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## **1 ARTICLE 10**

### **1.1 Text of Article 10**

#### **Article 10**

##### *Application of Article VI of GATT 1994<sup>35</sup>*

Members shall take all necessary steps to ensure that the imposition of a countervailing duty<sup>36</sup> on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated<sup>37</sup> and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

*(footnote original)*<sup>35</sup> The provisions of Part II or III may be invoked in parallel with the provisions of Part V; however, with regard to the effects of a particular subsidy in the domestic market of the importing Member, only one form of relief (either a countervailing duty, if the requirements of Part V are met, or a countermeasure under Articles 4 or 7) shall be available. The provisions of Parts III and V shall not be invoked regarding measures considered non-actionable in accordance with the provisions of Part IV. However, measures referred to in paragraph 1(a) of Article 8 may be investigated in order to determine whether or not they are specific within the meaning of Article 2. In addition, in the case of a subsidy referred to in paragraph 2 of Article 8 conferred pursuant to a programme which has not been notified in accordance with paragraph 3 of Article 8, the provisions of Part III or V may be invoked, but such subsidy shall be treated as non-actionable if it is found to conform to the standards set forth in paragraph 2 of Article 8.

*(footnote original)*<sup>36</sup> The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

*(footnote original)*<sup>37</sup> The term "initiated" as used hereinafter means procedural action by which a Member formally commences an investigation as provided in Article 11.

### **1.2 Footnote 35**

1. The Panel in *India – Export Related Measures* pointed out that "[w]hile footnote 35 of the SCM Agreement makes it clear that the provisions of Part II and III 'may' be invoked in parallel

with the provisions of Part V, there is no suggestion that Parts II and V *must* always be invoked in parallel."<sup>1</sup>

### 1.3 Footnote 36

#### 1.3.1 "offsetting"

2. Discussing the premise that "no countervailing duty may be imposed absent (countervailable) subsidization"<sup>2</sup>, the Panel in *US – Lead and Bismuth II* considered that this premise "underlies the very purpose of the countervailing measures envisaged by Part V of the SCM Agreement."<sup>3</sup> The Panel continued with the statement that "footnote 36 of Article 10 does not envisage the imposition of countervailing duties when no (countervailable) subsidy is found to exist, for in such cases there would be no (countervailable) subsidy to 'offset'."<sup>4</sup>

3. In *US – Countervailing Measures on Certain EC Products*, the Panel noted that Article VI:3 of the GATT 1994 and Article 10, footnote 36 of the SCM Agreement refer to countervailing duties as "special duties" levied for the purpose of "offsetting" a subsidy. Furthermore, the Panel found that countervailing duties are not designed to counteract all market distortions or resource misallocations which might have been caused by subsidization.<sup>5</sup>

#### 1.3.2 "any subsidy bestowed directly or indirectly upon the manufacture": pass-through of benefit from subsidized inputs

4. In *US – Softwood Lumber IV*, in examining the "pass-through" issue, the Appellate Body quoted *inter alia* Article 10, footnote 36 of the SCM Agreement as one of the relevant legal provisions. The Appellate Body stated that the phrase "subsid[ies] bestowed ... *indirectly*," as used in Article VI:3 of the GATT 1994, implies "that financial contributions by the government to the production of *inputs* used in manufacturing products subject to an investigation are not, in principle, excluded from the amount of subsidies that may be offset through the imposition of countervailing duties on the *processed product*."<sup>6</sup> Moreover, the Appellate Body stated:

"In our view, it would not be possible to determine whether countervailing duties levied on the processed product are *in excess* of the amount of the total subsidy accruing to that product, without establishing whether, and in what amount, subsidies bestowed on the producer of the input flowed through, downstream, to the producer of the product processed from that input. Because Article VI:3 permits *offsetting* through countervailing duties no more than the subsidy determined to have been granted ... directly or indirectly, on the manufacture [or] production ... of such *products*, it follows that Members must not impose duties to offset an amount of the input subsidy that has not passed through to the countervailed processed products. Rather, '[i]t is only the amount by which an indirect subsidy granted to producers of inputs flows through to the processed product, together with the amount of subsidy bestowed directly on producers of the processed product, that may be offset through the imposition of countervailing duties.'"<sup>7</sup>

5. In *US – Ripe Olives from Spain*, the Panel stated that an investigating authority's discretion in establishing the pass-through of subsidies is not unlimited, and that it should provide the analytical basis for its findings in this regard:

"[T]he discretion afforded to an investigating authority under Article VI:3 for the purpose of establishing the pass-through of subsidies is not unfettered. As already noted, pursuant to Article VI:3 an investigating authority is required to analyse to what extent direct subsidies on inputs may have indirectly flowed to the processed

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<sup>1</sup> Panel Report, *India – Export Related Measures*, para. 7.215.

<sup>2</sup> Panel Report, *US – Lead and Bismuth II*, para. 6.56.

<sup>3</sup> Panel Report, *US – Lead and Bismuth II*, para. 6.56.

<sup>4</sup> Panel Report, *US – Lead and Bismuth II*, para. 6.56.

<sup>5</sup> Panel Report, *US – Countervailing Measures on Certain EC Products*, paras. 7.41-7.43.

<sup>6</sup> Appellate Body Report, *US – Softwood Lumber IV*, para. 140.

<sup>7</sup> Appellate Body Report, *US – Softwood Lumber IV*, para. 141. For a discussion of this case law, see the Panel Report, *Mexico – Olive Oil*, paras. 7.130-7.142.

investigated product where the respective producers operate at arm's length and which therefore may be included in the determination of the estimated total amount of subsidies bestowed on the investigated product. In our assessment, this means that an investigating authority must provide an *analytical basis* for its findings of the existence and extent of pass-through that takes into account *facts and circumstances* that are *relevant* to the exercise and that are directed to ensuring that any countervailing duty imposed on the downstream product is not in excess of the total amount of subsidies bestowed on the investigated product. Thus, we do not understand an investigating authority's discretion in evaluating the pass-through of subsidies under Article VI:3 to be so wide as to permit it to exclude any consideration of facts and circumstances that may be relevant to the very analysis that it must perform."<sup>8</sup>

6. Based on this reasoning, the Panel found that the relevant part of the respondent's domestic law on this issue was inconsistent with Article VI:3 of the GATT 1994 and Article 10 of the SCM Agreement and that its application in the challenged investigation was also inconsistent with these provisions:

"We have found above that Section 771B is inconsistent as such with Article VI:3 of the GATT 1994 and Article 10 of the SCM Agreement, because it directs the USDOC to *presume* the existence of pass-through between raw and processed agricultural products, whenever the two factual circumstances it prescribes are established, and to *avoid* consideration of additional factors that may potentially be relevant. We found this inconsistent with the obligations in Article VI:3 and Article 10 to establish the existence and extent of indirect subsidization (i.e. pass-through) taking into account facts and circumstances that are relevant to that exercise. As we already explained, this follows from the operation of the law itself. In view of this, we find the USDOC's determination in the ripe olives investigation to be inconsistent with Article VI:3 and Article 10 for the same reasons that Section 771B is inconsistent "as such" with those same provisions."<sup>9</sup>

#### **1.4 Footnote 37: "initiated"**

7. The Panel in *Mexico – Olive Oil* interpreted the term "initiated" in the context of a claim brought under Article 13.1 of the SCM Agreement. The Panel based its analysis on the definition of "initiated" as contained in footnote 37 of the SCM Agreement. The Panel started out by focusing on the ordinary meaning of footnote 37:

"We begin by examining the definition of 'initiated' in footnote 37 of the *SCM Agreement*. It is important to note that the definition describes a 'procedural action by which a *Member* formally commences an investigation', without specifying any particular action, or any particular procedure, that a Member must undertake in this regard. The European Communities admits that 'the particular steps to be taken [in regard to initiation] are largely left to Members', and that while '[i]t can be inferred from Footnote 37 that the process will involve one element of formality ... precisely what this should consist of is not specified'.

The heart of this dispute is not over what constitutes a 'procedural action' as many steps within an investigation may qualify as such, but rather which procedural action 'formally commences' an investigation. The Shorter Oxford English Dictionary defines 'formally' as 'In prescribed or customary form; with the formalities required to make an action valid or definite.' The Shorter Oxford English Dictionary also defines 'commence' as 'make a start or beginning; come into operation.' As footnote 37 states, we are concerned with 'a Member's' initiation of an investigation. Because the *SCM Agreement* does not contain any specific standards for determining the validity of an action meant to start a countervailing duty investigation, the date of 'formal

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<sup>8</sup> Panel Report, *US – Ripe Olives from Spain*, para. 7.154.

<sup>9</sup> Panel Report, *US – Ripe Olives from Spain*, para. 7.175.

commencement' must be in reference to the internal regime of the importing Member."<sup>10</sup>

8. The Panel took into account relevant context for interpreting footnote 37, as well as the object and purpose of the SCM Agreement:

"Other articles of the *SCM Agreement* that refer to initiation provide context for interpreting the term 'initiated' in footnote 37. For example, Article 11 of the *SCM Agreement* contains a number of substantive requirements that must be satisfied before an importing Member may initiate a countervailing duty investigation. Article 11 demonstrates that when the drafters intended to prescribe that Members satisfy particular standards, they were perfectly able to do so. Additionally, Article 22.2 requires investigating authorities to give public notice of the initiation. Article 22.2 (ii) requires that the investigating authority include in the published notice the 'date of initiation'. In our view, this confirms a reading of footnote 37 that leaves it up to the investigating authority to determine on what date it 'formally commenced' an investigation and to then make the public aware of that date through the notice.

Finally, in terms of the object and purpose of the *SCM Agreement*, we note that the deadline for completing an investigation in Article 11.11; the requirement to release the application to interested exporters in Article 12.1.3; and the timeframes for imposing provisional measures in Article 17.3 all flow from the date of initiation. We view a reading whereby the date of initiation is based on the internal law of the importing Member as ensuring predictability for the interested parties in the investigation under the domestic system of each Member. If WTO dispute settlement proceedings taking place considerably after the termination of an investigation could revisit these procedural steps in the absence of any specific requirements in the *SCM Agreement*, this predictability would be substantially reduced."<sup>11</sup>

9. Ultimately, the Panel concluded that the meaning of the term would vary based on the procedural actions defined in each Member's individual countervailing duty regime:

"Based on the foregoing analysis, we find that what constitutes 'initiation' within the meaning of the *SCM Agreement* will vary based on the procedural actions defined in each Member's individual regime. Therefore, to determine the date on which Economía initiated the investigation and whether Mexico sent the invitation to consultations prior to initiation, as required by Article 13.1 of the *SCM Agreement*, we must examine what constitutes the procedural act by which an investigation is formally commenced in the Mexican system."<sup>12</sup>

### **1.5 Consequential nature of a finding of inconsistency under Article 10**

10. In a few reports, the Appellate Body indicated that "where it has not been established that the essential elements of the subsidy within the meaning of Article 1 of the SCM Agreement are present, the right to impose a countervailing duty has not been established and, as a consequence, the countervailing duties imposed are inconsistent with Articles 10 and 32.1 of the SCM Agreement."<sup>13</sup>

11. The Panel in *China – Broiler Products* further explained that "to succeed in a claim under ... Article 10 of the SCM Agreement, a complaining Member need only establish that ... countervailing

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<sup>10</sup> Panel Report, *Mexico – Olive Oil*, paras. 7.24-7.25.

<sup>11</sup> Panel Report, *Mexico – Olive Oil*, paras. 7.26-7.27.

<sup>12</sup> Panel Report, *Mexico – Olive Oil*, para. 7.28.

<sup>13</sup> Appellate Body Report, *US – Countervailing Measures (China)*, para. 4.211 (referring to Appellate Body Reports, *US – Softwood Lumber IV*, para. 143; *US – Anti-Dumping and Countervailing Duties (China)*, para. 358).

duties were imposed and the imposing Member acted inconsistently with one of its obligations under the relevant Agreement."<sup>14</sup>

## **1.6 Relationship with Article VI of the GATT 1994**

### **1.6.1 Combined application of Article VI of the GATT 1994 and the SCM Agreement**

12. In its analysis of the relationship between Article VI of the GATT 1994 and the SCM Agreement, the Appellate Body in *Brazil – Desiccated Coconut* relied on Article 10 and stated that "[f]rom reading Article 10, it is clear that countervailing duties may only be imposed in accordance with Article VI of the *GATT 1994* and the *SCM Agreement*."<sup>15</sup> In this determination, the Appellate Body relied also on Articles 32.1 and 32.3 of the SCM Agreement.

### **1.6.2 Pass-through: subsidized inputs**

13. In *US – Softwood Lumber IV*, the Appellate Body concluded that "in cases where logs are sold by a harvester/sawmill in arm's-length transactions to unrelated sawmills, it may not be assumed that benefits attaching to the *logs* (non-subject products) automatically pass through to the *lumber* (the subject product) produced by the harvester/sawmill." Therefore, a pass-through analysis is required in such situations.<sup>16</sup> The Appellate Body's analysis was based on Article VI:3 of the GATT 1994 and footnote 36 to Article 10 of the SCM Agreement. It was on this basis that the Appellate Body upheld the Panel's finding that the Department of Commerce's failure to conduct a pass-through analysis in respect of arm's length sales of *logs* by tenured harvesters/sawmills to unrelated sawmills is inconsistent with Articles 10 and 32.1 of the SCM Agreement and Article VI of the GATT 1994.<sup>17</sup>

## **1.7 Relationship with other provisions of the SCM Agreement**

14. In *US – Washing Machines*, the Appellate Body noted that Article 19.4 of the SCM Agreement and Article VI:3 of the GATT 1994 require that "investigating authorities must, in principle, ascertain as accurately as possible the amount of subsidization bestowed on the investigated products", and that "[i]t is only with respect to those products that a countervailing duty may be imposed, and only within the limits of the amount of subsidization that those products received."<sup>18</sup> The Appellate Body noted that the "wording of Article 10 – and especially the phrase 'take all necessary steps to ensure' – indicates that the obligation to establish precisely the amount of subsidization requires a proactive attitude on the part of the investigating authority".<sup>19</sup>

Current as of: December 2022

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<sup>14</sup> Panel Report, *China – Broiler Products* (referring to Appellate Body Reports, *US – Anti-Dumping and Countervailing Duties (China)*, para. 358; *US – Softwood Lumber IV*, para. 143). See also Panel Report, *US – Supercalendered Paper*, paras. 7.274 and 7.276.

<sup>15</sup> Appellate Body Report, *Brazil – Desiccated Coconut*, p. 15.

<sup>16</sup> Appellate Body Report, *US – Softwood Lumber IV*, paras. 156-157. See also Panel Report, *US – Ripe Olives from Spain*, para. 7.147.

<sup>17</sup> Appellate Body Report, *US – Softwood Lumber IV*, para. 159.

<sup>18</sup> Appellate Body Report, *US – Washing Machines*, para. 5.268.

<sup>19</sup> Appellate Body Report, *US – Washing Machines*, para. 5.268.