under Article 21.3(c) of the DSU, of the economic consequences of the expiry of certain patents during the "reasonable period of time" for the implementation of the recommendations and rulings of the DSB. I recall the United States' assertion that, if Canada is permitted to delay its implementation of the recommendations and rulings of the DSB, thousands of patents will continue to expire "prematurely", causing irreparable harm to patent owners; on average, 1,149 patents will fall into the public domain each month during 2001.³⁵

47. At the oral hearing, Canada accepted the statistics presented by the United States, but submitted that they are misleading as they fail to indicate whether or not the "prematurely" expiring patents have any commercial significance. According to Canada, "in the period between 2001 and 2009, where the last of the 53,500 term-deficient patents will expire, there are only 34 patents which both fall into the class of affected patents and the class of those known to have some current commercial value." "[B]etween now and December 2001, only 12 of these patents which have commercial value will expire".³⁶ The United States disagreed with this assertion made by Canada.

48. Canada advanced the argument about the small number of patents with commercial value for the first time at the oral hearing. It is obvious that this argument would raise a major procedural problem if the commercial value of the patents expiring during the "reasonable period of time" had any relevance as a "particular circumstance" for the determination of the length of the "reasonable period of time" in this case. However, in my view, this is not so. Measures taken by Members, which

³³ According to Canada, the amendment of Section 45 of its *Patent Act* entails not only an amendment of Section 78.1 of the same Act but also an amendment of Sections 78.2 and 78.5 of its *Patent Act*, and Section 46 of the "Old Act", that is, Section 46 as it read before October 1989. According to the United States, the amendment of Sections 78.2 and 78.5 of Canada's *Patent Act* and of Section 46 of the "Old Act" appear not to be necessary.

In order to avoid any misunderstandings, I would like to stress that I am mindful of the limits of my mandate in this arbitration which relates exclusively to determining the "reasonable period of time" for implementation under Article 21.3(c). See, Award of the Arbitrator, *European Communities - Hormones*, *supra*, footnote 10, para. 38; Award of the Arbitrator, *Australia - Measures Affecting Importation of Salmon*, under Article 21.3(c) of the DSU ("*Australia - Salmon*"), WT/DS18/9, 23 February 1999, DSR 1999:I, 267, para. 35; Award of the Arbitrator, *Korea - Alcoholic Beverages*, *supra*, footnote 11, para. 45; and Award of the Arbitrator, *Canada - Pharmaceutical Patents*, *supra*, footnote 17, paras. 40 - 43.

³⁴ United States' submission, paras. 15 and 19.

³⁵ United States' submission, para. 3.

³⁶ Canada's opening statement at the oral hearing, paras. 12 and 14.

are inconsistent with one of the covered agreements will, naturally, or at least very often, cause irreparable harm to economic operators who are nationals of other Members. In this respect, violations of the *TRIPS Agreement* will generally not differ from violations of one of the other covered agreements. The precise assessment of damage caused to a group of economic operators or to single individuals, or companies, may well be more difficult to evaluate than in the present case. However, this does not distinguish the present case from other cases involving violations of covered agreements for the purposes of determining the "reasonable period of time", under Article 21.3(c). I note that this view corresponds to the position taken by the United States at the oral hearing according to which the argument of urgency was raised to provide context. The United States acknowledged that the commercial value of the expiring patents is not relevant to the determination of the shortest period possible, within the Canadian legal system.

49. I now turn to Canada's main argument in support of its request for a "reasonable period of time" of 14 months and two days. I recall Canada's observation that the required amendment of its *Patent Act* will have an economic impact on Canada's health care system, so that it can be expected that there will be significant debate which is likely to be divisive, and that, therefore, the Government of Canada will have to carefully manage the legislative process. In support of its argument, Canada refers to the arbitration award in *Chile - Alcoholic Beverages*.³⁷

50. The United States considers that previous arbitration awards have made clear that the existence of domestic controversy, or the "contentiousness" of proposed implementation, is not a relevant factor in determining a "reasonable period of time". The United States refers to the arbitration award in *Canada - Pharmaceutical Patents*, in which the Arbitrator said:

I see nothing in Article 21.3 to indicate that the supposed domestic "contentiousness" of a measure taken to comply with a WTO ruling should in any way be a factor to be considered in determining a "reasonable period of time" for implementation. All WTO disputes are "contentious" domestically at least to some extent; if they were not, there would be no need for recourse by WTO Members to dispute settlement.³⁸

51. The United States also refers to the award in *United States - Section 110(5)*, in which the arbitrator, quoting from the earlier award in *Canada - Pharmaceutical Patents*, said that:

... any argument as to the "controversy", in the sense of domestic "contentiousness", regarding the measure at issue is not relevant.³⁹

52. Canada considers that the arbitrator in the latter case ignored the fact that the *Canada - Pharmaceutical Patents* award concerned implementation by *administrative* promulgation of an *executive* regulation while the arbitration in *United States - Section 110(5)* concerned implementation by *legislative* means. According to Can-

³⁷ Award of the Arbitrator, *Chile - Alcoholic Beverages*, *supra*, footnote 14, para. 43.

³⁸ Award of the Arbitrator, *Canada - Pharmaceutical Patents*, *supra*, footnote 17, para. 60.

³⁹ Award of the Arbitrator, *United States - Section 110(5)*, *supra*, footnote 16, para. 42.

ada, the arbitrator in the latter case should have taken into account that the legislative process in a democratic state inevitably involves debate. Such legislative debate will be more intense and last longer where there are competing legislative approaches for the implementation of the recommendations and rulings of the DSB.

53. The issue raised by Canada is of great importance, both from the point of view of the implementation of recommendations and rulings of the DSB, that is, the respect of international treaty obligations, and from the point of view of fundamental principles of the democratic process. I do not believe, however, that I have to decide the controversy between the parties for the implementation through legislation in general. My only task is to determine the "reasonable period of time" for the case before me. My reasoning, therefore, applies to this case only.

54. I recall that Canada is obliged to bring Section 45 of its *Patent Act* into conformity with its obligations under Article 33 of the *TRIPS Agreement* which states that "[t]he term of protection available shall not end before the expiration of a period of twenty years counted from the filing date". Article 33 prescribes a precise result. It defines the earliest date on which the term of a patent may end.⁴⁰ Canada may establish a longer period before a patent expires, if it so wishes. However, Canada is not allowed to provide for a period of patent protection shorter than 20 years counted from the filing date.

55. In prescribing a precise result, that is, the duration of the minimum period of patent protection, Article 33 of the *TRIPS Agreement* is quite different from provisions which limit only marginally the discretion of the legislator, such as prohibitions of discrimination between imported and domestic goods or services. Such discrimination can, of course, be eliminated in several ways, while a violation of Article 33 of the *TRIPS Agreement* can only be remedied through one action, that is, by providing for the required minimum period of patent protection.

56. Thus, with respect to the minimum period of patent protection, Article 33 of the *TRIPS Agreement* leaves no room for any legislative discretion or legislative choices. In amending its *Patent Act*, Canada has to ensure that the term of patent protection does not end before the expiration of 20 years counted from the date of filing.

57. Canada cannot, and does not, contest this reasoning. Canada's argument relates, in reality, to "competing legislative choices" that are outside the strict boundaries of the implementation of the recommendations and rulings of the DSB in this case. In particular, Canada has mentioned the view of the Canadian Drug Manufacturers Association, that is, the generic segment of Canada's pharmaceutical industry, that "if the patent term is amended to 20 years from application, it must apply to all patents."⁴¹

58. The treatment of existing patents which benefit from a longer period of protection than the period prescribed by Article 33 of the *TRIPS Agreement* may be

⁴⁰ Report of the Appellate Body, *Canada - Patent Term*, *supra*, footnote 2, para 85.

⁴¹ Canada offered this explanation at the oral hearing, see Canada's opening statement, para. 32. In response to questioning by the Arbitrator, Canada explained that, according to the Canadian Drug Manufacturers Association, an extension of the existing period of patent protection (to 20 years from the filing date, as required by Article 33 of the *TRIPS Agreement*) should be accompanied by a reduction of the period of protection of *all* existing patents to exactly the same period of 20 years.

highly controversial and closely connected politically with the amendment of Article 45 of the Canadian *Patent Act*. However, as I have already said, this issue is outside the strict boundaries of the implementation of the recommendations and rulings of the DSB. Consequently, the "contentiousness" of this issue is certainly not a "particular circumstance" which I should take into account in determining the "reasonable period of time" in the present case. Therefore, Canada cannot invoke legislative choices and the likely divisiveness of the debate in the Canadian Parliament to justify its request for a "reasonable period of time" of 14 months and two days.

59. While Canada invokes the controversial character of any amendment to its *Patent Act* which will have an impact on the Canadian health care system, the United States emphasizes that under Canada's parliamentary system, the Government of Canada controls the majority in both Houses of Parliament, the House of Commons and the Senate. According to the United States, with this majority, the government controls the legislative process, and sets the timetable for both Houses of Parliament from start to finish; the Government of Canada can essentially pass any legislation it wishes in whatever time it likes.

60. It may well be possible that Canada's political system and the actual distribution of seats among the political parties in Canada's Parliament facilitate the passage of legislative initiatives taken by the present Canadian government. I am, however, very reluctant to take these factors into account in determining the "reasonable period of time". These factors vary from country to country, and from constitution to constitution. Even within a given country, they will change over time. In addition, their evaluation will often be difficult and highly speculative. I also note that such factors have never been considered as "particular circumstances" in any of the earlier awards under Article 21.3 (c) of the DSU. Thus, the political factors mentioned in the preceding paragraph, and invoked by the United States in support of its request for a "reasonable period of time" of six months, are not relevant to my task.

61. Having examined these arguments advanced by Canada and the United States, I now turn to the evaluation of the requested "reasonable period of time" in the light of Canada's normal legislative process.

62. Contrary to other cases,⁴² I do not believe that it is necessary to examine the pre-legislative phase of Canada's law making process, as it is likely that this phase will be practically completed by the time that this award is made public. Canada has said that, anticipating the comments made by the arbitrator in *United States - Section 110(5)*, it has made good use of the period following the adoption of the panel and Appellate Body Reports by the DSB.⁴³ At the oral hearing, Canada indicated that the government's aim is to introduce the bill for the first reading in early March.

⁴² See, in particular, Award of the Arbitrator, *Chile - Alcoholic Beverages*, *supra*, footnote 14, para. 43.

⁴³ In this award, the arbitrator said:

Arbitrators will scrutinize very carefully the actions an implementing Member takes in respect of implementation during the period after adoption of a panel and/or Appellate Body report and prior to any arbitration proceeding. If it is perceived by an arbitrator that an implementing Member has not adequately begun implementation after adoption so as to effect "prompt compliance", it is to be expected that the arbitrator will take this into account in determining the "reasonable period of time".

63. Canada has described, in detail, in its written submission the different steps of the legislative phase of its law making process. The passage of legislation requires, in essence, three readings in both Houses of the Canadian Parliament, that is, the House of Commons and the Senate. The process includes an examination of the proposed legislation by committees, which normally takes place between the second and the third reading. Once the House of Commons has considered the bill, it is sent to the Senate for its consideration. After approval by the Senate, the bill is given Royal Assent by the Governor-General. The different steps in this process and their sequence are clearly structured and defined. With respect to timing and scheduling, however, the process is flexible, as Canada acknowledged at the oral hearing. Use of this flexibility does not require recourse to extraordinary procedures.⁴⁴ Following earlier arbitration awards, I consider this flexibility to be an important element in establishing the "reasonable period of time".⁴⁵

64. Ultimately, the "reasonable period of time" appears to be a function of the priority which Canada attributes to the amendment of its *Patent Act* in order to bring it into conformity with its obligations under Article 33 of the *TRIPS Agreement*. I recognize that in all democratic societies, legislative initiatives designed to satisfy different needs and wishes compete with each other. I share, however, the view expressed in a recent arbitration award concerning another Member, which I adopt only to the extent that it fits the present case concerning Canada; it seems to me that this is the type of matter for which the Canadian Parliament should try to comply with the international obligations of Canada as soon as possible, taking advantage of the flexibility that it has in its normal legislative procedures.⁴⁶

65. Canada justifies its request for a "reasonable period of time" of 14 months and two days on the basis that the fall session of the Canadian Parliament ends on 14 December 2001. I consider that, in the circumstances of this case, the inclusion of the fall session of the Canadian Parliament is not justified. Turning to the position of the United States, I note that the end of an implementing period of six months would fall in the middle of the spring session of the Canadian House of Commons, that is, 12 April 2001. However, this period seems to me to be unreasonably short.

66. I note that the last sitting day, actually foreseen by the Canadian House of Commons calendar, before the summer recess is 22 June 2001. However, establishing the "reasonable period of time" so that it ends on this day does not seem to me to be appropriate. Fixing the "reasonable period of time" to coincide with a date which is not determined by constitution or by statute, but which can easily be modified, would give the actual calendar of the House of Commons a legal value and significance that it simply does not have. In addition, I note that the bill must also pass the Senate and be given Royal Assent. I, therefore, determine the "reasonable period of

See, Award of the Arbitrator, *United States - Section 110(5)*, *supra*, footnote 16, para. 46.

⁴⁴ I recall that, although the "reasonable period of time" should be the 'shortest period possible within the legal system of the Member', this does not require a Member to utilize an 'extraordinary legislative procedure' in every case." See, *supra*, para. 39 and footnote 29.

⁴⁵ See, Award of the Arbitrator, *United States - Section 110(5)*, *supra*, footnote 16, for legislative action. See, also, Award of the Arbitrator, *Canada - Automotive Industry*, *supra*, footnote 27, para. 47 and 48, for regulatory action.

⁴⁶ Award of the Arbitrator, *United States - Section 110(5)*, *supra*, footnote 16, para. 39.

time" independently of the date actually foreseen by the Canadian House of Commons calendar for the beginning of the summer recess of the House of Commons.

IV. THE AWARD

67. For all the above reasons, I determine that the "reasonable period of time" for Canada to implement the recommendations and rulings of the DSB is *10 months* from the date of adoption of the Panel and Appellate Body Reports by the DSB on 12 October 2000. The "reasonable period of time" will, thus, expire on 12 August 2001.

UNITED STATES - ANTI-DUMPING ACT OF 1916**Report of the Appellate Body**

WT/DS136/AB/R

WT/DS162/AB/R

*Adopted by the Dispute Settlement Body
on 26 September 2000*

United States, *Appellant/Appellee*
European Communities,
Appellant/Appellee/Third Participant
Japan, *Appellant/Appellee/Third
Participant*
India, *Third Participant*
Mexico, *Third Participant*

Present:
Lacarte-Muró, Presiding Member
Ehlermann, Member
Feliciano, Member

TABLE OF CONTENTS

	Page
I. INTRODUCTION	4554
II. ARGUMENTS OF THE PARTICIPANTS AND THIRD PARTICIPANTS	4556
A. Claims of Error by the United States - Appellant	4556
1. Claims Against the 1916 Act as Such.....	4556
2. Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act.....	4558
3. Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement	4559
B. Arguments by the European Communities - Appellee/Third Participant.....	4560
1. Claims Against the 1916 Act as Such.....	4560
2. Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act	4561
3. Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement	4562
C. Arguments by Japan - Appellee/Third Participant.....	4562
1. Claims Against the 1916 Act as Such.....	4562
2. Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act.....	4563

	Page
3. Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement	4563
D. Claims of Error by the European Communities and Japan - Appellants	4563
1. Third Party Rights.....	4563
2. Conditional Appeals	4564
E. Arguments by the United States - Appellee.....	4564
1. Third Party Rights.....	4564
2. Conditional Appeals	4565
F. Arguments by India and Mexico - Third Participants.....	4565
1. India.....	4565
2. Mexico.....	4566
III. ISSUES RAISED IN THESE APPEALS.....	4566
IV. CLAIMS AGAINST THE 1916 ACT AS SUCH	4567
A. Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such.....	4567
B. Mandatory and Discretionary Legislation	4574
V. APPLICABILITY OF ARTICLE VI OF THE GATT 1994 AND THE ANTI-DUMPING AGREEMENT TO THE 1916 ACT	4579
VI. ARTICLES VI:1 AND VI:2 OF THE GATT 1994, CERTAIN PROVISIONS OF THE ANTI-DUMPING AGREEMENT AND ARTICLE XVI:4 OF THE WTO AGREEMENT	4585
VII. THIRD PARTY RIGHTS	4586
VIII. ARTICLES III:4 AND XI OF THE GATT 1994 AND ARTICLE XVI:4 OF THE WTO AGREEMENT	4588
IX. FINDINGS AND CONCLUSIONS	4589

I. INTRODUCTION

1. The United States, the European Communities and Japan appeal from certain issues of law and legal interpretations in the Panel Reports, *United States - Anti-Dumping Act of 1916*, complaint by the European Communities (the "EC Panel Report")¹ and *United States - Anti-Dumping Act of 1916*, complaint by Japan (the "Japan Panel Report").² These Panel Reports were rendered by two Panels composed of

¹ Panel Report, *United States - Anti-Dumping Act of 1916, Complaint by the European Communities* (the EC Panel Report), WT/DS136/R, adopted 26 September 2000, as upheld by the Appellate Body Report.

² Panel Report, *United States - Anti-Dumping Act of 1916, Complaint by Japan* (the Japan Panel Report), WT/DS162/R, adopted 26 September 2000, as upheld by the Appellate Body Report.

the same three persons.³ The two Panel Reports, while not identical, are alike in all major respects.

2. The Panel was established to consider claims by the European Communities and Japan that Title VIII of the United States Revenue Act of 1916 (the "1916 Act")⁴ is inconsistent with United States' obligations under the covered agreements. The 1916 Act allows, under certain conditions, civil actions and criminal proceedings to be brought against importers who have sold foreign-produced goods in the United States at prices which are "substantially less" than the prices at which the same products are sold in a relevant foreign market.⁵

3. The European Communities claimed that the 1916 Act is inconsistent with Articles VI:1 and VI:2 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"), Articles 1, 2.1, 2.2, 3, 4 and 5 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "Anti-Dumping Agreement") and Article XVI:4 of the *Marrakesh Agreement Establishing the World Trade Organization* (the "WTO Agreement"). In the alternative, the European Communities claimed that the 1916 Act is inconsistent with Article III:4 of the GATT 1994. Japan claimed that the 1916 Act is inconsistent with Articles III:4, VI and XI of the GATT 1994, Articles 1, 2, 3, 4, 5, 9, 11, 18.1 and 18.4 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*.

4. In the EC Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 31 March 2000, the Panel concluded that:

- (i) the 1916 Act violates Article VI:1 and VI:2 of the GATT 1994;
- (ii) the 1916 Act violates Articles 1, 4 and 5.5 of the Anti-Dumping Agreement;
- (iii) the 1916 Act violates Article XVI:4 of the Agreement Establishing the WTO;
- (iv) as a result, benefits accruing to the European Communities under the WTO Agreement have been nullified or impaired.⁶

5. In the Japan Panel Report, circulated to Members of the WTO on 29 May 2000, the Panel concluded that:

- (i) the 1916 Act violates Article VI:1 and VI:2 of GATT 1994;
- (ii) the 1916 Act violates Articles 1, 4.1, 5.1, 5.2, 5.4, 18.1 and 18.4 of the Anti-Dumping Agreement;
- (iii) the 1916 Act violates XVI:4 of the Agreement Establishing the WTO; and

³ As the composition of both Panels was identical, we will refer to the Panels as "the Panel".

⁴ Act of 8 September 1916, 39 Stat. 756 (1916); 15 U.S.C. § 72.

⁵ Relevant factual aspects of the 1916 Act are set out at paras. 2.1 - 2.5 and 2.13 - 2.16 of the EC Panel Report, and at paras. 2.1 - 2.5 and 2.14 - 2.16 of the Japan Panel Report. Relevant portions of the 1916 Act are also reproduced in this Report, *infra*, para. 129.

⁶ EC Panel Report, *supra*, footnote 1, para. 7.1.

- (iv) as a result, benefits accruing to Japan under the WTO Agreement have been nullified or impaired.⁷

6. In both Panel Reports, the Panel recommended that the Dispute Settlement Body (the "DSB") request the United States to bring the 1916 Act into conformity with its obligations under the *WTO Agreement*.⁸

7. On 29 May 2000, the United States notified the DSB of its intention to appeal certain issues of law covered in the EC Panel Report and the Japan Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed two Notices of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). In view of the close similarity of the issues raised in the two appeals, it was decided, after consultation with the parties, that a single Division would hear and decide both appeals. On 8 June 2000, the United States filed one appellant's submission for both appeals.⁹ On 13 June 2000, the European Communities and Japan filed a joint other appellants' submission in respect of both appeals.¹⁰ On 23 June 2000, the European Communities and Japan each filed an appellee's/third participant's submission¹¹, and the United States filed an appellee's submission.¹² On the same day, India and Mexico each filed a third participant's submission.¹³

8. The oral hearing in the two appeals was held on 19 July 2000. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeals.

II. ARGUMENTS OF THE PARTICIPANTS AND THIRD PARTICIPANTS

A. *Claims of Error by the United States - Appellant*

1. *Claims Against the 1916 Act as Such*

- (a) Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such

9. The United States argues that the Panel erred in failing to dismiss the claims raised by the European Communities and Japan under Article VI of the GATT 1994 and the *Anti-Dumping Agreement* for lack of jurisdiction. In each dispute, the complaining party invoked the jurisdiction of the Panel pursuant to Article 17 of the *Anti-Dumping Agreement*. However, when Article 17 of the *Anti-Dumping Agreement* is

⁷ Japan Panel Report, *supra*, footnote 2, para. 7.1.

⁸ EC Panel Report, para. 7.2; Japan Panel Report, para. 7.2.

⁹ Pursuant to Rule 21 of the *Working Procedures*.

¹⁰ Pursuant to Rule 23(1) of the *Working Procedures*.

¹¹ Pursuant to Rules 22 and 24 of the *Working Procedures*. The European Communities is an appellee in dispute WT/DS136 and a third participant in dispute WT/DS162. Japan is an appellee in dispute WT/DS162 and a third participant in dispute WT/DS136.

¹² Pursuant to Rule 23(3) of the *Working Procedures*.

¹³ Pursuant to Rule 24 of the *Working Procedures*. India is a third participant in both disputes. Mexico is a third participant in dispute WT/DS136, but not in dispute WT/DS162.

invoked as a basis for a panel's jurisdiction to determine claims made under that Agreement, it is necessary for the complaining party to challenge one of the three types of measure set forth in Article 17.4 of that Agreement, i.e., a definitive anti-dumping duty, a provisional measure or a price undertaking. In the view of the United States, a Member wishing to challenge another Member's anti-dumping law as such must wait until one of the three measures referred to in Article 17.4 is also challenged.

10. The United States considers that this rule is clearly established by the text and context of Article 17.4 of the *Anti-Dumping Agreement*, as well as by the Appellate Body Report in *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala - Cement*").¹⁴ In the present cases, the complainants only challenged the 1916 Act as such, and did not challenge any measure of the type identified in Article 17.4. For this reason alone, according to the United States, the Panel's findings must be vacated for lack of jurisdiction.

11. The United States also contends that the Panel erred in finding that it had jurisdiction to consider claims under Article VI of the GATT 1994. The United States considers that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* form part of an inseparable package of rights and obligations and that, based on the reasoning of the Appellate Body in *Brazil - Measures Affecting Desiccated Coconut*¹⁵, one part of such a package cannot be invoked independently of the other. The United States thus concludes that, since the Panel did not possess jurisdiction to consider the *Anti-Dumping Agreement* claims, and since Article VI cannot be invoked independently of the *Anti-Dumping Agreement*, it follows that the Panel also lacked jurisdiction to consider claims under Article VI of the GATT 1994.

(b) Mandatory and Discretionary Legislation

12. The United States requests the Appellate Body to reverse the Panel's analysis and findings regarding the distinction between mandatory and discretionary legislation. If the Panel found, or the Appellate Body finds, that the 1916 Act is ambiguous, then, the United States submits, the Panel should have asked, and the Appellate Body should ask, whether there is an interpretation of the 1916 Act that would permit the United States to act in conformity with its WTO obligations. Instead, according to the United States, the Panel interpreted and applied the distinction between mandatory and discretionary legislation in a way that has no basis in existing WTO/GATT jurisprudence, erred in treating the distinction as a "defence", and erred in its treatment of United States' municipal law relevant to this issue.

13. As regards the nature of the mandatory and discretionary legislation distinction, the United States considers that the Panel based its approach on a "gross misreading" of the panel report in *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco* ("*United States - Tobacco*").¹⁶ Contrary to the Panel's finding, whether or not a law has been applied in the past does not determine

¹⁴ Appellate Body Report, *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("*Guatemala - Cement*"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767.

¹⁵ Appellate Body Report, WT/DS22/AB/R, adopted 20 March 1997, DSR 1997:I, 167.

¹⁶ Panel Report, adopted 4 October 1994, BISD 41S/131.

the applicability of the distinction between mandatory and discretionary legislation. The United States also asks the Appellate Body to reject the Panel's finding in the Japan Panel Report that Article 18.4 of the *Anti-Dumping Agreement* renders the distinction between mandatory and discretionary legislation "irrelevant". The cases cited by the Panel, *EC - Anti-Dumping Duties on Audio Tapes in Cassettes Originating in Japan ("European Communities - Audio Cassettes")*¹⁷ and *United States - Definition of Industry Concerning Wine and Grape Products ("United States - Wine and Grape Products")*¹⁸, do not support such a conclusion. Furthermore, the United States contends, the ordinary meaning and context of Article 18.4 demonstrate that this provision does not modify or otherwise limit the distinction between mandatory and discretionary legislation.

14. The United States also underlines that there is no legal basis for the Panel's finding that the distinction between discretionary and mandatory legislation is a "defence" which the United States bore the burden of proving. The burden of proving that a measure is inconsistent with a WTO provision rests with the complaining party, which must demonstrate that the law in question *mandates* a violation of the relevant provision. Since the European Communities and Japan have not met the burden of proof, properly applied, the United States asks the Appellate Body to reverse the Panel's findings that the 1916 Act violates the provisions at issue in this dispute.

2. *Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act*

15. The United States claims that the principal substantive error made by the Panel was its finding that Article VI of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*, applies to the 1916 Act.

16. According to the United States, this finding is erroneous because it is based on an erroneous test for determining the applicability of Article VI. The correct analysis, in the view of the United States, is that for a Member's law to fall within the scope of Article VI, it must satisfy two criteria. First, the law must impose a particular type of border adjustment measure, namely, duties on an imported product. Second, the duties imposed by the Member's law must specifically target "dumping" within the meaning of Article VI:1. Consequently, the United States concludes, if the Member's law imposes a type of measure other than duties, or if it does not specifically target dumping, it is not governed by Article VI.

17. The United States submits that, with respect to dumping, Article VI of the GATT 1994 simply provides Members with a right to use anti-dumping duties, and then sets forth rules regulating the manner in which Members may exercise this right. Article VI does not attempt to regulate other types of measure that a Member may want to take in order to counteract dumping, as that task is left to other GATT provisions, including Article III:4 of the GATT 1994. The United States considers that the ordinary meaning of the terms used in Article VI - and, in particular, Article VI:2 - as well as the limited role of Article VI within the GATT framework, Articles 1 and

¹⁷ Panel Report (unadopted), ADP/136, circulated 28 April 1995.

¹⁸ Panel Report, adopted 28 April 1992, BISD 39S/436.

18.1 of the *Anti-Dumping Agreement*, the panel reports in *Japan - Trade in Semi-Conductors* ("*Japan - Semi-Conductors*")¹⁹ and *EEC - Regulation on Imports of Parts and Components* ("*EEC - Parts and Components*")²⁰ and the negotiating history of Article VI, confirm such an interpretation of the scope of Article VI.

18. According to the United States, the word "may" in Article VI:2 of the GATT 1994 confirms that Article VI provides a right that Members would not otherwise have - the right to impose duties - but does not contain any prohibition on the use of other types of measure. Article 1 of the *Anti-Dumping Agreement* means that a Member's actions are governed by Article VI and the *Anti-Dumping Agreement* if a Member is applying one of the specified measures to counteract dumping, i.e., anti-dumping duties, provisional measures or price undertakings. Article 18.1 of the *Anti-Dumping Agreement* and its footnote 24 also make clear that when specific action taken against dumping is in the form of anti-dumping duties, provisional measures or price undertakings, such action must comply with Article VI, as interpreted by the *Anti-Dumping Agreement*, but that when specific action against dumping takes another form, such action is governed by the provisions of the GATT 1994 *other than* Article VI.

19. The United States claims that the Panel engaged in a flawed analysis of the scope of Article VI and, as a result, erroneously concluded that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to *all* anti-dumping measures. The United States reasons that, when the correct test is applied, it is clear that Article VI does not apply to the 1916 Act. The United States underscores that the 1916 Act does not impose any type of border adjustment, much less duties, on imported products: it is an internal law.

20. The United States adds that the 1916 Act is also not subject to Article VI because it does not specifically target "dumping" within the meaning of Article VI:1. Although one element of a 1916 Act claim is the existence of a price difference between two national markets, the United States argues that this element alone is not sufficient under the 1916 Act. Rather, the United States contends, such a price difference is simply one indicator, or supporting evidence, of the possible existence of the activity which the 1916 Act does target, i.e., predatory pricing by the importer in the United States' market, which consists of sales at predatorily low price levels with the intent to destroy, injure, or prevent the establishment of an American industry or to restrain trade in or monopolize a particular market. According to the United States, the existence of such predatory intent is the primary indicator of the anti-competitive conduct which is targeted by the 1916 Act, as the United States' courts have held.

3. *Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement*

21. The United States observes that the Panel found that the 1916 Act violates various substantive and procedural requirements of Article VI of the GATT 1994 and the *Anti-Dumping Agreement*. The United States requests the Appellate Body to re-

¹⁹ Panel Report, adopted 4 May 1988, BISD 35S/116.

²⁰ Panel Report, adopted 16 May 1990, BISD 37S/132.

verse these findings as they were all based on the Panel's erroneous view of the scope of Article VI and the *Anti-Dumping Agreement*.

22. The United States reiterates that the Panel found support for its broad view of the scope of Article VI in Article VI:1 even though the actual text of this provision does not address the issue of whether Article VI regulates all actions against dumping, or only the imposition of anti-dumping duties. The United States recalls that, on its interpretation of Article VI:2 of the GATT 1994 and Articles 1 and 18.1 of the *Anti-Dumping Agreement*, a Member may take specific action against dumping - other than the imposition of anti-dumping duties - so long as such action is in accordance with, or consistent with, the provisions of the GATT 1994 other than Article VI. If the Appellate Body accepts this interpretation, it follows that Article VI does not apply to the 1916 Act, the claims made by the European Communities and Japan under the various provisions of Article VI and the *Anti-Dumping Agreement* must fail, and the Panel's findings of violations of those provisions must be reversed. In addition, the United States submits, since the Panel's findings of violation of Article XVI:4 of the *WTO Agreement* are based on its findings of violation of Article VI, the Appellate Body must also reverse the findings of violation of Article XVI:4.

B. Arguments by the European Communities - Appellee/Third Participant

1. Claims Against the 1916 Act as Such

(a) *Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such*

23. The European Communities requests the Appellate Body to reject the United States' arguments on the issue of jurisdiction on the basis that this ground of appeal is both untimely and unfounded. The United States could have and should have raised this objection before the interim review stage of the panel proceedings in the case brought by the European Communities. Interim review is only intended to allow review of "precise aspects" of the report and not the presentation of new arguments. The European Communities relies in particular on the principle that procedural objections must be raised in a timely manner and in good faith, as confirmed by the Appellate Body in *Korea - Definitive Safeguard Measure on Imports of Certain Dairy Products* ("*Korea - Dairy Safeguards*")²¹ and *United States - Tax Treatment for "Foreign Sales Corporations"* ("*United States - FSC*").²²

24. The European Communities also argues that the jurisdictional arguments of the United States are misconceived since Article 17.4 of the *Anti-Dumping Agreement* only applies to proceedings involving the imposition of the measures identified in that provision and does not generally shelter anti-dumping legislation from scrutiny under the dispute settlement mechanism. Even if it did, the legislation would still

²¹ Appellate Body Report, *Korea - Definitive Safeguard Measures on Imports of Certain Dairy Products* ("*Korea - Dairy Safeguards*"), WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3.

²² Appellate Body Report, *United States - Tax Treatment for "Foreign Sales Corporations"* ("*United States - FSC*"), WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619.

have to comply with Article XVI:4 of the *WTO Agreement*, which has also been invoked in this proceeding and is properly before the Appellate Body.

(b) Mandatory and Discretionary Legislation

25. In relation to the issue of the relevance and meaning of the alleged distinction between mandatory and discretionary legislation in WTO law, the European Communities contests that any such general principle exists and refers the Appellate Body to the report of the panel in *United States - Sections 301-310 of the Trade Act of 1974* ("*United States - Section 301*").²³

26. The European Communities also considers that the existing GATT and WTO case law clearly demonstrates that the alleged distinction between mandatory and discretionary legislation would in any event not protect the 1916 Act from review in dispute settlement proceedings.

2. *Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act*

27. On the central question of the scope of application of Article VI of the GATT 1994, the European Communities supports the view of the Panel that Article VI recognizes the existence of a specific problem in international trade - dumping - and establishes a specific discipline which must be followed by WTO Members in dealing with it. This discipline applies to rules and measures taken thereunder, which, viewed objectively, deal with dumping. The discipline is not limited to rules which provide for the imposition of duties at the frontier.

28. The European Communities bases its interpretation of the scope of Article VI of the GATT 1994 on the text of Article VI itself, as well as on Articles 1 and 18.1 of the *Anti-Dumping Agreement*. In particular, Article VI:1 establishes that Article VI applies to measures which: (i) are targeted at imports; and (ii) provide a remedy against trading practices defined by reference to price discrimination in the form of lower prices in the importing country than those in the country of export. When Article VI:2, on which the United States relies, is read in the context of Article VI:1, it is clear that the word "may" simply means that the imposition of duties is optional, and that the amount of any such duty may not be greater than the margin of dumping. Furthermore, according to the European Communities, Article 18.1 of the *Anti-Dumping Agreement* and footnote 24 make clear that "specific action" against dumping may only be taken in accordance with Article VI, but this does not prevent the application of safeguard measures or countervailing duties (pursuant to and in conformity with Articles XIX and VI of the GATT 1994, respectively) to conduct which may also involve dumping.

29. The European Communities considers that the arguments made by the United States on appeal mischaracterize the Panel's findings, and find no support in the text or context of Article VI, Articles 1 or 18.1 of the *Anti-Dumping Agreement*, or the panel reports in *Japan - Semi-Conductors* or *EEC - Parts and Components*. The

²³ Panel Report, *United States - Sections 301-310 of the Trade Act of 1974* ("*United States - Section 301*"), WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815.

European Communities cautions that the arguments of the United States as regards the scope of Article VI of the GATT 1994 would eviscerate the disciplines of Article VI and allow Members easily to circumvent their WTO obligations by modifying their legislation to provide for fines instead of anti-dumping duties.

3. *Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement*

30. Since the European Communities believes that the Panel correctly interpreted the scope of Article VI of the GATT 1994 and the *Anti-Dumping Agreement*, the European Communities asks the Appellate Body also to uphold the Panel's related conclusions that the 1916 Act violates Article VI:1 and VI:2 of the GATT 1994 and Articles 1, 4.1, 5.4, 5.5, 18.1 and 18.4 of the *Anti-Dumping Agreement*.

31. The European Communities reasons that when an anti-dumping law, which falls within the scope of application of Article VI of the GATT 1994 and the *Anti-Dumping Agreement*, allows the imposition of sanctions other than duties, this is a breach of the discipline established by Article VI of the GATT 1994 and the *Anti-Dumping Agreement*. Likewise, if such a law provides for imposition of measures on the basis of criteria which do not fulfil the substantive requirements of the discipline, or pursuant to procedures which do not respect its procedural requirements, such measures also constitute breaches of the discipline. The European Communities contends that the 1916 Act breaches the discipline in all three respects.

C. *Arguments by Japan - Appellee/Third Participant*

1. *Claims Against the 1916 Act as Such*

(a) *Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such*

32. Japan argues that the Panel correctly concluded that it had jurisdiction. According to Japan, nothing in the text of Article 17 of the *Anti-Dumping Agreement* or its context takes away the well-established GATT/WTO right to challenge facially inconsistent legislation. Article 17.4 is a special and additional rule listed in Appendix 2 to the DSU. According to Japan, Article 17.4 is an exception to the general rule contained in Article 17.1 of the *Anti-Dumping Agreement* and, by its terms, Article 17.4 establishes special rules that apply only to challenges of actions taken by anti-dumping authorities.

(b) *Mandatory and Discretionary Legislation*

33. According to Japan the Panel correctly concluded that, in light of Article 18.4 of the *Anti-Dumping Agreement*, the distinction between mandatory and discretionary legislation is not relevant in this dispute. In any event, Japan contends, the 1916 Act is mandatory in character. When its substantive elements are established, the remedies (fines and/or imprisonment) prescribed by the 1916 Act must be imposed. Japan submits that the Panel also correctly concluded that the burden of proof was properly on the United States to substantiate its claim that the 1916 Act was not mandatory.

2. *Applicability of Article VI of the GATT 1994 and the Anti-Dumping Agreement to the 1916 Act*

34. In Japan's view, the Panel correctly concluded that the proper basis for applicability of Article VI of the GATT 1994 is the type of conduct addressed, not the remedies applied to the conduct. By its terms, the object of Article VI is to counteract "dumping". Japan underscores that anti-dumping duties are the instrument, not the object of Article VI.

35. Japan believes that its interpretation is supported by the plain meaning of Article VI, as well as Articles 1 and 18.1 of the *Anti-Dumping Agreement*. Japan also expresses concern that Members could easily circumvent WTO obligations if a Member could escape Article VI simply by enacting legislation providing for fines and/or imprisonment rather than anti-dumping duties.

36. Japan agrees with the Panel that the 1916 Act falls within the scope of Article VI of the GATT 1994. On its face, the 1916 Act addresses the same type of price discrimination as Article VI. The existence in the 1916 Act of certain additional requirements, which make the imposition of measures to counteract dumping more difficult than required by Article VI, do not make the Act fall outside the scope of Article VI. According to Japan, the historical context, legislative history and United States' case law regarding the 1916 Act all support this conclusion.

3. *Articles VI:1 and VI:2 of the GATT 1994, Certain Provisions of the Anti-Dumping Agreement and Article XVI:4 of the WTO Agreement*

37. Japan argues that since the Panel correctly determined that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* were applicable to the 1916 Act, its findings and conclusions regarding violations of the GATT 1994 and *Anti-Dumping Agreement* provisions also were correct. In particular, the Panel correctly concluded that anti-dumping duties are the only permissible remedy to counteract dumping. The text of Article VI:2 of the GATT 1994 explicitly and unambiguously establishes that anti-dumping duties are the only authorized remedy for dumping, and Article 18.1 and footnote 24 of the *Anti-Dumping Agreement* confirm this conclusion. Japan adds that this conclusion is further supported by the object and purpose of Article VI:2, as well as by the negotiating history.

D. *Claims of Error by the European Communities and Japan - Appellants*

1. *Third Party Rights*

38. The European Communities and Japan contend that the Panel erred in not granting enhanced third party rights to Japan in the case brought by the European Communities, and in not granting enhanced third party rights to the European Communities in the case brought by Japan. They ask the Appellate Body to reverse the Panel's findings and reasoning in this regard, in particular with respect to the proper interpretation of Article 9.3 of the DSU and the appropriate standard for evaluating whether enhanced third party rights should be granted. The European Communities and Japan stress the similarity between the present cases and *EC Measures Con-*

cerning *Meat and Meat Products (Hormones)* ("*European Communities - Hormones*").²⁴

39. According to the European Communities and Japan, in *European Communities - Hormones* the Appellate Body identified three conditions for the granting of enhanced third party rights to a Member involved in a related dispute: (i) the two proceedings deal with the same matter; (ii) the same panelists serve in both disputes; and (iii) the proceedings are held concurrently. They add that, even if the treatment of the European Communities and Japan as third parties was simply a matter of the Panel's discretion under Article 12.1 of the DSU, such discretion should have been exercised on the basis of the principles reflected in Articles 9 and 10 of the DSU, taking account of the need to respect due process.

2. *Conditional Appeals*

(a) Articles III:4 and XI of the GATT 1994

40. If the Appellate Body finds the United States' arguments on the scope of Article VI of the GATT 1994 admissible and well-founded, then the European Communities and Japan request the Appellate Body to find that the 1916 Act violates Articles III:4 and XI of the GATT 1994. The European Communities and Japan incorporate by reference and to the extent necessary the arguments that they developed before the Panel in this regard.

(b) Article XVI:4 of the *WTO Agreement*

41. Should the Appellate Body find the United States' arguments regarding the Panel's jurisdiction and the "non-mandatory" character of the 1916 Act to be admissible and well-founded, the European Communities and Japan ask the Appellate Body to find that the 1916 Act violates Article XVI:4 of the *WTO Agreement*. The European Communities and Japan incorporate by reference and to the extent necessary all the arguments that they developed before the Panel in this connection.

E. *Arguments by the United States - Appellee*

1. *Third Party Rights*

42. The United States urges the Appellate Body to affirm the Panel's decision to deny enhanced third party rights to the European Communities and Japan. As a preliminary matter, the United States contests the claim of the European Communities and Japan that they were "prejudiced" by such denial, given that they prevailed on every substantive argument on which the Panel made findings.

43. The United States contends that the Panel's denial of enhanced third party rights was correct as a matter of law. In the view of the United States, Articles 9.2 and 9.3 of the DSU are of no assistance to the European Communities and Japan. Rather, as the Panel correctly noted and as the Appellate Body found in *European*

²⁴ Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("*European Communities - Hormones*"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.

Communities - Hormones, the question of whether to grant enhanced third party rights is a matter within the sound discretion of a panel. Unlike that case, these proceedings did not involve the consideration of complex facts or scientific evidence or a joint meeting of the parties. There were no "concurrent deliberations" as that term was used in the context of *European Communities - Hormones*. Furthermore, the granting of enhanced third party rights in these proceedings might have prejudiced the United States. In view of these circumstances, the United States considers that the Panel correctly denied enhanced third party rights to the European Communities and Japan.

2. *Conditional Appeals*

(a) Articles III:4 and XI of the GATT 1994

44. The United States submits that the Appellate Body lacks the authority to consider the claims by the European Communities and Japan under Articles III:4 and XI of the GATT 1994. First, the European Communities cannot request the Appellate Body to make any findings regarding Article XI of the GATT 1994 since that provision was not included in the European Communities' request for a panel. Second, the Panel made no factual or legal findings relating to the claims under Article III:4 and XI of the GATT 1994. As the facts relevant to the assessment of these claims were disputed before the Panel, the United States concludes that the limits on appellate review contained in Article 17 of the DSU prevent the Appellate Body from making any determinations of the claims under Articles III:4 and XI of the GATT 1994.

(b) Article XVI:4 of the *WTO Agreement*

45. Should the Appellate Body reach this issue, the United States requests the Appellate Body to affirm the Panel's conclusion that the 1916 Act only violates Article XVI:4 of the *WTO Agreement* to the extent that the 1916 Act violates Article VI of the GATT 1994.

F. *Arguments by India and Mexico - Third Participants*

1. *India*

(a) Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such

46. India argues that the Panel correctly assumed jurisdiction in these disputes. The United States' argument amounts to a contention that a Member's anti-dumping law *as such* may not be challenged. If accepted, this position would deprive Article 18.4 of the *Anti-Dumping Agreement* of any meaning or legal effect, and allow a Member to maintain a WTO-incompatible law with impunity as long as none of the measures referred to in Article 17.4 of the *Anti-Dumping Agreement* were adopted. India considers that the Panel correctly held that the Appellate Body ruling in *Guatemala - Cement* applies only if the dispute is related to the initiation and conduct of

an anti-dumping investigation, and does *not* exclude review of anti-dumping laws *as such*.

47. India also considers that the reasoning in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*²⁵ is sufficient to dispose of the United States' argument that it is the interpretation by the United States' courts of the 1916 Act that is dispositive of the nature of the Act and whether it is mandatory or discretionary.

(b) Applicability of Article VI of the GATT 1994 and the *Anti-Dumping Agreement* to the 1916 Act

48. India does not accept the United States' contention that the 1916 Act is an anti-trust rather than an anti-dumping law. The 1916 Act clearly addresses transnational price discrimination and targets imported products sold in the United States. This is entirely consonant with the definition of dumping in Article VI of the GATT 1994. India underlines that Article VI applies whether the dumping is limited, sporadic, frequent or systemic. Accordingly, the 1916 Act cannot escape the disciplines of Article VI simply because it requires the prohibited conduct to be "common and systematic". India therefore agrees with the Panel that Article VI establishes that anti-dumping duties are the sole means authorized to deal with dumped imports.

2. *Mexico*

49. Mexico argues that the Panel correctly concluded that the key to the applicability of Article VI of the GATT 1994 to the 1916 Act is whether that law objectively addresses "dumping" within the meaning of that article, that the 1916 Act does address such "dumping", and that anti-dumping duties are the sole remedy authorized under Article VI of the GATT 1994.

III. ISSUES RAISED IN THESE APPEALS

50. The following issues are raised in these appeals:

- (a) Whether the Panel erred in its assessment of the claims against the 1916 Act as such, in particular:
 - (i) in concluding that it had jurisdiction to consider claims that the 1916 Act as such is inconsistent with United States' obligations under Article VI of the GATT 1994 and the *Anti-Dumping Agreement*; and
 - (ii) in its interpretation and application of the distinction between mandatory and discretionary legislation;
- (b) Whether the Panel erred in concluding that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to the 1916 Act;
- (c) Whether the Panel erred in concluding:

²⁵ Appellate Body Report, *India - Patent Protection for Pharmaceutical and Agricultural Products*, (*India - Patents (US)*), WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9, paras. 65 - 66.

- (i) in the EC Panel Report, that the 1916 Act is inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4 and 5.5 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*; and
- (ii) in the Japan Panel Report, that the 1916 Act is inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4.1, 5.1, 5.2, 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*;
- (d) Whether the Panel erred in refusing to grant "enhanced" third party rights to Japan in the case brought by the European Communities, and to the European Communities in the case brought by Japan; and
- (e) If the Appellate Body were to reverse the Panel's findings that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to the 1916 Act, whether the Appellate Body can or should find that the 1916 Act is inconsistent with Articles III:4 and XI of the GATT 1994; and, if the Appellate Body were to reverse the Panel's findings on jurisdiction or on the distinction between mandatory and discretionary legislation, whether the Appellate Body can or should find that the 1916 Act is inconsistent with Article XVI:4 of the *WTO Agreement*.

IV. CLAIMS AGAINST THE 1916 ACT AS SUCH

A. *Jurisdiction of the Panel to Hear Claims Against the 1916 Act as Such*

51. With respect to its jurisdiction to examine the claims of the European Communities and Japan, the Panel found that:

... Article 17 of the *Anti-Dumping Agreement* does not prevent us from reviewing the conformity of laws as such under the *Anti-Dumping Agreement*. The same applies, a fortiori, with respect to Article VI of the GATT 1994. ...²⁶

52. The United States appeals the Panel's finding that it had jurisdiction to consider the claims that the 1916 Act as such is inconsistent with Article VI of the GATT 1994 and the *Anti-Dumping Agreement*.

53. In its appellee's submission, the European Communities argues that the United States' appeal relating to the Panel's finding on jurisdiction should be rejected because the United States' objection to the Panel's jurisdiction was both not timely raised before the Panel and not well founded. In the case brought by the European Communities, the United States did not raise this objection to the jurisdiction of the Panel until the stage of interim review. The Panel stated that "there would be a number of reasons to reject the US argument as untimely."²⁷ The European Communities agrees and argues before us that the jurisdictional objection by the United States

²⁶ EC Panel Report, *supra*, footnote 1, para. 5.27. See also Japan Panel Report, *supra*, footnote 2, para. 6.91.

²⁷ EC Panel Report, *supra*, footnote 1, para. 5.19.

could have and should have been raised before the interim review stage of the proceedings before the Panel. The European Communities invokes the principle that procedural objections must be made in a timely manner and in good faith and refers in this respect to the Appellate Body Reports in *Korea - Dairy Safeguards*²⁸ and *United States - FSC*.²⁹

54. We agree with the Panel that the interim review was not an appropriate stage in the Panel's proceedings to raise objections to the Panel's jurisdiction for the first time. An objection to jurisdiction should be raised as early as possible and panels must ensure that the requirements of due process are met. However, we also agree with the Panel's consideration that "some issues of jurisdiction may be of such a nature that they have to be addressed by the Panel at any time."³⁰ We do not share the European Communities' view that objections to the jurisdiction of a panel are appropriately regarded as simply "procedural objections". The vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings. We, therefore, see no reason to accept the European Communities' argument that we must reject the United States' appeal because the United States did not raise its jurisdictional objection before the Panel in a timely manner.

55. The United States appeals, on the basis of the wording of Article 17.4 of the *Anti-Dumping Agreement* and our Report in *Guatemala - Cement*, the Panel's finding that it had jurisdiction to examine the 1916 Act as such. According to the United States, Members cannot bring a claim of inconsistency with the *Anti-Dumping Agreement* against legislation as such independently from a claim of inconsistency of one of the three anti-dumping measures specified in Article 17.4, i.e., a definitive anti-dumping duty, a price undertaking or, in some circumstances, a provisional measure. The United States contends that:

[When a Member has] a law which [provides for the imposition of] duties to counteract dumping and, under the *Anti-*

²⁸ Appellate Body Report, *Korea - Dairy Safeguards*, *supra*, footnote 21, paras. 127 - 131.

²⁹ Appellate Body Report, *United States - FSC*, *supra*, footnote 22, para. 166.

³⁰ EC Panel Report, para. 5.17. We note that it is a widely accepted rule that an international tribunal is entitled to consider the issue of its own jurisdiction on its own initiative, and to satisfy itself that it has jurisdiction in any case that comes before it. See, for example, *Case Concerning the Administration of the Prince von Pless (Preliminary Objection)* (1933) P.C.I.J. Ser. A/B, No. 52, p. 15; Individual Opinion of President Sir A. McNair, *Anglo-Iranian Oil Co. Case (Preliminary Objection)* (1952) I.C.J. Rep., p. 116; Separate Opinion of Judge Sir H. Lauterpacht in *Case of Certain Norwegian Loans* (1957) I.C.J. Rep., p. 43; and Dissenting Opinion of Judge Sir H. Lauterpacht in the *Interhandel Case (Preliminary Objections)* (1959) I.C.J. Rep., p. 104. See also M.O. Hudson, *The Permanent Court of International Justice 1920-1942* (MacMillan, 1943), pp. 418-419; G. Fitzmaurice, *The Law and Procedure of the International Court of Justice*, Vol. 2 (Grotius Publications, 1986), pp. 530, 755-758; S. Rosenne, *The Law and Practice of the International Court* (Martinus Nijhoff, 1985), pp. 467-468; L.A. Podesta Costa and J.M. Ruda, *Derecho Internacional Público*, Vol. 2 (Tipográfica, 1985), p. 438; M. Diez de Velasco Vallejo, *Instituciones de Derecho Internacional Público* (Tecnos, 1997), p. 759. See also the award of the Iran-United States Claims Tribunal in *Marks & Umman v. Iran*, 8 Iran-United States C.T.R., pp. 296-97 (1985) (Award No. 53-458-3); J.J. van Hof, *Commentary on the UNCITRAL Arbitration Rules: The Application by the Iran-U.S. Claims Tribunal* (Kluwer, 1991), pp. 149-150; and Rule 41(2) of the rules applicable to ICSID Arbitration Tribunals: International Centre for Settlement of Investment Disputes, Rules of Procedure for Arbitration Proceedings (Arbitration Rules).

Dumping Agreement, if [another Member wishes] to challenge that law, then [the other Member must] wait until one of the three measures [referred to in Article 17.4 of the *Anti-Dumping Agreement*] is in place.³¹

56. Since, in the present cases, the European Communities and Japan did not challenge a definitive anti-dumping duty, a price undertaking or a provisional measure, the United States concludes that the Panel did not have jurisdiction to examine the 1916 Act as such. Moreover, the United States contends that if the 1916 Act as such cannot be challenged under the *Anti-Dumping Agreement*, it cannot be challenged under Article VI of the GATT 1994 because Article VI and the *Anti-Dumping Agreement* are an inseparable package of rights and obligations.

57. In examining the legal basis for the Panel's jurisdiction to consider the claims of inconsistency made in respect of the 1916 Act as such, we begin with Article 1.1 of the DSU, which states, in relevant part:

The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements"). (emphasis added)

For the DSU to apply to claims that the 1916 Act as such is inconsistent with Article VI of the GATT 1994 and the *Anti-Dumping Agreement*, a legal basis to bring the claims must be found in the GATT 1994 and the *Anti-Dumping Agreement*, respectively.

58. We note that in the present cases, the European Communities and Japan both brought their claims of inconsistency with Article VI of the GATT 1994 and the *Anti-Dumping Agreement* pursuant to Article XXIII of the GATT 1994 and Article 17 of the *Anti-Dumping Agreement*.³²

59. Articles XXII and XXIII of the GATT 1994 serve as the basis for consultations and dispute settlement under the GATT 1994 and, through incorporation by reference, under most of the other agreements in Annex 1A to the *WTO Agreement*.³³ According to Article XXIII:1(a) of the GATT 1994, a Member can bring a dispute settlement claim against another Member when it considers that a benefit accruing to it under the GATT 1994 is being nullified or impaired, or that the achievement of any objective of the GATT 1994 is being impeded, as a result of the failure of that other Member to carry out its obligations under that Agreement.

60. Prior to the entry into force of the *WTO Agreement*, it was firmly established that Article XXIII:1(a) of the GATT 1947 allowed a Contracting Party to challenge legislation as such, independently from the application of that legislation in specific instances. While the text of Article XXIII does not expressly address the matter, pan-

³¹ United States' response to questioning at the oral hearing.

³² WT/DS/136/2, 12 November 1998; WT/DS162/3, 4 June 1999; and WT/DS162/3/Corr.1, 10 February 2000.

³³ We note, however, that, as discussed in our Report in *Guatemala - Cement*, the *Anti-Dumping Agreement* does not incorporate by reference Articles XXII and XXIII of the GATT 1994: Appellate Body Report, *supra*, footnote 14, para. 64 and footnote 43.

els consistently considered that, under Article XXIII, they had the *jurisdiction* to deal with claims against legislation as such.³⁴ In *examining* such claims, panels developed the concept that mandatory and discretionary legislation should be distinguished from each other, reasoning that only legislation that mandates a violation of GATT obligations can be found as such to be inconsistent with those obligations. We consider the application of this distinction to the present cases in section IV(B) below.

61. Thus, that a Contracting Party could challenge legislation as such before a panel was well-settled under the GATT 1947. We consider that the case law articulating and applying this practice forms part of the GATT *acquis* which, under Article XVI:1 of the *WTO Agreement*, provides guidance to the WTO and, therefore, to panels and the Appellate Body. Furthermore, in Article 3.1 of the DSU, Members affirm "their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947". We note that, since the entry into force of the *WTO Agreement*, a number of panels have dealt with dispute settlement claims brought against a Member on the basis of its legislation as such, independently from the application of that legislation in specific instances.³⁵

62. Turning to the issue of the legal basis for claims brought under the *Anti-Dumping Agreement*, we note that Article 17 of the *Anti-Dumping Agreement* addresses dispute settlement under that Agreement. Just as Articles XXII and XXIII of the GATT 1994 create a legal basis for claims in disputes relating to provisions of the GATT 1994, so also Article 17 establishes the basis for dispute settlement claims relating to provisions of the *Anti-Dumping Agreement*. In the same way that Article

³⁴ See, for example, Panel Report, *United States - Taxes on Petroleum and Certain Imported Substances* ("*United States - Superfund*"), adopted 17 June 1987, BISD 34S/136; Panel Report, *United States - Section 337 of the Tariff Act of 1930*, adopted 7 November 1989, BISD 36S/345; Panel Report, *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes* ("*Thailand - Cigarettes*"), adopted 7 November 1990, BISD 37S/200; Panel Report, *United States - Measures Affecting Alcoholic and Malt Beverages* ("*United States - Malt Beverages*"), adopted 19 June 1992, BISD 39S/206; and Panel Report, *United States - Tobacco*, *supra*, footnote 16. See also Panel Report, *United States - Wine and Grape Products*, *supra*, footnote 18, examining this issue in the context of a claim brought under the Tokyo Round Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement of Tariffs and Trade.

³⁵ See, for example, Panel Report, *Japan - Taxes on Alcoholic Beverages* ("*Japan - Alcoholic Beverages II*"), WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125; Panel Report, *Canada - Certain Measures Concerning Periodicals* ("*Canada - Periodicals*"), WT/DS31/R, adopted 30 July 1997, as modified by the Appellate Body Report, WT/DS31/AB/R, DSR 1997:I, 481; Panel Report, *EC - Measures Concerning Meat and Meat Products* ("*EC - Hormones (US)*"), WT/DS26/R/USA, adopted 13 February 1998, as modified by the Appellate Body Report, WT/DS26/AB/R, WT/DS48/AB/R, DSR, 1998:III, 699; Panel Report, *Korea - Taxes on Alcoholic Beverages* ("*Korea - Alcoholic Beverages*"), WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by the Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R, DSR 1999:I, 44; Panel Report, *Chile - Taxes on Alcoholic Beverages*, ("*Chile - Alcoholic Beverages*") WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS87/AB/R, WT/DS110/AB/R, DSR 2000:I, 303; Panel Report, *United States - Tax Treatment for "Foreign Sales Corporations"* ("*United States - FSC*"), WT/DS108/R, adopted 20 March 2000, as modified by the Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1677; and Panel Report, *United States - Section 110(5) of the US Copyright Act* ("*United States - Section 110(5) of the US Copyright Act*"), WT/DS160/R, adopted 27 July 2000.

XXIII of the GATT 1994 allows a WTO Member to challenge *legislation* as such, Article 17 of the *Anti-Dumping Agreement* is properly to be regarded as allowing a challenge to legislation as such, unless this possibility is excluded. No such *express* exclusion is found in Article 17 or elsewhere in the *Anti-Dumping Agreement*.

63. In considering whether Article 17 contains an *implicit* restriction on challenges to anti-dumping legislation as such, we first note that Article 17.1 states:

Except as otherwise provided herein, the Dispute Settlement Understanding is applicable to consultations and the settlement of disputes under this Agreement.

64. Article 17.1 refers, without qualification, to "the settlement of disputes" under the *Anti-Dumping Agreement*. Article 17.1 does not distinguish between disputes relating to anti-dumping legislation as such and disputes relating to anti-dumping measures taken in the implementation of such legislation. Article 17.1 therefore implies that Members can challenge the consistency of legislation as such with the *Anti-Dumping Agreement* unless this action is excluded by Article 17.

65. Similarly, Article 17.2 of the *Anti-Dumping Agreement* does not distinguish between disputes relating to anti-dumping legislation as such and disputes relating to anti-dumping measures taken in the implementation of such legislation. On the contrary, it refers to consultations with respect to "any matter affecting the operation of this Agreement".

66. Article 17.3 of the *Anti-Dumping Agreement* states, in wording that mirrors Article XXIII of the GATT 1994:

If any Member considers that any benefit accruing to it, directly or indirectly, under this Agreement is being nullified or impaired, or that the achievement of any objective is being impeded, by another Member or Members, it may, with a view to reaching a mutually satisfactory resolution of the matter, request in writing consultations with the Member or Members in question. ...

67. In our Report in *Guatemala - Cement*, we described Article 17.3 as:
... the equivalent provision in the *Anti-Dumping Agreement* to Articles XXII and XXIII of the GATT 1994, which serve as the basis for consultations and dispute settlement under the GATT 1994 ...³⁶

68. Article 17.3 does not explicitly address challenges to legislation as such. As we have seen above, Articles XXII and XXIII allow challenges to be brought under the GATT 1994 against legislation as such. Since Article 17.3 is the "equivalent provision" to Articles XXII and XXIII of the GATT 1994, Article 17.3 provides further support for our view that challenges may be brought under the *Anti-Dumping Agreement* against legislation as such, unless such challenges are otherwise excluded.

69. As indicated above, the United States bases its objection to the Panel's jurisdiction on Article 17.4 of the *Anti-Dumping Agreement* and our Report in *Guatemala - Cement*.

70. Article 17.4 of the *Anti-Dumping Agreement* provides:

³⁶ Appellate Body Report, *Guatemala - Cement*, *supra*, footnote 14, para. 64.

If the Member that requested consultations considers that the consultations pursuant to paragraph 3 have failed to achieve a mutually agreed solution, and if *final action* has been taken by the administering authorities of the importing Member to levy *definitive anti-dumping duties* or to *accept price undertakings*, it may refer the matter to the Dispute Settlement Body ("DSB"). When a *provisional measure has a significant impact* and the Member that requested consultations considers that the measure was taken contrary to the provisions of paragraph 1 of Article 7, that Member may also refer *such matter* to the DSB. (emphasis added)

We note that, unlike Articles 17.1 to 17.3, Article 17.4 is a special or additional dispute settlement rule listed in Appendix 2 to the DSU.

71. In *Guatemala - Cement*, Mexico had challenged Guatemala's *initiation* of anti-dumping proceedings, and its *conduct* of the investigation, without identifying any of the measures listed in Article 17.4. We stated that:

... Three types of anti-dumping measure are specified in Article 17.4: definitive anti-dumping duties, the acceptance of price undertakings, and provisional measures. According to Article 17.4, a "matter" may be referred to the DSB *only if* one of the relevant three anti-dumping measures is in place. This provision, when read together with Article 6.2 of the DSU, requires a panel request in a dispute brought under the *Anti-Dumping Agreement* to identify, as the specific measure at issue, either a definitive anti-dumping duty, the acceptance of a price undertaking, or a provisional measure. ... (original emphasis)

... We find that in disputes under the *Anti-Dumping Agreement relating to the initiation and conduct of anti-dumping investigations*, a definitive anti-dumping duty, the acceptance of a price undertaking or a provisional measure must be identified as part of the matter referred to the DSB pursuant to the provisions of Article 17.4 of the *Anti-Dumping Agreement* and Article 6.2 of the DSU.³⁷ (emphasis added)

72. Nothing in our Report in *Guatemala - Cement* suggests that Article 17.4 precludes review of anti-dumping legislation as such. Rather, in that case, we simply found that, for Mexico to challenge Guatemala's initiation and conduct of the anti-dumping investigation, Mexico was required to identify one of the three anti-dumping measures listed in Article 17.4 in its request for establishment of a panel. Since it did not do so, the panel in that case did not have jurisdiction.

73. Important considerations underlie the restriction contained in Article 17.4. In the context of dispute settlement proceedings regarding an anti-dumping investigation, there is tension between, on the one hand, a complaining Member's right to seek

³⁷ Appellate Body Report, *supra*, footnote 14, paras. 79 - 80.

redress when illegal action affects its economic operators and, on the other hand, the risk that a responding Member may be harassed or its resources squandered if dispute settlement proceedings could be initiated against it in respect of each step, however small, taken in the course of an anti-dumping investigation, even before any concrete measure had been adopted.³⁸ In our view, by limiting the availability of dispute settlement proceedings related to an anti-dumping investigation to cases in which a Member's request for establishment of a panel identifies a definitive anti-dumping duty, a price undertaking or a provisional measure³⁹, Article 17.4 strikes a balance between these competing considerations.

74. Therefore, Article 17.4 sets out certain conditions that must exist before a Member can challenge action taken by a national investigating authority in the context of an anti-dumping investigation. However, Article 17.4 does not address or affect a Member's right to bring a claim of inconsistency with the *Anti-Dumping Agreement* against anti-dumping legislation as such.

75. Moreover, as we have seen above, the GATT and WTO case law firmly establishes that dispute settlement proceedings may be brought based on the alleged inconsistency of a Member's legislation as such with that Member's obligations. We find nothing, and the United States has identified nothing, inherent in the nature of anti-dumping legislation that would rationally distinguish such legislation from other types of legislation for purposes of dispute settlement, or that would remove anti-dumping legislation from the ambit of the generally-accepted practice that a panel may examine legislation as such.

76. Our reading of Article 17 as allowing Members to bring claims against anti-dumping legislation as such is supported by Article 18.4 of the *Anti-Dumping Agreement*.

77. Article 18.4 of the *Anti-Dumping Agreement* states:

Each Member shall take all necessary steps, of a general or particular character, to ensure, not later than the date of entry into force of the WTO Agreement for it, the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement as they may apply for the Member in question.

78. Article 18.4 imposes an affirmative obligation on each Member to bring its legislation into conformity with the provisions of the *Anti-Dumping Agreement* not later than the date of entry into force of the *WTO Agreement* for that Member. Nothing in Article 18.4 or elsewhere in the *Anti-Dumping Agreement* excludes the obligation set out in Article 18.4 from the scope of matters that may be submitted to dispute settlement.

79. If a Member could not bring a claim of inconsistency under the *Anti-Dumping Agreement* against legislation as such until one of the three anti-dumping measures

³⁸ An unrestricted right to have recourse to dispute settlement during an anti-dumping investigation would allow a multiplicity of dispute settlement proceedings arising out of the same investigation, leading to repeated disruption of that investigation.

³⁹ Once one of the three types of measure listed in Article 17.4 is identified in the request for establishment of a panel, a Member may challenge the consistency of any preceding action taken by an investigating authority in the course of an anti-dumping investigation.

specified in Article 17.4 had been adopted and was also challenged, then examination of the consistency with Article 18.4 of anti-dumping legislation as such would be deferred, and the effectiveness of Article 18.4 would be diminished.

80. Furthermore, we note that Article 18.1 of the *Anti-Dumping Agreement* states:
No specific action against dumping of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.

81. Article 18.1 contains a prohibition on "specific action against dumping" when such action is not taken in accordance with the provisions of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*. Specific action against dumping could take a wide variety of forms. If specific action against dumping is taken in a form other than a form authorized under Article VI of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*, such action will violate Article 18.1.⁴⁰ We find nothing, however, in Article 18.1 or elsewhere in the *Anti-Dumping Agreement*, to suggest that the consistency of such action with Article 18.1 may only be challenged when one of the three measures specified in Article 17.4 has been adopted. Indeed, such an interpretation must be wrong since it implies that, if a Member's legislation provides for a response to dumping that does *not* consist of one of the three measures listed in Article 17.4, then it would be impossible to test the consistency of that legislation, and of particular responses thereunder, with Article 18.1 of the *Anti-Dumping Agreement*.

82. Therefore, we consider that Articles 18.1 and 18.4 support our conclusion that a Member may challenge the consistency of legislation as such with the provisions of the *Anti-Dumping Agreement*.

83. For all these reasons, we conclude that, pursuant to Article XXIII of the GATT 1994 and Article 17 of the *Anti-Dumping Agreement*, the European Communities and Japan could bring dispute settlement claims of inconsistency with Article VI of the GATT 1994 and the *Anti-Dumping Agreement* against the 1916 Act as such. We, therefore, uphold the Panel's finding that it had jurisdiction to review these claims.

B. Mandatory and Discretionary Legislation

84. In the proceedings before the Panel, the United States invoked the distinction between mandatory and discretionary legislation⁴¹ to make two types of argument:

... the 1916 Act is non-mandatory legislation within the meaning of the GATT/WTO practice essentially because (i) with respect to both civil and criminal proceedings, US courts have interpreted in the past and/or could in the future interpret the 1916 Act in a manner consistent with the WTO obligations of the United States and (ii) the US Department of Justice has

⁴⁰ See *infra*, paras. 122-126.

⁴¹ While the Panel used the phrase "non-mandatory legislation" to describe legislation that does not mandate a violation of a relevant obligation, we prefer the phrase "discretionary legislation".

discretion to initiate or not criminal proceedings under the 1916 Act.⁴²

85. With respect to the first of these arguments, the Panel concluded:
The question whether the 1916 Act could be or has been interpreted in a way that would make it fall outside the scope of Article VI is ... simply a question of assessing the current meaning of the law.⁴³
86. As regards the second argument made by the United States, the Panel found:
... the discretion enjoyed by the US Department of Justice to initiate a case under the 1916 Act should not be interpreted as making the 1916 Act a non-mandatory law.⁴⁴
87. On appeal, the United States asks us to reverse the Panel's interpretation and application of the distinction between mandatory and discretionary legislation.
88. As indicated above, the concept of mandatory as distinguished from discretionary legislation was developed by a number of GATT panels as a threshold consideration in determining when legislation as such - rather than a specific application of that legislation - was inconsistent with a Contracting Party's GATT 1947 obligations.⁴⁵ The practice of GATT panels was summed up in *United States - Tobacco*⁴⁶ as follows:

... panels had consistently ruled that legislation which mandated action inconsistent with the General Agreement could be challenged as such, whereas legislation which merely gave the discretion to the *executive authority* of a contracting party to act inconsistently with the General Agreement could not be challenged as such; only the actual application of such legislation inconsistent with the General Agreement could be subject to challenge.⁴⁷ (emphasis added)

⁴² EC Panel Report, *supra*, footnote 1, para. 6.82. See also Japan Panel Report, *supra*, footnote 2, para. 6.95.

⁴³ EC Panel Report, *supra*, footnote 1, para. 6.84. See also Japan Panel Report, *supra*, footnote 2, para. 6.97.

⁴⁴ EC Panel Report, *supra*, footnote 1, para. 6.169. See also Japan Panel Report, *supra*, footnote 1, para. 6.191.

⁴⁵ The reason it must be possible to find legislation as such to be inconsistent with a Contracting Party's GATT 1947 obligations was explained as follows:

[the provisions of the GATT 1947] are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade.

Panel Report, *United States - Superfund*, *supra*, footnote 34, para. 5.2.2.

⁴⁶ Panel Report, *supra*, footnote 16.

⁴⁷ *Ibid.*, para. 118, referring in footnote to: Panel Report, *United States - Superfund*, *supra*, footnote 34, p. 160; Panel Report, *EEC - Parts and Components*, *supra*, footnote 20, pp. 198-199; Panel Report, *Thailand - Cigarettes*, *supra*, footnote 34, pp. 227-228; Panel Report, *United States - Malt Beverages*, *supra*, footnote 34, pp. 281-282 and 289-290; Panel Report, *United States - Denial of Most-Favoured*

89. Thus, the relevant discretion, for purposes of distinguishing between mandatory and discretionary legislation, is a discretion vested in the *executive branch* of government.

90. The 1916 Act provides for two types of actions to be brought in a United States federal court: a civil action initiated by private parties, and a criminal action initiated by the United States Department of Justice. Turning first to the civil action, we note that there is no relevant discretion accorded to the executive branch of the United States' government with respect to such action.⁴⁸ These civil actions are brought by private parties. A judge faced with such proceedings must simply *apply* the 1916 Act. In consequence, so far as the civil actions that may be brought under the 1916 Act are concerned, the 1916 Act is clearly mandatory legislation as that term has been understood for purposes of the distinction between mandatory and discretionary legislation.

91. The Panel, however, examined that part of the 1916 Act that provides for criminal prosecutions, and found that the discretion enjoyed by the United States Department of Justice to initiate or not to initiate criminal proceedings does not mean that the 1916 Act is a discretionary law.⁴⁹ In light of the case law developing and applying the distinction between mandatory and discretionary legislation⁵⁰, we believe that the discretion enjoyed by the United States Department of Justice is not discretion of such a nature or of such breadth as to transform the 1916 Act into discretionary legislation, as this term has been understood for purposes of distinguishing between mandatory and discretionary legislation. We, therefore, agree with the Panel's finding on this point.

92. In any event, we note that, on appeal, the United States does not directly challenge the Panel's finding that the discretion to enforce the 1916 Act enjoyed by the United States Department of Justice does not mean that the 1916 Act is discretionary legislation, but instead takes issue with several aspects of the reasoning employed by the Panel in reaching this conclusion. First, according to the United States, the Panel erred by "creating" a rule that the mandatory/discretionary distinction can apply only if the challenged legislation has never been "applied". In response to our inquiries at the oral hearing, the United States identified the following statement by the Panel as "creating" such a rule:

The question whether there could be a possibility to interpret the 1916 Act in the future so that it would fall outside the scope of Article VI would be relevant, according to the *United*

Nation Treatment as to Non-Rubber Footwear from Brazil, adopted 19 June 1992, BISD 39S/128, p. 152.

⁴⁸ The Panel noted that the United States did not allege that any discretion of the executive branch of government in relation to the civil proceedings would make the 1916 Act discretionary. EC Panel Report, footnote 350 to para. 6.82; Japan Panel Report, *supra*, footnote 2, footnote 482 to para. 6.95.

⁴⁹ EC Panel Report, *supra*, footnote 1, para. 6.169; Japan Panel Report, *supra*, footnote 2, para. 6.191.

⁵⁰ See, in particular the reasoning in the Panel Report, *United States - Malt Beverages*, *supra*, footnote 34, para. 5.60.

States - Tobacco case, only if the 1916 Act had not yet been applied.⁵¹

93. Review of the context in which the above passage appears in the Panel Reports reveals that the Panel did not, as the United States argues, find that the distinction between mandatory and discretionary legislation is only relevant if the challenged legislation has never been applied. Rather, in response to the United States' argument that the circumstances of the present cases resemble those in *United States - Tobacco*, the Panel noted that these cases are factually different from *United States - Tobacco*, where no implementing measures had been adopted and the law had never been applied, and reasoned that "[t]hese differences have implications for the burden of proof."⁵² We see no *finding* by the Panel that the distinction between mandatory and discretionary legislation is relevant only if the challenged legislation has never been applied.

94. The United States also takes issue with the Panel's identification and application of the burden of proof, in particular the Panel's statement that:

... the United States, as the party having raised this *defence*, failed to supply convincing evidence that the 1916 Act should be considered as "non-mandatory legislation" within the meaning of GATT 1947/WTO practice.⁵³ (emphasis added)

95. According to the United States, the Panel erred in characterizing the distinction between discretionary and mandatory legislation as a "defence" which the United States bore the burden of proving.

96. In our Reports in *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*⁵⁴ and *European Communities - Hormones*⁵⁵, we found that a complaining Member bears the burden of bringing forth sufficient evidence and legal argument to demonstrate that, *prima facie*, another Member's measure is inconsistent with a relevant obligation of that other Member under the covered agreements. Once the complaining Member has done so, the burden shifts to the defending Member to introduce evidence and legal argument sufficient to rebut the *prima facie* case.

97. Our examination of the Panel Reports shows that the Panel correctly articulated⁵⁶ and applied⁵⁷ the burden of proof in the cases before it. The Panel, in its analysis, found that the European Communities and Japan had satisfied their respective burdens of proof by establishing a *prima facie* case that the 1916 Act is, on its

⁵¹ EC Panel Report, *supra*, footnote 1, para. 6.89; Japan Panel Report, *supra*, footnote 2, para. 6.103.

⁵² EC Panel Report, *supra*, footnote 1, paras. 6.86 - 6.87; Japan Panel Report, *supra*, footnote 2, paras. 6.100 - 6.101.

⁵³ Japan Panel Report, *supra*, footnote 2, para. 6.192. See also EC Panel Report, *supra*, footnote 1, para. 6.170.

⁵⁴ Appellate Body Report, WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:I, 323, at 333-336.

⁵⁵ Appellate Body Report, *supra*, footnote 24, para. 109.

⁵⁶ EC Panel Report, *supra*, footnote 1, paras. 6.37 - 6.38; Japan Panel Report, *supra*, footnote 2, paras. 6.24 - 6.25.

⁵⁷ EC Panel Report, *supra*, footnote 1, paras. 6.86 - 6.90; Japan Panel Report, *supra*, footnote 2, paras. 6.100 - 6.104.

face, inconsistent with Article VI of the GATT 1994 and the *Anti-Dumping Agreement*. Having so found, the Panel went on to examine the arguments and evidence presented by the United States to rebut this *prima facie* case. One such argument made by the United States was that the 1916 Act is discretionary legislation. The Panel found that the United States did not supply persuasive evidence in support of this argument. We are satisfied that, in these cases, the Panel correctly identified and applied the burden of proof.

98. The United States further claims that, in the Japan Panel Report, the Panel wrongly concluded, based on the reasoning of the panel in the unadopted *European Communities - Audio Cassettes* panel report, that:

... to the extent that Article 18.4 requires the conformity of the 1916 Act with the Anti-Dumping Agreement as of the date of entry into force of the WTO Agreement for the United States, *the notion of mandatory/non-mandatory legislation is no longer relevant* in determining whether the Panel can or cannot review the conformity of the 1916 Act with the Anti-Dumping Agreement.⁵⁸ (emphasis added)

99. We note that answering the question of the continuing relevance of the distinction between mandatory and discretionary legislation for claims brought under the *Anti-Dumping Agreement* would have no impact upon the outcome of these appeals, because the 1916 Act is clearly not discretionary legislation, as that term has been understood for purposes of distinguishing between mandatory and discretionary legislation. Therefore, we do not find it necessary to consider, in these cases, whether Article 18.4, or any other provision of the *Anti-Dumping Agreement*, has supplanted or modified the distinction between mandatory and discretionary legislation.⁵⁹ For the same reasons, the Panel did not, in the Japan Panel Report, need to opine on this issue.⁶⁰

100. Lastly, we note that, before the Panel and before us, the United States invoked the distinction between mandatory and discretionary legislation to argue that the 1916 Act cannot be mandatory legislation because United States' courts have interpreted or may interpret the 1916 Act in ways that would make it consistent with the WTO obligations of the United States. As we have seen, in the case law developed under the GATT 1947, the distinction between mandatory and discretionary legislation turns on whether there is relevant discretion vested in the *executive branch* of government. The United States, however, does not rely upon the discretion of the executive branch of the United States' government, but on the interpretation of the 1916 Act by the United States' courts. In our view, this argument does not relate to the distinction between mandatory and discretionary legislation.

⁵⁸ Japan Panel Report, *supra*, footnote 2, para. 6.189.

⁵⁹ We note that in a recent case, a panel found that even discretionary legislation may violate certain WTO obligations. See Panel Report, *United States - Section 301*, *supra*, footnote 23, paras. 7.53 - 7.54.

⁶⁰ We note that, in the EC Panel Report, the Panel reached the same results as in the Japan Panel Report, *supra*, footnote 2, without making any finding that the notion of mandatory/discretionary legislation "is no longer relevant".

101. On this point, we agree with the Panel that the question whether the 1916 Act could be or has been interpreted by the United States' courts in a way that would make it fall outside the scope of Article VI of the GATT 1994 is a matter of determining the meaning of the law in order to examine its consistency with the United States' obligations.⁶¹ We review, to the extent that it is relevant in these appeals, the Panel's assessment of the meaning and consistency of the 1916 Act in the following sections of this Report.

102. As a result of the above reasoning, we uphold, to the extent that we have found it necessary to consider the issue, the Panel's interpretation and application of the distinction between mandatory and discretionary legislation.

V. APPLICABILITY OF ARTICLE VI OF THE GATT 1994 AND THE ANTI-DUMPING AGREEMENT TO THE 1916 ACT

103. The Panel found that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to the 1916 Act. With respect to the applicability of Article VI to the 1916 Act, the Panel concluded:

Having interpreted Article VI of the GATT 1994 in accordance with the Vienna Convention, we have reached the conclusion that the rules and disciplines of that article apply to laws that address "dumping" as defined in Article VI:1. Having examined the text of the 1916 Act, we have found that the transnational price discrimination test incorporated in that law falls within the definition of "dumping" of Article VI:1 of the GATT 1994. ...⁶²

The Panel further concluded that:

... the applicability of Article VI to the 1916 Act also implies the applicability of the Anti-Dumping Agreement to the 1916 Act.⁶³

104. The United States appeals these findings. According to the United States, Article VI of the GATT 1994 applies to a law of a Member only when two criteria are satisfied: first, the law must impose anti-dumping duties and, second, it must "specifically target" dumping within the meaning of Article VI:1. The United States emphasizes that the 1916 Act does not impose anti-dumping duties - it provides for imprisonment, the imposition of fines or an award of treble damages. Moreover, the United States argues that the 1916 Act does not "specifically target" dumping, but rather predatory pricing. The United States, therefore, maintains that Article VI and, by implication, the *Anti-Dumping Agreement*, do not apply to the 1916 Act.

⁶¹ EC Panel Report, *supra*, footnote 1, para. 6.84; Japan Panel Report, *supra*, footnote 2, para. 6.97.

⁶² EC Panel Report, *supra*, footnote 1, para. 6.163; Japan Panel Report, *supra*, footnote 2, para. 6.182.

⁶³ Japan Panel Report, *supra*, footnote 2, para. 6.184. See also EC Panel Report, *supra*, footnote 2, para. 6.165.

105. Article VI of the GATT 1994 concerns "dumping". "Dumping" is defined in Article VI:1 of the GATT 1994 and further elaborated in Article 2 of the *Anti-Dumping Agreement*. The first sentence of Article VI:1 defines "dumping" as conduct:

... by which products of one country are introduced into the commerce of another country at less than the normal value of the products ...

106. The second and third sentences of Article VI:1 state:

For the purposes of this Article, a product is to be considered as being introduced into the commerce of an importing country at less than its normal value, if the price of the product exported from one country to another

- (a) is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or,
- (b) in the absence of such domestic price, is less than either
 - (i) the highest comparable price for the like product for export to any third country in the ordinary course of trade, or
 - (ii) the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.

Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability.

Article 2 of the *Anti-Dumping Agreement* further elaborates the definition of "dumping" in Article VI:1 by setting out detailed rules for the determination of dumping.

107. We note that, under Article VI:1 of the GATT 1994 and Article 2 of the *Anti-Dumping Agreement*, neither the intent of the persons engaging in "dumping" nor the injurious effects that "dumping" may have on a Member's domestic industry are constituent elements of "dumping".

108. With regard to "dumping", Article VI of the GATT 1994 states, in relevant part:

- 1. The Members recognize that dumping ... is to be condemned if it causes or threatens material injury to an established industry in the territory of a Member or materially retards the establishment of a domestic industry. ...
- 2. In order to offset or prevent dumping, a Member may levy on any dumped product an anti-dumping duty not greater in amount than the margin of dumping in respect of such product. ...

109. Whether Article VI of the GATT 1994 is applicable to the 1916 Act depends, first of all, on whether Article VI regulates all possible measures Members can take in response to dumping. If Article VI regulates *only* the imposition of anti-dumping

duties and neither prohibits nor regulates other measures which Members may take to counteract dumping, then, since the 1916 Act does not provide for anti-dumping duties, Article VI would not apply to the 1916 Act.

110. Article VI:1 of the GATT 1994 makes clear that dumping is "to be *condemned* if it causes or threatens material injury". (emphasis added) However, Article VI:1 does not address the remedies that Members may take against dumping.

111. Remedies are addressed in Article VI:2 of the GATT 1994. The only type of measure that Article VI:2 explicitly authorizes Members to impose "in order to offset or prevent dumping" is an anti-dumping duty. However, Article VI:2 does not specify that Members may impose *only* anti-dumping duties in order to offset or prevent dumping.

112. In arguing that Article VI of the GATT 1994 regulates only the imposition of anti-dumping duties and does not apply to other measures taken to counteract dumping, the United States emphasizes that Article VI:2 states that Members "*may* levy on any dumped product an anti-dumping duty ...". (emphasis added). For the United States, the verb "may" indicates that while Members "may" choose to impose anti-dumping duties and thereby be bound by the rules of Article VI, Members may also choose to impose other types of anti-dumping measures, in which case they are not bound by the rules of Article VI.

113. We agree with the first part of the United States' argument, namely, that the verb "may" indicates that it is permissive, rather than mandatory, to impose anti-dumping duties. However, it is not obvious to us, based on the wording of Article VI:2 alone, that the verb "may" also implies that a Member is permitted to impose a measure other than an anti-dumping duty.

114. We believe that the meaning of the word "may" in Article VI:2 is clarified by Article 9 of the *Anti-Dumping Agreement* on the "Imposition and Collection of Anti-Dumping Duties". Article VI of the GATT 1994 and the *Anti-Dumping Agreement* are part of the same treaty, the *WTO Agreement*. As its full title indicates, the *Anti-Dumping Agreement* is an "Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994". Accordingly, Article VI must be read in conjunction with the provisions of the *Anti-Dumping Agreement*, including Article 9.

115. Article 9 of the *Anti-Dumping Agreement* states in relevant part:

It is desirable that the imposition [of an anti-dumping duty] be permissive in the territory of all Members, and that the duty be less than the margin if such lesser duty would be adequate to remove the injury to the domestic industry.

116. In light of this provision, the verb "may" in Article VI:2 of the GATT 1994 is, in our opinion, properly understood as giving Members a choice between imposing an anti-dumping duty *or not*, as well as a choice between imposing an anti-dumping duty equal to the dumping margin or imposing a lower duty. We find no support in Article VI:2, read in conjunction with Article 9 of the *Anti-Dumping Agreement*, for the United States' argument that the verb "may" indicates that Members, to counteract dumping, are permitted to take measures other than the imposition of anti-dumping duties.

117. As a result of the above reasoning, it appears to us that the text of Article VI is inconclusive as to whether Article VI regulates all possible measures which Members may take to counteract dumping, or whether it regulates only the imposition of anti-dumping duties.

118. As we have stated, Article VI of the GATT 1994 must be read together with the provisions of the *Anti-Dumping Agreement*. Article 1 of that Agreement provides:

An anti-dumping measure shall be applied only under the circumstances provided for in Article VI of GATT 1994 and pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement. The following provisions govern the application of Article VI of GATT 1994 in so far as action is taken under anti-dumping legislation or regulations.

119. The first sentence of Article 1 states that "an anti-dumping measure" must be consistent with Article VI of the GATT 1994 and the provisions of the *Anti-Dumping Agreement*. However, as the United States concedes, the meaning of an "anti-dumping measure" in this sentence is "not immediately clear".⁶⁴ The United States argues, on the basis of the history of this provision, that the phrase "anti-dumping measure" refers *only* to definitive anti-dumping duties, price undertakings and provisional measures. However, the ordinary meaning of the phrase "an anti-dumping measure" seems to encompass all measures taken against dumping. We do not see in the words "an anti-dumping measure" any explicit limitation to particular types of measure.⁶⁵

120. Since "an anti-dumping measure" must, according to Article 1 of the *Anti-Dumping Agreement*, be consistent with Article VI of the GATT 1994 and the provisions of the *Anti-Dumping Agreement*, it seems to follow that Article VI would apply to "an anti-dumping measure", i.e., a measure against dumping.

121. We consider that the scope of application of Article VI is clarified, in particular, by Article 18.1 of the *Anti-Dumping Agreement*. Article 18.1 states:

No *specific action against dumping* of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement. (emphasis added)

122. 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 in response to situations presenting the constituent elements of "dumping". "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.⁶⁶ Since intent is not a constituent element of "dumping", the *intent* with which action against dumping is taken is not relevant to the determination of whether such action is "specific action against dumping" of exports within the meaning of Article 18.1 of the *Anti-Dumping Agreement*.

⁶⁴ United States' appellant's submission, para. 85.

⁶⁵ We consider that the second sentence of Article 1 merely indicates that the *Anti-Dumping Agreement* implements only those provisions of Article VI of the GATT 1994 that concern dumping, as distinguished from the provisions of Article VI of the GATT 1994 that concern countervailing duties imposed to offset subsidies.

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

123. Footnote 24 to Article 18.1 of the *Anti-Dumping Agreement* states:

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

We note that footnote 24 refers generally to "action" and not, as does Article 18.1, to "specific action against dumping" of exports. "Action" within the meaning of footnote 24 is to be distinguished from "specific action against dumping" of exports, which is governed by Article 18.1 itself.

124. Article 18.1 of the *Anti-Dumping Agreement* contains a prohibition on the taking of any "specific action against dumping" of exports when such specific action is not "in accordance with the provisions of GATT 1994, as interpreted by this Agreement". Since the only provisions of the GATT 1994 "interpreted" by the *Anti-Dumping Agreement* are those provisions of Article VI concerning dumping, Article 18.1 should be read as requiring that any "specific action against dumping" of exports from another Member be in accordance with the relevant provisions of Article VI of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*.

125. We recall that footnote 24 to Article 18.1 refers to "*other* relevant provisions of GATT 1994" (emphasis added). These terms can only refer to provisions other than the provisions of Article VI concerning dumping. Footnote 24 thus confirms that the "provisions of GATT 1994" referred to in Article 18.1 are in fact the provisions of Article VI of the GATT 1994 concerning dumping.

126. We have found that Article 18.1 of the *Anti-Dumping Agreement* requires that any "specific action against dumping" be in accordance with the provisions of Article VI of the GATT 1994 concerning dumping, as those provisions are interpreted by the *Anti-Dumping Agreement*. It follows that Article VI is applicable to any "specific action against dumping" of exports, i.e., action that is taken in response to situations presenting the constituent elements of "dumping".

127. We now turn to the question whether the 1916 Act provides for "specific action against dumping" of exports from another Member and, thus, falls within the scope of application of Article VI of the GATT 1994.

128. As mentioned above, the United States contends that the 1916 Act does not fall within the scope of application of Article VI of the GATT 1994 because it does not "specifically target" dumping. According to the United States, the activity targeted by the 1916 Act is "predatory pricing; that is, sales at predatorily low price levels with the intent to destroy, injure, or prevent the establishment of an American industry, or to restrain trade in or monopolize a particular market."⁶⁷ Although one element of liability under the 1916 Act is the existence of price differences between national markets, this element is, according to the United States, "simply one indicia of whether the U.S. importers pricing practices are predatory in nature."⁶⁸

129. The 1916 Act states in relevant part:

It shall be unlawful for any person importing or assisting in importing any articles from any foreign country into the United States, commonly and systematically to import, sell or cause to be imported or sold such articles within the United States at a

⁶⁷ United States' appellant's submission, para. 133.

⁶⁸ Ibid.

price substantially less than the actual market value or wholesale price of such articles, at the time of exportation to the United States, in the principal markets of the country of their production, or of other foreign countries to which they are commonly exported after adding to such market value or wholesale price, freight, duty, and other charges and expenses necessarily incident to the importation and sale thereof in the United States: *Provided*, That such act or acts be done with the intent of destroying or injuring an industry in the United States, or of preventing the establishment of an industry in the United States, or of restraining or monopolizing any part of trade and commerce in such articles in the United States.

Any person who violates or combines or conspires with any other person to violate this section is guilty of a misdemeanor, and, on conviction thereof, shall be punished by a fine not exceeding \$5,000, or imprisonment not exceeding one year, or both, in the discretion of the court.

Any person injured in his business or property by reason of any violation of, or combination or conspiracy to violate, this section, may sue therefor in the district court of the United States for the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages sustained, and the cost of the suit, including a reasonable attorney's fee.⁶⁹

130. On the basis of the wording of the 1916 Act, it is clear that the 1916 Act provides for civil and criminal proceedings and penalties when persons import products from another country into the territory of the United States, and sell or offer such products for sale at a price less than the price for which the like products are sold or offered for sale in the country of export or, in certain cases, a third country market. In other words, in the light of the definition of "dumping" set out in Article VI:1 of the GATT 1994, as elaborated in Article 2 of the *Anti-Dumping Agreement*, the civil and criminal proceedings and penalties contemplated by the 1916 Act require the presence of the constituent elements of "dumping". The constituent elements of "dumping" are built into the essential elements of civil and criminal liability under the 1916 Act. The wording of the 1916 Act also makes clear that these actions can be taken *only* with respect to conduct which presents the constituent elements of "dumping". It follows that the civil and criminal proceedings and penalties provided for in the 1916 Act are "specific action against dumping". We find, therefore, that Article VI of the GATT 1994 applies to the 1916 Act.

131. We note that the United States places much emphasis on the "intent" requirement of the 1916 Act, i.e., the stipulation that dumping is "unlawful" when it is:

... done with the intent of destroying or injuring an industry in the United States, or of preventing the establishment of an industry in the United States, or of restraining or monopolizing

⁶⁹ *Supra*, footnote 4.

any part of trade and commerce in such Articles in the United States.⁷⁰

132. This requirement of intent to destroy, injure, or prevent the establishment of an American industry, or to restrain or monopolize any part of trade, does not affect the applicability of Article VI of the GATT 1994 to the 1916 Act. As already noted, action may be taken under the 1916 Act only when the constituent elements of dumping are present. The fact that an importer can only be found to have violated the 1916 Act when the sales of dumped products in the United States were carried out with a certain intent does not mean that the actions under the 1916 Act are not "specific action against dumping". Proof of a requisite intent under the 1916 Act only constitutes an additional requirement for the imposition of the civil and criminal penalties set out in that Act. Even if the 1916 Act allowed the imposition of penalties *only* if the intent proven were an intent to monopolize or an intent to restrain trade (i.e., an "antitrust"-type intent), this would not transform the 1916 Act into a statute which does not provide for "specific action against dumping", and, thus, would not remove the 1916 Act from the scope of application of Article VI.

133. For all these reasons, we agree with the Panel's conclusion that Article VI of the GATT 1994 applies to the 1916 Act. We also agree with the Panel that, having regard to the relationship between Article VI and the *Anti-Dumping Agreement*, "the applicability of Article VI to the 1916 Act also implies the applicability of the Anti-Dumping Agreement" to the 1916 Act.⁷¹

VI. ARTICLES VI:1 AND VI:2 OF THE GATT 1994, CERTAIN PROVISIONS OF THE ANTI-DUMPING AGREEMENT AND ARTICLE XVI:4 OF THE WTO AGREEMENT

134. With regard to the EC Panel Report, the United States argues that the Panel erred in finding that the 1916 Act was inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4 and 5.5 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*. With regard to the Japan Panel Report, the United States argues that the Panel erred in finding that the 1916 Act was inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4.1, 5.1, 5.2, 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*.

135. With the exception of the finding of inconsistency with Article VI:2 of the GATT 1994, the United States appeals these findings of inconsistency on the sole basis that the 1916 Act does not fall within the scope of application of Article VI and

⁷⁰ *Supra*, footnote 4.

⁷¹ EC Panel Report, *supra*, footnote 1, para. 6.165. See also Japan Panel Report, *supra*, footnote 2, para. 6.184. We note that the Panel frequently referred to the concept of "transnational price discrimination". It should be stressed that "transnational price discrimination", i.e., a difference in price between two markets, is a broader concept than "dumping" as defined in Article VI:1 of the GATT 1994. Unlike transnational discrimination, "dumping" requires *importation*, and a lower price in the *import market* than in the export market or relevant third country market. Dumping is always transnational price discrimination, but transnational price discrimination is not always dumping. We are, therefore, of the opinion that the Panel's use of the term "transnational price discrimination" in its findings is problematic, and deserves specific mention.

the *Anti-Dumping Agreement* and that the Panel, therefore, erred in making these findings of inconsistency. These findings of inconsistency, thus, stand or fall along with the Panel's findings regarding the scope of application of Article VI of the GATT 1994 and the *Anti-Dumping Agreement*. Since we have upheld the Panel's conclusion that the 1916 Act falls within the scope of application of Article VI and the *Anti-Dumping Agreement*, we also uphold these findings of inconsistency of the Panel.

136. As regards the Panel's finding that the 1916 Act is inconsistent with Article VI:2 of the GATT 1994, the United States argues that Article VI:2 only regulates the imposition of anti-dumping duties, and that other measures to counteract dumping are not addressed by Article VI:2.

137. As we have concluded above, Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to "specific action against dumping". Article VI, and, in particular, Article VI:2, read in conjunction with the *Anti-Dumping Agreement*, limit the permissible responses to dumping to definitive anti-dumping duties, provisional measures and price undertakings. Therefore, the 1916 Act is inconsistent with Article VI:2 and the *Anti-Dumping Agreement* to the extent that it provides for "specific action against dumping" in the form of civil and criminal proceedings and penalties.

138. With the caveat that Article VI:2 must be read together with the relevant provisions of the *Anti-Dumping Agreement*, we, therefore, agree with the conclusion of the Panel that:

... by providing for the imposition of fines or imprisonment or for the recovery of treble damages, the 1916 Act violates Article VI:2 of the GATT 1994.⁷²

VII. THIRD PARTY RIGHTS

139. The European Communities and Japan contend that the Panel erred in refusing to grant "enhanced" third party rights to Japan in the case brought by the European Communities, and to the European Communities in the case brought by Japan.

140. The rules relating to the participation of third parties in panel proceedings are set out in Article 10 of the DSU, and, in particular, paragraphs 2 and 3 thereof, and in paragraph 6 of Appendix 3 to the DSU.

141. Article 10.2 of the DSU states:

Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (referred to in this Understanding as a "third party") shall have an opportunity to be heard by the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.

142. Article 10.3 of the DSU states:

Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel.

⁷² EC Panel Report, *supra*, footnote 1, para. 6.204; Japan Panel Report, *supra*, footnote 2, para. 6.230.

143. Paragraph 6 of Appendix 3 to the DSU provides:

All third parties which have notified their interest in the dispute to the DSB shall be invited in writing to present their views during a session of the first substantive meeting of the panel set aside for that purpose. All such third parties may be present during the entirety of this session.

144. Although the European Communities and Japan invoke Article 9 of the DSU, and, in particular, Article 9.3, in support of their position, we note that Article 9 of the DSU, which concerns procedures for multiple complaints related to the same matter, does not address the issue of the rights of third parties in such procedures.

145. Under the DSU, as it currently stands, third parties are only entitled to the participatory rights provided for in Articles 10.2 and 10.3 and paragraph 6 of Appendix 3.

146. Article 12.1 of the DSU states:

Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.

Pursuant to Article 12.1, a panel is required to follow the Working Procedures in Appendix 3, unless it decides otherwise after consulting the parties to the dispute.

147. In support of their argument that the Panel should have granted them "enhanced" third party rights, the European Communities and Japan refer to the considerations that led the panel in *European Communities - Hormones* to grant third parties "enhanced" participatory rights, and stress the similarity between *European Communities - Hormones* and the present cases.

148. The Panel in the present cases gave the following reasons for refusing to grant the European Communities and Japan "enhanced" participatory rights in the panel proceedings:

... We conclude from the reports in the *EC - Hormones* cases that enhanced third party rights were granted primarily because of the specific circumstances in those cases.

We find that no similar circumstances exist in the present matter, which does *not* involve the *consideration of complex facts or scientific evidence*. Moreover, *none* of the parties requested that the panels *harmonise their timetables or hold concurrent deliberations* in the two procedures (WT/DS136 and WT/DS162). In fact, the European Communities was not in favour of delaying the proceedings in WT/DS136 and the United States objected to concurrent deliberations. ... (emphasis added)⁷³

149. In our Report in *European Communities - Hormones*, we stated:

Although Article 12.1 and Appendix 3 of the DSU do not specifically require the Panel to grant ... ["enhanced" third party

⁷³ EC Panel Report, *supra*, footnote 1, paras. 6.33 - 6.34. See also Japan Panel Report, *supra*, footnote 2, paras. 6.33 - 6.34.

rights] to the United States, we believe that this decision falls within the sound discretion and authority of the Panel, particularly if the Panel considers it necessary for ensuring to all parties due process of law.⁷⁴

150. A panel's decision whether to grant "enhanced" participatory rights to third parties is thus a matter that falls within the discretionary authority of that panel. Such discretionary authority is, of course, not unlimited and is circumscribed, for example, by the requirements of due process. In the present cases, however, the European Communities and Japan have not shown that the Panel exceeded the limits of its discretionary authority. We, therefore, consider that there is no legal basis for concluding that the Panel erred in refusing to grant "enhanced" third party rights to Japan or the European Communities.

VIII. ARTICLES III:4 AND XI OF THE GATT 1994 AND ARTICLE XVI:4 OF THE WTO AGREEMENT

151. Before the Panel, the European Communities and Japan submitted that the 1916 Act is inconsistent with Article III:4 of the GATT 1994 and Article XVI:4 of the *WTO Agreement*. Japan also claimed that the 1916 Act is inconsistent with Article XI of the GATT 1994. The Panel found that:

... we are entitled to exercise judicial economy and decide not to review the claims of [the European Communities and] Japan under Article III:4 of the GATT 1994.⁷⁵

...

... we are entitled to exercise judicial economy and decide not to review the claims of Japan under Article XI.⁷⁶

152. With respect to the alleged violations of Article XVI:4 of the *WTO Agreement*, the Panel held, in the EC Panel Report:

We therefore find that, by violating Articles VI:1 and VI:2 of the GATT 1994, the 1916 Act violates Article XVI:4 of the Agreement Establishing the WTO.⁷⁷

In the Japan Panel Report the Panel found:

... that by violating provisions of Article VI of the GATT 1994, the United States violates Article XVI:4 of the WTO Agreement.⁷⁸

153. In their joint other appellant's submission, the European Communities and Japan ask us to rule that the 1916 Act is inconsistent with United States' obligations under Articles III:4 and XI of the GATT 1994 and Article XVI:4 of the *WTO Agreement*. With respect to Articles III:4 and XI of the GATT 1994, their requests are con-

⁷⁴ Appellate Body Report, *European Communities – Hormones*, *supra*, footnote 24, para. 154.

⁷⁵ Japan Panel Report, *supra*, footnote 2, para. 6.272. See also EC Panel Report, *supra*, footnote 1, para. 6.220.

⁷⁶ Japan Panel Report, *supra*, footnote 2, para. 6.281.

⁷⁷ EC Panel Report, *supra*, footnote 1, para. 6.225.

⁷⁸ Japan Panel Report, *supra*, footnote 2, para. 6.288.

ditioned on our reversal of the Panel's findings that the 1916 Act falls within the scope of Article VI of the GATT 1994 and the *Anti-Dumping Agreement*. With respect to Article XVI:4 of the *WTO Agreement*, their requests are conditioned on our reversal of the Panel's findings with respect to jurisdiction and the distinction between mandatory and discretionary legislation. Since, however, the conditions on which these requests are predicated have not been fulfilled, there is no need for us to examine the conditional appeals of the European Communities and Japan.

154. For these reasons, we decline to rule on the conditional appeals of the European Communities and Japan relating to Articles III:4 and XI of the GATT 1994 and Article XVI:4 of the *WTO Agreement*.

IX. FINDINGS AND CONCLUSIONS

155. For the reasons set out in this Report, the Appellate Body:

- (a) upholds the Panel's conclusion that it had jurisdiction to consider claims that the 1916 Act as such is inconsistent with United States' obligations under Article VI of the GATT 1994 and the *Anti-Dumping Agreement*;
- (b) upholds, to the extent it found it necessary to consider the issue, the Panel's interpretation and application of the distinction between mandatory and discretionary legislation;
- (c) upholds the Panel's findings that Article VI of the GATT 1994 and the *Anti-Dumping Agreement* apply to the 1916 Act;
- (d) upholds the Panel's findings in the EC Panel Report that the 1916 Act is inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4 and 5.5 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*;
- (e) upholds the Panel's findings in the Japan Panel Report that the 1916 Act is inconsistent with Articles VI:1 and VI:2 of the GATT 1994, Articles 1, 4.1, 5.1, 5.2, 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement* and Article XVI:4 of the *WTO Agreement*;
- (f) upholds the Panel's refusal to grant "enhanced" third party rights to Japan in the case brought by the European Communities, and to the European Communities in the case brought by Japan; and
- (g) declines to rule on the conditional appeals of the European Communities and Japan relating to Articles III:4 and XI of the GATT 1994 and Article XVI:4 of the *WTO Agreement*.

156. The Appellate Body *recommends* that the DSB request the United States to bring the 1916 Act into conformity with its obligations under Article VI of the GATT 1994 and the *Anti-Dumping Agreement*.