

GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

GPR/M/47

17 August 1992

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Committee on Government Procurement

MINUTES OF THE MEETING HELD ON 26 JUNE 1992

Chairman: Mr. D. Hayes (United Kingdom)

1. The following agenda was adopted:

A. Consideration of the Report of the Panel on the United States Procurement of a Sonar Mapping System (GPR.DS1/R);

B. Other Business.

- (i) Spanish entities list
- (ii) Portuguese entities list
- (iii) Greek entities list
- (iv) Liechtenstein
- (v) Modification of the entity list of the European Communities

A. Consideration of the Report of the Panel on the United States Procurement of a Sonar Mapping System (GPR.DS1/R)

2. The Chairman recalled that this was the second time the Committee considered the Report of the Panel since it had not been able to adopt the Report at its meeting of 13 May 1992. He asked whether the Committee this time could agree to the adoption of the Report.

3. The representative of the United States recalled that his government had been actively reviewing the Panel's findings and recommendations. In doing so, his country had contacted all the parties to the Agreement to gain a better appreciation of how each party read the Panel's findings, particularly vis-à-vis their own practice, and to determine how parties had interpreted the Agreement to date. In addition, his country had been reflecting further on the legal merits of the Panel's findings. The results of this review had confirmed his government's view that the Panel's interpretation of the Agreement did not square with the living interpretation of the Agreement. His delegation had also found that parties' interpretations of the implications of the Panel's findings varied widely, but with one common thread - almost nobody seemed to view these findings as having any relevance to their own practices. In reviewing the implementing measures of the parties to the Agreement his delegation had found one document which was particularly topical and which stated: "A problem of distinguishing supply contracts from public works contracts may arise in borderline cases, such as where construction materials are

supplied for a construction project and the supplier is also responsible for installing or incorporating them on sight. The question is decided, in line with the definition of procurement in the GATT Agreement on Government Procurement (Article I:1(a)) by the relative values of the goods and services elements in the contract. If the value of the goods to be supplied exceeds that of the services to be performed, then it is a supply contract. If on the other hand, the services included in the contract are construction or civil engineering works ... and their value exceed that of the goods, it is a public works contract." The source of this authoritative statement on the interpretation of the Agreement on Government Procurement was a December 1987 edition of the Official Journal of the European Communities. Further evidence of this interpretation on the part of the Communities existed. For instance, in document GPR/3/Add.10, the implementing measures of the United Kingdom stated: "The Agreement on Government Procurement does not apply to the following contracts: (a) works, services or leasing contracts". There was no qualification whatsoever to this stated exception. Conversations with Member State procurement officials confirmed that prior to 1989 the Agreement on Government Procurement was not applied to products associated with service contracts. In 1989, the Commission had initiated a change to this approach through a case it had taken to the European Court of Justice concerning the interpretation of Community law. The United States spokesman noted that a common theme in discussions with other parties was that they would abide by the Panel's decision, but that it was not the way they had interpreted the Agreement on Government Procurement up to now. The discussions with other parties on their interpretation of the Panel's findings had indicated fundamental differences in how they viewed the report's implications and had confirmed his government's worst fears. Member States of the Communities, for instance, appeared to view the report as adopting the Communities' concept of separability - a product was covered if it was separable from the service. During the Panel's review, the Communities had raised this theory. In their view, for instance, products used in the construction of a building were not covered by the Agreement because they were inseparable from the service of construction. The Panel's findings, however, had not adopted this distinction. The report stated that the Agreement on Government Procurement covered any procurement of products above the threshold by an entity covered by the Agreement, regardless of whether such purchases were merely a part of a service contract. This interpretation was unqualified. Although the Communities had proposed that the Panel adopt their concept of separability, the Panel had chosen not to. Under the Panel's reasoning, any product purchased under a service contract which was above the threshold was covered, unless it could be determined that the purchase was not government procurement. At the last meeting of the Committee the Communities representative had stated that the Panel's findings did not reach the question of bricks used in construction. The United States delegation disagreed with this. The Panel's reasoning certainly covered such sub-contracts. There was the possible exception for so called "non-government procurement" but the applicability of this provision was questionable. The United States delegate noted in passing that the Panel's report raised a large number of practical questions that the parties would be left to deal with. For instance, in looking at a service contract

involving the procurement of products, did one determine whether the threshold was met based on each individual product to be purchased or on total products purchased pursuant to the contract? In the case of procurement that only involved products - for instance, procurement of suites of office furniture - the threshold determination would be based on the total value of the contract, not on the value of each individual type of furniture. This would seem to suggest that in the case of a service contract one needed to add up all the products being purchased and treat them all as covered by the Agreement if the total value was above SDR 130,000. The United States spokesman was concerned that the Report created a loophole because it had made it more difficult to address informal means of discrimination. The problem was that should informal intervention by a government take place, it was all but impossible to uncover this under the Panel's concept of government control. The Agreement was clearly designed to address both formal and informal means of discrimination. This was why the two pillars of the Agreement were an obligation of non-discrimination and detailed procedures to ensure that this obligation was not circumvented. The Panel's reasoning fundamentally conflicted with this fact. He added that in further analysis of the legal reasoning behind the Panel's findings, his government had found that it irreconcilably contradicted the plain language of the Agreement. He illustrated this with the example of construction. The Report stated that the procurement of products above threshold were covered by the Agreement, irrespective of the legal structure of a contract. When a government signed a contract for the construction of a building it would be contracting for products and services. The value of the products would normally exceed the threshold. Since the government's contract for the purchase would be with the prime contractor, it would appear that according to the Panel's reasoning the goods element of such contracts would have to be covered by the Agreement. The question of how the prime contractor sub-contracted for the goods and whether the government exerted influence over this process became irrelevant. The question of whether such sub-contracts were public or private would also be irrelevant. The supplier of the goods to the government would be the prime contractor, whether it produced the goods itself or bought them from another firm. He argued that at the time an entity invited tenders on a public works contract, it had no way of knowing whether prospective bidders would be supplying all or some of the products involved from their own stocks or be purchasing them from sub-contractors. It followed that entities would therefore have to treat the entire contract as covered by the Agreement. While in theory the entity could divide the product and service portion of the contract and compete the former, in practice this would not be a generally workable procurement approach. One could argue that the entity could simply require that the prime contractor follow the requirements under the Agreement in its procurement of products. However, it was questionable whether this would meet such requirements. He further argued that because the national treatment provision in the Agreement explicitly stated that a government could neither discriminate against foreign goods nor suppliers, and because in the case of a contract involving sub-contracts, the supplier had to be considered to be the prime contractor because the contractual relationship was between it and the government, the prime contractor had to be selected in a manner consistent with the full

obligations of the Agreement, unless the products were purchased by the entity as a separate procurement. He concluded that it would not be possible to have effective national treatment at the sub-contractor level in the absence of such treatment at the prime contractor level. All in all, it appeared to his delegation that the practical effect of the Panel's reasoning would require that parties treat at least certain types of service procurement as covered by the Agreement in their entirety, which was irreconcilable with the Agreement's plain language.

4. The spokesman for the European Communities circulated to the Committee the written statement at Annex 1 commenting on the arguments put forward by the United States against the adoption of the Report at the previous meeting. (Points made by the United States in response to this statement are at Annex 2.) The representative of the Communities reiterated his request that the Report be adopted today. The delegate of Japan stated that his government was in favour of adoption of the Report. He noted that the Panel had taken account of the unique proprieties of this procurement case such as the imposition of a "Buy American" requirement by the United States government, in judging the directness of government involvement. He felt that the Panel Report should be seen as an observation on a particular procurement case, not as a general statement suggesting coverage or otherwise of procurement of goods incidental to service procurement contracts, under the present Agreement. The Japanese delegation supported the Panel's reasoning in determining what was government procurement (Article I:1(a)): by taking overall account of government expenditure, use, ownership and control over procurement. It was not his delegation's understanding that this report tried to present general parameters for determining the scope of the Agreement on Government Procurement. The Canadian delegate supported adoption of the Report at this meeting and stated that, based on the information provided in the Panel Report, and given the circumstances of the sonar mapping case, the conclusions reached by the Panel were appropriate and consistent with Canada's understanding of its obligations under the Agreement. He continued that it was important for the Committee to note that this Panel was asked to interpret the Agreement as it applied to a particular circumstance. The conclusions reached by the Panel did not in any way modify the existing Agreement; rather, they interpreted it. He warned that, therefore, one should be careful not to give too broad an interpretation to the Panel's decision. The Canadian delegate recalled that the Panel's analysis of the case had led it to a determination that the product sub-contract procurement in question was covered by the Agreement. In examining the Panel's decision, his delegation recognised that service contracts, per se, were not covered by the Agreement. But it was concerned by incidents, such as in the sonar mapping case, where a government exerted such influence over product procurement that it effectively turned an otherwise private procurement into government procurement and, in this particular instance, proceeded to apply very strong domestic preferences to that procurement. The principles of the Government Procurement Agreement should be maintained to ensure that this type of governmental influence over product sub-contracts did not impair the integrity of the Agreement.

5. The Canadian spokesman added that it was his delegation's view that requests for tenders for service contracts had to be limited to the identification of service or technical specifications, information requirements or service levels. Service contracts should be designed to provide services without governmental influence over any product sub-contracts. Members of the Agreement on Government Procurement should examine carefully why there would be a need in a service contract for governments to exert control over the sub-contract for a product procurement. Implementation problems could, in his delegation's view, be minimised with efforts to adhere to service specifications in a service contract. If government involvement was necessary in product sub-contracts, then the procurement would fall under the Agreement.

6. The delegate of Sweden, on behalf of the Nordic countries, concurred with the conclusions of the Panel. His delegation shared the view of the Panel that exceptions to the Agreement must be interpreted narrowly. When it came to the question of private or government procurement, it was quite clear to his delegation that the procuring company, Antarctic Research Associates, was not covered by the Agreement. However, the payment would be made with government money, the selection would be subject to the final approval of an Agreement-covered entity and the government would take title to the sonar mapping system. In addition, several non-technical requirements were imposed. In view of the strong links between the government and the procurement of the sonar mapping system it was, in his delegation's view, quite clear that this was a case of government procurement. The second question was whether the procurement of products incidental to a service contract was covered by the Agreement. He recalled that the Agreement stated that any procurement of products above the threshold was covered. That was the main principle. In addition to this, procurement of products below the threshold was also covered if the cost of the services incidental to the procurement of the product would bring the value of the contract above the threshold. The Agreement stated, furthermore, that services incidental to the supply of products were included only if their value did not exceed that of the product. The only exception was service contracts per se. However, his delegation agreed with the Panel's findings that this did not imply that products incidental to the supply of services would necessarily be excluded. As the Panel had pointed out, the view that procurement of products incidental to a service contract was excluded if the services were of a greater value, would be a derogation from the basic principle of the Agreement i.e. that any procurement of products was covered by the Agreement. He concluded that the Nordic countries supported the adoption of the Panel Report. The representative of Hong Kong stated that her delegation also supported the adoption of this Panel Report since it agreed with the Panel's findings; in particular it shared the Panel's view that product procurement - above threshold - incidental to service contracts, regardless of value, would be included under the coverage of the Agreement. The contrary would be a very large derogation from the principle that any procurement of products was covered. In her delegation's view, it would be very difficult to accept that such a derogation would be consistent with the intent of the text. She concurred with the argumentation of the Canadian and Nordic delegations. The delegate of Austria also agreed with the Panel findings

and supported adoption of the Report. He could subscribe to the interventions of Canada and the Nordic countries. The delegate of Israel also supported adoption of the Panel Report. In principle his delegation was in favour of adoption of panel reports unless there were grave exceptional circumstances like a major, fundamental mistake in the panel's findings and conclusions. He continued that although he had heard some very strong arguments he was not at this stage convinced that they demonstrated that such exceptional circumstances existed. He concurred with the argumentation of the Nordic and Canadian delegations. The spokesman of the United States stated that his government viewed the findings and conclusions of the Panel's Report to be fundamentally flawed. Today's discussion had offered no comfort with respect to these concerns. It had become clear that there was serious disagreement among the parties as to what the Panel had concluded. Under these circumstances his government was not in a position to agree to the adoption of the Report. His delegation remained willing to work within the Committee to attempt to come to a common understanding of what the Panel Report said and to craft an interpretation of the Report which would be reasonable and acceptable to all. His delegation was also prepared to discuss the broader questions raised by the Report in the context of the ongoing negotiations on improvement and expansion of the Agreement. In order to facilitate discussion of this Report in capitals, he furthermore proposed the derestriction of the Panel Report at this meeting.

7. The Chairman remarked that there was a growing convention in the GATT that the Council or Committees should adopt panel reports at their second consideration. He also noted that in certain recent cases a party to a dispute which did not wish to block adoption of a report had placed on record in the Minutes of the relevant meeting its reasons for disagreeing with it. In the light of this, he asked whether the Committee could proceed to the adoption of the Report of the Panel. The delegate from the United States reiterated that he was not in a position to agree to the adoption of the Panel Report for the reasons he had set out earlier. In response to a comment from his Canadian colleague he said that he would be willing to examine with other Members of the Agreement the general question why there would be a need in a service contract for governments to exert influence over product sub-contracting. Responding to the Nordic intervention he clarified that under United States national law the determining factor as to whether a contract was a service or a goods contract was the purpose of the contract. To determine subsequently whether the contract would fall under the obligations of the Agreement the preponderant value test would be applicable.

8. The Committee therefore noted that all signatories who had spoken apart from the United States supported the adoption of the Report of the Panel on the Procurement of a Sonar Mapping System.

B. Other Business

(a) Spanish entity list (document GPR/65 refers)

9. The delegate of the United States raised a point with regard to the Spanish entities list of the European Communities which was adopted

pursuant to a Committee decision taken at its meeting on 13 May 1992. He noted the fact that the Commission had a case pending before the European Court of Justice relating to Spain's implementation of the government procurement rules which appeared relevant to whether Spain was prepared to implement the Agreement. He expressed concern that the Communities had not brought this to the attention of the parties at the Committee meeting of 13 May 1992 and that the United States had now been forced to suspend its internal process for designating Spain as a party entitled to the benefits of the Agreement. He asked the Communities for clarification. The spokesman for the European Communities provided reassurances that the case before the European Court of Justice in no way prejudiced the rights of other Agreement parties and did not change the basis on which the Committee's decision of 13 May was made.

- (b) Modification of the entity list of the European Communities:
Entity list for Portugal (document GPR/63/Add.3 refers)

10. The spokesman for the European Communities recalled that a list of entities for Portugal had been circulated to the members of the Committee today with a view to the rights and obligations of the GPA becoming applicable to Portugal. He assured the Committee that the Portuguese authorities had taken steps to implement the rules. The Chairman proposed that the Committee adopt the same expedited procedure for acceptance of this list as it had adopted for the Spanish entity list at its meeting of 13 May 1992. The representatives of the United States and Canada said that they were not able to agree to this procedure today, in view of the very recent transmission of the Portuguese list, though the representative of Canada added that he did not foresee any substantive difficulty. The Chairman concluded that either the Committee would return to this matter at an early date or an alternative solution would be proposed.

- (c) Modification of the entity list of the European Communities:
Entity list for Greece (document GPR/63/Add.2 refers)

11. The spokesman for the European Communities recalled that a Greek entity list had been circulated to the members of this Committee on 17 February 1992 with a view to the rights and obligations of the Agreement on Government Procurement becoming applicable to Greece (document GPR/63/Add.2 refers). The Committee decided to adopt the same expedited procedure for the Greek entity list as the one it had adopted in relation to the Spanish entity list on 13 May 1992. To this effect it decided that the Greek entity list would be considered approved ten days from the date of this Committee meeting (i.e. on 6 July 1992) unless objections by parties had been received by the secretariat before that date; in the absence of such objections the Agreement on Government Procurement would be considered to apply between each Party and Greece as from sixty days after the date of approval of the list of entities for Greece (5 September 1992) or, in cases where the relevant national legislation implementing this Decision had not been enacted by that date, as soon as such enactment had taken place.

- (d) Addition of the Government of Liechtenstein to the Swiss entity list (document GPR/W/114 refers)

12. The delegate of Switzerland recalled that it had informed the Committee on 27 April 1992 of the addition to its entity list of the Government of Liechtenstein under Article IX:5(a) of the Agreement on Government Procurement. He added that his government did not ask for any compensation. At the 13 May Committee meeting, some signatories had asked whether the legally correct procedure in this case might not be the more elaborate one set out in Article IX:5(b). The GATT secretariat had, upon request by the Committee, prepared a legal opinion on this matter, which concurred with the Swiss proceedings (document GPR/W/114 refers). He invited reactions from other signatories. The Canadian spokesman stated that he could approve the Swiss request to modify its list of entities under the provisions of Article IX:5(a). The delegate of the United States found the legal opinion of the secretariat compelling and therefore his country could accept the change in the Swiss entity list based on Article IX:5(a). He noted that nevertheless it had not been immediately obvious to his government that it should have been applying the benefits of the Agreement to Liechtenstein. It would take a small amount of time to enact the implementing procedures in his country. He had understood, having spoken to his Swiss colleague, that he had their understanding on this point. He noted that Liechtenstein applied detailed procurement rules at a threshold of only SwF 10,000, which in his opinion was good news for the Agreement, especially in the light of the ongoing negotiations. The delegate of the Community also agreed with the analysis of the secretariat.

13. The Committee noted that the addition of the Government of Liechtenstein to Switzerland's list of covered entities had been correctly notified under Article IX:5(a). Since the criteria provided for under Article IX:5(a) for this change to become effective had been met, the Committee decided that the proposed addition to the Swiss entity list would be effective as from 26 June 1992.

- (e) Modification of the entity list of the European Communities pursuant to Article IX:5(b) (document GPR/63 refers)

14. The spokesman for the European Communities recalled that his delegation had circulated a modification of its entity list pursuant to Article IX:5(b) on 6 December 1991 (document GPR/63 refers). He was now in a position to provide written answers to a number of questions which had been put to his delegation on this list by the delegations of the United States and Canada, pertaining to the level of procurement. He confirmed that the twenty-three entities which were deleted from the EC's entity list had not had any procurement above the threshold in 1987, 1988 and 1989. However, the eighteen entities offered as compensation did have procurement above threshold in that same period ranging from SDR 2,500,000 to 7,800,000. In the light of the foregoing he requested adoption of this modification. It was so agreed (document GPR/66 of 7 July 1992 refers).

ANNEX 1

European Communities: Comments on United States
Talking Points Sonar Mapping Case

1. The Panel was asked to decide on a specific case: that of the procurement of a sonar mapping system for use in the US Antarctic Survey. It was not asked to decide on issues of principle.
2. In reaching its conclusions, the Panel considered two questions:
 - is the purchase of the sonar mapping system to be considered as public procurement?
 - if so, is the sonar mapping system excluded from Code coverage by being a "service contract per se"?

The Panel's answers refer therefore to the sonar mapping system in the particular circumstances surrounding its procurement. The European Community would have found either answer acceptable to the first question. The Panel followed the United States, which consistently insisted that this was indeed public procurement.

On the second, the Panel found that the public procurement of a product above the threshold was not a "service contract per se".

"... By contracting ... service functions to ASA, the NSF cannot alter its obligations under the Agreement in relation to the procurement of the product itself ... It made no difference whether the draft contract between ASA and the eventual supplier of the sonar mapping system was or was not a sub-contract of the service contract between the NSF and ASA. This was a mere question of form within the control of the NSF". (Paragraphs 4.22 and 4.23 of the Report).

3. The European Community finds those conclusions unsurprising. It sees no basis, in the Panel's reasoning, for the assertion by the United States authorities, in their "sonar mapping talking points" that "service sub-contracts are Code-covered".

Such a general statement is rejected by the Panel, whose conclusions refer to a specific case. Further, it notes that the United States authorities appear to confuse the NSF-ASA contract, whose legitimacy has not been challenged by the European Community, with the procedures for procurement of a sonar mapping system by ASA. It is this latter that has been found to be in breach of the Agreement.

4. Curiously, the United States talking points appear to envisage public procurement as falling into three categories - products, services and sub-contracts - of which only the first is Code-covered. The European Community sees no basis in the Code for such a threshold division.

5. Below, the European Community comments on some of the remarks made by the United States delegation during the last meeting of the Committee on Government Procurement on 13 May 1992 with respect to the possible adoption of the Panel Report on the Procurement of a Sonar Mapping System. These comments follow the order of the United States remarks, as contained in the (informally distributed) United States "talking points" document.

Alleged contradiction between the Trondheim and sonar mapping cases

6. There is no contradiction between the Trondheim and sonar mapping cases. Both panels interpret certain exceptions restrictively, but they are different exceptions. The Sonar Mapping case was concerned with the coverage of the GPA as a whole; the Trondheim case concerns one of the single tendering exceptions. Therefore a different methodology in arriving at a restrictive interpretation is acceptable. Moreover, if one were to accept the United States "purpose" test and apply it to the sonar mapping case, then the purpose of the contested ASA call for tender was very clear: to procure a product.

Textual arguments

7. All the textual arguments advanced in the United States talking points relating to Article I:1(a) (service contracts per se) and Article V of the GPA have been extensively represented in the Panel's Report and have been rejected by the Panel. The Committee on Government Procurement is not an appeal body and should not redo the Panel's discussion.

The United States now adds a historical argument based on a draft text which is clearly far removed from the final version of the text. This is of little value for the interpretation of what came out at the end of the negotiation.

The so-called "living interpretation" of the Code

8. This argument was made by the United States during the Panel procedure. Since the United States then, as now, admitted that failure to exercise certain rights does not extinguish those rights, the Panel did not see fit to come to this issue. Rightly so.

Even if the "living" practice of the parties were to corroborate that they consciously intended to keep a loophole open - which the Community does not believe - the Panel has now closed it. It would be outrageous on the part of this Committee to re-open it.

Coverage of sub-contracts

9. Here the United States stands the Panel's reasoning on its head by saying "having concluded that service sub-contracts are Code-covered, (the Panel) then turns around and says that most of these sub-contracts are not Code-covered because they are not government procurement".

The Panel's logic is precisely the other way around: first, the Panel took the position that "the purchase by service contractors of products they need in order to be able to render the services contracted for would not normally be government procurement." (Paragraph 4.8)

Secondly, the Panel decided that because of certain specific factors the procurement of the sonar mapping system was government procurement by the NSF. (Paragraph 4.9 - 4.13).

Finally, the Panel concludes that the NSF, as a covered entity, cannot escape or alter its obligations as to the procurement of products by contracting certain service functions to a private (non-covered) company.

The Panel, therefore, has never concluded that "service sub-contracts are Code-covered". It has concluded rather that transactions which in reality are Code-covered product procurements cannot be hidden behind the veil of a service sub-contract.

Is this public procurement?

10. The United States criticises the four factors the Panel has used in order to decide that there was government procurement in this case, and in particular the fourth criterion, the existence of effective government control over the obtaining of the product. The United States complains that this issue has not sufficiently been aired before the Panel. This is demonstrably untrue. The whole discussion about the relationship between the NSF and ASA, which covers over five pages in the Panel Report (pages 6-11), was largely about the degree of control exercised by a covered entity over its sub-contractor.

Further the United States complains that more subtle forms of control are not covered by the four factors. However, the Panel was asked to examine a specific case. Its four factors are sufficient for the case in question. The Panel has left open the possibility that criteria could be developed in future cases. It is too much to ask that one panel resolve every possible case at once.

Other issues on public versus private procurement

11. The United States criticises the "government money" criterion advanced by the Panel and its application to cost-plus versus lump sub-contract. The United States makes the mistake of regarding this as the decisive criterion. The Panel has clearly said that none of the four factors is in itself decisive.

The United States criticism of the Panel's treatment of the so-called "cost plus award fee contract" is also overdone. On the basis of the United States own statement (reproduced in paragraph 3.14) about the cost risk falling on the United States government and the need for the NSF to exercise cost control (presumably for its own protection and not to increase the profit for the sub-contractor) the Panel's conclusion that ASA

had not much of a profit motive or commercial risk in this transaction is reasonable.

A new loophole?

12. There is no new loophole opened by the Panel's Report. If a so-called sub-contract or upstream contract of a government procurement contract (whether it is for services or products) is purely private transaction, it will be covered by Article III:4 of the GATT. No "buy national" provision could escape from Article III in such a situation.

The practical application of the Panel Report

13. The United States has been able to impose FAR rules and a Buy American requirement on the procurement in question; it is hard to understand why it would be more difficult to impose non-discriminatory rules compatible with the Code or to leave the procurement to the service provider, without interference.

Finally, the United States complains that the Panel Report might create complications for the negotiations on the extension of the coverage of the Code. If the result of this Panel is to bring to light certain ambiguities in texts which are still under negotiation, that is only to the good. We still have the possibility to clarify these texts further and should not reject the Panel Report in order to be able to maintain these ambiguities. That would amount to executing the bringer of bad news.

14. To the Community, however, the Panel does not bring bad news at all; it is a good Panel Report which closes a major (potential) loophole in the GPA and which can be respected by procurement authorities without great practical difficulties. The Panel's Report should, therefore, be adopted.

ANNEX 2

United States: Response to EC Comments on
United States Talking Points

1. The Panel decided a specific case

It is true that the Panel was only asked to decide a specific case.

However, in order to reach its conclusions the Panel, as is normal, had to interpret the Code.

The Panel's interpretations in this case, also as is normal, will be looked to by future panels handling similar questions.

The question in this case, and the implications of the Panel's findings, are in no way narrow.

The Panel was called upon to decide how to interpret the fact that Article I:1(a) states that service contracts per se are not covered while also stating that all products are covered.

They basically had two choices:

(1) to decide that this language meant that service contracts in their entirety, including goods elements, are not subject to the Code; or

(2) to decide that the earlier language of the provision stating that all product purchases are covered by the Code is controlling and, thus, products procured under a service contract are covered.

The Panel unambiguously chose the second option.

In the Panel's own words:

"... the exclusion of service contracts per se cannot be taken to mean the exclusion of any product above threshold procured through them [meaning service contracts] by covered entities ..."

This is a line of reasoning with far-reaching consequences and to say that these consequences do not exist because the Panel was dealing with a specific case simply ignores the reality of the GATT dispute settlement process.

2. What did the Panel consider?

The EC suggests that in reaching its conclusion the Panel considered two questions;

(1) was the purchase "government procurement"? and

- (2) is the sonar mapping system excluded from Code coverage by being a service contract per se?

The first point is correct.

However, the second point is a serious distortion of what the Panel considered.

At no time did the United States ever suggest that the purchase by the NSF's prime contractor of a sonar mapping system was a service contract.

What we argued was that the NSF's contract with ASA for Antarctic support services was a service contract and that ASA's purchase of a sonar mapping system was one small element of this service contract. (The EC, in fact has stated that it agrees that the prime contract is a services contract.)

We pointed out to the Panel that almost all service contracts involve products in some way but noted the Code's statement that service contracts per se are not covered means that all elements of a services contract are not covered.

The Panel disagreed.

The EC had argued before the Panel, as recorded in para. 4.23, that the sonar mapping system was not really a part of the service contract between the NSF and ASA. However, as recorded in the same paragraph, the Panel decided not to even reach this question since they viewed it as irrelevant to their decision.

The Panel stated that all that was relevant was that it was a government procurement of a good above the threshold.

We find it disturbing to see the EC distort the Panel's conclusions and have to wonder if it reflects some unease on their part with the conclusions.

3. The EC sees no basis for the statement that the Panel finds service sub-contracts to be Code-covered

First of all, the Panel in this case did find that a service sub-contract was Code-covered. It chose not to even consider the EC's contention that the sonar mapping purchase was not really a subcontract.

Secondly, the Panel's own words clearly state that sub-contracts are covered.

Again to quote the Panel, it stated that:

"... the exclusion of service contracts per se cannot be taken to mean the exclusion of any product above threshold procured through them by covered entities ..."

The Panel says that if you procure goods through a service contract, they are covered - that is exactly what happens in a sub-contract.

The Panel goes on to state that not all sub-contracting can be considered government procurement.

However, the implications of this reasoning are far from clear.

It would seem to us that when a service contract unambiguously requires the provision of products, as for instance is the case in construction, a government must be considered to be procuring goods (the bricks, steel etc.) through a service contract.

As this is called for in the contract between the government and the prime contractor it will always be considered government procurement. The status of sub-contracts is irrelevant.

Where the service contract does not clearly call for the provision of products the situation is less clear, but since the Code applies to leasing as well as purchases, the potential questions and permutations are mind-boggling.

4. The United States sees three categories of procurement?

This is patently untrue.

We see two categories of contracts - goods and services.

Goods contracts are covered by the Code and service contracts, in their entirety, are not.

It is the Panel that seems to believe there to be three categories of contracts - goods, goods portions of service contracts, and service contracts.

We agree with the EC that there is no basis in the Code for a threefold division.

5. Sonar and Trondheim are different

The EC misreads the conclusions of the Panel in the Trondheim case.

Norway argued in that case that the toll ring procurement was an R&D contract (a service contract) and that the toll stations, therefore, were simply prototypes within the meaning of Article V:16(e).

In support of its reasoning the Government of Norway provided data indicating that the preponderant value of what the contractor was being paid to perform was R&D.

The Panel said that Article V:16(e) was not applicable because the toll ring contract was not an R&D/service contract.

In reaching this conclusion the Panel stated that one had to examine the principle purpose of the contract.

Since the Panel agreed with us that the principle purpose of this contract was the procurement of a product (the toll ring) as opposed to knowledge, it in effect determined that the relative values of goods and services (R&D) that were being delivered under the contract were not relevant.

In our statement at the last meeting we simply pointed out that the Panel's approach in this case showed that the Sonar Panel was incorrect in its stated assumption that the only alternative to its findings was adopting a predominant value rule.

6. The Committee is not an appeals body

The Committee is, in fact, the court of final appeal under the current dispute settlement structure.

It is not simply a rubber stamp mechanism.

As noted in para. 11 of the secretariat's informal note on the remedies issue: "Panels are not empowered to make recommendations or rulings, but only to make such findings as will assist the Committee in doing so".

The Committee is in no way required to accept the findings or reasoning of a panel report.

As a matter of practice, GATT bodies generally do accept panel findings and we do not question that this is an important and positive aspect of GATT practice.

Nevertheless, parties retain the right to argue that the Committee should not adopt a panels findings.

In the exceptional case where such arguments are well-founded, the Committee can and should give serious consideration to not adopting panel findings or adopting them with alterations.

In our view, this is just such an exceptional case.

7. The earlier draft is too far removed to be relevant

We agree that the first draft appeared much earlier in time than the final text of the Code.

Nevertheless, if one looks at the language of both versions, it is clear that the final version was nothing more than a reworking of the original version to read more clearly.

There was no serious disagreement during the course of the negotiations as to the substance of the provision.

In our view the current wording of the text is quite clear on the issue of coverage of service contracts. The first draft simply reinforces our argument as to its interpretation.

8. So what if the Parties intentionally left a loophole?

Make no mistake, the drafters of the Code intentionally left a loophole when they decided not to cover services. Notwithstanding this Panel Report, as long as the Code does not cover service contracts per se, there will be many ways for parties to evade their responsibilities under the Code.

We strongly support efforts to close this loophole through the Code renegotiations.

Nevertheless we find it astounding to hear the EC say that even if it was the intention of the drafters of the Code not to cover service contracts, it is appropriate for the Panel to close this loophole.

It is an accepted legal principle that panels are expected to interpret the plain words of an Agreement in light of the intentions of the drafters.

Panels have no authority to fix inadequacies in the texts of such Agreements.

The 1982 Ministerial Declaration states:

"It is understood that decisions in this [dispute settlement] process cannot add to or diminish rights and obligations provided in the GATT".

In our view, this Panel has quite clearly proposed findings that add to rights and obligations provided under the Code.

When the United States offered its entity list and signed the Code, we did so based on the understanding, which the record shows was generally held, that service contracts in their entirety fell outside the Code.

The Code is based upon a balance of negotiated concessions that includes not only each country's entity list but the shared understanding of how the Code would apply to such entities.

It is unacceptable to us for the EC to suggest that the Panel can change this balance of obligations because it sees an imperfection in the Code.

Contrary to the EC's view, we would argue that if the Panel has legislated as opposed to interpreted the Agreement, as we believe to be the case, the Committee has a responsibility not to let this stand.

9. Coverage of sub-contracts

The EC notes that the Panel Report first states that service sub-contracts are normally not covered by the Code because they are private transactions and then goes on to say that this particular case was government procurement and thus covered.

While this is correct, the conclusion that the EC draws from this set of facts is incorrect.

The Panel obviously felt compelled to deal with the EC's argument over public versus private first because they had to determine if government procurement was involved before deciding whether it was necessary to interpret the Code.

The Panel determined that the contract in question was government procurement - which to us was a discovery of the obvious.

It then went on to interpret Article I:1(a) of the Code to mean that product elements of service contracts are Code-covered, in effect, unless you can argue that they are private procurement.

There are different ways of interpreting the Panel's statement that sub-contracting by service contractors is generally not government procurement. We ourselves find it perplexing.

On the one hand, it could simply be saying that in most cases service contracts are between private operators and therefore their sub-contracts have nothing to do with government procurement or that any relationship to a government procurement is remote at best.

This would be a truism.

Another possibility is that the Panel is saying that, in practice, most sub-contracts of clearly government procurement contracts will not be considered government procurement.

It is our impression that many of you subscribe to this second possibility and take some comfort from it.

However, we find it hard to believe that this is what the Panel meant because they in no way possessed the qualifications to make such a judgment.

The three panelists are trade policy experts, not procurement officials.

They have no knowledge of the way all the parties to the Agreement, and perhaps their own governments, structure their many and various types of service procurements involving goods.

They themselves stated that they were not trying to set out definitive criteria as to what constitutes government vs. private procurement.

In the absence of such definitive criteria, it is hard to imagine that the Panel would have felt qualified to make a sweeping statement that would seem to indicate that most parties' sub-contracting practices meet necessary criteria to be considered private.

Therefore, I would advise those of you who take comfort from this interpretation to think again. The true implications of this section of the Panel's findings would only become clear in the light of the numerous future disputes that would be engendered by the adoption of this Report. No one should assume for a second that they are not at risk.

10. Is this public procurement?

The EC misstates our point with regard to the Panel's fourth criterion.

What we said is that the Panel derived its criterion of "control" by interpreting the wording "by the entities" in Article I:1(a).

This interpretation was neither proposed by the United States nor the EC, or suggested by the Panel during the Panel's hearings.

In our view these words cannot be interpreted to hold the meaning ascribed to them by the Panel and we regretted that there had been no opportunity to discuss it with them.

11. Subtle forms of control

In raising the issue of subtle forms of control, we were not implying that the Panel was in any way responsible for making findings beyond the case at hand.

We pointed out that the Code was specifically and quite obviously designed to deal with both formal and informal means of discrimination.

We further pointed out that the Panel's introduction of the concept of control was fundamentally at odds with this fact because there is no way that a test such as control could be used to pick up subtle forms of discrimination.

It would flow from this that the Panel's findings are seriously flawed because they fail to take into account the clear intent of the drafters to deal with formal and informal means of discrimination.

12. Government money

There is no question in our mind that use of government money is one of the key characteristics of a government procurement.

However, the Panel went further and reached the conclusion, which they apparently viewed as significant to the case, that because the contract was a cost-plus contract the money "remained government money."

We were perplexed by the implication that if it had not been a cost-plus contract, the sub-contract might not have been viewed by the Panel as involving government money.

We would see no logic to such a distinction.

13. A new loophole?

The EC says that we should not worry about a new loophole because whatever the Code does not cover will be picked up by GATT Article III.

The EC does not understand our argument.

First, the EC makes an assumption that because the Committee on Government Procurement decides a practice not to be government procurement that a GATT panel would necessarily decide that the procurement exception of GATT Article III:8(a) could not be invoked.

This is wrong. GATT Article III has its own words, in its own context and its own negotiating history.

What we do here in this Committee cannot be assumed to be in any way determinative of how a GATT panel will decide a case on Article III.

Just looking around this room we can see a number of countries who would be in trouble if a GATT panel interpreted Article III:8(a) in line with this Panel's findings.

Moreover, it is our view that Article III was not designed to deal with the unique means of discrimination that are available when a government is not only the regulator but also the customer.

14. Practical application

The EC makes the facile claim that if the United States can impose FAR rules and place "Buy American" restrictions on the purchase in question it should be an easy matter to impose non-discriminatory rules or leave the procurement to the service provider.

First of all, our concern regarding the impracticability of implementing the Panel's findings goes far beyond the instant case.

As we have said before, we would have to be incredibly naive to assume that this case will not engender further cases seeking to build on and extend the Panel's reasoning.

Looking at the EC's ideas in turn, we are not at all confident that, in effect, sub-contracting our Code obligations to a prime contractor would meet the obligations of the Code.

The prime contractor, in strict legal terms, will be the supplier of the sonar mapping system to the government, albeit as a small part of a service contract. In our view, it would be necessary to recompute the entire prime contract under the Code in order to ensure that no questions would arise.

Further, while no one questions that Buy National restrictions raise serious questions of economic policy, it would also be questionable to require governments to more generally interfere in the procedures chosen by contractors in making their purchases.

The EC's suggestion would create contingent liabilities that no government would intentionally bring upon itself and substantial inefficiencies in the procurement process.

We have spend a good deal of time with our procurement officials since the last meeting of the group.

They view implementation of the Panel's findings as a nightmare from the perspective of the efficient and effective operation of the procurement process.

In conversations with procurement officials from a number of other parties to the Agreement, we have picked up similar concerns.

As a matter of sound procurement policy our procurement experts are not sure that it is even possible to find a way to implement the Panel's rulings without covering in their entirety all prime contracts involving goods valued at above the threshold.

14. Complications for the negotiations

We did not say that we were concerned that the Panel's findings will complicate the renegotiations.

What we were suggesting was that we found it hard to imagine why parties would be proposing the wide disparity in threshold levels between goods, services and construction contracts that we have seen in the renegotiations if they interpreted the Agreement the way the Panel does.

Why propose an SDR 4.5 million threshold for construction if you expect that all or any construction sub-contracts will be subject to an SDR 130,000 threshold?

Again we see this as evidence of the living interpretation of the Code.