

ANNEX B

Submissions of Canada

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ANNEX B-1

COMMUNICATION OF 16 MAY 2001 FROM CANADA TO BRAZIL

(16 May 2001)

Brazil's panel request in the above-noted dispute has raised seven claims. In order to know the case that it has to answer and the violations that Brazil is alleging, Canada requests further clarification from Brazil as to certain of these claims. In particular:

1. Canada seeks confirmation from Brazil that, pursuant to the title of this dispute and the 21 February 2001 consultations as described in Brazil's request, Brazil's claims 1, 5 and 7 are intended to refer to certain practices or programs only as they relate to regional aircraft.
2. Canada seeks clarification as to whether Brazil's claims 1, 5 and 7 are in respect of certain practices or programs *per se* or as they have been applied in specific instances. If the latter, Canada asks that Brazil identify the applications of the practices or programs to which its claims refer.
3. Brazil's claims 1, 5 and 7 allege that "export credits" are prohibited export subsidies. Brazil's panel request indicates that "export credits" includes certain types of practices, but its claims do not appear to be limited to these types of "export credits". The same is true of "guarantees" as used in Brazil's claim 7. Canada asks that Brazil specify the types of export credits and guarantees to which these claims refer.
4. Brazil's claim 1 alleges that certain practices "are and continue to be prohibited export subsidies...". Canada seeks clarification as to the distinction Brazil is making between "are" and "continue to be".
5. Brazil's claim 3 refers to export credits to the "regional aircraft industry" through the Canada Account. Canada seeks clarification as to what is meant by "regional aircraft industry" as it is used in this claim.

To enable Canada to prepare its defence even before the filing of the first written submissions, Canada asks that Brazil provide these clarifications no later than Monday, 21 May 2001.

ANNEX B-2

RESPONSE OF CANADA TO COMMUNICATION OF 21 MAY 2001 FROM BRAZIL TO THE PANEL

(28 May 2001)

1. In a letter to the Panel of 21 May 2001, Brazil has asked the Panel immediately to request that Canada provide documents regarding Export Development Corporation, Canada Account and Investissement Quebec support for Canadian regional aircraft transactions since the coming into force of the WTO Agreement in 1995. This letter provides Canada's comments on the Brazilian letter.

General Comments

2. Canada will limit its comments to the appropriateness of Brazil's request. Canada notes that Brazil, in its letter, makes a variety of arguments and allegations that it asserts constitute a *prima facie* case that certain Canadian programmes are inconsistent with Canada's obligations under the SCM Agreement. Canada does not agree either with Brazil's arguments and allegations or that they would constitute a *prima facie* case. However, Canada will not address them in this response. As the Appellate Body has found, and Brazil's letter acknowledges, whether a *prima facie* case has been demonstrated is irrelevant to whether and when a panel might undertake the kind of information gathering exercise proposed by Brazil.

3. Canada wishes to cooperate in every possible way in this dispute, including the provision of information that the Panel considers necessary for its task. Canada nevertheless respectfully suggests that the request by Brazil should be declined as both premature and overbroad.

4. Canada submits that any request is premature at this stage, in the context of this dispute. What information a panel may need to request depends on what is properly at issue in a dispute and whether that information will be available on a timely basis in the normal course of the dispute. Careful reflection is particularly warranted where, as in this case, much of the information is of a commercially sensitive nature. The Brazilian request for a panel is unclear in many respects and also appears to contain allegations regarding Canadian compliance with a prior DSB recommendation. These allegations are outside the jurisdiction of a panel formed to hear a new claim under Article 6 of the DSU. As the Panel is aware, Canada, acting in accordance with the guidance of the Appellate Body in *Thailand – Steel*¹ asked by letter of 16 May 2001 for Brazil to clarify its claims. However, Brazil refused to do so, saying in effect that Canada would have to learn the claims against it from Brazil's first submission.

5. Brazil's letter is also misleading in asserting that Canada has refused to produce evidence in response to Brazilian requests. Brazil's only prior request to Canada for information was much narrower than that which Brazil is now requesting. That request was presented to Canada for the first

¹ Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland, (WT/DS122/AB/R), 12 March 2001, para 97.

time at the consultation meeting, at which Canada answered Brazil's questions to the best of its ability under the circumstances.

6. Brazil's current request also is clearly overbroad. Leaving aside all questions as to their consistency with the DSU, the claims in Brazil's request for the establishment of a panel appear to be a series of accusations about the current practices of the agencies concerned. By contrast, in its letter of 21 May, Brazil asks the Panel to solicit comprehensive information about completed transactions going back more than six years.

Brazil's Request is Premature

7. In Canada's view it is not appropriate for the Panel to seek information at this stage of the proceedings in this case. The reason for a panel to request information is because the panel has determined that it requires that information. What information a panel considers "necessary and appropriate" (to use the language of Article 13.1), will depend on the claims before the panel and the arguments of the parties. In the present case, with the exception of Brazil's letter of 21 May, which refers in detail only to the Air Wisconsin transaction, the parties have not presented their arguments, and indeed, Brazil has not presented clear, proper claims in its request for a panel.

8. In *Canada – Measures Affecting the Export of Civilian Aircraft*², the panel declined to seek any information before receiving at least the first written submissions of the parties. The panel stated at paragraph 9.50 of its Report:

We did not consider it appropriate to seek any information before receiving at least the first written submissions of both parties. We considered that it was only on the basis of these first written submissions that we could properly determine what, if any, additional information might need to be sought. In this regard, we recall that the Appellate Body in *India-Patents* referred to "additional fact-finding" by a panel in a context where pertinent facts are "not before the panel". In our view, the Appellate Body could not have been referring in that case to a situation where information is not before the panel because the panel has not yet received any submissions from the parties. Any contrary view would be absurd, since it would at once defeat the very purpose of the parties making written submissions. [footnotes omitted]

9. The panel added, at paragraph 9.53:

In the circumstances of the present case, we did not consider it appropriate to exercise our discretionary authority under Article 13.1 to make generalized requests for information. Instead, we only sought detailed information of relevant loans, funds, contributions, assistance etc. identified in the record. Whereas more generalized requests for information (of the sort envisaged in Brazil's submission of 23 October 1998) may be appropriate for bodies such as commissions of enquiry, we do not consider them appropriate for a panel acting under Article 13.1 of the DSU.

10. The reasons of the panel in that dispute are equally persuasive in the present dispute. Brazil, in its panel request and in its letter of 21 May 2001 has referred to only one transaction, that involving Air Wisconsin. Canada will be addressing the Air Wisconsin transaction in its first submission. If, once both parties have filed their submissions, the Panel considers that pertinent facts with respect to Brazil's offer to support Air Wisconsin and Canada's offer in response are not before it, the Panel may then need to exercise its discretion to seek additional information under Article 13.1 of the DSU.

² Canada – Measures Affecting the Export of Civilian Aircraft, (WT/DS70/R) 14 April 1999.

11. In this regard, Canada notes that at paragraph 12 of its 21 May letter, Brazil acknowledges that in respect of Air Wisconsin transaction, Canada has simply sought to match support offered (or in Brazil's words, "allegedly offered") by Brazil to help its aircraft manufacturer Embraer secure the sale. Brazil alleges that such support by Canada is a prohibited export subsidy. However, in a separate proceeding³, Brazil has asserted that the export financing support it offers on Embraer regional aircraft has been WTO consistent since last year. To address this inconsistency, Canada asks that if, at any time, the Panel does decide to seek information under Article 13.1 of the DSU, it seek from Brazil information of the sort identified in paragraph 29 of Brazil's 21 May letter, with respect to all financing support provided, offered or proposed by Brazil and/or Embraer since 4 August 2000⁴ to potential or actual purchasers of Embraer regional aircraft.

12. Fundamentally, Canada considers that few of Brazil's seven claims are properly before this panel. At least two of Brazil's claims, those numbered 2 and 3 in its request for the establishment of a panel, and perhaps Brazil's claims 1 and 4 as well, appear to allege Canadian non-compliance with the recommendations and rulings of the DSB in the *Canada – Aircraft* dispute. The appropriate procedures for addressing such alleged non-compliance are set out in Articles 21 and 22 of the DSU and involve, wherever possible, recourse to the original panel.

13. In addition, Brazil's claims 1, 5 and 7 are inadequate to meet the requirements of Article 6.2 of the DSU. Canada's letter of 16 May 2001 asked Brazil to clarify these claims and its claim 3 as well. However, Brazil has refused to do so, as it informed the Panel, and Canada, in its response of 21 May.

14. Accordingly, Canada will be seeking preliminary findings from the Panel with respect to Brazil's claims. At the May 23 organizational meeting, Canada asked the Panel to set aside time in the schedule for this purpose. As it cannot be necessary or appropriate for a panel to seek information in respect of claims that are not properly before it, Canada respectfully suggests that the Panel will be in a position to assess whether it needs specific information only once it has made preliminary findings on the adequacy and appropriateness of Brazil's claims and has received the parties' first submissions.

Brazil's Allegation that Canada Has Refused to Produce Evidence Is Irrelevant or Incorrect

15. Brazil bases its 21 May request to the Panel in part on the allegation that Canada has refused to provide information in a past panel proceeding and in bilateral consultations in this dispute. Neither contention is a fair basis for acceding to Brazil's request. Canada did refuse to provide certain information requested by the panel in Brazil's previous regional aircraft dispute with Canada. Canada did so for two reasons it considered legitimate according to its understanding of Article 13 of the DSU at that time: the inadequacy of the procedures for protecting business confidential information and Brazil's failure to make a *prima facie* case. The Appellate Body subsequently disagreed with Canada's views. Canada's response to a request by a panel in another dispute is irrelevant to the issue of whether this Panel should request certain information in this dispute.

16. Brazil also alleges that Canada refused to "produce" any information in the course of consultations. This is simply untrue. Even if the adequacy of consultations were relevant to this issue, which is doubtful, Brazil has neglected in its 21 May letter to acknowledge that it did not provide Canada with any of the questions it has attached as exhibit Bra-1 in advance of the

³ Brazil – Export Financing Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU.

⁴ This date was the date of adoption of the Appellate Body Report and Panel Report as modified by the Appellate Body Report in the first Article 21.5 proceeding regarding regional aircraft export subsidies by Brazil under its PROEX programme.

consultations. Rather, it withheld them until the parties were in the room at the consultations. (By contrast, members of the Brazilian media received the questions prior to the consultations). Canada answered Brazil's questions to the best of its ability under the circumstances. Having chosen not to accord Canada an opportunity to prepare, if Brazil now considers Canada's answers to have been insufficient, it has only itself to blame.

17. Moreover, if Brazil regarded Canada's answers as inadequate, or if it felt that it required any other specific information, it could have made a written request to Canada under Article 25.8 of the SCM Agreement. In fact, the Appellate Body identified this course of action in its Report in *the Canada-Aircraft* case in August 1999, with respect to certain of the EDC's financing measures.⁵ However, Brazil did not do so.

Brazil's Request is Overbroad

18. Contrary to what is implied in Brazil's 21 May letter, the questions it put to Canada in the consultations in this dispute differ greatly from the information it is now asking the Panel to seek. As Brazil's exhibit Bra-1 shows, at the consultations, Brazil did not request any documents from Canada and most of the questions related either to the Air Wisconsin transaction or more generally to the use of the Canada Account since 20 August 1999.

19. Moreover, in last year's Article 21.5 proceeding in the *Canada – Aircraft* dispute, Brazil agreed that there was no issue concerning past Canada Account subsidies, both because prior to the 18 November 1999 deadline for compliance Canada had completed the transactions found to be subsidies and had granted no new Canada Account financing in the regional aircraft sector since that date.⁶

20. Even if that were not so, the claims made in Brazil's request for the establishment of a panel in this dispute are worded in the present tense and appear to relate to the current practices of the agencies concerned. By contrast, Brazil's 21 May letter asks the Panel to seek "documents concerning EDC, Canada Account and IQ support for Canadian regional aircraft transactions from 1 January 1995 onward, including but not limited to the Air Wisconsin deal". Thus, Brazil is now asking the panel to cast its net far more broadly than Brazil itself did in the consultations and more broadly than its claims in its request for a panel would seem to warrant.

Conclusion

21. The assertions made in Brazil's 21 May letter are neither accurate nor a basis for acceding to Brazil's request for immediate, sweeping information gathering beyond the scope of Brazil's complaint and certainly beyond the scope of its consultations with Canada. Canada respectfully requests that the Panel defer information requests until it has clarified what information it needs from either or both parties, having regard to which claims are legitimately before the Panel and what information has been provided in the submissions of the parties.

22. If the Panel has any questions regarding these comments, Canada would be pleased to respond.

⁵ (WT/DS70/AB/R), 2 August 1999, Para. 206.

⁶ Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, (WT/DS70/RW) 9 May 2000, para. 5.57.

ANNEX B-3

PRELIMINARY SUBMISSION OF CANADA REGARDING THE PANEL'S JURISDICTION

(18 June 2001)

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I. INTRODUCTION

1. In its request for the establishment of a panel in this dispute¹, Brazil has failed to comply with certain mandatory requirements of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”). It has raised certain claims which fall outside the jurisdiction of this panel. These claims should be rejected.

2. The specific violations of the DSU in Brazil’s panel request are as follows:

? Claims 1, 2 and 3 raise issues of compliance or implementation related to another dispute. These claims are inconsistent with Article 21.5 of the DSU. This panel does not have the jurisdiction to examine compliance issues that have arisen in other disputes; and

? Claims 1, 2, 5 and 7 are inconsistent with the requirements of Article 6.2 of the DSU, which require a complaining party to identify the specific matters at issue and to provide a brief summary of the legal basis of the complaint, sufficient to present the problem clearly. Brazil has not met the minimum standards of this provision.

3. A WTO panel has both the right and the obligation to determine whether the claims raised by a party fall within its jurisdiction. It is equally clear that Canada, as a defending party, is entitled to its full measure of due process in this dispute. As this submission explains, Brazil’s violations of the DSU undermine Canada’s due process rights in these proceedings. It is therefore incumbent on the panel to declare that certain claims do not fall within its jurisdiction.

4. Nevertheless, because of the sequence established by paragraph 13 of the Working Procedures, Canada will also show in its first written submission that Brazil’s claims fail on the merits.

II. THE PANEL HAS THE RIGHT AND THE OBLIGATION TO DECIDE WHETHER A PARTY’S CLAIMS FALL WITHIN ITS JURISDICTION

5. It is well established in WTO dispute settlement that a Panel has both the right and the duty to determine whether the claims raised by a party comply with the DSU. As noted by the Appellate Body in *EC – Bananas*:

We recognize that a panel request will usually be approved automatically at the DSB meeting following the meeting at which the request first appears on the DSB’s agenda. As a panel request is normally not subject to detailed scrutiny by the DSB, *it is incumbent upon a panel to examine the request for the establishment of the panel very carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the DSU.*² [emphasis added]

¹ *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Request for the Establishment of a Panel by Brazil, WT/DS222/2, 1 March 2001.

² *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, para. 142 [hereinafter ‘*EC – Bananas*, Appellate Body Report’].

6. This statement was re-affirmed by the Appellate Body in *Korea – Dairy Safeguard*³ and in *Thailand – Anti-Dumping Duties on Steel*.⁴

7. Indeed, the Appellate Body has “stressed, on more than one occasion, the fundamental importance of a panel’s terms of reference.”⁵ Thus, as a preliminary matter, it is imperative that this Panel determine whether certain of the claims advanced by Brazil in this case fall within its jurisdiction. As the Appellate Body stated in *India – Patent Protection for Pharmaceutical and Agricultural Products*:

Nothing in the DSU gives a panel the authority either to disregard or to modify other explicit provisions of the DSU. The jurisdiction of a panel is established by that panel’s terms of reference, which are governed by Article 7 of the DSU. *A panel may consider only those claims that it has the authority to consider under its terms of reference. A panel cannot assume jurisdiction that it does not have.*⁶ [emphasis added]

8. As will be argued by Canada below, the Panel in this case does not have the authority, under its terms of reference, to consider a number of the claims made by Brazil. This panel cannot assume jurisdiction that it does not have.

III. CERTAIN OF BRAZIL’S CLAIMS ARE INCONSISTENT WITH ARTICLE 21.5 OF THE DSU

A. APPLICABLE LAW

9. The DSU provides that disputes over compliance are to be resolved through the expedited proceedings provided for in Article 21.5, rather than through new panel proceedings.

10. Article 21.5 provides as follows:

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. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

11. Article 21.5 uses mandatory, not hortatory, language. Where there is disagreement over implementation, such a dispute “shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel.”

³ *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R, adopted 14 December 1999, para. 122 [hereinafter “*Korea – Dairy Safeguard*, Appellate Body Report”].

⁴ *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Appellate Body, WT/DS122/AB/R, adopted 5 April 2001, para. 86 [hereinafter “*Thailand – Steel*, Appellate Body Report”].

⁵ *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body, WT/DS50/AB1R, adopted 16 January 1998, para. 87 [hereinafter “*India – Patent Protection*, Appellate Body Report”].

⁶ *Id.*, para. 92.

12. Thus the DSU mandates recourse to Article 21.5 expedited procedures to resolve implementation disputes, unless it is “impossible” to use these procedures.

13. This interpretation is consistent with the practice to date of WTO Members. In all cases to date in which there has been a dispute over the existence or WTO-consistency of measures taken to comply with DSB recommendations or rulings, resort has been made to Article 21.5.⁷ To allow a Member to ignore the specific requirements of Article 21.5 and instead to resort to *de novo* panel proceedings to determine issues of compliance would be contrary to Article 21.5.

14. More fundamentally, any Panel established through the regular dispute settlement procedures of Article 6 of the DSU would not have the jurisdiction to make findings on issues of compliance arising from other cases. Such other cases have different terms of reference, and different panel members. Where a complaining party asserts that a defending party has failed to comply with DSB rulings in a particular case, the proper avenue to pursue such claims is to reconvene the original panel.

B. THE MATTERS AT ISSUE

15. In its 1 March 2001 request for a panel, Brazil has made three claims that would require this panel to adjudicate issues of compliance with the earlier DSB rulings in a different case. It has done so explicitly in Claims 2 and 3, and implicitly in Claim 1. These claims must be pursued through an Article 21.5 compliance panel proceeding rather than through this proceeding.

⁷ *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products – Recourse to Article 21.5 of the DSU*, Request for Consultations, WT/DS50/11, 20 January 1999; *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*, Report of the Panel, WT/DS27/RW/ECU, adopted 6 May 1999; *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by the European Communities*, Report of the Panel, WT/DS27/RW/EEC; *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 by Canada*, Report of the Panel, WT/DS18/RW, adopted 20 March 2000; *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, Report of the Panel, WT/DS126/RW, adopted 11 February 2000; *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, report of the panel and the Appellate Body adopted 4 August 2000; *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW; report of the panel and the Appellate Body adopted 4 August 2000; *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse by the United States to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS132/6, 13 October 2000; *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse by Malaysia to Article 21.5 of the DSU*, Report of the Panel, WT/DS58/RW, 15 June 2001; *United States – Anti-Dumping Duties on Dynamic Random Access Memory Semiconductors (DRAMs) of One Megabit or Above from Korea – Recourse to Article 21.5 of the DSU by Korea*, Report of the Panel (Suspension of Panel Proceedings), WT/DS99/RW, 7 November 2000; *United States – Tax Treatment for “Foreign Sales Corporations” – Recourse by the European Communities to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS108/16, 8 December 2000; *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS46/26, 22 January 2001; *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse by the United States to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS103/16, 19 February 2001; *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse by New Zealand to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS113/16, 19 February 2001.

1. Explicit compliance claims

16. Claim 2 states that:

Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

17. Claim 2 fails to specify which “report of the Article 21.5 panel” is the subject of the current Brazilian complaint. Canada presumes that it is the report of the Article 21.5 panel in *Canada – Measures Affecting the Export of Civilian Aircraft*.⁸ In any event, a complaint that Canada “has not implemented” the Article 21.5 panel report is clearly an issue of compliance or implementation related to an earlier dispute, which is outside the jurisdiction of the present panel.

18. Claim 3 provides:

Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

19. Once again, Brazil has referred to “the rulings and recommendations of the Dispute Settlement Body”, without any reference as to which such rulings or recommendations are the subject of the current complaint. Again, Canada surmises that Brazil is referring to the rulings and recommendations of the DSB in *Canada – Measures Affecting the Export of Civilian Aircraft*. The reference to the alleged granting of, or offers to grant, prohibited subsidies “in defiance of” the DSB rulings clearly indicates that this claim raises issues of compliance with earlier rulings. Such claims are outside the jurisdiction of the current panel.

2. Implicit compliance claim

20. Claim 1 states that:

Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and *continue to be* prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

21. In this claim, Brazil asserts in part that certain export credits “continue to be” prohibited export subsidies. All measures of a Member are presumed to be WTO-consistent absent a specific DSB ruling to the contrary. Therefore, the reference by Brazil to export credits that “continue to be” prohibited export subsidies must refer back to earlier DSB rulings that certain “export credits” granted by Canada are not WTO-consistent. This would appear to be a claim that Canada has not complied with the DSB rulings in *Canada Measures Affecting the Export of Civilian Aircraft*.⁹ This panel does not have the jurisdiction to determine issues of compliance related to other cases.

3. Compliance disputes cannot be resolved through new panel proceedings

22. Thus, in its request for the establishment of a panel, Brazil has raised compliance issues, both explicitly and implicitly. As noted above, DSU Article 21.5 provides that implementation disputes

⁸ *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 4 August 2000.

⁹ In its letter of 16 May 2001, Canada asked Brazil to clarify this claim. However, as noted below, Brazil refused to do so.

are to be resolved “through recourse to these dispute settlement procedures, including *wherever possible resort to the original panel*.” It was clearly “possible” for Brazil to seek to resort to the original panel, yet Brazil made no attempt to do so.

23. If Brazil believes that Canada had not complied with the DSB recommendations in the Article 21.5 proceeding in *Canada – Measures Affecting the Export of Civilian Aircraft*, it could also have requested DSB authorization to take appropriate countermeasures pursuant to Article 4.10 of the SCM Agreement and Article 22.6 of the DSU. Brazil did not seek to do so.

24. Brazil instead is seeking to have this panel rule on issues of implementation related to a different dispute. This would be unprecedented in the history of the WTO and contrary to the requirements of Article 21.5.

25. This Panel does not have the jurisdiction to adjudicate compliance issues that have arisen in other cases. The issues before the Panel in the present case may be similar to those examined by the Panel in *Canada – Measures Affecting the Export of Civilian Aircraft*. However, they are still different panels, established in different disputes, with different terms of reference and different members of the panel. The present Panel has no more jurisdiction to determine compliance issues arising from *Canada – Measures Affecting the Export of Civilian Aircraft* than it does to determine compliance issues arising from *Bananas, FSC*, or any other different WTO dispute.

IV. BRAZIL’S CLAIMS 1, 2, 5 and 7 ARE INCONSISTENT WITH ARTICLE 6.2 OF THE DSU

A. APPLICABLE LAW

1. DSU Article 6.2: text and objective

26. Requests for the establishment of a Panel must comply with the requirements of DSU Article 6.2. Article 6.2 provides in part as follows:

The request for the establishment of a panel ... shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

27. The Appellate Body has stressed the need to adhere to the requirements of DSU Article 6.2:

It is important that a panel request be sufficiently precise for two reasons: first, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.¹⁰

2. Due process objective of Article 6.2

28. It is clear that “a defending party is always entitled to its full measure of due process in the course of WTO dispute settlement.”¹¹

¹⁰ *EC – Bananas*, Appellate Body Report, para. 142; *Korea – Dairy Safeguard*, Appellate Body Report, para. 122; *Thailand – Steel*, Appellate Body Report, para. 84.

¹¹ *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Panel, WT/DS122/R, adopted with the Appellate Body Report 5 April 2001, para. 7.24 [hereinafter “*Thailand – Steel*, Panel Report”] See also the Report of the Panel in *Turkey –*

29. Moreover, the fundamental fairness of the proceedings may be undermined where the complaining party has failed to comply with the requirements of Article 6.2, particularly the obligation to “provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.” In *Thailand – Steel*, the Appellate Body stated that:

Article 6.2 of the DSU calls for sufficiently clarity with respect to the legal basis of the complaint, that is, with respect to the “claims” that are being asserted by the complaining party. *A defending party is entitled to know what case it has to answer, and what violations have been alleged so that it can begin preparing its defence.* Likewise, those Members of the WTO who intend to participate as third parties in panel proceedings must be informed of the legal basis of the complaint. *This requirement of due process is fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings.*¹² [emphasis added]

3. Requirements of Article 6.2

30. In *Korea – Dairy Safeguard*, the Appellate Body discussed the requirements imposed by Article 6.2:

When parsed into its constituent parts, Article 6.2 may be seen to impose the following requirements. The request must: (i) be in writing; (ii) indicate whether consultations were held; (iii) identify the specific measures at issue; and (iv) provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In its fourth requirement, Article 6.2 demands only a summary – and it may be a brief one – of the legal basis of the complaint; but the summary must, in any event, be one that is “sufficient to present the problem clearly”. It is not enough, in other words, that “the legal basis of the complaint” is summarily identified; the identification must “present the problem clearly”.¹³

31. Whether a request for the establishment of a panel meets the requirements of Article 6.2 must be decided on a case-by-case basis.¹⁴ As the *Korea – Dairy Safeguard* Appellate Body report stated:

Identification of the treaty provisions claimed to have been violated by the respondent is always necessary both for purposes of defining the terms of reference of a panel and for informing the respondent and the third parties of the claims made by the complainant; such identification is a minimum prerequisite if the legal basis of the

Restrictions on Imports of Textile and Clothing Products, WT/DS34/R, adopted with the Appellate Body report 19 November 1999, para. 9.3.

¹² *Thailand – Steel*, Appellate Body Report, para. 88. Similarly, in *Brazil – Measures Affecting Desiccated Coconut*, the Appellate Body noted that:

A panel’s terms of reference are important for two reasons. First, *terms of reference fulfil an important due process objective* - they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant’s case. Second, they establish the jurisdiction of the panel by defining the precise claims at issue in the dispute. [emphasis added]

Appellate Body Report, WT/DS22/AB/R, adopted 20 March 1997, p. 22 [hereinafter “*Brazil – Coconut*, Appellate Body Report”].

¹³ *Korea – Dairy Safeguard*, Appellate Body Report, para. 120.

¹⁴ *Id.*, para. 127; *Thailand – Steel*, Appellate Body Report, para. 87.

complaint is to be presented at all. But it may not always be enough. There may be situations where the simple listing of the articles of the agreement or agreements involved may, in the light of attendant circumstances, suffice to meet the standard of *clarity* in the statement of the legal basis of the complaint. However, there may also be situations in which the circumstances are such that the mere listing of treaty articles would not satisfy the standard of Article 6.2. This may be the case, for instance, where the articles listed establish not one single, distinct obligation, but rather multiple obligations. In such a situation, the listing of articles of an agreement, in and of itself, may fall short of the standard of Article 6.2.¹⁵ [emphasis in original]

4. Deficiency in panel request cannot be “cured” by submission

32. It is well established that the requirements of Article 6.2 must be met in the request for the panel, and that any deficiencies in the panel request cannot be “cured” by the submissions of the complainant. The Appellate Body in *EC – Bananas* held that:

We do not agree with the Panel that “even if there was some uncertainty whether the panel request had met the requirements of Article 6.2, the first written submissions of the Complainants ‘cured’ that uncertainty because their submissions were sufficiently detailed to present all the factual and legal issues clearly”. Article 6.2 of the DSU requires that the *claims*, but not the *arguments*, must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint. If a *claim* is not specified in the request for the establishment of a panel, then a faulty request cannot be subsequently “cured” by a complaining party’s argumentation in its first written submission to the panel or in any other submission or statement made later in the panel proceeding.¹⁶ [emphasis in original]

¹⁵ *Korea – Dairy Safeguard*, Appellate Body Report, para. 124; *Thailand – Steel*, Appellate Body Report, para. 87. See also the Report of the Panel in *Mexico – Anti-Dumping Investigation of High-Fructose Corn Syrup (HFCS) from the United States*, WT/DS132/R, adopted 24 February 2000; para. 7.13.

The Panel in the *Bed Linen* case rejected certain claims made by India under Article 6 of the Anti-Dumping Agreement because India had failed to set forth such claims in its request for the establishment of the panel. The panel recalled that in the *Korea – Dairy Safeguard* dispute, the Appellate Body had found that there might be situations where a “mere listing” of treaty Articles would not satisfy the standards of Article 6.2. It then went on to state that:

... the treaty Articles alleged to be violated *are not even listed* in the request for establishment – “Article 6” of the AD Agreement does [not] appear on the face of the document at all. In this circumstance, we consider that the legal basis of a complaint with respect to that Article has not been presented at all. ... In our view, a failure to state a claim in even the most minimal sense, by listing the treaty Articles alleged to be violated, cannot be cured by reference to subsequent submissions. ... Thus, the fact that India may have fully elucidated its position with respect to alleged violations of Article 6 of the AD Agreement in its first written submission to the Panel avails it nothing as a legal matter. Failure to even mention in the request for establishment the treaty Article alleged to have been violated in our view constitutes failure to state a claim at all. [emphasis in original]

European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India, Report of the Panel, WT/DS141/R, adopted with the Appellate Body report on 12 March 2001, paras. 6.13 and 6.15 [hereinafter “*EC – Bed Linen*, Panel Report”].

¹⁶ *EC – Bananas*, Appellate Body Report, para. 143. See also *European Communities – Customs Classification of Certain Computer Equipment*, Report of the Appellate Body, WT/DS62/AB/R,

33. In a subsequent case, the Appellate Body reinforced this point by stating that “a claim *must* be included in the request for establishment of a panel in order to come within a panel’s terms of reference in a given case.”¹⁷ [emphasis in original]

5. Efforts of the Defending party to seek clarifications

34. Previous cases have noted that the defending party may seek clarifications from the complaining party about the claims that have been made. As the Appellate Body stated in *Thailand – Anti-Dumping Duties on Steel*:

In view of the importance of the request for the establishment of a panel, we encourage complaining parties to be precise in identifying the legal basis of the complaint. We also note that nothing in the DSU prevents a defending party from requesting further clarification on the claims raised in a panel request from the complaining party, even before the filing of the first written submission. In this regard, we point to Article 3.10 of the DSU which enjoins Members of the WTO, if a dispute arises, to engage in dispute settlement procedures “in good faith in an effort to resolve the dispute”. As we have previously stated, the “procedural rules of WTO dispute settlement are designed to promote, not the development of litigation techniques, but simply the fair, prompt and effective resolution of trade disputes”.¹⁸

6. Prejudice to the Defending Party

35. In determining whether Article 6.2 has been violated, Panels and the Appellate Body have taken into account whether there has been prejudice to the rights of defence of the Defending party

WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, para. 72, footnote 49; and *EC – Bed Linen*, Panel Report, para. 6.15. In addition, the Panel in the *Argentina – Footwear* dispute noted that: “Clearly, due process and adequate notice would not be served if a complaining party were free to add new measures or new claims to its original complaint as reflected in its panel request at a later stage of a panel proceeding.” (*Argentina – Safeguard Measures on Imports of Footwear*, Report of the Panel, WT/DS121/R, panel and Appellate Body report adopted on 12 January 2000, para. 8.45.)

¹⁷ *India – Patent Protection*, Appellate Body Report, para. 89. See also *Brazil – Coconut*, Appellate Body Report, p. 22.

¹⁸ *Thailand – Steel*, Appellate Body Report, para. 97.

Similarly, the Panel in *United States – Lamb* stated that:

... we consider it appropriate to recall the Appellate Body's statements in *United States – Tax Treatment for Foreign Sales Corporations ("US - FSC")* that:

"responding Members [should] seasonably and promptly bring claimed procedural deficiencies to the attention of the complaining Member, and to the DSB or the Panel, so that corrections, if needed, can be made to resolve disputes."

We note that the Appellate Body made the preceding statements in relation to the “statement of available evidence” as required by SCM Agreement Article 4.2 in the context of a request for *consultations*, not a request for a *panel*. But we nevertheless find the above statement of the Appellate Body to be relevant to our examination of “attendant circumstances” in this case in connection with the procedural issue [DSU Article 6.2] before us. [emphasis in original] [footnote omitted]

United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia, Report of the Panel, WT/DS/177/R, WT/DS178/R, adopted with the Appellate Body report 16 May 2001, paras. 5.44-5.45.

during the course of the panel proceedings. For example, the Panel in *Thailand – Steel*, in dismissing Poland’s claims under Article 6 of the Anti-Dumping Agreement, stated:

... we find that Thailand has demonstrated, with respect to Poland’s claims under this Article, that its ability to defend itself was prejudiced in the course of the Panel proceedings. The prejudice to Thailand’s ability to defend itself was a function of the fact that the precise nature and scope of the claims under Article 6 remained unclear and confusing to Thailand – and to us – even following Poland’s first written submission.¹⁹

36. The *Bed Linen* panel commented on the issue of prejudice in the case where a complaining party has not made a particular claim in its panel request:

In the absence of any reference in the request for establishment to the treaty Article alleged to have been violated, the question of possible prejudice as a result of failure to state a claim with sufficient clarity simply does not arise. ... Whether inadvertent or not, as a result of the omission of Article 6 from the request for establishment the defending Member, the European Communities, and third countries had no notice that India intended to pursue claims under Article 6 of the AD Agreement in this case, and were entitled to rely on the conclusion that it would not do so. Consequently, India would be estopped in any event from raising such claims.²⁰

B. THE MATTERS AT ISSUE

37. In accordance with the fundamental principles of procedural fairness, as enunciated by the Appellate Body in the *Thailand – Steel* case, Canada is entitled to know what case it has to answer, and what violations have been alleged, so that it can prepare its defence. As the Appellate Body has made clear, this requirement of due process is “fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings.”

38. Even if Brazil were not under an obligation to bring its Claims 1 and 2 in an Article 21.5 proceeding, they are inconsistent with DSU Article 6.2 because they do not identify the specific measures at issue and because they do not present the problem clearly. Either failure on its own is a violation of Article 6.2. Brazil’s Claims 5 and 7 are similarly inconsistent with Article 6.2. Brazil’s failure to comply with the requirements of Article 6.2 undermines the fundamental fairness of these proceedings.

39. The specific inconsistencies of each Claim with the requirements of Article 6.2 are set out below.

1. Claim 1

40. As noted above, in Claim 1, Brazil states that:

Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

41. The reference to “export credits” is extremely broad. Any practice that allows payment to be deferred for an exported good or service could conceivably qualify as an “export credit.” Moreover,

¹⁹ *Thailand – Steel*, Panel Report, para. 7.29. This finding was not appealed by Poland.

²⁰ *EC – Bed Linen*, Panel Report, para. 6.16.

the term “export credits” is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. The scope of “export credits”, without any further clarification, is infinite. Brazil has failed to specify either the meaning or the scope of its claim.

42. The term “Canada Account” is not limited in any way in Brazil’s claim. It is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. It appears from the terms of the claim that Brazil is challenging the whole of Canada Account. Canada Account transactions number in the hundreds and vary from tied-aid transactions to insurance products.²¹

43. Thus, Canada submits that by using the terms “export credits” and “Canada Account”, Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

44. Accordingly, Canada does not know the violations Brazil is alleging and the case it has to answer.

2. Claim 2

45. As stated earlier, Claim 2 provides that:

Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

46. The Appellate Body report in *Korea – Dairy Safeguard* left no doubt that “[i]dentification of the treaty provisions claimed to have been violated by the respondent is *always necessary* both for purposes of defining the terms of reference of a panel and for informing the respondent and the third parties of the claims made by the complainant; such identification is *a minimum prerequisite* if the legal basis of the complaint is to be presented at all.”²² [emphasis added].

47. However, in Claim 2, Brazil has failed to identify any treaty provision that Canada is alleged to have violated. It makes no reference to any provision of the WTO Agreements. It thus fails to meet the “minimum prerequisites” of Article 6.2. As noted by the *Bed Linen* panel, “[f]ailure to even mention in the request for establishment the treaty Article alleged to have been violated ... constitutes failure to state a claim at all.”²³

48. In addition, the arguments under Claim 1 with respect to the “Canada Account” apply equally to Claim 2, and are incorporated by reference here.

²¹ In considering a term as broad as “Canada Account”, it is useful to recall the observations of the *Japan – Film* panel when faced with a similar request:

In considering whether these. . . measures were adequately identified in the panel request, we note that in contrast to the Premiums Law, which has a relatively narrow focus (i.e., premiums), the Antimonopoly Law has a very broad scope and deals with a broad range of issues. As such, we would have some hesitation in saying that a reference to the Antimonopoly Law alone would be sufficient to bring all measures taken by Japan under that Law within the scope of the panel request.

However, it was not necessary for the *Japan – Film* panel to decide this issue. (*Japan – Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R; adopted 22 April 1998, para. 10.16.)

²² *Korea – Dairy Safeguard*, Appellate Body Report, para. 124.

²³ *EC – Bed Linen*, Panel Report, para. 6.15.

3. Claim 5

49. Brazil's fifth Claim states:

Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

50. The arguments under Claim 1 with respect to "export credits" apply equally to Claim 5, and are incorporated by reference here.

51. In addition, Brazil's reference to "the EDC" is similarly so broad as to defy definition. The term "EDC" in this Claim is limited neither to the Air Wisconsin transaction nor the regional aircraft industry. The claim appears to be an ill-defined attack on the whole of EDC, a claim that could potentially cover hundreds of clients and many thousands of transactions since 1995.

52. The deficiency of Brazil's claim is illustrated by paragraphs 46 and 65 of Brazil's First Submission. Those paragraphs indicate that Brazil is seeking in this proceeding to challenge not only the sort of EDC "financial contributions" at issue in *Canada – Aircraft* (i.e. those covered by sub-paragraph 1.1(a)(1)(i) of the SCM Agreement), but an unlimited range of "financial services" under sub-paragraph 1.1(a)(1)(iii). In its claim, Brazil neither specified which services it is challenging, nor even identified the specific provisions of Article 1 on which it is relying, contrary to the requirements of Article 6.2 as interpreted by the Appellate Body in *Korea – Dairy Safeguard*.

53. Thus, Canada submits that by using the terms "export credits" and "EDC", Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

4. Claim 7

54. The seventh Brazilian Claim is that:

Export credits and guarantees provided by *Investissement Québec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

55. The arguments under Claim 1 with respect to "export credits" apply equally to Claim 7, and are incorporated by reference here.

56. In addition, the reference to "Investissement Québec" in Claim 7 is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry.

57. Thus, Canada submits that by using the terms "export credits" and "Investissement Québec", Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

C. BRAZIL REJECTED CANADA'S EFFORTS TO SEEK CLARIFICATION

58. Canada made good-faith efforts to seek clarification with respect to Brazil's panel request. On 16 May 2001, Canada wrote to the Chair of the Panel, seeking the following specific clarifications. The letter stated in part:

In order to know the case that it has to answer and the violations that Brazil is alleging, Canada requests further clarification from Brazil as to certain of these claims. In particular:

1. Canada seeks confirmation from Brazil that, pursuant to the title of this dispute and the 21 February 2001 consultations as described in Brazil's request, Brazil's claims 1, 5 and 7 are intended to refer to certain practices or programmes only as they relate to regional aircraft.
2. Canada seeks clarification as to whether Brazil's claims 1, 5 and 7 are in respect of certain practices or programmes *per se* or as they have been applied in specific instances. If the latter, Canada asks that Brazil identify the applications of the practices or programmes to which its claims refer.
3. Brazil's claims 1, 5 and 7 allege that "export credits" are prohibited export subsidies. Brazil's panel request indicates that "export credits" includes certain types of practices, but its claims do not appear to be limited to these types of "export credits". The same is true of "guarantees" as used in Brazil's claim 7. Canada asks that Brazil specify the types of export credits and guarantees to which these claims refer.
4. Brazil's claim 1 alleges that certain practices "are and continue to be prohibited export subsidies...". Canada seeks clarification as to the distinction Brazil is making between "are" and "continue to be".
5. Brazil's claim 3 refers to export credits to the "regional aircraft industry" through the Canada Account. Canada seeks clarification as to what is meant by "regional aircraft industry" as it is used in this claim.

To enable Canada to prepare its defence even before the filing of the first written submissions, Canada asks that Brazil provide these clarifications no later than Monday, 21 May 2001.

59. Brazil cursorily refused to provide the clarifications requested. In a letter to the Chair of the Panel dated 21 May, Brazil stated that:

In a letter to the Panel dated May 16, 2001, Canada requested that Brazil provide "confirmation" and "clarification" on a number of points concerning Brazil's challenge to several Canadian subsidies. In accordance with normal practice in the WTO, Brazil intends to present its position to the Panel, to Canada, and to the Third Parties, in its first written submission to the Panel at the time established by the Panel in its Working Procedures.

Thus Brazil refused to clarify its claims, despite Canada's requests.

D. NO "CURE"

60. The requirements of Article 6.2 must be met in the request for the panel. As the Appellate Body made clear in *EC – Bananas*, the deficiencies in the panel request with respect to Claims 1, 2, 3, 5, 7 cannot be "cured" by Brazil's subsequent submissions.

E. PREJUDICE TO CANADA'S DEFENCE

61. As was the case for Thailand in the *Anti-Dumping Duties on Steel* dispute, the prejudice to Canada's ability to defend itself is a function of the fact that the precise nature and scope of the claims by Brazil remain unclear and confusing.²⁴ Brazil's violations of the mandatory requirements of Article 6.2 of the DSU prejudice Canada's ability to prepare and present a full defence in this proceeding.

V. REQUEST FOR PRELIMINARY RULINGS

62. Canada respectfully requests that the Panel make the following preliminary findings with respect to its jurisdiction:

1. Claims 2 and 3 raise issues of compliance related to another dispute. Brazil was required to bring these claims under DSU Article 21.5. Accordingly, Claims 2 and 3 are outside the jurisdiction of the panel;

2. The reference in Claim 1 to certain export credits that "continue to be" prohibited subsidies similarly raises compliance issues related to another dispute. This claim is also properly the subject of an Article 21.5 proceeding, and accordingly, is outside the jurisdiction of the panel; and

3. Claims 1, 2, 5 and 7 are inconsistent with the requirements of DSU Article 6.2, and therefore these Claims are outside the jurisdiction of the panel.

²⁴ With respect to Claim 2, in which Brazil has failed to identify any treaty provision that Canada is alleged to have violated, Canada recalls the statement of the *Bed Linen* panel that "the question of possible prejudice as a result of failure to state a claim with sufficient clarity simply does not arise." *EC – Bed Linen*, Panel Report, para. 6.16.

ANNEX B-4

FIRST WRITTEN SUBMISSION OF CANADA

(18 June 2001)

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I. INTRODUCTION

1. This submission provides Canada's initial response to Brazil's allegations that Canada is providing export subsidies inconsistent with the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The task of responding is made difficult, in that the only clear and consistent element of Brazil's complaint at each stage of the process in this dispute is Canada's offer of financing for the sale of regional jet aircraft to Air Wisconsin Airlines Corporation ("Air Wisconsin"). Nevertheless, Canada will respond to all of Brazil's claims insofar as Canada understands them, pending the Panel's disposition of Canada's request, in its Preliminary Submission, for preliminary rulings on certain of Brazil's claims.

2. In its complaints about the Air Wisconsin financing, Brazil neglects to mention that Canada's offer was made to match financing offered last year to Air Wisconsin by Brazil, through its PROEX (Programa de Financiamento as Exportações) interest-rate buy-down programme and BNDES (Banco Nacional de Desenvolvimento Econômico e Social). In a separate WTO proceeding¹, Brazil has denied that its PROEX programme now constitutes illegal export subsidization. If Brazil is correct, this would mean that Canada's offer to Air Wisconsin must also be consistent with the SCM Agreement, since under the SCM Agreement Brazil has no defences regarding regional aircraft financing that are not also available to Canada. However, even if, as Canada considers, Brazil's offer to Air Wisconsin was an illegal export subsidy, Canada's matching offer is protected under the "safe haven" of the second paragraph of Item (k) of the Illustrative List of export subsidies in Annex I to the SCM Agreement.

3. In its first submission,² Brazil appears to claim broadly that any financing by Canada's Export Development Corporation ("EDC") and Investissement Québec is, as such, an export subsidy in violation of the SCM Agreement. In addition, Brazil seems to be challenging either types of financing offered by those agencies or specific transactions in which those agencies were, or are alleged to have been, involved.

4. In any case, Brazil's claims have no foundation. EDC administers two programmes, the Canada Account and the Corporate Account. In a previous dispute settlement case brought by Brazil, both were found to involve discretionary rather than mandatory legislation.³ Canada Account financing is provided consistent with the interest rates provisions of the *Arrangement on Guidelines for Officially Supported Export Credits*⁴ (the "OECD Arrangement" or the "Arrangement") and therefore qualifies for the "safe haven" of Item (k). Since 1998, all Corporate Account financing for regional aircraft has been provided on a commercial basis, and therefore does not confer a "benefit" under Article 1 of the SCM Agreement.⁵ Similarly, Investissement Québec does not involve mandatory legislation, its financing does not confer a "benefit" and, even on the basis of Brazil's evidence, it is not contingent upon export performance.

¹ *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46.

² *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222, First Submission of Brazil, 30 May 2001 [hereinafter "Brazil's First Submission"].

³ *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, paras. 9.123 and 9.129 [hereinafter *Canada – Aircraft I*, Panel Report].

⁴ OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998). (Exhibit BRA-42)

⁵ From 1 January 1995 through 1997, the Corporate Account was also used for [] official support transactions. These transactions were consistent with the OECD Arrangement. They involved a total of [] propeller-driven aircraft but no regional jets.

5. With no basis for its complaints, Brazil tries to build a case on faulty interpretations of the SCM Agreement, unsustainable legal arguments and selective and sometimes inaccurate quotations from public documents and press reports. These do not demonstrate that Canada has breached its WTO obligations in any way.

6. In this submission, Canada will first show that the programmes or agencies challenged by Brazil are not, “as such”, inconsistent with the SCM Agreement. Then it will show that its matching of Brazil’s financing offer to Air Wisconsin is permitted under the SCM Agreement. Finally, it will show that there is no basis for Brazil’s complaint that the application of Corporate Account or Investissement Québec financing is inconsistent with the SCM Agreement.

II. THE CONTEXT FOR THIS PROCEEDING AND THE FACTS

A. BRAZIL’S PROEX PROGRAMME

7. It is no secret that this proceeding is part of a broader dispute. For several years, Brazil has been engaged in a well-documented campaign of illegal export subsidization to win contracts and gain market-share for Embraer at the expense of its competitors, particularly Bombardier.

8. In 1999 and again last year, the DSB ruled that Brazil provides illegal export subsidies to Embraer under PROEX, Brazil’s interest-rate buy-down programme for exports. Under PROEX, Brazil buys down to a lower rate the interest rate commercially available to a potential purchaser of Embraer aircraft. The original version of PROEX (“PROEX I”) involves interest rate buy-downs of up to 3.8 percentage points. This means that a potential purchaser that would otherwise have to finance a purchase of Embraer aircraft at, for example, a commercially available interest rate of 8 per cent, would receive financing at a 4.2 per cent interest rate thanks to the PROEX I interest rate buy-down.

9. After a panel had found and the Appellate Body had affirmed that these PROEX subsidies were illegal⁶, the DSB ruled that Brazil had until 18 November 1999 to withdraw them. Brazil claimed compliance with the initial ruling of the DSB by revising PROEX to reduce the interest rate buy-down to 2.5 percentage points (“PROEX II”), but Brazil declined to cease granting subsidies with respect to aircraft under contract for delivery after the 18 November 1999 compliance date.

10. In a proceeding under Article 21.5 of the Dispute Settlement Understanding (DSU) Brazil was found not to have complied with the original DSB ruling because (i) after 18 November 1999 it continued to deliver PROEX I subsidized aircraft pursuant to contracts made before that date and the PROEX subsidies were granted on the delivery of the aircraft; and (ii) PROEX II remained a prohibited export subsidy which Brazil continued to grant on Embraer regional jets.⁷ When the parties were unable to reach an agreement on compensation, Canada sought and obtained

⁶ *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999 [hereinafter “*Brazil – Aircraft*, Panel Report”] and *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999 [hereinafter “*Brazil – Aircraft*, Appellate Body Report”].

⁷ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000 [hereinafter “*Brazil - Aircraft*; Article 21.5 Panel Report”] and *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, adopted 4 August 2000 [hereinafter “*Brazil – Aircraft*, Article 21.5 Appellate Body Report”].

authorization from the DSB to take countermeasures against Brazil in the amount of C\$344.2 million per year.⁸

11. In December 2000, Brazil announced that it had again revised PROEX. According to Brazil, this revision, which will be referred to as PROEX III, continued the same programme that has twice been found to be an illegal export subsidy, but with a nominal limit on PROEX interest-rate buy-downs to no more than the Commercial Interest Reference Rate (or “CIRR”). The CIRR is a constructed rate developed at the OECD and published by the OECD as one component of the Arrangement.⁹ Brazil’s position is that it may offer buy-downs to the CIRR rate, without any of the other terms or conditions required under the Arrangement or by the market. Brazil contends that as a result of this revision, PROEX III interest-rate buy-downs are no longer prohibited export subsidies. Canada disagrees and has challenged the conformity of PROEX III with the WTO rules in a separate proceeding under Article 21.5 of the DSU.

B. AIR WISCONSIN

12. After the Arbitrators had issued their decision in the Article 22.6 proceeding, Embraer and Bombardier became involved in a competition to win a large order from Air Wisconsin for approximately [] regional jets at a purchase price of approximately C\$ [] billion. Air Wisconsin is a US regional airline. It operates under a code-share agreement with United Airlines Inc.

13. In late October 2000, Canada learned that Brazil was prepared to finance the sale of Embraer regional jets to Air Wisconsin on terms far more favourable than those that Air Wisconsin would have been able to obtain in the commercial marketplace. Thus, it was evident that Brazil again was offering export subsidies inconsistent with the SCM Agreement on a major sale.

14. Embraer insisted on a commercial confidentiality agreement that precluded Air Wisconsin from disclosing to Canada precise details of the Brazilian offer. However, from the responses of Air Wisconsin officials to a variety of questions posed by Canadian officials, the Government of Canada concluded that the terms of the Brazilian offer included []. Evidence of Brazil’s offer is contained in Canada’s Confidential Exhibit CDA-1 and Exhibit CDA-2.¹⁰

15. In the eyes of some observers, Brazil was using a strategy of prolonging negotiations and litigation with a view to continuing its illegal subsidization to gain market share. As a major Brazilian newspaper reported when the Article 22.6 arbitration decision was released:

“[b]ut the major victory of the MFA [Ministry of Foreign Affairs] refers to the fact that it was able to extend the dispute with Canada for almost four years. Meanwhile, Embraer became one of the biggest aircraft manufacturer[s] in the world. Today, the company has half of the world market for small aircraft (with up to 70 seats). In order

⁸ *Brazil – Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000.

⁹ CIRR is determined by taking the average of the 7-year US Treasury rate (in the case of regional aircraft deals, i.e., Category A under Annex III of the Arrangement, in US dollars with repayment terms of over 8 ½ years up to 10 years) for the previous month and adding 100 basis points. See Article 16 of the main text. The usual practice in the regional aircraft sector is to use US dollars.

¹⁰ See [], dated 21 March 2001 [hereinafter “[] Declaration”] (Confidential Exhibit CDA-1) and Letter from [], operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001 [hereinafter “Air Wisconsin Letter”] (Exhibit CDA-2).

to extend negotiations as much as possible, the MFA contracted big advocacy companies abroad specialized in international trade.”¹¹

16. Almost three years of WTO litigation had demonstrated that Brazil would not be bound by its WTO commitments. Four panel and Appellate Body decisions had confirmed that PROEX is an illegal export subsidy and the DSB had twice, unsuccessfully, called for Brazil to withdraw its illegal PROEX subsidies. Further, over the previous year, Brazil had rebuffed efforts by Canada to reach a negotiated solution committing both countries to financing on either market or Arrangement terms. Experience with PROEX I and II had shown that even if Brazil’s export subsidies were ruled illegal, once it had made financing commitments Brazil would not cease its export subsidies on aircraft still to be delivered.

17. Thus, it was clear that, at best, WTO dispute settlement proceedings could afford limited relief with respect to the Air Wisconsin sale. Canada would permanently lose the sale unless it could match Brazil’s offer. Accordingly, the Canadian government decided on a two-track approach to try to forestall future illegal subsidization by Brazil and to preserve competition for the Air Wisconsin sale. As one-track, in January 2001, Canada commenced a new Article 21.5 proceeding to test Brazil’s assertions that PROEX III conforms to the recommendations and rulings of the DSU and the SCM Agreement. That Article 21.5 panel is scheduled to issue its interim report on 20 June 2001 and to circulate its final report by the end of July of this year.

18. The second track was to use the Canada Account programme to support Bombardier’s bid for the Air Wisconsin contract with financing that matched the support that Brazil was offering to Air Wisconsin. Such matching, including non-identical matching, is permitted under the OECD Arrangement and, in Canada’s view, by the exception in the second paragraph of Item (k) to Annex I of the SCM Agreement. Canada also reasons that if Brazil is found in the current Article 21.5 proceeding to be correct in its claims that PROEX III conforms to the SCM Agreement, then Canadian support on a matching basis will also conform to the SCM Agreement without the need to invoke the second paragraph of Item (k).

C. THE EXPORT DEVELOPMENT CORPORATION

19. Many of Brazil’s allegations in this dispute are directed at Canada’s Export Development Corporation (“EDC”). EDC is incorporated under the laws of Canada and is wholly-owned by the Government of Canada. It operates on commercial principles with the objectives of:

- (a) supporting and developing, directly or indirectly Canada’s export trade; and
- (b) supporting and developing, directly or indirectly Canada’s capacity to:
 - (i) engage in exports, and
 - (ii) respond to international business opportunities.¹²

20. EDC’s activities on its own account are referred to as “Corporate Account” activities. EDC may also undertake and administer financing transactions that it would not otherwise undertake provided that the Government of Canada deems them to be in the national interest. Obligations under such activities are funded by the Government of Canada and the risk is assumed directly by the Government of Canada. This is the so-called “Canada Account”. Canada Account transactions will

¹¹ Guilherme Barros, “Canada can retaliate against Brazil by US\$1.3 billion” *Folha de Sao Paulo* (22 August 2000) (Exhibit CDA-3).

¹² See *Export Development Act*, R.S.C. 1985, c. E-20, s. 10. (Exhibit BRA-17)

always be in compliance with the OECD Arrangement, as Canada committed in response to the DSB ruling of 20 August 1999 in *Canada – Aircraft I*.

III. RELEVANT FINDINGS IN CANADA – AIRCRAFT I

21. In its first submission, Brazil refers to findings by the panel and the Appellate Body in the various proceedings in *Canada – Aircraft I*. Some of the findings in that dispute are indeed relevant to the present dispute, including findings regarding the EDC's Corporate Account and Canada Account programmes.

22. In the original panel proceeding in *Canada – Aircraft I*, the parties and the panel distinguished between the EDC Corporate Account programme (which the panel referred to as the "EDC programme") and the Canada Account. Brazil challenged both programmes as *per se* (i.e. "as such") export subsidies and as applied in specific transactions.¹³

A. BRAZIL'S PER SE CLAIMS IN CANADA – AIRCRAFT I

23. Applying "the distinction that GATT/WTO panels have consistently drawn between discretionary legislation and mandatory legislation,"¹⁴ the panel found that Brazil had failed to demonstrate that the Corporate Account, as such, mandates the grant of subsidies. It found that the Corporate Account programme in fact "constitutes discretionary legislation", since the legislation does not require Canada to grant illegal export subsidies in any circumstances.¹⁵

24. The panel made similar findings in the case of the Canada Account: "we find 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."¹⁶ Brazil did not appeal these findings in respect of either Corporate Account or Canada Account and they were adopted unmodified by the DSB when it adopted the panel and Appellate Body reports on 20 August 1999.

B. CORPORATE ACCOUNT AS APPLIED IN CANADA – AIRCRAFT I

25. In support of its claims that the Corporate Account as applied provided prohibited export subsidies, Brazil in *Canada – Aircraft I* challenged certain forms of EDC financing assistance that it alleged were provided to the Canadian regional aircraft industry, including debt financing and loan guarantees.

26. In attempting to make out a case that Corporate Account debt financing constituted a benefit, Brazil relied on many of the same statements by officials and assertions about EDC's performance that it has again raised in this dispute. The panel found that "we do not believe that the evidence and arguments adduced by Brazil in respect of statements by EDC officials or EDC's overall financial performance demonstrates subsidized debt financing"¹⁷ and that "Brazil has not demonstrated, on the basis of its arguments concerning statements by EDC officials and EDC's financial performance, that EDC debt financing generally confers a 'benefit'"¹⁸.

¹³ *Canada – Aircraft I*, Panel Report, paras. 9.121, 9.130, 9.204 and 9.214.

¹⁴ *Id.*, para. 9.124.

¹⁵ *Id.*, para. 9.129.

¹⁶ *Id.*, para. 9.213.

¹⁷ *Id.*, para. 9.180.

¹⁸ *Id.*, para. 9.181.

27. In *Canada – Aircraft I*, Brazil also attempted to argue its case on the basis of evidence concerning certain transactions. In its arguments on debt financing and loan guarantees it relied on evidence that it has again referred to in this dispute, regarding two transactions, involving ASA and Comair respectively.

28. The panel in *Canada – Aircraft I* found that “Brazil’s arguments concerning ASA provide no basis for finding that either this specific instance of EDC debt financing, or EDC debt financing in the regional aircraft sector generally, confers a ‘benefit’ within the meaning of Article 1.1(b) of the SCM Agreement,”¹⁹ and that “the evidence adduced by Brazil concerning the ASA debt financing transaction in no way indicates that the general EDC debt financing policy of covering costs and a minimum risk margin has not been applied in the regional aircraft sector.”²⁰

29. In the case of Comair, the panel rejected “Brazil’s allegation that EDC granted an export subsidy in the form of a loan guarantee to Comair in 1997.”²¹

C. CANADA ACCOUNT AS APPLIED IN *CANADA – AIRCRAFT I*

30. Brazil also challenged the Canada Account programme as applied. The panel found that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constituted prohibited export subsidies.²² Canada then took measures intended to ensure that future Canada Account transactions in the regional aircraft sector would be in conformity with the interest rates provisions of the OECD Arrangement, and would therefore qualify for the “safe haven” of the second paragraph of Item (k) of Annex I to the SCM Agreement. In an Article 21.5 proceeding brought by Brazil, the panel found that the measures taken by Canada did not “ensure” this with respect to future transactions.²³ However, in the Article 21.5 proceeding, Brazil did not dispute that Canada had brought itself into compliance in respect of Canada Account transactions up to 18 November 1999. Accordingly, the panel did not consider further past Canada Account transactions.²⁴

IV. LEGAL ARGUMENT

A. CANADA ACCOUNT “AS SUCH”

31. GATT/WTO panels have consistently drawn a distinction between discretionary legislation and mandatory legislation. Generally, it is not sufficient for a complaining Member to show that an impugned measure might allow the Member complained against to violate its WTO obligations but

¹⁹ *Id.*, para. 9.179.

²⁰ *Id.*, para. 9.180.

²¹ *Id.*, para. 9.186.

²² *Id.*, para. 10.1(b).

²³ *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 4 August 2000, para. 6.1 [hereinafter “*Canada – Aircraft I*, Article 21.5 Panel Report”]. In rejecting an appeal by Brazil from the panel’s finding that Canada had implemented another of the DSB’s recommendations, the Appellate Body subsequently stated that the “ensure” standard applied by the panel “should be viewed with caution” because if read too literally, it would “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.” *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 4 August 2000, para. 38 [hereinafter “*Canada – Aircraft I*, Article 21.5 Appellate Body Report”].)

²⁴ *Canada – Aircraft I*, Article 21.5 Panel Report, para. 5.57.

rather, that the measure required, or would require, the Member to violate its obligations in at least some circumstances.²⁵

32. In the original *Canada – Aircraft I* panel decision, the panel found that the Canada Account programme constituted discretionary legislation because there was nothing to suggest that Canada Account must, in law, subsidize. Therefore, the panel found that it was not permitted to make any findings on the Canada Account *per se* and confined its analysis to claims concerning the actual application of the Canada Account programme.²⁶

33. Some of Brazil's assertions in its first submission in this dispute seem to suggest again that Canada Account *per se* is a prohibited export subsidy.²⁷ However, the findings that Brazil relies on to support these assertions are findings on the Canada Account *as applied* in the regional aircraft sector.²⁸ Brazil presents no arguments or evidence that Canada Account *mandates* the granting of prohibited export subsidies (other than a misrepresented panel finding),²⁹ because the Canada Account indeed is not mandatory legislation. Nothing since the finding in *Canada – Aircraft I* has changed that. Brazil's allegations in respect of Canada Account are only relevant to an *as applied* challenge. Therefore, if Brazil is challenging Canada Account *as such*, that challenge must fail.

B. CORPORATE ACCOUNT “AS SUCH”

34. In this dispute it is unclear from Brazil's panel request and its first submission whether Brazil's new claims in respect of the EDC are restricted to certain forms of alleged EDC financial support for regional aircraft sales (as the title of this dispute would suggest), or extend to the EDC's alleged provision of unspecified “financial services” generally, as paragraphs 21 to 39 and 73 might suggest; whether it is the provision of these unspecified services to the regional aircraft industry that is being challenged (as paragraphs 40 to 70 might suggest); or even that the EDC itself is somehow prohibited, as paragraphs 71 and 72 (“EDC is Contingent upon Export”) might suggest.

35. In its Request for Preliminary Rulings, Canada has addressed the prejudice caused by this lack of clarity and by Brazil's refusal to clarify its claims when requested to do so. Canada has explained in that submission why Brazil's claims regarding EDC do not meet the requirements of Article 6.2 of the DSU. However, pending the panel's ruling and as noted in the introduction, Canada will respond to what it understands to be Brazil's claims.

36. If Brazil is indeed challenging the EDC Corporate Account as such, Canada notes that, as the panel in *Canada – Aircraft I* found, the Corporate Account constitutes discretionary legislation. It does not in any way mandate subsidies inconsistent with the SCM Agreement and cannot be *per se* inconsistent with Articles 1 and 3 of the SCM Agreement.³⁰ It therefore is not surprising that Brazil has no evidence to support its claim.

37. In Sections III.A and B of its first submission (paragraphs 21 to 39), Brazil appears to be arguing that because the EDC is a governmental entity and as such does not pay income taxes, *any*

²⁵ See *United States – Anti-Dumping Act of 1916*, Report of the Appellate Body, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, paras. 60 and 88.

²⁶ *Canada – Aircraft I*, Panel Report, paras. 9.208-9.213.

²⁷ Brazil's First Submission, paras. 74-81.

²⁸ In each paragraph that Brazil cites in footnote 107 of its first submission, the panel used the language “Canada Account debt financing *in issue*.” [emphasis added]

²⁹ The actual finding reads “Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft” See *Canada – Aircraft I*, Panel Report, para. 10.1(b). Brazil reads this as the whole of “Canada Account.” (See Brazil's First Submission, para. 75.)

³⁰ See *supra*, para. 23.

financing by it constitutes a subsidy. There is no support for this argument in Article 1.1 of the SCM Agreement. Whether the EDC pays income taxes is irrelevant to the issue of whether it is granting a subsidy on aircraft exports, since the issue is not whether the EDC, as a public body, is, or is not, subsidized. Indeed, it would come as a great surprise to the many WTO Members who operate government financing agencies if those institutions were considered *per se* illegal under the SCM Agreement if they receive government support of any kind.

C. INVESTISSEMENT QUÉBEC “AS SUCH”

38. It is also unclear from Brazil’s panel request and its first submission whether Brazil is challenging certain forms of Investissement Québec financing or is challenging Investissement Québec as such. If the latter, Brazil’s own evidence demonstrates the broad mandate and discretion of Investissement Québec.³¹ Investissement Québec is an agency established by *An Act Respecting Investissement-Québec and Garantie-Québec*³² (“the Act”), which continues the Société de développement industriel du Québec.

39. As Brazil's own evidence at paragraph 84 of its first submission demonstrates, Investissement Québec's mandate and powers are broad. Investissement Québec's “general mission” to which Brazil refers, in part, at paragraph 83 of its first submission, is set out in Article 25 of the Act. Article 25 provides:

25. The mission of the agency is to facilitate the growth of investment in Québec and thus contribute to the economic development of Québec and the creation of employment opportunities.

The agency shall centralise and consolidate the actions of the State to seek out, promote and support investment, and shall become the main channel for communications with the enterprises concerned.

The agency shall strive to stimulate domestic investment and to attract investors outside Québec. It shall promote Québec among investors as a propitious location for investment, offer investors orientation services to guide them in their dealings with the Government, and provide them with financial and technical support.

The agency shall participate in the growth of enterprises, in particular by facilitating research and development and export activities.

The agency shall also work to retain current investment in Québec by providing support to enterprises established in Québec that show particular dynamism or potential.

40. Article 28 of the Act provides:

28. The Government may, where a project is of major economic significance for Québec, mandate the agency to grant and administer the assistance determined by the Government to facilitate the realisation of the project. The mandate may authorise the agency to fix the terms and conditions of the assistance.

³¹ Brazil’s First Submission, paras. 83-84.

³² *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

41. Article 34 of the Act provides:

34. The agency may provide technical services to an enterprise, a government department or body or a state-owned enterprise, in particular in the field of financial analysis, credit arrangement and portfolio management.

42. As these articles demonstrate, Investissement Québec's mandate and discretion is very broad. Nothing in the Investissement Québec Act mandates it to provide financing at all. Nothing mandates it to provide financing that would confer a "benefit" within the meaning of Article 1 of the SCM Agreement. Nor is the financing it does provide made contingent upon exportation. Brazil has offered no evidence to support any claim that Investissement Québec is a prohibited export subsidy as such because there is no evidence.

D. CANADA ACCOUNT – THE AIR WISCONSIN TRANSACTION

(i) Canada Offered Financing on a Matching Basis to Air Wisconsin in Response to Brazil's Offer.

43. In late October 2000, Canada learned that Brazil was prepared to finance the sale of Embraer regional jets to Air Wisconsin on below-market terms. The information indicated that Brazil was offering [].³³

44. The information Canada was receiving about the PROEX offer to Air Wisconsin was consistent with evidence that Brazil was continuing to offer prohibited export subsidies generally and in specific transactions. At approximately the same time as the PROEX offer was made to Air Wisconsin, Brazil made similar offers of PROEX support in the context of the campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air System.³⁴

45. Canada's information was also consistent with a statement made by Brazil's then foreign minister the week after Canada learned of Brazil's offer to Air Wisconsin, regarding the manner in which Brazil intended to apply PROEX: "For us, the interest rate is OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."³⁵

46. In the light of Brazil's below-market financing offer to Air Wisconsin, Canada had no choice but to offer Air Wisconsin debt financing on a matching basis.³⁶ Therefore, Canada offered [] with a repayment term of [] years and a loan-to-value ratio ("LTV") of [] per cent.³⁷ As a pre-condition to the financing, Canada required Air Wisconsin to confirm in writing that Canada's offer was valued by Air Wisconsin as no more favourable, viewed in its entirety, than that offered by Brazil. Air Wisconsin provided written confirmation on March 20, 2001.³⁸

³³ [] Declaration (Confidential Exhibit CDA-1) and Air Wisconsin Letter (Exhibit CDA-2).

³⁴ See Declaration of [], dated 21 March 2001 and Declaration of [], dated 20 March 2001. (Confidential Exhibits CDA-4 and CDA-5)

³⁵ See M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Económico* (30 October 2000). (Exhibit CDA-6).

³⁶ In the Arrangement context, "matching" refers only to the matching of "official support" offered by another government through the provision of "official support" by the matching Participant. The matching need not be term-for-term identical, i.e., it may be non-identical matching, because it is often impossible – due to confidentiality commitments – to know the precise terms of the initiating offer (as in this case). For new aircraft except large aircraft, the applicable matching provision of the Arrangement is Article 25 of Annex III.

³⁷ Air Wisconsin will have the option to choose between [] or a []. In the case of a [] structure, with respect to [] aircraft, the Government of Quebec is providing a guarantee to the equity investor for an amount equal to [] per cent of the sale price of each aircraft.

³⁸ Air Wisconsin Letter (Exhibit CDA-2).

(ii) The Air Wisconsin Transaction Qualifies for the “Safe Haven” of the Second Paragraph of Item (k).

47. The Air Wisconsin transaction is consistent with Canada’s SCM Agreement obligations because Canada is merely matching Brazil’s offer in a manner consistent with the “interest rates provisions” of the Arrangement. Canada’s offer on a matching basis thus falls within the exception of the second paragraph of Item (k) in Annex I to the SCM Agreement.

48. Canada is aware that the *Canada – Aircraft I* Article 21.5 panel opined as to which provisions of the Arrangement would constitute “interest rates provisions”. It did so on the theory that its mandate was to determine what was necessary to “ensure” compliance. Subsequently, the Appellate Body stated that this standard “should be viewed with caution”.³⁹ Moreover, the panel offered its opinion in the absence of an actual disputed transaction.

49. In Canada’s view, the correct interpretation of the “interest rates provisions” includes matching. Matching in the context of the OECD Arrangement qualifies for the “safe haven” because the matching provisions of the Arrangement, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in “conformity” with the “interest rates provisions” and indeed are themselves “interest rates provisions.” A body of disciplines on matching has been developed in the Arrangement in order to “govern” this practice. In particular, Articles 50 through 53 of the main text set out matching procedures. The mere existence of this body of disciplines demonstrates that matching is a legitimate exercise that is permitted by, and conforms to, the OECD Arrangement.⁴⁰

50. Accordingly, because Canada’s action with respect to Air Wisconsin was on a matching basis as expressly permitted by the OECD Arrangement,⁴¹ the transaction qualifies for the “safe haven” in the second paragraph of Item (k) and is not considered an export subsidy prohibited by the SCM Agreement.

(iii) Matching is in Conformity with the “Interest Rates Provisions” of the OECD Arrangement.

51. Under the second paragraph of Item (k), “an export credit practice” which is in “conformity” with the “interest rates provisions” of the OECD Arrangement “shall not be considered an export credit subsidy prohibited by” the SCM Agreement.⁴²

52. The *Canada – Aircraft I* Article 21.5 panel found that some matching – but not all – was, by the OECD Arrangement’s own terms, not in “conformity” with the provisions of the OECD Arrangement.⁴³ Essentially, the panel equated matching, in some circumstances, to a derogation.⁴⁴ Canada does not share this view.

53. Matching is specifically permitted by Article 29 as a response to an “initiating offer” that may or may not comply with the OECD Arrangement. The *Canada – Aircraft I* Article 21.5 panel agreed. It stated at paragraph 5.124:

³⁹ *Canada – Aircraft I*, Article 21.5 Appellate Body Report, para. 38.

⁴⁰ The Appellate Body in *Brazil – Aircraft*, at para. 184, mentioned the possibility of using the “matching” provisions of the OECD Arrangement.

⁴¹ See note 36, *supra*.

⁴² See *Canada – Aircraft I*, Article 21.5 Panel Report, para. 5.78.

⁴³ *Id.*, paras. 5.124-5.125.

⁴⁴ *Id.*

Thus, if a country offers terms that are within permitted variations, ... any matching of those terms ... “complies” [with the Arrangement].

54. In the next paragraph, the *Canada – Aircraft I* Article 21.5 panel stated:

... Article 29 further provides that if an initiating offer “does not comply with the Arrangement”, competing Participants are permitted to match those non-complying terms. [underlining added][footnote omitted]

55. Yet, the panel then reasoned that this latter matching – which is explicitly permitted by the Arrangement – somehow “departs from” the Arrangement and is therefore a derogation.⁴⁵ Matching cannot be “permitted” by the Arrangement and at the same time “depart from” the same Arrangement. If the Arrangement permits it, it “conforms” to the Arrangement by its own terms. If the Arrangement does not permit it, it does not “conform” to the Arrangement by its own terms.

(a) Matching is an “Interest Rates Provision”

56. The most logical interpretation of the term “interest rates provisions” used in Item (k) would include all substantive provisions in the OECD Arrangement that determine what interest rates are permitted, and that affect what the interest rate and what the amount of interest will be, in a given transaction, but would exclude procedural requirements with which a non-Participant inherently could not comply.⁴⁶

57. Matching within the context of the OECD Arrangement provides one alternative permitted way of determining an interest rate and is consistent with the Arrangement. Therefore, matching is itself an “interest rates provision.”⁴⁷

(b) Matching is Consistent with the Object and Purpose of the SCM Agreement

58. The SCM Agreement is based on the premise that some forms of government intervention distort international trade, some have the potential to distort, and still others do not distort at all. The disciplines imposed by the SCM Agreement reflect this accepted approach, commonly known as the “traffic light approach”:⁴⁸ trade distorting subsidies are to be prohibited outright (red light); potentially trade distorting subsidies are to be disciplined *if* they cause distortions in the market (amber); non-trade distorting subsidies are not subject to disciplines (green). Hence the prohibition on

⁴⁵ *Id.*

⁴⁶ The matching procedures are Articles 50 – 53 of the main text of the Arrangement. In Canada’s view, the right to offer terms on a matching basis is available to all Members. 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.

⁴⁷ Both the US and the EC support the view that the matching provisions of the Arrangement constitute “interest rates provisions” within the meaning of the second paragraph of Item (k). (See *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5*, Third Party Submission of the United States, para. 23; and Third Party Submission by the European Communities, paras. 34-39. (Exhibits CDA-7 and CDA-8))

⁴⁸ See Negotiating Group on Subsidies and Countervailing Measures, *Communication from Switzerland*, MTN.GNG/NG10/W/17, 1 February 1988, pp. 1-2; Negotiating Group on Subsidies and Countervailing Measures, *Meeting of 1-2 June 1988: Note by the Secretariat*, MTN.GNG/NG10/7, 8 June 1988; and *Trade Negotiations Committee Meeting at Ministerial Level, Montreal, December 1988*, MTN.TNC/7(MIN), 9 December 1988, pp. 18-20. (Exhibits CDA-9 – CDA-11)

export subsidies, the disciplines on actionable subsidies if they cause serious prejudice, and the absence of disciplines on certain types of research and development subsidies.⁴⁹

59. Although the SCM Agreement disciplines trade distorting subsidies, the prospective nature of the dispute settlement remedies means that – in the absence of matching – illegal subsidizers will have a perpetual advantage. The events of this case provide practical evidence of why the SCM Agreement includes matching. Despite a DSB ruling that Brazil withdraw its prohibited export subsidies, Brazil has consistently and knowingly refused to cease illegal subsidies under “commitments” it made prior to the compliance date, i.e., 18 November 1999. This assures the regional aircraft market that it will be able to keep any subsidies that Brazil offers to secure a sale, which in turn means that Canada has no chance and will be out of the market for that sale unless it offers terms that are similar to Brazil’s on a matching basis.⁵⁰

60. Finally, it is significant 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. Given that the signatories of the GATT Subsidies Code were at the same time participants in the OECD Arrangement, it is illogical that the signatories of the GATT Subsidies Code would have allowed matching in the Arrangement but then would have forbade it in the subsidies agreement one year later.

E. EDC CORPORATE ACCOUNT FINANCING

61. If Brazil is challenging specific types of Corporate Account financing, it bears the burden of establishing that those types of EDC financing constitute a subsidy within the meaning of Article 1 of the SCM Agreement that is prohibited by Article 3. In particular, Brazil must establish a *prima facie* case that EDC financing is a subsidy. This requires it to show that there is a financial contribution by a government or a public body that thereby confers a benefit.⁵¹ Brazil must do this for each application of the EDC Corporate Account that it is challenging.

62. Article 1 of the SCM Agreement makes clear that for a subsidy to exist, there must be both a financial contribution by a government or a public body (Article 1.1(a)(1)); and a benefit must *thereby* be conferred (Article 1.1(b)). Read together, these provisions require a causal link between a “benefit” and the fact that the financial contribution is made by a public body. In the case of EDC Corporate Account financing, Brazil has failed to make even a *prima facie* case of this link.

(i) Financial Contribution

63. In section III.C of its first submission, Brazil asserts that EDC offers “a wide range of financial services” and that, all of them, apparently, “constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement”.⁵² Brazil does not seek to substantiate this argument except in respect of loans and loan guarantees, which it considers to fall within Article 1.1(a)(1)(i) of the SCM Agreement.⁵³ Canada agrees that loans and loan guarantees may be financial contributions within the meaning of Article 1.1(a)(1)(i). However, Canada does not agree with Brazil’s assertion that those same loans and loan guarantees are also financial contributions within the meaning of Article 1.1(a)(1)(iii).⁵⁴

⁴⁹ The exemptions for research and development have lapsed.

⁵⁰ See note 36, *supra*.

⁵¹ *Canada – Aircraft I*, Panel Report, paras. 9.158-9.159.

⁵² Brazil’s First Submission, para. 40.

⁵³ *Id.*, paras. 44, 45.

⁵⁴ *Id.*, para. 46.

64. In the same section, Brazil has incorrectly identified two transactions as constituting financial contributions involving EDC Corporate Account. One of these is Midway. The EDC has not participated in the Midway transaction. The other is the Air Wisconsin sale.⁵⁵ Canada made clear in public statements⁵⁶ and again during the consultations in this dispute that financing by the Canadian government for the Air Wisconsin transaction would be provided through the Canada Account alone. Throughout the course of the *Canada – Aircraft I* dispute, Brazil and Canada both distinguished between Canada Account transactions and EDC Corporate Account financing. Brazil has again drawn this distinction in this dispute. Any allegations that EDC Corporate Account financing is involved in either a Midway sale or the Air Wisconsin transaction are false.

65. Brazil has also alleged incorrectly that Comair received loan guarantees under EDC Corporate Account.⁵⁷ Brazil relies for this allegation on essentially the same evidence that it put before the *Canada – Aircraft I* panel.⁵⁸ As previously noted, Canada denied and the panel rejected Brazil's allegation in *Canada – Aircraft I*.⁵⁹ Canada again denies Brazil's allegation.

(ii) Corporate Account Financing For Regional Aircraft Does Not Confer A Benefit

66. The Appellate Body has found that whether a benefit is conferred for the purposes of Article 1.1(b) can be determined by whether the financial contribution is on terms more favourable than those available to the recipient in the market.⁶⁰

67. Since 1998, all Corporate Account financing for regional aircraft has been provided on a commercial basis. Therefore it does not confer a benefit.⁶¹ In both the *Canada – Aircraft I* dispute and in the first Article 21.5 proceeding in *Brazil – Aircraft*, Canada described EDC's practices as follows:

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 programme, *LA Encore*. This programme 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

⁵⁵ *Id.*, paras. 1, 3, 4, 43 and 44.

⁵⁶ See e.g., "Bombardier Snags \$2.4 B order from US airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001 and "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001. (Exhibits BRA-2 and BRA-3)

⁵⁷ Brazil's First Submission, paras. 43 and 45.

⁵⁸ *Id.*, para. 43; *Canada – Aircraft I*, Panel Report, para. 6.94 and fn. 223.

⁵⁹ Panel Report, para. 9.186.

⁶⁰ *Canada – Aircraft I*, Appellate Body Report, para. 157.

⁶¹ As described in footnote 5, *supra*, prior to 1998, the Corporate Account was used for [] official support transactions, involving [] aircraft. These transactions were consistent with the OECD Arrangement.

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.⁶²

(a) The OECD Arrangement is Relevant Only If a Subsidy Has Been Found

68. In the absence of evidence of “benefits”, at paragraphs 47 to 59 of its first submission, Brazil resorts to sophistry. Its argument seems to be that the OECD Arrangement determines what is a benefit by determining, at least presumptively, what is at market. According to Brazil, if EDC transactions do not conform to the OECD Arrangement they are not at market and confer a benefit.

69. However, under the SCM Agreement, the Arrangement becomes relevant only once a subsidy has been found to exist and the analysis turns to whether that otherwise prohibited subsidy is permitted under the “safe haven” of the second paragraph of Item (k) in Annex I or is “used to secure a material advantage in the field of export credit terms” under the first paragraph of Item (k).⁶³ Brazil’s argument is circular. It relies on a standard that requires the existence of a subsidy in order to assess whether a subsidy exists.

(b) Rates below the Arrangement’s CIRR Need Not Confer a Benefit

70. At paragraphs 56 and 57 of its first submission, Brazil makes much of Canada’s statement in the *Brazil – Aircraft* Article 21.5 panel proceeding that it has, on occasion, provided export credits at interest rates that, despite being below the CIRR, were nevertheless commercial and did not confer a “benefit” within the meaning of Article 1. The Appellate Body indicated in *Brazil – Aircraft* that a net interest rate below one of the interest rates provisions of the Arrangement, the CIRR, is a positive indication that the government payment in a particular transaction has been used to secure a material advantage.⁶⁴ However, it subsequently emphasized that:

... the CIRR is “*one example*” of a “market benchmark” that may be used to determine whether a “payment” is used to “secure a material advantage”. The CIRR is a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets.⁶⁵ [emphasis in original]

71. Thus, Brazil is misguided in its attempt to imply something sinister about Canada’s statement that it has, on occasion, provided export credits, on commercial terms, at interest rates below the CIRR. Canada made this statement in response to the panel’s question: “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?” Canada answered in part:

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

⁶² See e.g., *Brazil – Aircraft*, Article 21.5 Panel Report, p. 91, included in Brazil’s Exhibit BRA-27.

⁶³ *Brazil – Aircraft*, Appellate Body Report, paras. 180-181.

⁶⁴ *Id.*, para. 182.

⁶⁵ *Brazil – Aircraft*, Article 21.5 Appellate Body Report, para. 64.

risk associated with the particular borrower, and said transactions included customary collateral security protection.⁶⁶

72. Contrary to Brazil's assertion in paragraph 57 of its first submission, Canada did explain why these instances were commercial. As the Panel noted at paragraph 6.102 of its Report, "Canada explains in some detail that the situation of below-CIRR market rates can arise because the CIRR lags behind the market."⁶⁷ Canada stated:

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.⁶⁸

73. On the basis of Canada's statements, the Panel concluded 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".⁶⁹

(c) The Transactions Described By Brazil Do Not Demonstrate a Benefit

74. The weakness of Brazil's argument that the Arrangement as applied in Item (k) somehow determines what is at market – and therefore a "benefit" for the purposes of Article 1 – is demonstrated by paragraph 59 of its first submission.

75. In paragraph 59, Brazil cites five regional aircraft financing transactions for the proposition that "Canada routinely exceeds the *Arrangement's* 10-year maximum repayment term." Canada has already explained that Brazil has incorrectly identified EDC's involvement in two of these transactions, Midway and Comair.⁷⁰ More importantly, the terms described in the five transactions vary between [] and [] years. Standard commercially available financing terms for regional aircraft sales range from 10 to 18 years.⁷¹ That is, marketplace financing for regional aircraft routinely exceeds 10 years. Thus, the terms Brazil has identified are all entirely within the ordinary commercial range. This evidence does not show that "Canada" is providing a "benefit" let alone a "material

⁶⁶ *Brazil – Aircraft*, Article 21.5 Panel Report, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000, Response to Question 4(a), p. 82.

⁶⁷ *Brazil – Aircraft*, Article 21.5 Panel Report, para. 6.102.

⁶⁸ *Brazil – Aircraft*, Article 21.5 Panel Report, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000, Response to Question 4(a), p. 82.

⁶⁹ *Brazil – Aircraft*, Article 21.5 Panel Report, para. 6.103.

⁷⁰ See paragraphs 64 and 65, *supra*.

⁷¹ See "CIT Structured Finance," Presentation to Aircraft Finance and Commercial Aviation Forum (February 2001). (Exhibit CDA-12)

advantage”. On the contrary, it supports Canada’s position that its regional aircraft financing is offered on market terms.⁷²

76. Brazil also seeks to support its contention that EDC Corporate Account financing confers a benefit by raising the “matching” transaction to which Canada referred in *Brazil – Aircraft I*, and the Air Wisconsin transaction.⁷³ Both of these transactions involve the Canada Account and thus have no relevance for the Corporate Account. (As Canada has also explained, matching transactions, including Air Wisconsin, are permitted under the OECD Arrangement.)

(d) Generic Statements By the EDC and Its Officials Do Not Demonstrate a Benefit

77. At paragraphs 60 and 61 of its first submission, Brazil attempts to show that EDC programmes confer a “benefit” by relying on general statements from an EDC document that it previously submitted in *Canada – Aircraft I*. The statements are that “EDC complements the banks and other financial institutions but cannot substitute for them”, and that “EDC’s goal is to help absorb the risk beyond what is possible by other financial intermediaries”. Nothing in these statements indicates that EDC provides “financial services” on non-market terms. The statements cited do not refer to specific “financial services”, or to transactions, or even to “financial services” at all. As the panel found in *Canada – Aircraft I*, the answer to whether Corporate Account as applied confers a benefit cannot be inferred or extrapolated from the generic statements of the EDC or its officials.⁷⁴

78. At paragraphs 62 to 67 of its first submission, Brazil seeks to argue, again on the basis of a statement by an EDC official, that Brazil put before the *Canada – Aircraft I* panel, that EDC financial contributions confer a benefit. In the statement, the official, Mr. Labbé, said, among other things, that “EDC’s financing support gives Canadian exporters an edge”. According to Brazil, this constitutes an acknowledgement that EDC provides a benefit within the meaning of Article 1 of the SCM Agreement.

79. However, the panel in *Canada – Aircraft I* found that this statement “provides no firm guidance as to whether EDC provides exporters with an ‘edge’ through subsidization.”⁷⁵ Moreover, the panel did not accept the interpretation of the statement advanced by Brazil. The panel inferred that “the relevant ‘edge’ is the ability of the EDC officials to assemble better structured financial packages on the basis of their knowledge and expertise.”⁷⁶ The Appellate Body concluded that this inference was neither illogical nor unreasonable.⁷⁷

80. Now Brazil seems to be arguing that even if this is so, it is still evidence of a “benefit” because “[g]overnment provision of ability, knowledge and expertise through financial services” is a financial contribution, and moreover, the provisions of this ability, knowledge and expertise through financial services superior to those the recipient could otherwise obtain in the market also constitutes the conferral of a benefit.⁷⁸

⁷² In fact, the “terms” Brazil has identified in paragraph 59 appear to be *lease* terms – that is, the duration of aircraft leases – rather than loan *repayment* terms. In aircraft financing transactions, the term of loan repayment may run as long as the term of the lease but it will not be longer. Thus, Brazil may have erroneously overstated somewhat the repayment terms in these transactions. However, *even overstated*, these terms are still within the ordinary commercial range for repayment terms.

⁷³ Brazil’s First Submission, paras 57, 58.

⁷⁴ *Canada – Aircraft I*, Panel Report, paras. 9.162-9.165.

⁷⁵ *Id.*, para. 9.163.

⁷⁶ *Id.*

⁷⁷ *Canada – Aircraft I*, Appellate Body Report, para. 213.

⁷⁸ Brazil’s First Submission, para. 66.

81. There are two basic problems with this argument, one procedural, the other substantive. The procedural problem, which is addressed in Canada's Preliminary Submission at paragraph 52, is that this argument relies on Article 1.1(a)(1)(iii) of the SCM Agreement. Brazil asserts that "[t]his proceeding explicitly involves both subparagraph (i) and subparagraph (iii)" of that Article.⁷⁹ However, contrary to Article 6.2 of the DSU, Brazil failed to make this explicit at all, either in its request for a panel (which referred to no more than "Article 1" generally) or when Canada asked for clarification of Brazil's claims.

82. The substantive problem is that Brazil offers no evidence that, even if the "ability, knowledge and expertise" required to develop a financial package is a financial contribution", it confers a "benefit" within the meaning of Article 1 of the SCM Agreement. Services such as "ability, knowledge and expertise" are paid for by the recipient as part of the price of the financial package. Brazil has offered no evidence that those services as such are priced below market and are therefore a "benefit".

83. It appears that Brazil tries to escape this result by interpreting Article 1.1(a)(1)(iii) as requiring as a precondition that a benefit already be conferred under Article 1.1(a)(1)(i) through the provision of financial packages superior to those the recipient could otherwise obtain in the market. As Canada has shown, Brazil has not demonstrated that EDC provides financial packages that are better than what a recipient could otherwise obtain in the market. Thus, Brazil's argument is circular here too. It assumes, falsely, that a benefit is conferred by a "financial package" to argue that a benefit is conferred by the "ability, expertise and knowledge" used to develop that package.

(e) Brazil Has Not Shown That Loan Guarantees Confer A Benefit

84. Lastly, Brazil asserts, at paragraphs 68 to 70 of its first submission, that loan guarantees provided by EDC confer a benefit. Brazil appears to be asserting that all government loan guarantees necessarily confer a benefit. Brazil does not explain how its position – which would come as a surprise to most government export credit agencies – is consistent with the definition of "benefit" adopted by the Appellate Body. Brazil has failed to recognize that most guarantors, including EDC, charge fees for their guarantees.

(iii) Conclusion

85. In sum, having failed to show that Corporate Account as such constitutes a prohibited export subsidy, Brazil has also failed to make out a *prima facie* case that the application of Corporate Account financing confers a benefit. Brazil has not demonstrated, either by reference to the statements of EDC officials or to transactions, that Corporate Account financing is applied to confer a benefit. Corporate account loans and loan guarantees are not offered on terms more favourable than those available in the market. They do not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement and therefore do not amount to subsidies. As Brazil has failed to show that Corporate Account financing amounts to a subsidy, the issue of export contingency is moot.

F. INVESTISSEMENT QUÉBEC FINANCING

86. The onus lies with Brazil to make out a *prima facie* case that Investissement Québec financing constitutes a subsidy within the meaning of Article 1 of the SCM Agreement. In particular, Brazil must make out a *prima facie* case of the existence of financial contributions by Investissement Québec that thereby confer a benefit on the recipient.

⁷⁹ *Id.*, para. 65.

(i) Financial Contribution

87. The only financial contributions by Investissement Québec that Brazil appears to allege are the provision of “loan guarantees” and “first loss deficiency guarantees” or “equity guarantees”.⁸⁰ The provision of such guarantees by a government or public body constitutes potential direct transfers of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement and would therefore be a “financial contribution”.

(ii) Brazil Has Failed to Show the Existence of a “Benefit”

88. As the Appellate Body has found, the existence of a “benefit” within the meaning of Article 1.1(b) of the SCM Agreement can be determined by whether the financial contribution is on terms more favourable than those available to the recipient in the market.⁸¹ Brazil has not demonstrated this. Instead, its only arguments appear to be that equity guarantees “do not even appear to be available commercially” or “are not available in the market”,⁸² and that government loan guarantees necessarily confer a benefit.⁸³

89. The first of these arguments is surprising coming from Brazil. Equity guarantees are not only offered commercially in the aircraft sector but they have been used to support the sale of Embraer regional aircraft. For example, according to the Preliminary Prospectus issued in conjunction with the financing of a 1997 sale of Embraer EMB-145 regional jets for use by Continental Airlines, the structure of the transaction includes an equity guarantee by the engine supplier Rolls-Royce.⁸⁴

90. Moreover, as Brazil recognizes at paragraph 88 of its first submission, leveraged lease transactions, which often include first-loss deficiency guarantees, are hardly “unusual”. They are a commonplace aircraft financing structure based on the tax laws of certain jurisdictions.

91. Nor has Brazil demonstrated that Investissement Québec loan guarantees confer a “benefit”. As Canada noted above with respect to Brazil’s Corporate Account arguments, Brazil does not explain how its position – which would come as a surprise to most government export credit agencies – is consistent with the definition of “benefit” adopted by the Appellate Body. Brazil has failed to recognize that most guarantors, including Investissement Québec, charge fees for their guarantees.

(iii) Brazil Has Failed to Demonstrate Contingency Upon Exportation

92. Investissement Québec financing for aircraft sales is provided pursuant to section 28 of the Investissement Québec Act. As noted, Section 28 provides that:

The Government may, where a project is of major economic significance for Qu? bec, mandate the agency to grant and administer the assistance determined by the

⁸⁰ At footnote 131 to its First Submission, Brazil appears to imply that Investissement Québec may have offered residual value guarantees on Bombardier regional aircraft sales. Investissement Québec has never provided residual value guarantees.

⁸¹ *Canada – Aircraft I*, Appellate Body Report, para. 157.

⁸² Brazil’s First Submission, para 95.

⁸³ Brazil’s First Submission, para. 96.

⁸⁴ Continental Airlines, Preliminary Prospectus, 16 October 1997 SEC Filing 424(b)3, cited from www.sec.gov, p.S-33 (Exhibit CDA-13). Also available at www.continental.com/corporate under Investor Relations/SEC Filings.

Government to facilitate the realization of the project. The mandate may authorize the agency to fix the terms and conditions of the assistance.⁸⁵

93. Section 28 of the Act is used for many types of projects, whether or not they have export potential. Nevertheless, Brazil argues, on the basis of Investissement Québec regulations, that Investissement Québec financing “is contingent in law upon export”.⁸⁶ However, the programmes described in the decrees to which Brazil refers, 572-2000 and 841-2000, have nothing to do with aircraft sales financing and are not used for aircraft sales financing.⁸⁷

94. Furthermore, Brazil appears to have misread Decree 572-2000. That decree states that funding can be for domestic or export projects but “exportation” as it refers to sale of goods refers to sale outside of Quebec. This, of course, does not mean that funding under the decree must be for sales outside of Quebec but that funding of export projects involving sales of goods must involve sales outside of Quebec. That is, “export projects” can include purely domestic sales to other parts of Canada as well as exports outside of Canada. Brazil’s conclusion, that Investissement Québec financing for aircraft sales is contingent in law upon export performance, rests on the misreading of inapplicable decrees.

95. Nor do the remainder of Brazil’s arguments support its claim. Brazil contends, at paragraph 101 of its first submission, that virtually all of Bombardier’s production is exported and that this demonstrates “the *de jure* export contingency” of both a loan guarantee fund established for Bombardier as well as equity guarantees. Brazil has failed to show that either loan guarantees or equity guarantees offered by Investissement Québec are subsidies. They are not, but even if they were, Brazil has failed to establish their *de jure* export contingency.

96. According to the Appellate Body: “... the ordinary connotation of ‘contingent’ is ‘conditional’ or ‘dependent for its existence on something else’.”⁸⁸ A subsidy is contingent “in law” upon export performance “when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure”.⁸⁹ Brazil failed to identify any legal instrument from which the export contingency of Investissement Québec financing can be demonstrated, nor does any such instrument exist. At most, Brazil has shown that some of Investissement Québec’s financing *involves* export sales.⁹⁰ This in no way makes Investissement Québec financing contingent in law upon export performance.

(iv) Conclusion

97. Brazil has failed to show that any of Investissement Québec’s financing either confers a benefit or is contingent upon exportation. It has therefore failed to make out even a *prima facie* case that Investissement Québec financing is a prohibited export subsidy.

⁸⁵ *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

⁸⁶ Brazil’s First Submission, para 97.

⁸⁷ *Id.*, paras. 98-100.

⁸⁸ *Canada – Aircraft I*, Appellate Body Report, para. 166, citing with approval the panel’s definition.

⁸⁹ *Canada – Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 100.

⁹⁰ Although Brazil has alleged only contingency in law, the mere fact that Investissement Québec financing involves export sales does not amount to contingency in fact either. (See *Canada – Aircraft I* Appellate Body Report, para. 173.)

V. CONCLUSION

98. Brazil's claims in this dispute fall into two categories. On the one hand, it is challenging Canada's decision to offer financing to Air Wisconsin. Its claims in this regard are clear, but they ignore the fact that Canada is simply responding, on a matching basis, to a financing offer that Brazil made to Air Wisconsin in an effort to win a sale for Embraer. Under the second paragraph of Item (k) in Annex I to the SCM Agreement, Canada is fully within its rights to do this. Canada asks that the Panel find accordingly.

99. On the other hand, Brazil appears to be challenging, at one or more levels, the EDC's Canada Account and Corporate Account programmes and Investissement Québec. As Canada has argued in its Preliminary Submission, the scope and substance of these claims are far from clear. They are contrary to Articles 6.2 or 21.5 of the DSU, or both. However, even on the merits, Brazil has failed in all instances to meet its burden of establishing a *prima facie* case. In its first submission, it has largely recycled allegations and evidence that have already been rejected by the panel and the Appellate Body in *Canada – Aircraft I*.

100. If Brazil is again challenging Canada Account or Corporate Account "as such", it has offered no basis, in law or in fact, for this Panel to revisit the findings of the *Canada – Aircraft I* panel that those programmes involve discretionary legislation. Brazil has also confirmed by its own evidence that Investissement Québec involves discretionary legislation. It too is not inconsistent "as such" with the SCM Agreement.

101. To the extent that Brazil is challenging types of Corporate Account or Investissement Québec financing generally or in respect of specific transactions, it has neither demonstrated nor can it demonstrate that this financing is a prohibited export subsidy. In the light of Brazil's failure to establish a *prima facie* case of inconsistency with the SCM Agreement, Canada asks that the Panel reject these claims as well.

ANNEX B-5

ORAL STATEMENT OF CANADA REGARDING JURISDICTIONAL ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

I. INTRODUCTION

1. In its Preliminary Submission of June 18, Canada asked the Panel to make a number of findings with respect to its jurisdiction. Today, Canada will respond to the points raised by Brazil in its reply submission of 22 June, and in so doing will summarize briefly its positions on these issues. Certain of Brazil's Claims are Inconsistent with DSU Article 21.5

A. CERTAIN OF BRAZIL'S CLAIMS ARE INCONSISTENT WITH DSU ARTICLE 21.5

2. On reading the 22 June reply submission of Brazil, Canada learned – for the first time – that Brazil does not consider each of the numbered paragraphs in its Panel request to constitute separate claims. Instead, according to Brazil, it has made one “overarching claim” in paragraph 1 with respect to the Canada Account. Paragraphs 2, 3 and 4, argues Brazil, merely “explain the nature of that claim in more detail”.

3. There is nothing in the Panel request that would indicate that Brazil has made one “overarching” claim in paragraph 1, of which paragraphs 2, 3 and 4 are mere subsets. Any reasonable construction of Brazil's Panel request supports the view that Brazil has made separate claims, duly set out in separate paragraphs. Nor did Brazil offer this or any other clarification when asked to do so by Canada.

4. Even if one were to accept the “overarching claim” theory, which Canada does not, this does not mean that any of its Claims are somehow immune from review from the Panel on jurisdictional grounds. Any part of the request for the Panel – whether part of an “overarching claim” or not – must comply with the mandatory requirements of the DSU, including Article 21.5 and 6.2. Any parts of the Panel request that fail to abide by these requirements should rightfully be considered by the Panel as outside its terms of reference.

5. This late addition of the “overarching claim” theory appears to be an attempt by Brazil to “cure” the deficiencies in its Panel request. As noted by Canada in its Preliminary Submission, it is not possible for a complaining party to use later submissions to “cure” defects in its Panel request.

6. Brazil states in paragraph 8 of its June 22 submission that it considered it “efficient” to forego Article 21.5. Brazil also states, in paragraph 9, that it considered it “preferable” to bring all its claims before this Panel, rather than reconvening the original Panel to consider compliance issues, and *de novo* proceedings to consider new claims. In Canada's view, the issue is demonstrably not what is “efficient” or “preferable.” Rather, the issue is what is permitted by the DSU.

7. Disputes over implementation must be resolved through recourse to DSU Article 21.5. This is clear from the language of the provision, which states that disagreements over compliance “shall” be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original Panel.

8. If the intent of the drafters of the DSU had been different, they could have used different language. They could have said that such disputes “may” be decided through recourse to the original Panel. They did not. They could have said that such disputes “should” be decided through recourse to the original Panel. They did not. The ordinary meaning of Article 21.5 is that the complaining party “shall” have recourse to the original Panel where it is possible to do so. Brazil has not sought to argue that recourse to Article 21.5 was not possible in this case.

9. This interpretation is consistent with the practice of WTO Members to date, all of which, when seeking to resolve implementation disputes, have done so through recourse to Article 21.5. Brazil would be the first WTO Member to seek to resolve a compliance dispute through *de novo* Panel proceedings. To allow Brazil to proceed in this manner would be to ignore completely the mandatory language of Article 21.5.

10. Furthermore, Brazil is seeking to have the Panel rule on issues of implementation related to another dispute, with different terms of reference. The Panel has no jurisdiction to hear such claims.

11. The EC agrees that Article 21.5 is “not of a purely hortatory nature”. However, Canada disagrees with the argument advanced by the EC that the word “shall” in Article 21.5 relates to “the use of the original panel once the option of an Article 21.5 panel has been chosen and not the use of the Article 21.5 procedure”. The wording of Article 21.5 does not support such an interpretation. The relevant portion of Article 21.5 states that: “such dispute shall be decided through recourse to these dispute settlement procedures, *including wherever possible resort to the original panel*”. If the drafters of the DSU intended to provide complaining parties with what the EC calls the “option” of an Article 21.5 procedure, they could easily have done so. Moreover, the use of the word including makes clear that the clause that follows this word (“wherever possible resort to the original panel”) is subordinate to the mandatory language of the earlier part of the sentence (“shall be decided”). In other words, Article 21.5 requires that compliance disputes must be decided through recourse to the original panel, unless this is not possible.

12. Canada therefore maintains that Brazil has failed to respect the mandatory requirements of DSU Article 21.5.

B. CERTAIN OF BRAZIL’S CLAIMS ARE INCONSISTENT WITH DSU ARTICLE 6.2

13. DSU Article 6.2 requires that a request for the establishment of a Panel must, among other things, identify the specific measures at issue, and provide a brief summary of the legal basis of the complaint, sufficient to present the problem clearly.

14. The Appellate Body has made clear that compliance with Article 6.2 is a requirement of “due process” that is “fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings”.

15. As noted above, it is equally clear that the deficiencies in the Panel request, including a failure to meet the minimum standards of Article 6.2, cannot be “cured” by the subsequent submissions of the complainant.

16. The specific deficiencies of Brazil’s request are set out in Canada’s submission. Canada recalls that with respect to Claim 2, the EC also considers that this Claim fails to meet the standard

required by Article 6.2, on the grounds that Brazil was required to cite a covered agreement, and that “a panel report in an earlier dispute...does not amount to a covered agreement.” Although the EC puts this forward as a different argument than that advanced by Canada, it would appear to be another way of explaining the test set out by the Appellate Body that the complaining party must identify the treaty provision alleged to have been violated.

17. In its 22 June arguments with respect to DSU Article 6.2, Brazil again advances its theory of the “one overarching claim”.

18. As Canada stated with respect to Article 21.5, there is nothing in the Panel request that would indicate that Brazil has made one “overarching” claim. Brazil has made separate claims, duly set out in separate paragraphs. The late addition of an “overarching claim” theory appears to be an attempt by Brazil to “cure” the deficiencies in its Panel request.

19. Even if one were to accept the “overarching claim” theory, which Canada does not, this would in no way mean that either paragraph 1, or the subsequent elaborations set out in the succeeding paragraphs, do not need to comply with DSU Article 6.2. Whether part of an overarching claim or not, the due process requirements of Article 6.2 mandate that the request for the establishment of the Panel both identify the specific matters at issue, and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. As we have argued in our submission, Claims 1, 2, 5 and 7 fail to meet this standard.

20. In paragraph 21 of its June 22 submission, Brazil informs Canada that it is challenging measures “as such”, and as applied, such as in the Air Wisconsin transaction. It adds that it is only concerned with the challenged measures with respect to their role in regional aircraft transactions.

21. Brazil cannot seek to “cure” the defects in its Panel request with such additional detail. The Panel request – as presented to the DSB - must be assessed against the requirements of Article 6.2, not in conjunction with whatever supplementary clarifications Brazil now wishes to present. Moreover, although Brazil reminds us of the title to this dispute, the title assigned by the Secretariat is of no relevance, one way or another, in determining whether Brazil’s request meets the requirements of Article 6.2. In any event, when Canada sought clarification from Brazil as to the scope of its claims, Canada indeed referred to the title of this dispute and asked Brazil whether Claims 1, 5 and 7 were intended to refer to certain practices or programs only as they relate to regional aircraft. Brazil chose not to respond, leaving Canada to conclude that their Claims may not, in fact, have been limited in the manner suggested by the title.

22. Even though Brazil is not permitted to “cure” the defects in its Panel request, its subsequent submissions have in fact only added to the confusion. For example, paragraph 24 of the 22 June submission states that “Canada Account uses types of support not included in Brazil’s claims, including export credits insurance, performance insurance, and political risk insurance.” However, paragraph 78 of Brazil’s First Submission provides in part that: “Canada Account offers...major financial services to support Canadian exporters: export credits insurance...performance insurance, and political risk insurance. These constitute either a ‘direct transfer of funds’ or a ‘potential direct transfer of funds or liabilities,’ under Article 1.1(a)(1)(i) to the SCM Agreement....All of these export credits, whatever their form, also constitute the provision of services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement.” Given this inconsistency, it remains entirely unclear which Canada Account “services” or “export credits” are included in Brazil’s claims.

23. Paragraph 24 of Brazil’s 22 June submission states that “EDC similarly provides various types of support not subject to Brazil’s claims, such as accounts receivable insurance, bonding, and political risk insurance.” Yet paragraph 40 of Brazil’s First Submission states that “EDC offers ‘a wide range of financial services’ to Canadian companies. These financial services include credit

insurance, financing services, bonding services, political risk insurance and equity. They constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement.” Brazil’s First Submission (starting at paragraph 60) also challenges “financial services” generally, which would seem to include the financial services listed above. Given this inconsistency, it remains entirely unclear which EDC support or financial services are included in Brazil’s claims.

24. Paragraph 24 of Brazil’s June 22 submission similarly states that Investissement Québec “extends support not included in Brazil’s claims, such as suretyship and exchange rate guarantees.” However, in its argument on Investissement Québec, Brazil’s First Submission states at paragraph 92 that: “[t]he provision of financial services in the form of loans and guarantees (“suretyship”) constitute financial contributions within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement.” Given this inconsistency, it remains entirely unclear to Canada which Investissement Québec financing or support is included in Brazil’s claims.

25. More generally, when Brazil states in paragraph 24 of its 22 June submission that certain types of support are not included in its claims, it seems to provide only examples of the types of support not subject to its claims. This raises the obvious question as to what other types of activities are not subject to Brazil’s claims.

26. Indeed, the failure of Brazil to abide by the requirements of DSU Article 6.2 are particularly evident when Brazil’s Panel request is read with paragraph 24 of Brazil’s 22 June submission. Claim 1 challenges “Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account....” However, paragraph 24 states in part that: “Canada Account uses types of support not included in Brazil’s claims, including....”

27. Claim 5 challenges “Export credits, including financing, loan guarantees, or interest rate support by or through the EDC....” Paragraph 24 says that “EDC similarly provides various types of support not subject to Brazil’s claims, such as....”

28. Claim 7 impugns “Export credits and guarantees provided by Investissement Québec, including....” Paragraph 24 states that Investissement Québec “also extends support not included in Brazil’s claims, such as....”)

29. Thus Brazil’s request for a Panel used all-encompassing language, advising Canada that certain measures were challenged, “including” some examples listed by Brazil. Canada was not advised what components of the challenged measures were not so “included”. In Brazil’s 22 June submission, Brazil has now advised Canada that certain measures were not included, although again without specifying which ones. This falls short of the minimum standards imposed by Article 6.2.

30. Canada also agrees with the observation made in paragraph 18 of the EC third party submission that “loosely worded requests for the establishment of a panel, such as the catch-all clause ‘including, but not limited to’, to describe the subject matter of a dispute have...rightly been held to fall short of the minimum requirements for a request for the establishment of a panel.” Brazil cannot have met the requirements of Article 6.2 of the DSU when even at this late date it has still failed to clearly specify the matters at issue

31. Brazil refers to the so-called “attendant circumstances” in this case. More specifically, Brazil argues that Canada’s ability to defend itself in this case has not been prejudiced, because “Canada is very much aware of the issues and claims involved and, as such, has been and will continue to be able to vigorously defend itself.” However, as a result of Brazil’s failure to meet the minimum requirements of Article 6.2, Canada has suffered actual prejudice in the conduct of its defence. In *Thailand Steel*, the Panel found that the prejudice to Thailand “was a function of the fact that the precise nature and scope” of Poland’s claim “remained unclear and confusing” to Thailand. The same

rationale applies equally here. Brazil's claims remain "unclear and confusing" to Canada. Moreover, given the contradictory statements cited above, they would also appear to be unclear and confusing to Brazil.

32. The deficiencies of Brazil's complaint are not mere formalities. Knowing the case to be met is essential to a Member's right to fully defend its laws and programs. Complaining Members should not be permitted to gain a litigation advantage by obscuring the target and the basis of their challenge until the filing of the first submission or later. Clarity in the framing of a complaint protects the interest of the defending Member, as well as third parties participating in the dispute and all other Members who stand to be affected by the outcome of the dispute. Article 6.2 safeguards Members' rights by ensuring that they know the case to be met.

33. Even after the filing of its first submission, the precise scope and nature of Brazil's claims 1, 2, 5 and 7 remain unclear. Canada therefore urges the Panel to find that those claims are inconsistent with Brazil's obligations and Canada's rights under Article 6.2 and therefore are not properly before this Panel.

34. In paragraph 36 of its 22 June Submission, Brazil refers to Canada's request to obtain clarifications with respect to the scope of Brazil's claims, and asserts that "the Appellate Body's statement in *Thailand – Steel* does not, as Canada implies, impose a legal obligation on Brazil to unfold all the details of its case in response to Canada's detailed 16 May request." Canada never implied that Brazil had a "legal obligation" to "unfold all the details of its case." Instead, given the vague and broadly-worded nature of Brazil's Panel request, Canada simply sought clarification as to the scope of Brazil's claims. Brazil chose not to respond substantively to Canada's letter. Consequently, Canada chose to assert its right to seek a preliminary ruling that certain of Brazil's claims are inconsistent with DSU Article 6.2.

35. In paragraph 37 of the Brazilian June 22 submission, Brazil refers to the "considerable detail" regarding its claims provided in its May 21 letter. However, that letter in no way identified the scope of Brazil's claims. On the contrary, the sweeping request in Brazil's 21 May letter implied that Brazil's claims were even broader than the Panel request suggested, in that they extended not just to current practices but to past practices as well.

36. The EC shares Canada's view on Article 6.2. Its third party submission states that "Canada's rights of defence and the third parties' ability to clearly understand the purview of the present dispute have been seriously curtailed." The EC urges the Panel to conclude that Claims 1, 2, 5 and 7 are not properly before it.

37. To conclude, Canada respectfully requests the Panel to make the rulings on jurisdiction identified in paragraph 62 of our Preliminary Submission, namely that:

Claims 2 and 3 raise issues of compliance related to another dispute, which Brazil was required to bring under DSU Article 21.5. Accordingly, Claims 2 and 3 are outside the jurisdiction of the Panel;

The reference in Claim 1 to certain export credits that "continue to be" prohibited subsidies raises compliance issues related to another dispute, and is also outside the jurisdiction of the Panel; and

Claims 1, 2, 5 and 7 are inconsistent with the requirements of DSU Article 6.2, and therefore these Claims are outside the jurisdiction of the Panel.

ANNEX B-6

ORAL STATEMENT OF CANADA REGARDING SUBSTANTIVE ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

I. INTRODUCTION

1. In the Written Submission that it filed nine days ago, Canada stated that the only clear and consistent element of Brazil's complaint in this dispute has been Canada's offer of financing for the sale of regional aircraft to Air Wisconsin. In that submission, Canada nevertheless made a full response to Brazil's claims as it understood them.

2. In its statement today, Canada will not repeat all of the arguments it made in its First Submission. Instead, Canada will begin with a brief review of Brazil's claims and Canada's responses, elaborating on the issue of "benefit". Due to the lack of clarity in certain of Brazil's claims, and pending the Panel's preliminary ruling, Canada will place particular emphasis on the Air Wisconsin transaction.

3. Canada will explain why it is simply not credible that Embraer, without any support from the Brazilian government, could commit to offering financing to Air Wisconsin on the terms described in the information provided on Monday by Brazil. Canada will show that if Embraer's offer truly did not entail Brazilian government support, this would demonstrate that the OECD Arrangement cannot be used to determine what is a benefit for the purposes of Article 1 of the SCM Agreement. It would also mean that Canada's offer to Air Wisconsin does not confer a benefit.

4. If, however, the Embraer offer did entail Brazilian government support, Canada's offer simply matched Brazil's offer to Air Wisconsin. My colleague, Karl Blume, will explain why such matching is permitted under the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") and more specifically, the "safe haven" of the second paragraph of Item (k) in Annex I.

II. ARGUMENT

A. BRAZIL HAS FAILED TO MAKE OUT ITS CASE

5. In its First Submission, Canada showed that Brazil has not demonstrated that Corporate Account, Canada Account or Investissement Québec, as such, are illegal. Canada showed that Brazil has offered no basis for the Panel to revisit the findings of the *Canada – Aircraft I* panel that the Corporate Account and Canada Account are discretionary. Brazil itself confirmed by its evidence that Investissement Québec is discretionary. Canada also explained that Brazil has failed to demonstrate that in their specific application, any of these programmes are offering prohibited export subsidies.

6. In the case of the EDC Corporate Account, Canada reconfirms that, with the exception of official support transactions, Corporate Account activities are undertaken on commercial principles and using market pricing. EDC offers financing at market rates by setting the interest rate payable by the borrower to reflect risk, in accordance with market principles. Consequently, except when

providing official support, EDC does not offer terms more favourable than those available in the market. It therefore does not confer a benefit and is not a prohibited export subsidy. Brazil has not shown otherwise. Brazil has similarly failed to show that Investissement Québec's financing is offered on terms more favourable than those available in the market. Brazil has also failed to show that Investissement Québec financing is contingent upon exportation.

B. REFERENCE TO THE ARRANGEMENT DOES NOT DEMONSTRATE A BENEFIT

7. In its arguments on the Corporate Account in its First Submission, Brazil contends that terms more favourable than those in the OECD Arrangement are positive evidence of a benefit within the meaning of Article 1 of the SCM Agreement. However, there is no textual basis, outside the second paragraph of Item (k), for incorporating the terms of the Arrangement into the SCM Agreement. The reference to the OECD Arrangement is thus in the context of an exception to Article 3. No principle of logic or legal interpretation requires the incorporation of an exception as a benchmark for a definition.

8. In fact, it is particularly odd that Brazil would suggest that it can show the existence of a benefit under Article 1 of the SCM Agreement with reference to two terms of the OECD Arrangement, the 10 year repayment term and the CIRR. Just last month, at a meeting of the SCM Committee, Brazil expressed its concern that in the context of the SCM Agreement, reference to the OECD Arrangement could create what Brazil called "a permanent 'carte blanche' to the participants of that Arrangement to alter WTO rules".

9. It is one thing to allow conformity with the interest rates provisions of the Arrangement to offer a safe haven for what would otherwise be a prohibited export subsidy. The SCM Agreement expressly provides for this in Item (k) and the Members of the WTO have agreed to it. However, it is quite another to allow the Arrangement to determine what is or is not a benefit under Article 1. That would enable the participants in the Arrangement to alter WTO rules by altering the terms of the Arrangement – precisely the concern that Brazil has raised in the SCM Committee and something to which the Members of the WTO have not agreed.

10. Whether or not a benefit has been conferred must be determined not with reference to the Arrangement, but, as the Appellate Body has found, with reference to the terms that could be obtained in the market. As Canada explained in its Written Submission, the Arrangement becomes relevant only once a subsidy has been found to exist and a Member seeks to rely on the safe haven of Item (k).

11. There are no better examples of why this is the case than two of the situations before the Panel. First, Brazil has argued that EDC Corporate Account transactions confer a benefit because they are offered for repayment terms longer than the 10 year limit in the Arrangement. However, as Canada showed in its Written Submission, repayment terms of greater than 10 years for regional aircraft financing are entirely consistent with the terms that can be obtained in the market. By Brazil's reasoning, if all other terms of a transaction were equal but EDC offered financing with a repayment term of 11 years while a commercial bank offered 16 years, EDC's financing would be deemed to confer a benefit simply because it exceeded the Arrangement, even though it was significantly less favourable than the terms available in the market. The SCM Agreement simply cannot have this result.

12. The second example is the Air Wisconsin transaction itself. According to the information Brazil provided to the Panel on Monday, Embraer made two offers to Air Wisconsin, one at what Embraer calls []. At this time, Canada will not comment specifically on the first of these offers, as it was apparently superseded, except to state that to its knowledge there is no such thing as a [].

13. Brazil asks the Panel to believe that Embraer's offers involved no support from the Brazilian government. The Panel is asked to believe that the financing described in Embraer's letter was available in the commercial market to Air Wisconsin for []. However, the Arrangement imposes a maximum repayment term of 10 years and a loan-to value limit of 85 per cent, []. Thus, Embraer's claim, if accepted, confirms the illogic of Brazil's position that the Arrangement could determine what terms are "at market" for the purpose of establishing a "benefit" under Article 1 of the SCM Agreement.

C. EMBRAER'S EXPLANATION OF THE AIR WISCONSIN TRANSACTION IS NOT CREDIBLE

14. Embraer's exact statement in its letter is that: "EMBRAER made two financing offers, neither of them involving any support from the Brazilian Government." In Canada's view, this raises three possibilities:

? First, the statement may be the truth but not the whole truth. That is, at the time the offers were made, it may technically be true that the Brazilian Government had not formally committed to providing support, but the offers were made in the expectation and on the understanding that the Brazilian government or an agency of the government would provide the necessary support.

? Second the statement may be false. In order to accept the veracity of the statement, one would have to find: (a) that the Air Wisconsin official cited in Canada's Exhibit CDA-1 was lying to Bombardier when he told the Bombardier official that Embraer's offer involved BNDES and PROEX support, or that the Bombardier official was lying when he reported this back to his company; (b) that Air Wisconsin officials misrepresented the nature of Brazil's involvement when they met with Canadian officials; and (c) that Embraer realistically could have arranged commercial financing for []. Even the highest rated US airlines, such as American, are routinely required to pay interest rates significantly greater [] when financing aircraft even at loan-to-value ratios of below 70 per cent.¹ Yet Brazil would have the Panel believe that Embraer was capable of []. The claim is simply not credible.

? The third possibility is that the statement is true. That is, incredible as it might seem, Embraer discovered a source, or sources, of commercial credit that were prepared to support its offer to Air Wisconsin of [].

15. If the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms claimed by Embraer, then the financing offered by Canada - essentially a [] - would be no more favourable than Embraer's "market" terms. Air Wisconsin itself confirmed this in its letter of 20 March 2001 (filed as Canada's Exhibit CDA-2).

16. Accordingly, if the Panel determines that Embraer is telling the truth, then Canada's offer to Air Wisconsin would be on terms no more favourable than those available to the recipient in the market. One would therefore have to infer that Canada's offer does not confer a benefit within the meaning of Article 1 of the SCM Agreement.

17. If, however, the Panel considers that Embraer's offer to Air Wisconsin did involve Brazilian government support, Canada's offer was made to match Brazil's support and therefore qualifies for the "safe haven" of Item (k). I will now turn to Karl Blume, to discuss this issue.

¹ Morgan Stanley Dean Witter Report, 10 February 2001 (Exhibit CDA-14).

D. CANADA'S MATCHING OF BRAZIL'S OFFER TO AIR WISCONSIN IS PERMITTED BY THE SCM AGREEMENT

18. Brazil alleges that the Air Wisconsin transaction constitutes a prohibited export subsidy that does not qualify for the "safe haven" of the second paragraph of Item (k) to Annex I of the SCM Agreement because Canada's offer was made on a matching basis and matching is not an "interest rates provision".²

19. Brazil's argument is based on an *obiter dictum* by a previous panel.³ The previous panel made its findings in the abstract without the benefit of an actual disputed transaction. The events of this case provide practical evidence of why the SCM Agreement permits matching.

20. The matching provisions of the OECD Arrangement are expressly permitted by, and conform to, the OECD Arrangement. Moreover, the matching provisions of the OECD Arrangement are "interest rates provisions" within the meaning of the second paragraph of Item (k). Accordingly, because Canada's action with respect to Air Wisconsin is on a matching basis as expressly permitted by the OECD Arrangement and as envisaged by the SCM Agreement, the transaction qualifies for the "safe haven" of the second paragraph of Item (k).

21. The second paragraph of Item (k) provides an exception to the general prohibition on export subsidies found in Article 3 of the SCM Agreement. Under the second paragraph of Item (k), 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.⁴

1. Matching is in Conformity with the "Interest Rates Provisions" of the Arrangement

(i) Conformity with the Arrangement

22. The *Canada – Aircraft I* Article 21.5 panel ("Article 21.5 panel") found that some matching – but not all – was, by the OECD Arrangement's own terms, not in "conformity" with the provisions of the OECD Arrangement, and thereby, not in conformity with the "interest rates provisions" of the Arrangement.⁵

23. This is contrary to the text of the second paragraph of Item (k). As the Article 21.5 panel admitted itself, matching is "permitted" by the provisions of the Arrangement.⁶ Article 29 of the Arrangement specifically permits matching. Matching cannot be "permitted" by the Arrangement and at the same time not be in "conformity" with that same Arrangement.

(ii) Matching is an "Interest Rates Provision"

24. Moreover, matching is itself an "interest rates provision". The most logical interpretation of the term "interest rates provisions" includes all substantive provisions in the Arrangement that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be, in a given transaction. Matching addresses one set of circumstances that affect the

² Brazil's First Submission, at paras. 74-81.

³ *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 4 August 2000, at paras. 5.124-5.126 [hereinafter "*Canada – Aircraft I*, Article 21.5 Panel Report"].

⁴ *Id.*, at para. 5.78.

⁵ *Id.*, at paras. 5.124-5.126.

⁶ *Id.*, at paras. 5.124-5.125.

determination of interest rates and is consistent, and conforms with, the Arrangement. The US and EC both support Canada's view that matching is an "interest rates provision".⁷

25. All of the "interest rates provisions" – including matching – operate together to discipline the terms and conditions of a particular transaction in a way that minimum interest rates, on their own, could not achieve. Matching fosters compliance with the other "interest rates provisions".

(iii) *Conclusion*

26. The text of the second paragraph of Item (k) requires "conformity" with the "interest rates provisions" of the Arrangement.⁸ As Canada has demonstrated, matching conforms to the provisions of the Arrangement by its own terms. Furthermore, matching is itself an "interest rates provision". Accordingly, matching is in "conformity" with the "interest rates provisions" of the Arrangement.

2. Members Incorporated the Discipline of Matching.

27. Not only does the text of the second paragraph of Item (k) support Canada's view that matching is in "conformity" with the "interest rates provisions" of the Arrangement, matching is consistent with the object and purpose of the SCM Agreement.

28. The intent of the SCM Agreement drafters was not that some Members must remain at a permanent disadvantage to other Members that fail to fulfil their obligations. The SCM Agreement drafters envisaged such a situation and incorporated the discipline of matching into the SCM Agreement through the second paragraph of Item (k). Incorporating the matching disciplines of the Arrangement fulfils the drafters' intent and, as Canada has demonstrated, is consistent with the text of the second paragraph of Item (k).

29. The incorporation of the "interest rates provisions" of the OECD Arrangement in the GATT Subsidies Code and in the SCM Agreement indicates that the signatories were fully aware of the object and purpose of the Arrangement and found it to be consistent with, and support, the object and purpose of the SCM Agreement. The reliance on the disciplines developed by the Participants to the Arrangement reflects the acceptance by all Members of the Participants' particular expertise in the field of officially supported export credits.

30. When Members agreed to the WTO Agreements including the SCM Agreement in 1994, the Arrangement had been successfully disciplining trade distorting export subsidies for over 15 years. In that light, Members were almost certainly aware of the success of the Arrangement in limiting the use of trade distorting export subsidies. The Arrangement's success came through the implementation of a full set of well-balanced rights and obligations in the field of export credits. In the absence of any particular language in the second paragraph of Item (k), there is no reason to believe that Members would have wanted to discard one key instrument in this set of rights and obligations.

3. The "Interest Rates Provisions" – Including Matching – Do Not Introduce an Imbalance of Members Rights and Obligations.

31. The Article 21.5 panel stated that because the second paragraph of Item (k) creates an exemption from a prohibition in a WTO Agreement – with the scope of that exemption being in the hands of a subgroup of Members – it was important that the second paragraph of Item (k) not be

⁷ See US Third Party Submission, at paras. 10-15, and E.C. Third Party Submission, at paras. 57-70.

⁸ The OECD Arrangement is an "international undertaking on official export credits" in the sense of the second paragraph of Item (k). See *Canada-Aircraft I*, Article 21.5 Panel Report, at para. 5.78.

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 Members.⁹

32. The application of all the “interest rates provisions” of the OECD Arrangement – including matching – is not *de facto* more favourable treatment for Participants to the Arrangement because it is available to all other WTO Members. In Canada’s view, the right to offer terms on a matching basis is available to all Members. 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.

33. Furthermore, in Canada’s view, the “interest rates provisions” do not include procedural requirements of the Arrangement with which a non-Participant inherently could not comply.

4. On a Systemic Level, Matching Directly Supports Real Disciplines Under the SCM Agreement.

34. The Article 21.5 panel equated matching, in some circumstances, to a derogation.¹⁰ The text of the Arrangement does not support this view. Article 29 specifically permits matching as a response to an “initiating offer” that may or may not comply with the Arrangement. It is the initiating offer that, in some circumstances, is the derogation – never the response. The initiating offer – when it amounts to a derogation – is specifically prohibited under Article 27 of the Arrangement. The response is specifically permitted by Article 29 of the Arrangement, and qualifies for the “safe haven” by virtue of being an “interest rates provision” within the meaning of the second paragraph of Item (k).

35. Matching is an explicitly permitted response when, in certain cases, export subsidy disciplines have not been complied with. Matching does not encourage non-compliance with the disciplines. Instead, matching directly supports the disciplines of the SCM Agreement on a systemic level by providing a strong and effective disincentive to breach the disciplines. The strengthening of the export subsidy disciplines that matching provides to the Arrangement applies equally to the disciplines of the SCM Agreement because matching is an “interest rates provision” under the second paragraph of Item (k).

36. Matching is consistent with both the second paragraph of Item (k), and with the object and purpose of the SCM Agreement in disciplining trade-distorting export subsidies. Matching restores equilibrium and removes the illegal advantage of Brazil’s financing package as an element – often the deciding element – in the decision of an airline of which aircraft to purchase, rather than basing the decision on the characteristics, quality and price of the aircraft itself.

5. Transparency Is Not An Advantage For Participants to the Arrangement – It Is a Competitive Disadvantage.

37. When considering the importance of transparency to the SCM Agreement, the Article 21.5 panel stated that non-Participants to the Arrangement would not, as a matter of right, have access to information regarding the terms and conditions offered or matched by Participants. Therefore, non-Participants would be at a systemic disadvantage vis-à-vis Participants.¹¹ A closer examination of this issue reveals no systemic disadvantage to non-Participants.

⁹ *Id.*, at paras. 5.132-5.133.

¹⁰ *Id.*, at paras. 5.124-5.125.

¹¹ *Id.*, at para. 5.134

38. Transparency among Participants does not disadvantage non-Participants. In contrast to non-Participants, Participants must provide the terms and conditions of a matching offer to other Participants. Non-Participants would not be under an obligation to provide information on matching offers to anyone. When Participants provide the terms and conditions of a matching offer to other Participants, the offer is subject to the prior scrutiny of the other Participants. The matching offer of a non-Participant would not be subject to any scrutiny under the Arrangement. Furthermore, although non-Participants would not receive the terms and conditions of Participants' matching offers, Participants would likewise not receive non-Participants' matching offers.

39. Moreover, non-Participants are advantaged because the Arrangement is a public document. By virtue of the Arrangement being a public document, non-Participants know the basic terms and conditions that Participants may offer. However, the terms of non-Participants' offers are not public knowledge.

40. Accordingly, transparency is not an advantage for Participants to the Arrangement, it is a competitive disadvantage.

III. CONCLUSION

41. Mr. Chairman, distinguished members of the Panel, there are two distinct categories of claims before you. The first category is Brazil's Air Wisconsin claims. In considering these, you face the choice of accepting or rejecting Embraer's assertion that its offers to Air Wisconsin did not involve government support. In Canada's view, the assertion lacks all credibility. If you accept it, then the necessary inference is that Canada's offer to Air Wisconsin is on terms no more favourable than those available to the recipient in the market and does not confer a benefit under Article 1 of the SCM Agreement. If you reject it, the law and the evidence support a finding that Canada's offer was made to match Brazil's support and qualifies for the "safe haven" of the second paragraph of Item (k).

42. The other category of Brazil's claims involves EDC's Canada and Corporate Account programmes and Investissement Québec. Brazil has failed in all cases to substantiate these claims.

43. Accordingly, Canada requests that the Panel dismiss both categories of Brazil's claims. I thank you for your patience and attention.

ANNEX B-7

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING OF THE PANEL

(6 July 2001)

Both parties

Question 1

What, if any, is the precedential effect of the findings of the Canada – Aircraft (DS70) panel on this Panel's consideration of Brazil's claims regarding the Canada Account and EDC programmes as such? What, if any, is the precedential effect of the findings of the Canada – Aircraft (DS70) panel on the matching provisions of the OECD Arrangement under item (k) of the Illustrative List of the SCM Agreement.

1. In *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* the panel found that panels are not legally bound by previous decisions of panels or the Appellate Body even if the subject-matter is the same, but that they should take into account the conclusions and reasoning of previous panels and the Appellate Body.¹ Canada agrees. In Canada's view, previously adopted panel reports are not legally binding precedents (*stare decisis*). However, as the Appellate Body stated in *Japan – Taxes on Alcoholic Beverages*, at page 14:

Adopted panel reports are an important part of the GATT *aquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.

2. The Appellate Body was referring to GATT reports, but there is no reason why the Appellate Body's finding should not apply equally to WTO reports.

3. The general practice has been for panels and the Appellate Body to follow the relevant findings of previous reports. At least one publicist, observing the Appellate Body, has characterized this as "*de facto*" *stare decisis* and has argued that the absence of *stare decisis* is a "myth".² However, panels have in some cases seen fit to depart from the findings of previous panels. For example, in the current Article 21.5 proceeding in *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*,³ in response to a request by the European Communities

¹ *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Panel, WT/DS79/R, adopted 2 September 1998, para. 7.30.

² R. Bhala, "The Precedent Setters: *De Facto Stare Decisis* in WTO Adjudication," (1999) 9 J. Transnat'l L. and Pol'y 1; "The Myth About *Stare Decisis* and International Trade Law," (1999) 14 Am.U. Int'l L.Rev. 845. In the latter article, the author notes that among those who have grappled with the issue of *stare decisis* in the WTO, in his view inconclusively, are the Chairman of this Panel and counsel for Brazil.

³ WT/DS 103; WT/DS 113.

(EC), the panel made a preliminary ruling that Article 10.3 of the DSU entitles third parties to receive all submissions, including rebuttal submissions filed prior to the hearing. In reaching this conclusion, the panel departed from the approach taken by previous panels in *Australia – Automotive Leather*, *Australia – Salmon*, and *United States – DRAMS*. In each of those previous disputes, the panel had rejected a similar request by the EC. Similarly, in *Canada – Autos* the panel seems not to have followed the *Indonesia – Autos* panel with respect to the meaning of “unconditionally” in Article I:1 of the GATT.⁴

4. In practice, panels are likely to follow the findings of previous panels unless there is a good reason for not doing so, for example if the circumstances giving rise to the previous finding can be distinguished or if it can be shown that the previous panel was wrong.

5. In the present case, there is no good reason for this panel to diverge from the finding of the *Canada – Aircraft* (DS 70) panel that EDC’s Canada Account and Corporate Account programmes involve discretionary rather than mandatory legislation and are therefore not, as such, subsidies contingent upon export performance. These programmes still involve discretionary rather than mandatory legislation. The *Canada – Aircraft* (DS 70) panel found that Brazil had failed to demonstrate otherwise. Without prejudice to Canada’s answer to Question 2, in this dispute, Brazil has put forward no new arguments or evidence that would justify this Panel making a different finding.

6. By contrast, there are good reasons for this Panel not to follow the Article 21.5 panel report in *Canada – Aircraft* (DS 70) with respect to “matching”. The Article 21.5 panel interpreted the whole of the matching provisions of the OECD Arrangement as not being “interest rates provisions” within the meaning of Item (k), second paragraph, of the Illustrative List. In the present case, at paragraphs 47 to 61 of its First Submission and paragraphs 18 to 40 of its First Oral Statement, Canada has put forth arguments that justify this Panel making a different and more qualified finding.

Question 2

Does this Panel have jurisdiction to review Brazil's claims regarding the Canada Account and EDC programmes as such? In particular, is the principle of *res judicata*, or a similar principle, applicable in this case, so as to preclude the Panel's consideration of issues previously ruled on by a panel?

1. In its Preliminary Submission, Canada argued that Brazil’s claims regarding EDC’s Canada Account and Corporate Account programmes “as such” fell outside the Panel’s jurisdiction. However, Canada did not base its arguments on the principle of *res judicata*, i.e. the principle that the decision of a matter on the merits is conclusive as between the parties to the decision and therefore is a bar to a subsequent action by those parties on the same claim.

2. It may be that the principle of *res judicata* is a “generally recognized principle of law” within the meaning of Article 38(1) of the Statute of the International Court of Justice (ICJ).⁵ If so, the principle should apply to international dispute settlement bodies except where an applicable international agreement provides otherwise. The DSU does not provide otherwise. Moreover, there are three required elements for the application of the *res judicata* principle: identity of parties, identity

⁴ *Canada – Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 10.28.

⁵ *Effect of Awards of Compensation Made by the United Nations Administrative Tribunal*, 1954 I.C.J. 47, p. 53; *Request for Interpretation of the Judgment of 11 June 1998 in the case Concerning the Land and Maritime Boundary Between Cameroon and Nigeria (Cameroon v. Nigeria)*, Preliminary Objections, 1999 I.C.J. 3, p. 36.

of cause and identity of object in the subsequent proceedings.⁶ All three of these elements are present in this dispute with respect to Brazil's "as such" claims regarding Canada Account and Corporate Account. Thus, if the Panel considers that the principle of *res judicata* applies to WTO disputes, its application is warranted in respect of Brazil's "as such" claims regarding Canada Account and Corporate Account.

3. However, the Panel need not decide whether the principle of *res judicata* applies to WTO disputes because, as noted in Canada's answer to Question 1, Brazil has, in any event, failed to offer any evidence or arguments that would warrant this panel departing from the findings in *Canada – Aircraft* (DS 70) that Canada Account and Corporate Account involve discretionary legislation and therefore are not, as such, subsidies contingent upon export performance.

4. Canada also notes that with respect to the issue of "matching" under the OECD Arrangement, the principle of *res judicata* cannot apply because only one of the three requirements for the application of *res judicata*, the identities of the parties, is satisfied. Furthermore, the force of *res judicata* does not extend to the reasoning of a judgment.⁷ Canada has argued with respect to matching that both the reasoning and the conclusion of the Article 21.5 panel in *Canada – Aircraft* (DS 70) are incorrect.

Canada

Question 3

Is it Canada's position that EDC financing under market windows is provided on terms and conditions no more favourable than could be obtained by the borrower in the commercial market-place?

1. Yes. Broadly speaking, EDC undertakes two types of financing through its Corporate Account. One type, official support transactions, has occasionally been used for regional aircraft financing. Transactions of this type have been consistent with the OECD Arrangement. The other type of Corporate Account financing is undertaken on market terms. EDC does not offer terms more favourable than those available in the market when providing such financing.

Question 4

At page 22 of its first written submission, Canada includes a description of EDC's practices. The second paragraph thereof describes EDC's pricing process. It essentially involves fixing a "benchmark" or "alternative benchmark", and pricing "according to" that "benchmark" or "alternative benchmark".

- (a) **Is it Canada's position that this pricing process does not result in the provision of financing on terms more favourable than could be obtained by the relevant borrower in the commercial market place?**

⁶ *South West Africa (Ethiopia v. South Africa; Liberia v. South Africa)* 1966 I.C.J. 6, p. 333.

⁷ *Case Concerning the Barcelona Traction, Light and Power Company, Limited, (New Application: 1962)* 1970 I.C.J. 3, p. 267; *Application For Revision and Interpretation of the Judgment of 24 February 1982 in the Case Concerning the Continental Shelf (Tunisia v. Libyan Arab Jamahiriya)* 1985 I.C.J. 192, p. 228. But see S. Rosenne, *The Law and Practice of the International Court 1920-1996*, 3rd ed., vol. III: Procedure (The Hague: Martinus Nijhoff, 1997), p. 1656 and note 206. He suggests that *res judicata* as applied by the ICJ derives from Articles 59 and 60 of the Statute of the ICJ rather than from a general principle of law that the Court would adopt by virtue of Article 38 of the Statute.

1. Yes. In establishing Corporate Account pricing for non-official support transactions, EDC fixes the benchmark for each borrower by utilizing that borrower's credit rating for a similar debt situation. If independent credit ratings are not available for the borrower from a major rating agency, EDC will generate an internal rating by using financial modeling software (FAMAS/Moody's Financial Analyst and LA Encore/Moody's Risk Advisor both now owned by Moody's Risk Management Services a subsidiary of Moody's Investor Services, one of the world's premier rating agencies). This allows the establishment of a market-based rating using historical and projected financial information.

2. Using the credit rating generated or obtained for each borrower, EDC utilizes industry sources to determine pricing for comparable credit situations as well as historical pricing for the borrower involved (including secondary market pricing). Industry sources for such pricing data include Bloomberg Fair Market Yield Curves⁸, pricing offered to comparable borrowers, bond market pricing, structured transaction pricing (i.e. EETCs), as well as on-going contacts with financial institutions and financial arrangers active in the capital markets.

3. In addition, EDC can and does participate in financing arranged by commercial banks on market terms (for example, the Kendell transaction described in Canada's answer to Question 11).

(b) In fixing the "benchmark", EDC has regard to "what the relevant borrower has recently paid in the market". How does Canada define the "market"? Is it composed of commercial lenders, export credit agencies, or both?

1. The "market", as used in fixing the benchmark for a borrower is the commercial marketplace. It includes banks, other commercial financial institutions and the public bond market but does not include export credit agencies.

Question 5

For the purpose of Questions 5 - 7 only, please assume that Brazil's request for the establishment of a panel is interpreted as being limited to assistance provided to the regional aircraft industry. With respect to Brazil's request for findings that Canada Account as such, as applied and in individual transactions, constitute prohibited export subsidies, please indicate why Canada considers that Brazil's request for establishment fails to adequately identify the measure at issue. Please do the same in respect of Brazil's request for findings that EDC and IQ as such, as applied and in individual transactions also constitute prohibited export subsidies.

1. The Panel's question highlights the failure by Brazil in its panel request to adequately identify the measure at issue in respect of Canada Account, EDC (Corporate Account) and IQ as such, as applied and in individual transactions. Despite the wording of the question, in its panel request, Brazil did not request findings that Canada Account, Corporate Account and IQ "as such, as applied and in individual transactions" constitute prohibited export subsidies.

2. Brazil did not make this distinction until its 22 June Reply Submission, when Canada learned for the first time of Brazil's "overarching claim" theory. Even then, as the European Communities noted at paragraph 10 to 14 of in its Oral Statement of 27 June, it is still not clear whether Brazil is

⁸ The Bloomberg Fair Market Yield Curve or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating.

FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

challenging a programme (such as Canada Account “as such”), specific financing under a programme, (such as the Kendell transaction under Corporate Account), or all financing under those programmes, at least in respect of the Canadian regional aircraft industry. Programs “as such”, “as applied” and “individual transactions” may all involve measures for the purposes of dispute settlement, but they will not be the same measures. By failing in its panel request to adequately identify the measures it is challenging, Brazil has failed to satisfy the requirements of Article 6.2 of the DSU.

3. Brazil clearly cannot use its subsequent submissions to attempt to “cure” the deficiencies of its panel request. The panel request – as presented to the DSB – must be the sole point of reference for the Panel in determining whether Brazil has met the standards of Article 6.2. Brazil did not distinguish in its panel request between claims made “as such”, “as applied” and in “individual transactions”. In any event, Brazil’s subsequent submissions have failed to clarify the measures at issue. The EC put the matter succinctly in paragraph 12 of its 27 June Oral Statement. In assessing whether Brazil is challenging Canada Account, Corporate Account and IQ as such, as applied, or in respect of individual transactions, the EC said: “It is still not clear to the European Communities which Brazil is seeking to do.”

4. Furthermore, in respect of what Brazil now seems to assert are its challenges to Canada Account, Corporate Account and IQ measures “as applied”, Brazil has still failed to identify the specific measures at issue. For example, as Canada noted at the first substantive meeting, for all three programs Brazil’s request used general and imprecise language (“Export credits, “including...”). By contrast, Brazil’s 22 June submission apparently sought to circumscribe the scope of its claim, but only provided examples of types of measures that were not included in its claims. Brazil’s 28 June statement has only added to the confusion. Many of the assertions in Brazil’s 28 June statement are simply inconsistent with its Panel request.

5. Paragraph 5 of Brazil’s 28 June statement asserts that: “Brazil’s claims against the Canada Account are limited to ‘financing, loan guarantees, or interest rate support’ for the regional aircraft industry [emphasis added].” However, no such limitation is found in paragraph 1 of Brazil’s panel request, which challenges “Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account...”. In addition, despite the assumption on which the panel’s questions 5 to 7 are based, the important qualifier “for the regional aircraft industry” is not found in paragraph 1 of Brazil’s panel request.

6. Paragraph 7 of Brazil’s 28 June statement says that “Brazil’s claims against the EDC are limited to ‘financing, loan guarantees, or interest rate support’ for the regional aircraft industry.” However, paragraph 5 of the Panel request refers to “Export credits, including financing, loan guarantees, or interest rate support by or through the EDC...”. The qualifier “for the regional aircraft industry” is also missing in paragraph 5 of Brazil’s panel request.

7. Similarly, paragraph 9 of Brazil’s 28 June statement contends that “Brazil’s claims against IQ are limited to “loan guarantees, equity guarantees, residual value guarantees, and ‘first loss deficiencies guarantees’ for the regional aircraft industry.” However, paragraph 7 of Brazil’s panel request challenges export credits and guarantees provided by IQ, including loan guarantees, equity guarantees, residual value guarantees, and ‘first loss deficiency guarantees’...”. Paragraph 7 of Brazil’s panel request also does not contain the qualifier “for the regional aircraft industry”.

8. Accordingly, Brazil’s panel request failed to adequately identify the specific matters at issue and therefore failed to meet the minimum standard prescribed by Article 6.2 of the DSU.

Question 6

If a measure is not identified in the request for establishment of a panel as required by Article 6.2 of the DSU, is that measure necessarily outside of the panel's terms of reference? Or does the jurisdiction of the panel over the measure also depend on whether or not the respondent has suffered prejudice as a result of the failure to identify the measure in the request for establishment.

1. If a measure is not identified in the request for establishment of a panel, as required by DSU Article 6.2, then the measure is outside the panel's terms of reference. The obligations imposed by Article 6.2 are mandatory. A panel lacks jurisdiction over the claim in respect of the measure, regardless of whether or not the respondent has suffered prejudice.

2. If the complainant has not complied with the requirements of Article 6.2, then the Panel request is invalid by the terms of Article 6.2. Such invalidity is not dependent on whether the complaining party has suffered prejudice. Even if it happens to guess correctly, a defending Member is not required to guess at what is being challenged, either with respect to what is being included in a complaint, what is being excluded from it or the legal basis of the complaint. Rather, as the Appellate Body has stated, "[a] defending party is entitled to know what case it has to answer, and what violations have been alleged so that it can begin preparing its defence".⁹

3. Article 6.2 does not impose any additional "prejudice" requirement. Nor does it create an exception from the obligations imposed if there is no "prejudice". Although, as Canada noted at paragraph 35 of its Preliminary Submission, panels and the Appellate Body have taken prejudice into account, to excuse non-compliance with the requirements of Article 6.2 on the basis that a defending Member did not suffer prejudice would create an exception to the obligations in Article 6.2. It would diminish the obligations on complainant Members, contrary to Articles 3.2 and 19.2 of the DSU. It cannot be an answer for a Member, having made an inadequate panel request, to say to the defendant in effect, "You figured it out so we didn't have to tell you".

4. In any event, Canada has suffered prejudice in the present proceedings as a result of Brazil's failure to comply with Article 6.2. As Canada noted at paragraph 61 of its Preliminary Submission, the prejudice to Canada's ability to defend itself is a function of the fact that the precise nature and scope of the claims made by Brazil are unclear and confusing. This was the test applied by the Panel in the *Thailand – Steel* dispute.¹⁰ A party is entitled to know the case it has to answer. Even if a defending Member succeeds in deducing part, or even all, of a complaining Member's claims from an inadequate panel request, a lack of specificity regarding the measures at issue and/or a failure to provide a clear summary of the legal basis of the complaint will necessarily dissipate the efforts of the defendant, and therefore prejudice it in preparing its defence.

Question 7

With respect to Brazil's request for findings that Canada Account as such, as applied and in individual transactions constitute prohibited export subsidies, please indicate why Canada considers that Brazil's request for establishment fails to "provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly". Please do the same in respect of Brazil's request for findings that EDC and IQ as such, as applied and in individual transactions also constitute prohibited export subsidies.

⁹ *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Appellate Body, WT/DS122/AB/R, adopted 5 April 2001, para. 88.

¹⁰ *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Panel, WT/DS122/R, adopted 5 April 2001, para. 7.29.

1. The Panel's question asks Canada to indicate why Brazil's panel request with respect to Canada Account, Corporate Account and IQ "as such, as applied and in individual transactions" fails to provide "a brief summary of the legal basis of the complaint sufficient to present the problem clearly" as required by Article 6.2 of the DSU. Again, Canada emphasizes that in its panel request, Brazil did not request findings that Canada Account, EDC (Corporate Account) or IQ constitute prohibited export subsidies "as such, as applied and in individual transactions". This failure goes to the inadequacy of Brazil's identification of the measures at issue, as described in Canada's answer to Question 5. Given this failure, it is impossible for Canada to answer the question as posed. Nevertheless, Canada will review precisely where Brazil, in its panel request, failed to satisfy this requirement of Article 6.2.

2. In its first claim, with respect to Canada Account, Brazil failed to explain what it meant when it asserted that measures "continue to be" prohibited export subsidies. As Canada noted in its Preliminary Submission, this phrase appears to be a claim that Canada has not complied with the DSB's rulings in another dispute, *Canada – Measures Affecting the Export of Civilian Aircraft* (DS70). However, this is not clear from the claim itself. The claim therefore fails to provide a summary of the legal basis of the complaint sufficient to present the problem clearly. It is therefore inconsistent with Article 6.2 of the DSU.

3. In its second claim, Brazil failed to identify the treaty provisions that Canada is alleged to have violated. As the Appellate Body stated in the *Korea – Dairy Safeguard* case, "[i]dentification of the treaty provisions claimed to have been violated by the respondent is always necessary...; such identification is a minimum prerequisite if the legal basis of the complaint is to be presented at all."¹¹ As the panel noted in *EC – Bed Linen*, "[f]ailure to even mention in the request for establishment the treaty Article alleged to have been violated ... constitutes failure to state a claim at all."¹²

4. Both of the foregoing claims relate to Canada Account, but as noted, it is impossible to link these failures to requests for findings "as such, as applied and in individual transactions" because the claims themselves fail to do so.

5. In its fifth and seventh claims, regarding Corporate Account and IQ respectively, Brazil alleges that measures are "prohibited export subsidies within the meaning of Articles 1 and 3" of the SCM Agreement. However, only in its First Submission, filed two months later, does Brazil explain that unlike the *Canada – Aircraft* (DS 70) dispute "[t]his proceeding explicitly involves both subparagraph (i) and subparagraph (iii)" of Article 1 of the SCM Agreement."¹³ Until then, Canada did not know that Brazil's claims involved subparagraph (iii) of Article 1. Canada could not tell that they did from the claims as articulated in Brazil's panel request. Furthermore, as Canada explained at the first substantive meeting of the parties, Brazil's failure to adequately identify the measures at issue in respect of these two claims made it particularly difficult to discern from the panel request the legal provisions underlying the claims. Thus, in respect of claims five and seven, Brazil failed to provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. These claims too are inconsistent with Article 6.2 of the DSU.

¹¹ *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R, adopted 12 January 2000, para. 124.

¹² *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, Report of the Panel, WT/DS141/R, adopted 12 March 2001, para. 6.15.

¹³ Brazil's First Submission, para. 65 (in respect of Corporate Account). Similarly, at paragraph 92 of its First Submission, Brazil asserts that its claims with respect to IQ extend to services within the meaning of Article 1.1(a)(1)(iii).

6. Again, Canada notes that while Brazil's claims five and seven relate to Corporate Account and IQ respectively, it is impossible to link the deficiencies in these claims to requests for findings "as such, as applied and in individual transactions" because the claims themselves fail to do so.

Question 8

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of Canada Account support to the regional aircraft industry.

1. Please see exhibits CDA-15 through CDA-23 and exhibit BRA-17. With respect to exhibit CDA-15, the process for Canada Account transactions over C\$50 million differs in only one respect from that for Canada Account transactions under C\$50 million. Transactions over C\$50 million require Cabinet approval. Transactions under C\$50 million require the approval of the Minister for International Trade and the concurrence of the Minister of Finance.

Question 9

Please provide the underlying legal instruments concerning the creation and funding of Canada Account, EDC and IQ.

1. For Canada Account, please see exhibits BRA-17 and CDA-24. For EDC Corporate Account, please see exhibits CDA-24 through CDA-32 and BRA-17. For IQ, please see exhibits CDA-33 through CDA-36 and BRA-18.

Question 10

First, we note Canada's assertion that "[i]n the light of Brazil's below-market financing offer to Air Wisconsin, Canada had no choice but to offer Air Wisconsin debt financing on a matching basis" (para. 46, Canada's first written submission). Second, we note Minister Tobin's assertion that the interest rate for the Air Wisconsin transaction was "a better rate than one would normally get on a commercial lending basis". Third, we note that the Air Wisconsin transaction was financed through Canada Account, rather than EDC market windows. In light of these considerations, would Canada agree that the Canada Account financing for the Air Wisconsin transaction was below market, and therefore conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement?

1. Prior to Brazil's submission of Embraer's letter describing its financing offers to Air Wisconsin, Canada had considered that the Canada Account financing for the Air Wisconsin transaction was below market, and therefore conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. However, as Canada explained at paragraphs 15 and 16 of its Oral Statement, if the Panel finds that commercial credit was available to Air Wisconsin, without Brazilian government involvement, on the terms claimed by Embraer and Brazil, those terms would be, by definition, market terms. The financing offered by Canada under the Canada Account is no more favourable than that in Embraer's offer. Accordingly, the offer under the Canada Account would be no more favourable than that available to Air Wisconsin in the market, as demonstrated by Embraer's offer, and would not confer a benefit within the meaning of Article 1 of the SCM Agreement.

2. Alternatively, if the Panel finds that Embraer's offer to Air Wisconsin did involve Brazilian government support, Canada's offer could not be said to be on market terms and would confer a "benefit". However, because the Canada Account financing is being offered on a matching basis to

Brazil's offer, it would qualify for the safe haven in the second paragraph of Item (k) to the Illustrative List and would not be a prohibited export subsidy.

Question 11

Please provide full details of the terms and conditions of the following transactions referred to at para. 43 of Brazil's first written submission:

- ? **the sale of [] Bombardier CRJ jets to Kendell;**
- ? **the sale of [] CRJ to ASA Holdings, Inc., and its subsidiary Atlantic Southeast Airlines; and**
- ? **the sale of [] CRJ-200 aircraft to ASA Holdings, Inc.**

Please also provide all documentation regarding the review of these transactions by the "committee" of the "EDC transportation group" referred to in the second paragraph of the description of EDC's practices set forth in para. 67 of Canada's first written submission. Please include the terms and conditions of specific transactions used to establish the committee's "benchmark" for the abovementioned transactions, or relevant details of the borrower(s) used to establish the "alternative benchmark" for the abovementioned transactions. Please also provide the credit ratings of Kendell, ASA and Atlantic Southeast Airlines at the time of the abovementioned transactions.

1. Kendell: EDC participated by way of a public offering in the initial financing of [] CRJ aircraft on an equal risk-sharing basis with five other commercial lenders: []. Terms and conditions were dictated by the arranging banks []. The financing was not conditional upon EDC's participation. Exhibits CDA-37 to CDA-41 are, respectively, Kendell's initial Executive Summary for the transaction, the Summary of Terms and Conditions of the Facility (provided by the arrangers), the Pricing Strategy submitted to the Aerospace Pricing Committee, the LA Encore ratings for the Borrower and the Kendell Term Sheet.

2. ASA: As of July 1, 2001 EDC has provided financing for the purchase of [] CRJ aircraft by ASA Inc. (inclusive of ASA Holdings, Inc. and Atlantic Southeast Airlines) and has committed financing to be completed by [] aircraft. EDC provided its commitment []. In March 1997, EDC issued a Letter of Offer for []. In August 1998, EDC issued a revised Letter of Offer for a total of [] aircraft (inclusive). The details of these letters, which offered pricing of UST + [], are provided as exhibits CDA-42 and CDA-43.

3. The Aerospace Pricing Committee was not established until after the issuance of both these Letters of Offer. At the time of the first Offer, LA Encore had not been developed but EDC was able to impute from Famas (commercial financial analysis software) a [] for ASA based on the company's financial results (provided as Exhibit CDA-44). Pricing was developed in consideration of the then current [], the rates paid by the airline on its other debt as well as the rate obtained by a comparable airline, [], on a recent market financing of regional jets. Then current EDC pricing offered to [] (then rated by EDC as a []) was also considered.

4. At the time of the second Offer LA Encore had been developed and a rating of "[]" was generated based on then current financial information (Exhibit CDA-45). It was determined that based on EDC's previous pricing of [], EDC's then current pricing of other like borrowers (e.g. [] which was then rated "[]" by LA Encore), the overall market conditions and the company's improved credit standing that the previous pricing was still appropriate. Although at UST + [] bps EDC's

pricing was [] bps below its [], it was deemed appropriate for the above-noted reasons and a [] was approved.

5. In addition EDC benefited from an agreement with [] which provided additional transaction support during the disbursement period for all [] aircraft such that, if [] deemed or published credit rating fell below certain benchmarks, [] would protect EDC's position.

Question 12

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of EDC / Corporate Account support to the regional aircraft industry.

1. Please see exhibits CDA-18 through CDA-23, CDA-25 and CDA-46 through CDA 50.

Question 13

Is the description of EDC's practices set forth in para. 67 of Canada's first written submission reflected in any general or sector-specific regulations, guidelines, policies or similar documents of EDC? If so, please provide the relevant documentation.

1. The relevant documentation is the same as that listed in Canada's answer to Question 12.

Question 14

Brazil has identified a number of IQ transactions in paragraphs 90 and 91 of its first written submission. Canada has not denied that IQ was involved in any of these transactions. Please provide full details of the terms and conditions of these transactions. Please also provide all documentation regarding the review of these transactions by IQ. Please also provide the credit ratings of the relevant airlines at the time of these transactions.

1. IQ has been involved with only two of the Bombardier customers identified by Brazil, MESA and Midway. MESA's Standard & Poors credit rating was B at the time of the guarantee was approved. Midway had no public credit rating at the time the guarantee was approved, as it was then a private company.

2. IQ was also involved in three other transactions, i.e., Air Littoral, Atlantic Coast Airlines and Air Nostrum.

3. For each of these Bombardier customers, IQ provided an "equity guarantee" of up to a maximum of [] per cent of the aircraft purchase price, and in the case of Mesa, a [] per cent loan guarantee was also provided. IQ support in these transactions was limited to a total of [] aircraft deliveries, as follows:

MESA

? [] CRJ 200 aircraft on a total of [] ordered.

? Date of transaction: September 1998 and December 1999.

? Term: [] years.

Midway

- ? [] CRJ 200 aircraft on a total of [] ordered.
- ? Date of transaction: July 1998.
- ? Term: [] years.

Air Littoral

- ? [] CRJ 100/200 aircraft on a total of [] ordered.
- ? Date of transaction: August 1997.
- ? Term: [] years.

Atlantic Coast Airlines

- ? [] CRJ 200 aircraft on a total of [] ordered.
- ? Date of transaction: May 1997.
- ? Term: [] years.

Air Nostrum

- ? [] CRJ 200 aircraft on a total of [] ordered.
- ? Date of transaction: January 1999.
- ? Term: [] years.

Canada also notes that:

(a) Equity Guarantees are often provided in regional aircraft transactions.

4. IQ is not alone in providing such guarantees. In the aerospace industry, Bombardier has informed Canada that in the aerospace industry such private sector commercial actors as GE, Rolls-Royce, and Pratt & Whitney have been known to provide such guarantees. For example, as discussed in paragraph 89 of Canada's first written submission, it is Canada's understanding that Embraer aircraft purchases have been financed in part through Rolls-Royce equity guarantees.

(b) Investissement Quebec's risk is substantially mitigated [].

5. On a commercial basis, []. In this way, Quebec's risk is substantially less [].

6. To illustrate, assume for example, there were [].

(c) As is the case of private sector transactions, Quebec receives both an up-front and an on-going fee for its participation.

7. In exchange for its guarantee, Quebec receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.

(d) The Investissement Quebec equity guarantee is used only by a small proportion of Bombardiers customers.

8. Based on order intake data for the period 1 January 1995 through 1 June 2001 inclusive, IQ guarantees were only present for [] per cent of Bombardier regional aircraft.

- (e) **Of those customers who have used the IQ guarantee, each has elected to use it on only some, not all of their delivered aircraft.**

9. No Bombardier customer has ever made a regional aircraft purchase contingent on the presence of an IQ guarantee. Indeed, as can be seen in the above transactions, on average, Bombardier customers using IQ equity guarantees have chosen to do so on less than [] per cent of their unit volume.

Question 15

Please describe the decision-making procedures regarding the provision of IQ support to the regional aircraft industry.

1. An analysis of a proposed transaction is made by the Canadair Québec Capital (CQC) Credit Committee. The Committee is composed of three members representing [];
2. In the event of a positive credit analysis, a recommendation is made by the Credit Committee to the CQC board of directors, which reviews it and may or may not decide to accept it;
3. In the event of a positive decision by the CQC board, the proposed transaction is taken to the IQ board of directors for review and approval.

Question 16

Please provide full details of the terms and conditions of the transactions accounting for the (approx.) \$300 million of IQ funding referred to in the press article cited in paragraph 85 of Brazil's first written submission.

1. Please see the answer to Question 14.

Question 17

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of IQ support to the regional aircraft industry.

1. Please see the criteria provided as Exhibit CDA-51. These criteria are used by the Credit Committee in arriving at its recommendations.

Question 18

Since the establishment of IQ, what proportion of total IQ support has directly or indirectly concerned Bombardier regional aircraft.

1. Since its establishment, 6.3 per cent of total IQ support has directly or indirectly concerned Bombardier regional aircraft.

Question 19

Since the establishment of IQ, what proportion of IQ support for Bombardier's regional aircraft products has involved the export of regional aircraft outside of Canada?

1. All of the 6.3 per cent has involved the export of regional aircraft outside of Canada.

Question 20

Since 1 January 1995, what proportion of Bombardier's regional aircraft production was exported outside of Canada?

1. From 1 January 1995 to 31 May 2001, Bombardier delivered 96.4 per cent of its regional aircraft, including jets and turboprops, to customers based outside of Canada. Bombardier has not yet compiled its deliveries for June 2001, but confirms that they will not materially change the percentage cited above.

Question 21

Since the establishment of IQ, what proportion of total IQ support has involved the export of goods / services outside of Canada?

1. Since the establishment of IQ, 23.41 per cent of IQ support has involved the "export" of goods and services outside of Québec, including to other parts of Canada. IQ does not distinguish between "exports" within Canada and those outside of Canada. Accordingly, the percentage of IQ support involving exports outside of Canada will not be greater than 23.41 per cent of total IQ support, and most likely will be lower, but it is not possible from the available data to determine the precise proportion.

Question 22

Please provide a copy of Canada's notification to the OECD regarding its decision to match EMBRAER's offer to Air Wisconsin. Please demonstrate how Canada complied with the requirements of the OECD Arrangement regarding matching in respect of the Air Wisconsin transaction.

1. A copy of Canada's notification is provided as Exhibit CDA-52.¹⁴

2. Article 53 of the Arrangement requires Participants that intend to match terms and conditions offered by a non-Participant to make "every effort to verify that these terms and conditions are officially supported" and to inform other Participants of the nature and outcome of these efforts. The Arrangement also requires that Participants notify all other Participants of the terms and conditions they intend to support at least 10 calendar days before issuing a commitment on such terms. If any other Participant requests a discussion during this period, the notifying Participant must wait an additional 10 days before issuing its commitment.

3. Government of Canada officials met with officials from Air Wisconsin and United Airlines on 19 December 2000 in Ottawa. The Government officials posed a variety of questions to Air Wisconsin. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support with []. The Brazilian government export financing programs that were discussed were BNDES and PROEX.

4. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Minister of Foreign Affairs, Luis Felipe Lampreia, who stated that: "[f]or us,

¹⁴ See Exhibit CDA-52. The contract value and credit value, i.e., items 7(a) and (b), have been redacted from the Arrangement Notification. These values are commercially sensitive as they would enable the average aircraft price to be computed. Moreover, it is Canada's view that this information is not relevant to the Panel's question.

the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms”.¹⁵

5. Canada notified other Participants of its intention to match Brazil’s offer on 12 January 2001. In the notification, Canada informed the other Participants of its knowledge of the Brazilian offer. No Participant requested a discussion during the 10 day waiting period. The Ministerial Authorization for EDC to commit Canada Account funding as required under Section 23(1) of the Export Development Act was issued on 25 April 2001. EDC issued a letter of offer to Air Wisconsin on 10 May 2001.

Question 23

Since 1 January 1995, how many transactions involving the sale of Bombardier regional aircraft have been financed in the commercial market, i.e., without any form of Canada Account, EDC, or IQ assistance, or without any other form of governmental assistance?

1. From 1 January 1995 to 31 May 2001, in unit terms, [] per cent of Bombardier’s order book was financed in the commercial market.

Question 24

Concerning paragraph 75 of Canada's first written submission, please specify precisely how, and on what grounds, Exhibit CDA-12 demonstrates that standard commercially available financing terms for regional aircraft sales range from 10 to 18 years. In this regard, we note that page 21 of Exhibit CDA-12 refers to different types of financing sources (“private, EETC, ECA”), including governmental. Please explain who made the presentation in that Exhibit, and for what purpose. Please also explain what the Aircraft Finance and Commercial Aviation Forum is.

1. Exhibit CDA-12 is the summary of a presentation made by [] to the Aircraft Finance and Commercial Aviation Forum that was held in Geneva in February 2001.

2. [] is a leading, global source of financing and leasing capital for many industries, including commercial aviation. [] offers customized leasing and financing packages for new and used aircraft, with an emphasis on regional aircraft. [] has developed transactions involving US\$ 7.6 billion of financing for regional aircraft. [] also provides bridge financing, long-term debt financing and financial advisory services worldwide. Its credentials are published on its website: []

3. The Aircraft Finance and Commercial Aviation Forum is an annual aircraft finance conference taking place in Geneva. It is internationally recognized as the leading conference on aircraft finance and commercial aviation and is a meeting place for all key players in the industry. This year’s event was the 15th annual Geneva Forum. It featured 90 speakers and panelists addressing such topics as the fundamentals of aircraft finance and the latest developments in aircraft financing sources, structures and products.

4. The [] presentation was prepared for the Forum and was presented by the Managing Director of the Aerospace Group []. Given []’s in-depth knowledge of regional aircraft financing and its involvement in structuring leasing and financing packages in the commercial market for regional aircraft transactions, Canada considers that the statement in the presentation that regional aircraft financing terms range from 10 to 18 years reflects commercial realities and demonstrates that marketplace financing for regional aircraft exceeds 10 years. Canada also notes that Brazil has not

¹⁵ See Exhibit CDA-6.

disputed Canada's position that standard commercially available financing terms for regional aircraft range from 10 to 18 years.

ANNEX B-8

SECOND WRITTEN SUBMISSION OF CANADA

(13 July 2001)

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I. INTRODUCTION

1. In this Rebuttal Submission, Canada will show, again, that despite the breadth of its challenge and its assertions, Brazil has failed to present a *prima facie* case that any of the Canada Account, Corporate Account¹ or Investissement Québec (“IQ”) programmes, “as such”, “as applied” or in respect of “specific transactions” are inconsistent with Canada’s obligations under the SCM Agreement.

2. Canada will show that:

- ? There is no basis for this Panel to reverse the findings in *Canada – Aircraft I*² that EDC (Corporate Account) and Canada Account are discretionary;
- ? IQ is not “as such” inconsistent with the SCM Agreement;
- ? Brazil’s “as such” claims would improperly condemn all ECAs, and are at odds with the facts and the law;
- ? Brazil seeks to make an untenable distinction between its challenges to measures “as applied” and in respect of “specific transactions”; an
- ? Brazil has failed to show that any specific transactions, under Corporate Account, IQ or Canada Account, including Air Wisconsin, are inconsistent with Canada’s obligations under the SCM Agreement, because they are not inconsistent.

II. ARGUMENT

A. BRAZIL’S GENERIC CLAIMS ARE WITHOUT MERIT

1. Brazil’s “as such” claims are groundless

3. As Canada has noted, there is no basis for finding EDC (Corporate Account) or Canada Account or IQ “as such” inconsistent with the SCM Agreement. Under well-established WTO jurisprudence, a measure can be found “as such” inconsistent with a Party’s obligations only if the measure mandates a violation of the Member’s obligations in some or all feasible circumstances.³ None of the challenged programmes require financing to be provided in a manner inconsistent with Canada’s obligations. Accordingly, even if Brazil’s “as such” claims were properly before this panel, there is no legal or factual basis for upholding such a claim.

4. In its responses to the Panel’s Question 2 concerning Brazil’s claims regarding the Canada Account and EDC (Corporate Account) programmes “as such”, Brazil asserts, first, that the *Canada – Aircraft I* panel did not find that these programmes were discretionary but rather, that Brazil had not

¹ Brazil has chosen to refer to what seems to be EDC’s Corporate Account as “EDC”. Canada asks Brazil to clarify if, by “EDC”, it is referring to anything other than Corporate Account.

² *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, and Report of the Appellate Body, adopted 20 August 1999 [hereinafter “*Canada – Aircraft I*, Panel Report” and *Canada – Aircraft I*, Appellate Body Report”].

³ See, e.g., *United States – Anti-Dumping Act of 1916*, Report of the Appellate Body, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, paras. 60 and 88 [hereinafter “*United States – Anti-Dumping Act of 1916*, Appellate Body Report”].

proved that they were mandatory; and second, that Brazil has offered new evidence and arguments in this case.⁴ Both assertions are unsustainable.

(a) The *Canada – Aircraft I* panel clearly found that EDC and Canada Account are discretionary

5. In respect of the EDC, the *Canada – Aircraft I* panel stated, at paragraph 9.129 of its Report:

[W]e find that Brazil has failed to demonstrate that the EDC programme as such mandates the grant of subsidies. *Rather, the EDC programme constitutes discretionary legislation.* [italics added]

6. Contrary to Brazil's assertion, the *Canada – Aircraft I* panel clearly found that the EDC programme is discretionary.

7. In respect of the Canada Account, the *Canada – Aircraft I* panel stated, at paragraph 9.213 of its Report:

[W]e find 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.* [italics added]

8. Contrary to Brazil's assertion, the *Canada – Aircraft I* panel clearly found that the Canada Account programme is discretionary.

9. There is no reason for this panel to diverge from the findings of the *Canada – Aircraft I* panel that EDC (Corporate Account) and Canada Account are discretionary. Brazil has not submitted arguments or evidence showing that the *Canada – Aircraft I* panel erred in its findings. Nor has Brazil offered any basis on which the circumstances giving rise to the *Canada – Aircraft I* findings can be distinguished from those in this dispute.

10. Brazil also contends that Canada's refusal to provide the *Canada – Aircraft I* panel with certain information regarding specific EDC transactions might have affected the "as such" findings of that panel. However, as Brazil acknowledges, this information was in respect of specific transactions. In fact, as the Report of the Appellate Body makes clear at paragraph 205, the information at issue concerned a single transaction, involving one airline, ASA.⁵ It could not possibly have affected the *Canada – Aircraft I* panel's "as such" findings.

11. Furthermore, in respect of this information, the Appellate Body indicated that Brazil was not precluded from pursuing another dispute settlement complaint against Canada "concerning the consistency of *certain of the EDC's financing measures*" with the provisions of the SCM Agreement.⁶ "Certain of the EDC's financing measures" did not mean the EDC programme "as such". Nor could it possibly have meant Canada Account "as such". Brazil therefore misrepresents the Appellate Body's Report when it states that "Brazil, in this case, is following the advice of the Appellate Body."

⁴ *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Responses of Brazil to Questions from the Panel, 6 July 2001 [hereinafter "Brazil's Response"].

⁵ *Canada – Measures Affecting the Export of Civilian Aircraft*, Appellate Body Report, para. 205.

⁶ *Id.*, para. 206.

(b) Brazil's "new information and evidence" is non-existent

12. In its previous submissions, Canada has shown that Brazil, not surprisingly, has offered no new evidence or information to support its allegations that Canada Account or Corporate Account are "as such" inconsistent with the SCM Agreement.⁷ Brazil still has not done so because no aspect of these programmes mandates a violation of the SCM Agreement.

13. In its response to Question 2, Brazil does not identify the alleged new evidence it has provided. Nor does it actually assert that this "evidence" demonstrates that Corporate Account or Canada Account mandate the use of prohibited export subsidies. Instead, Brazil asserts, without foundation that the "evidence" shows that the *'modus operandi'* or "the very existence" of the programmes is to provide export subsidies. This does not amount to a demonstration that the programmes require the granting of prohibited export subsidies.⁸

14. In respect of the Corporate Account, the *Canada – Aircraft I* panel found that: "Brazil has failed to demonstrate that the EDC programme as such mandates the grant of *subsidies*."⁹ [emphasis added] Thus, by failing to adduce new evidence, Brazil not only has failed to show that the Corporate Account programme mandates the use of prohibited export subsidies, it also has failed to show that it mandates the use of subsidies at all. It has still failed to show this, because Corporate Account financing does not mandate the use of subsidies.

15. Brazil has also failed to demonstrate that Canada Account financing mandates the granting of prohibited export subsidies. Brazil's new evidence in respect of the operation of Canada Account relates solely to the Air Wisconsin transaction. Canada's offer of Canada Account support on a matching basis in response to Brazilian government support for Embraer's offer to Air Wisconsin is not a prohibited export subsidy in accordance with Item (k) second paragraph of Annex I to the SCM Agreement.

16. Canada is also entitled to offer financing on terms no more favourable than those that would be available to the recipient in the marketplace, because such financing does not confer a benefit within the meaning of Article 1 of the SCM Agreement. At the first meeting of the parties, Brazil appeared to be contending, based on the Embraer letter it submitted,¹⁰ that Embraer's offers to Air Wisconsin involved only commercial financing and not Brazilian government support. If so, Embraer's offer would necessarily define the terms available to Air Wisconsin in the market. So long as Air Wisconsin will not receive financing from Canada Account on terms more favourable than those offered by Embraer – and it will not – the Canada Account offer does not confer a benefit and therefore is not a subsidy.

⁷ First Submission of Canada, 18 June 2001, paras. 33 and 36 [hereinafter "Canada's First Submission"] and Canada's Answers to the Panel's Questions, 6 July 2001, Answer to Question 1, para. 5; Answer to Question 2, para. 3.

⁸ In its response to the Panel's Question 2, Brazil also misrepresents Canada's position with respect to the Air Wisconsin transaction and the operation of Canada Account and Corporate Account. Brazil also seeks again to confuse the fact that the Air Wisconsin transaction involves Canada Account and not Corporate Account. In this submission, Canada's position with respect to the Air Wisconsin transaction is set out beginning at paragraph 69.

⁹ *Canada – Aircraft I*, Panel Report, para. 9.129.

¹⁰ Letter from Paulo César de Souza e Silva, Sales Financing Director, Embraer, to Roberto Azevêdo, Counsellor, Permanent Mission of Brazil, Geneva, dated 25 June 2001, faxed to the Panel on 25 June 2001.

(c) Brazil misstates the “as such” test

17. In seeking to evade the *Canada – Aircraft I* panel’s findings that neither the Canada Account nor the EDC (Corporate Account) programmes are “as such” inconsistent with the SCM Agreement, Brazil in its response to Question 26, misstates what is meant by a measure being “as such” inconsistent with a Member’s obligations.

18. Brazil asserts that a measure is “as such” inconsistent with a Member’s obligations “when it calls for action by the executive authority that is inconsistent with a Member’s WTO obligations.” Brazil cites paragraph 6.13 of the GATT panel report in *United States – Non-Rubber Footwear from Brazil*¹¹ for this proposition. In fact, paragraph 6.13 of that Report actually states:

The Panel noted that the CONTRACTING PARTIES had decided in previous cases that legislation mandatorily requiring the executive authority to impose a measure inconsistent with the General Agreement was inconsistent with that Agreement as such

19. The test the *Non-Rubber Footwear* panel described was the test the *Canada – Aircraft I* panel applied in finding that the Canada Account and EDC (Corporate Account) are not “as such” inconsistent with the SCM Agreement.

20. Contrary to Brazil’s argument in response to Question 26, a Member cannot look to individual transactions to “illustrate and prove that a measure is inconsistent ‘as such’.” To prove that a programme is inconsistent “as such”, a Member must prove that the executive is legally required to act in a manner inconsistent with the WTO Agreement in some circumstances. A programme is not “as such” inconsistent with WTO rules merely because it could be applied inconsistently with a Member’s obligations in some or all circumstances. Nor does the fact that a measure has been applied inconsistently make it “as such” inconsistent with WTO rules.¹² Thus, the cases have distinguished between measures that require (mandate) WTO inconsistent actions and those that grant the discretion to take such action.¹³

21. Brazil’s proposition that, in the absence of evidence that inconsistent action is required, a Member can look to individual transactions to make its case is both at odds with the established test and fallacious. Brazil cannot escape the fact that nothing in the programmes it has challenged mandates the granting of prohibited export subsidies.

(d) IQ is not “as such” inconsistent and Brazil has failed to show that it is

22. As Canada has described, sections 25 and 34 of the IQ Act¹⁴ clearly demonstrate that IQ’s authority is not limited to export financing.¹⁵ Its authority is very broad, as is its discretion in how to fulfil it. Like Canada Account and Corporate Account, nothing in the IQ Act requires the granting of prohibited export subsidies. IQ therefore cannot be inconsistent “as such” with the SCM Agreement.

¹¹ *United States – Denial of Most-Favoured Nation Treatment as to Non-Rubber Footwear from Brazil*, Report by the Panel, adopted 19 June 1992, BISD 39S/128.

¹² *European Economic Community – Regulation on Imports of Parts and Components*, Report by the Panel, adopted 16 May 1990, BISD 37S/132, para. 5.25.

¹³ See *United States – Anti-Dumping Act of 1916*, Appellate Body Report, paras. 60 and 88.

¹⁴ *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

¹⁵ Canada’s First Submission, paras. 38-42.

23. IQ's authority to participate in regional aircraft transactions is derived from section 28 of the IQ Act. Section 28 (formerly section 7 of the *Société de développement industriel du Québec Act*¹⁶) reads as follows:

The Government may, where a project is of major economic significance for Québec, mandate the agency to grant and administer the assistance determined by the Government to facilitate the realization of the project. *The mandate may authorize the agency to fix the terms and conditions of the assistance.* [emphasis added]

24. The wording of section 28 shows that the executive authority enjoys complete discretion regarding the terms and conditions of the assistance it provides. Section 28 does not mandate the granting of subsidies contingent upon exportation. In fact, section 28 does not relate specifically to export assistance at all. It is used mostly for projects that have no export component whatsoever as well as for projects involving exports.

25. IQ's involvement in regional aircraft transactions is authorized more specifically under Decrees 792-96 (26 June 26 1996); 879-97 (2 July 1997); 1187-98 (16 September 1998); and 1488-2000 (20 December 2000).¹⁷ These decrees simply empower IQ (and formerly the SDI) to grant guarantees or counter-guarantees up to certain amounts of money. Under these decrees, IQ enjoys complete discretion. Nothing in these decrees *mandates* the granting of prohibited export subsidies.

26. Nor does IQ provide prohibited export subsidies when it grants guarantees or counter-guarantees as it is empowered to do by the decrees because these guarantees and counter-guarantees are always provided on market terms.

27. Contrary to Brazil's assertion in the last paragraph of its response to the Panel's Question 29, nothing in the IQ programme "calls for" the provision of loan and equity guarantees. Nor does Brazil, in its response, identify the element of the IQ programme that allegedly does "call for" such guarantees. Finally, Brazil has not established that, "as such", loan or equity guarantees provided by IQ confer a benefit or are contingent upon export performance.

28. The IQ programme allows for the provision of guarantees but it does not require them. Any guarantees provided by IQ result from the exercise of its discretionary powers. Accordingly, the IQ programme could not be inconsistent "as such" with the SCM Agreement even if Brazil had established that, "as such", loan or equity guarantees provided by IQ confer a benefit and are contingent upon export performance.

29. Far from requiring the providing of a prohibited subsidy, the step-by-step description of the decision-making process for the provision of IQ financing assistance to the regional aircraft industry (set out in Canada's answer to the Panel's Question 15) shows that there are three levels of discretion when deciding whether or not to provide support.

(i) *IQ does not provide a "benefit"*

30. Furthermore, the criteria set out in Exhibit CDA-51 demonstrate that IQ must provide its financing assistance on market terms. The criteria provide that:

Le support de la Société ne sera pas disponible pour des transactions:

¹⁶ R.S.Q., c. S-11.01.

¹⁷ Filed as Exhibits CDA-33 – CDA-36.

- A. sauf si la compagnie aérienne (ou l'acheteur), sur la base d'état financiers couvrant une période minimale de deux années consécutives précédant le financement et des projections pour au moins la prochaine année:
 - (i) a une valeur nette tangible positive;
 - (ii) a un mouvement de trésorerie positif; et
 - (iii) est, ou est affiliée avec, (par voie de "code sharing", contrat d'affrètement, etc.) une compagnie aérienne.
- B. si la rémunération que la Société est appelée à recevoir est inférieure à ce qui est offert sur le marché pour une structure et un risque similaire, pour une transaction entre participants non reliés ("arm's length") et ce, en tenant compte de la nature compétitive des transactions.
- C. si le financement est d'une durée supérieure à ce qui est disponible pour un financement sans support gouvernemental pour une transaction de même nature (RJ, "arm's length", crédit, type de financement, juridiction, etc.), et ce, en tenant compte de la nature compétitive des transactions.

31. Consequently, IQ "as such" cannot mandate the provision of an export subsidy.

32. Furthermore, IQ "as such" does not mandate the provision of prohibited export subsidies because the fees it charges in order to provide support to the regional aircraft industry are at market. As the criteria set out above state, IQ will not make support available for transactions if the remuneration it is to receive is less than that offered in the market. Thus, Brazil cannot meet its burden of showing that IQ "as such" confers a benefit.

(ii) *IQ is not "as such" contingent upon exportation*

33. In its Oral Statement of 27 June 2001, at paragraphs 56 to 62, Brazil appears to argue that IQ is, or possibly IQ guarantees are, "as such" contingent upon exportation even though much of IQ's assistance involves the sale of goods and services within Canada. Canada elaborated, in its answer to the Panel's Question 21, that only 23.41 per cent of IQ support has involved sales of goods and services outside of Québec, including to other parts of Canada.

34. Faced with facts that make clear that IQ cannot "as such" be contingent upon exportation, Brazil argues in its oral statement that these inconvenient facts are somehow subversive of the export subsidy disciplines of the SCM Agreement. It asks: "may Canada convert a subsidy, otherwise contingent upon export, into a non-export contingent subsidy by making part, but not all, of its territory eligible for sales of the subsidized product?"

35. First, Brazil appears to be relying for its argument on Decree 572-2000, which defines "export" as being "outside of Québec". As Canada explained at paragraph 93 of its First Submission, this decree has nothing to do with aircraft sales financing. Nor does it preclude funding for projects within Québec. On the contrary, Decree 572-2000 relates to the (FAIRE) programme, the Private Investment and Job Creation Promotion Fund ("Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi"). Almost all of the financing provided under this programme is for projects within Québec.¹⁸

¹⁸ Paragraphs 71 and 72 of Brazil's Oral Statement, which suggest a contradiction in Canada's position, also rest on a confusion of different programmes. The "export development" eligibility criterion of SDI to

36. Second, neither Canada nor Québec “converted” anything “otherwise contingent upon export into a non-export contingent subsidy”. Most of IQ’s funding does not leave Québec, let alone Canada. That this does not involve exportation, and that IQ funding is not export contingent, is not due to a “conversion” of anything. It is due to the fact that “exportation” within the meaning of the SCM Agreement refers to the movement of goods and services between Members, not within them.

(e) Brazil’s “as such” claims seek falsely to condemn all ECAs

37. In its response to Questions 28 and 29 from the Panel, Brazil attempts to deal with its complete lack of new evidence that would refute the *Canada – Aircraft I* panel’s conclusion that Canada Account and EDC (Corporate Account) are discretionary, or that would refute the evidence that IQ is discretionary.¹⁹ It does so by making the extraordinary argument that *all* export credit agencies (ECAs) necessarily provide prohibited export subsidies. Brazil, by its argument, seeks to escape its burden of proving the existence of a subsidy and in particular, a benefit. Brazil’s argument is not supported by the text of the SCM Agreement, and it is contrary to what previous panels and the Appellate Body have found to constitute a “subsidy”.

(i) *Brazil seeks to escape its burden of proving a “benefit”*

38. The “substantive context” of ECAs is not, as Brazil would have it, that they “exist to subsidize exports.” ECAs vary with respect to legal status, policies and products. ECAs generally exist to facilitate exports by providing financial and risk management products. They do not necessarily subsidize exports. The test of whether an ECA offers a subsidy is not “is it an ECA?”. The test is whether the recipient of the financing receives a financial contribution on terms more favourable than those available to the recipient in the market.²⁰

39. In certain cases, officially supported export credits may confer a subsidy. They may, for example, be used to provide or insure credits in insolvent markets and absorb risks that “‘no banker in his right mind’ is willing to assume.” However, Exhibit BRA-54, from which Brazil extracted this quotation, states that this is “an extreme case”. It does not mean that EDC or any other ECA will necessarily offer subsidies.

40. Brazil can hardly contend, for example, that EDC’s participation in the Kendell transaction involved assuming risks that “no banker in his right mind” was willing to assume. As Canada described in its answer to Question 11 from the Panel, EDC participated in the Kendell transaction, a public offering, on an equal risk-sharing basis with seven commercial banks. The terms and conditions of the transaction were dictated by the arranging banks, []. The other banks were []. Evidently, all seven of those banks were quite willing to assume the same risk as EDC.

41. Similarly, in paragraphs 23, 24, 54 and 68 of its 27 June 2001 Oral Statement, and again in its response to the Panel’s Question 29, Brazil argues that whenever EDC or IQ provides a loan or equity guarantee, they automatically provide a benefit because their credit rating is invariably higher than that of a recipient of the financing. According to Brazil, any guarantee or counter-guarantee provided by a government credit agency automatically will be a subsidy because, given the high credit ratings of governments, they will automatically confer a benefit.

which Brazil refers was contained in the “Programme de développement des exportations”. No guarantees or financing were provided to the civil aircraft sector under that programme. Financing support for the transaction to which Brazil refers in paragraph 71 was provided under section 7 of the SDI Act (which has become section 28 of the IQ Act) [see Exhibit BRA-18], and not under the Programme de développement des exportations.

¹⁹ Canada’s First Submission, paras. 39-42.

²⁰ *Canada – Aircraft I*, Appellate Body Report, para. 157.

42. Brazil has not demonstrated this argument. To accept Brazil's argument is to suggest that any guarantor with a higher credit rating than the recipient of the financing would automatically be providing a subsidy. Brazil's argument is also puzzling given the statement on the website of BNDES, the Brazilian government's development bank, that: "In order to make possible the export of Brazilian products, BNDES-*exim* operates with the same guarantee instruments offered by the largest export credit agencies."²¹

(ii) *Brazil's argument is not supported by the text of the SCM Agreement*

43. Article 1.1 of the SCM Agreement provides:

For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(...)

and

(b) a benefit is thereby conferred.

44. If Brazil were correct that the provision by a government of a guarantee or a counter-guarantee automatically entails a benefit and therefore is a subsidy, it would render redundant paragraph (b) of Article 1.1. As a "financial contribution" as understood in Article 1.1(a)(1)(i) is always provided by a government or public body, there could not be a financial contribution in the form of a guarantee without conferring a benefit, and therefore a subsidy. However, the two-part test in Article 1.1 necessarily implies that a government or public body can provide a financial contribution in the form of a guarantee without conferring a benefit and therefore without granting a subsidy.

(iii) *Brazil's argument ignores the Appellate Body's findings as to when a "subsidy" exists*

45. According to the Appellate Body, the existence of a subsidy requires a financial contribution and a benefit. The existence of a benefit can be determined by whether a financial contribution was granted to the recipient on terms more favourable than the recipient could receive in the market.²² The focus, in determining the existence of a "benefit", is on whether the recipient received terms more favourable than those available in the market. It is not on the identity of the provider of the financial contribution, which, by definition, is always a government or a public body.

46. The fact that panels and the Appellate Body have sought to determine whether or not financial contributions by a government or public body was made on market terms necessarily implies that such financial contributions can be provided on market terms and do not in and of themselves confer a benefit.

²¹ "BNDES-*exim*. Your access to global markets," <http://www.bndes.gov.br/english/exim.htm> p. 2. (Exhibit CDA-53)

²² *Canada – Aircraft I*, Appellate Body Report, para. 157.

47. Thus, contrary to Brazil's assertion in response to Question 29 that Canada somehow bears the burden of showing that its programmes fall within the scope of the Item (k) exception, the burden of proof lies with Brazil to show that Canada's programmes make mandatory, action inconsistent with its WTO obligations in any circumstances. Brazil has failed to meet this burden. It cannot meet this burden because none of Corporate Account, Canada Account or IQ require Canada to provide prohibited export subsidies.

2. Brazil's claims fail to satisfy the "as applied" test

48. In addressing Question 25 from the Panel, Brazil states that it is challenging Canada's programmes, "as such", "as applied" and in respect of specific transactions. In taking this position, Brazil seems to be distinguishing between a challenge "as applied" and a challenge "in respect of specific transactions". In Canada's view, a challenge "as applied" is the same thing as a challenge to "specific transactions". Each refers to a challenge to a specific application of a measure.

(a) Brazil's distinction between "as applied" and "specific transactions" is untenable

49. If Brazil's implicit position is accepted, and a challenge to a measure "as applied" is to be distinguished from a challenge to "specific transactions", then the basis of the "as applied" challenge must be that the programme is applied such that all transactions, not just those specified, are inconsistent with the Member's obligations. Furthermore, if Brazil's "as applied" challenge is to be distinguished from an "as such" challenge, the basis of the "as applied" challenge must be that even if there is no legal requirement that transactions under a programme must be inconsistent the programme is applied such that all transactions are inconsistent. In Canada's view, there is no legal basis for such a characterization of an "as applied" challenge.

(b) Brazil has failed to identify the measures it is challenging "as applied"

50. The distinction between a challenge to a programme "as such", "as applied" and to specific transactions is important given the lack of clarity in Brazil's claims. As Canada emphasized in its answer to the Panel's Question 5, Brazil failed to make this distinction in its claims. None of Brazil's claims in its request for the establishment of a panel, other than those relating to Air Wisconsin, identify specific transactions.

51. In its response to Question 26, Brazil argues that to show that individual transactions under a programme are inconsistent with a Member's obligations "should be sufficient" for a finding that a programme is inconsistent "as applied". Not only should it not be sufficient, it cannot be sufficient, as a matter of logic.

52. Even if Brazil could identify specific transactions under a programme that were inconsistent with Canada's SCM Agreement obligations – and it cannot – this would only mean that, in the case of those specific transactions, a programme *has been applied* inconsistently with Canada's obligations. However, this would not mean that all transactions under the programme are or will be inconsistent with those obligations. Brazil has failed to identify under Canada Account, Corporate Account or IQ, a single transaction that is inconsistent with Canada's obligations. Even if it had done so, this would demonstrate only that the transaction is inconsistent, not that all transactions under the programmed "as applied" are inconsistent.

(c) Brazil alone is responsible for its failure to identify the measures it is challenging

53. Brazil seeks to blame Canada for its failure to identify the specific transactions it is challenging. Canada is at fault, according to Brazil, because it has not notified any of its challenged measures under Article 25 of the SCM Agreement and because it allegedly refused to respond to Brazil's questions during consultations. These assertions are not tenable.

54. Article 25 requires the annual notification of subsidies by 30 June of each year. Canada did not notify any subsidies because there were no subsidies it was obligated to notify. As the Appellate Body observed in its Report in *Canada – Aircraft I*, Brazil was entitled to request information under Article 25.8 of the SCM Agreement concerning certain of the EDC's financing measures.²³ Under Article 25.8 a Member can, among other things, seek an explanation of why a measure has *not* been notified under Article 25. Brazil never did this.

55. Moreover, Brazil's allegations regarding the 21 February 2001 consultations are mere posturing. Brazil arrived at the consultations with a wide-ranging list of questions for Canada. Brazil did not provide these questions to Canada in advance of the consultations to enable Canada to investigate and prepare responses. When Canada was unable to answer many of the questions at the consultation, Brazil declared the meeting concluded, told Canada that it would be requesting the establishment of a panel and did so eight days later.

56. Brazil implies that it asked Canada for written responses to its questions and that Canada "refused" to provide them. That is not true. Nor did Canada "refuse" to discuss anything at the consultations, disappointing as those consultations were from Canada's point of view. Brazil cannot use these misrepresentations as an excuse for its failure to adequately identify the measures that it is challenging.

3. Brazil has failed to show that the specific application of Canada's measures is inconsistent

(a) Brazil has failed to show that specific Corporate Account transactions are inconsistent

57. Brazil has failed to show that specific Corporate Account transactions are inconsistent with Canada's WTO obligations. Other than its CIRR argument, which Canada has refuted,²⁴ the only evidence it has advanced is that Canadian financing exceeds the 10 year limit of the OECD Arrangement.²⁵ Canada has explained in its submissions why the Arrangement is not necessarily reflective of market terms²⁶ and that in the commercial market, repayment terms for regional aircraft financing routinely exceed 10 years. Canada confirmed this by its Exhibit CDA-12, which it described in more detail in its answer to the Panel's Question 24.

58. In its comments on this evidence, in response to the Panel's Question 35, Brazil does not actually contest Canada's position that commercially available financing for regional aircraft exceeds 10 years. Nor could it credibly do so, given its position in *Brazil – Export Financing Programme For Aircraft, Recourse by Canada to Article 21.5 of the DSU (PROEX II)*. In its response to Question 6 from the Panel, Brazil stated with respect to PROEX, that the 10 year maximum financing period:

²³ *Canada – Aircraft I*, Appellate Body Report, para. 206.

²⁴ Canada's First Submission, paras. 70-73.

²⁵ *The Arrangement on Guidelines for Officially Supported Export Credits*, Organization for Economic Co-operation and Development (OECD) 1998, [hereinafter "OECD Arrangement"]. (Exhibit BRA-42)

²⁶ Canada's First Submission, paras. 70-75; Canada's Oral Statement, paras. 10-13.

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.²⁷

59. Instead, in response to Question 35, Brazil resorts to inductive reasoning, implying, without saying so, that because it could not find regional aircraft financing in excess of ten years by two particular banks, such commercial financing must not exist. In addition to being logically flawed, Brazil's argument is disingenuous. It claims that Canada has not elaborated on which commercial entities offer terms in excess of ten years but that in *Canada – Aircraft I*, Canada referred specifically to these two banks, Bank of America and Citibank, “as providing financing in the field”.

60. A review of paragraph 6.31 of the *Canada – Aircraft I* Panel Report shows that Canada said nothing of the sort. In the paragraph to which Brazil refers, Canada identified those banks as employing trade financing experts, not as providing regional aircraft financing on commercial terms.

61. Furthermore, contrary to Brazil's allegation, in *Canada – Aircraft I*, Canada did identify commercial entities offering financing for regional aircraft in excess of ten years.²⁸ Canada identified, for example, the 1997 issuance by Northwest Airlines of pass-through certificates financing 12 British Aerospace Avro RJ85 aircraft. The term for the 1997-1A (Class A) certificates is 18.25 years (from September 1997 to January 2016): *Northwest Airlines 1997-1 Pass Through Trusts*, Credit Suisse First Boston, Lehman Brothers, Morgan Stanley Dean Witter, Prospectus 16 September 1997, at pp. S-1, S-5 and S-6.²⁹

62. Canada also identified the 1997 issuance by Continental Airlines of pass-through certificates financing nine Embraer EMB-145ER Regional Jets. The term for the 1997 3A (Class A) certificates is 15.25 years (from December 1997 to March 2013): *Continental Airlines 1997-3 Pass Through Trusts*, Morgan Stanley Dean Witter, Prospectus, 23 July 1997, at pp. 1, S-3.³⁰

63. The Morgan Stanley Dean Witter Report, filed as Exhibit CDA-14, offers additional evidence that the standard length of financing available in the market for regional aircraft financing ranges from 10 to 18 years.³¹ This report contains information on structured transaction pricing in the commercial marketplace. It indicates that US airlines have financed regional aircraft in the market using enhanced equipment trust certificate (EETC) tranches that feature a greater than 10 year term of maturity. For example, the EETC Class A and B tranches issued on 19 September 1997 by Atlantic Coast Airlines for 6 CRJ-200 and 8 British Aerospace J-41 aircraft have terms of maturity of respectively 16 years (Class A) and 13 years (Class B).³² Other examples include Midway EETC tranches issued on 6 August 1998 for 8 CRJ-200, with terms of maturity of approximately 16.5 and 14.5 years.³³

64. In sum, Brazil has failed entirely to demonstrate that in any instance in which Canada granted financing terms in excess of ten years, those terms were more favourable than those available in the market and therefore conferred a benefit.

²⁷ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, Annex 2-4, p. 135.

²⁸ *Canada – Aircraft I*, Canada's Appellee Submission, 28 May 1999, para. 64 and footnote 55.

²⁹ *Northwest Airlines 1997-1 Pass Through Trusts*, Credit Suisse First Boston, Lehman Brothers, Morgan Stanley Dean Witter, Prospectus, 16 September 1997. (Exhibit CDA-54)

³⁰ *Continental Airlines 1997-3 Pass Through Trusts*, Morgan Stanley Dean Witter, Prospectus, 23 July 1997. (Exhibit CDA-55)

³¹ “EETC Market Update: Monthly Update: Airlines” (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials) 10 February 2001. (Exhibit CDA-14)

³² *Id.*, p. 13.

³³ *Id.*, p. 15.

(b) Brazil has failed to show that specific IQ transactions are inconsistent

65. Brazil has failed to meet its burden of showing that IQ financing assistance “as applied” to regional aircraft transactions constitutes a subsidy. As described at paragraph 30 of this Submission, the criteria applied to transactions for which IQ assistance has been requested ensure that the financing assistance is being offered on market terms.³⁴ Accordingly, there is no benefit within the meaning of Article 1 of the SCM Agreement.

66. In its answer to the Panel's Question 14, Canada also explained that, in exchange for its guarantees, IQ receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.

67. On a commercial basis, this fee is justified by the fact that [].

68. As a result, and consistent with the IQ criteria set out in Exhibit CDA-51, IQ's involvement in regional aircraft financing transactions is on terms no more favourable than those available in the market and does not confer a benefit within the meaning of Article 1 of the SCM Agreement.

(c) Brazil has failed to show that specific Canada Account transactions are inconsistent

69. The only Canada Account transaction that Brazil has challenged is that involving Air Wisconsin. Canada's position is that the offer to Air Wisconsin was made on a matching basis in response to an offer of Brazilian government supported financing to Air Wisconsin by Embraer. Canada's offer therefore qualifies for the “safe haven” of the second paragraph of Item (k) to Annex I to the SCM Agreement. Canada's response to Brazil's argument that Canada's matching offer does not qualify under Item (k) is set out in section B below.

70. Moreover, although Brazil seems to be suggesting, in its response to Question 32, that the second Embraer offer was made “to compete with the offer made by Bombardier and Canada,” that second offer is dated 29 December 2000. This predates Canada's matching offer. Canada's offer was not announced until 10 January 2001 and the letter of offer was not issued until 10 May 2001. This confirms that Canada's offer was made in response to that of Embraer or Brazil, contrary to what Brazil appears to suggest in its response to Question 32.

71. However, Brazil also maintains that Embraer's offer to Air Wisconsin did not involve a commitment of Brazilian government support.³⁵ In its response to Question 32, Brazil seems to be acknowledging what its Exhibit BRA-56 makes clear: Embraer's second offer [] to the benefit of Air Wisconsin. This is consistent with the information provided by Air Wisconsin to [].³⁶

72. It is also consistent with Embraer's 31 March 2001 Interim Financial Statements, which discloses Embraer's continuing dependency on PROEX support. The statement warns:

If the ProEx programme or another similar programme is not available in the future, or if its terms are substantially reduced, the customers' financing costs could be

³⁴ See Exhibit CDA-51.

³⁵ See Brazil's Response to Question 31, second paragraph. Brazil does not state whether Embraer made its offer in the expectation of receiving Brazilian government support.

³⁶ Canada's Confidential Exhibit CDA-1.

higher and the cost-competitiveness of the Company in the regional jet market could decrease.³⁷

73. If, nevertheless, the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms claimed by Embraer and Brazil, and without Brazilian government involvement, those terms would be, by definition, market terms. Although Brazil's Exhibit BRA-56 is silent as to certain terms that one would expect to see in an offer of this sort such as administration fees, Canada notes that the number of aircraft offered, the financed amount and the repayment term offered by Canada are, together, no more favourable than the terms Brazil alleges to be commercial market terms. The Canada Account offer therefore would not confer a benefit within the meaning of Article 1 of the SCM Agreement.³⁸

B. THE SCM AGREEMENT PERMITS CANADA'S OFFER ON A MATCHING BASIS IN RESPONSE TO BRAZIL'S OFFER TO AIR WISCONSIN

74. The matching provisions of the OECD Arrangement are expressly permitted by, and conform to, the OECD Arrangement. Moreover, the matching provisions of the Arrangement are "interest rates provisions" within the meaning of the second paragraph of Item (k). Accordingly, because Canada's action with respect to Air Wisconsin was on a matching basis as expressly permitted by the "interest rates provisions" of the OECD Arrangement, the transaction qualifies for the "safe haven" of the second paragraph of Item (k).

1. Matching is in conformity with the "interest rates provisions" of the Arrangement

75. In Brazil's response to Question 36 from the Panel, Brazil states that "[r]ecourse to the matching provisions of the OECD Arrangement does not constitute 'conformity with' the 'interest rate provisions' of the OECD Arrangement." Brazil also claims that the ordinary meaning of Item (k), in its context, along with the object and purpose of the SCM Agreement supports this interpretation. For this assertion, Brazil relies on the reasoning of the *Canada – Aircraft I* Article 21.5 Panel ("Article 21.5 Panel").³⁹

76. Canada has demonstrated that the Article 21.5 Panel's interpretation does not follow the ordinary meaning of the second paragraph of Item (k).⁴⁰ It is illogical to say that a matching transaction – which includes the rate of interest and other terms – can be specifically permitted by the OECD Arrangement and yet condemned as not "in conformity" with the Arrangement's "interest rates provisions". The Article 21.5 Panel tried to justify this result by an argument that interprets "interest rates provisions" extremely narrowly – effectively to mean only the normal permitted rate without any other terms. The Panel then tried to escape the illogic of such a result by selectively bringing in other provisions such as the amount financed and length of financing term on the theory that they are measures of whether the financing is "in conformity". This is a strained reading in comparison to the

³⁷ *Embraer – Empress Brasileira de Aeronática S.A.: Interim Financial Statements Together with Report of Independent Public Accountants, March 31, 2001*, pp. 22-23 (complete document is available at <http://www.embraer.com/english> under Investor Relations, Financial Statements, Filed in SEC). (Exhibit CDA-57). *Embraer – Empress Brasileira de Aeronática S.A.: Financial Statements Together with Report of Independent Public Accountants, December 31, 1998, 1999 and 2000*, pp. F-2, F-92 (complete document is available at <http://www.embraer.com/english> under Investor Relations, Financial Statements, Filed in SEC). (Exhibit CDA-58)

³⁸ Canada has also been able to shed some light on the reference to [] in Embraer's first offer to Air Wisconsin. The so-called [] rate is, generally, a rate applicable to commercial real property mortgages denominated in British sterling. Canada has found no evidence that it is a rate available in international capital markets.

³⁹ See Brazil's Response to Question 36, first paragraph and eighth to tenth paragraphs.

⁴⁰ See Canada's First Submission, paras. 51-57, and Canada's Oral Statement, paras. 22-26.

interpretation proposed by Canada, which would include matching transactions specifically permitted by the Arrangement.

77. Brazil's response to Question 36 does not respond to Canada's argument that matching is specifically "permitted" by, and in conformity with, the provisions of the Arrangement, and thereby is in conformity with the "interest rates provisions" of the Arrangement.

78. Moreover, Canada demonstrated in its Oral Statement at paragraphs 27 through 40 that matching is consistent with the object and purpose of the SCM Agreement.

2. Canada complied with its WTO obligations when it matched Brazil

(a) The MFN rule of Article I is not an obligation on the WTO generally to ensure that all of its rules apply equally

79. In its response to Question 36 from the Panel, Brazil argues that "matching" results in a violation of the most-favoured-nation requirements of Article I of GATT 1994.⁴¹ This argument, in each of its forms, is wholly without merit and must fail.

80. Article I is an obligation addressed to Members to accord most-favoured-nation ("MFN") treatment to products of other Members. Article I is not, as Brazil appears to argue, an obligation that requires all rules written under the WTO to benefit equally the trade of each WTO Member. Such an interpretation is utterly without support in the text of Article I of the GATT or any other MFN rule of the WTO.

81. Were there some obligation to write or interpret WTO obligations so that each rule equally benefits all, as Brazil seems to argue, then special and differential treatment of developing countries under any of the WTO agreements would be forbidden, as would any other rule or exception that *de facto* or *de jure* could be argued to benefit one Member or group of Members more than others.

82. Thus, while Canada does not agree with Brazil that the rule allowing matching favours Participants to the Arrangement over non-Participants, there is in any event no basis for claiming that Item (k) does or could constitute a violation of Article I of the GATT.

(b) Canada offered financing to Air Wisconsin on a matching basis in good faith and using reasonable due diligence in response to Brazil's offer

83. In Canada's view, the term "interest rates provisions" used in the second paragraph of Item (k) includes all substantive provisions that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be in a given transaction. In Canada's view "interest rates provisions" would exclude procedural requirements with which a non-Participant inherently could not comply.⁴²

84. Matching in the context of the OECD Arrangement qualifies for the "safe haven" of Item (k) because the substantive matching provisions of the Arrangement, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in "conformity" with the "interest rates provisions" and indeed are themselves "interest rates provisions".⁴³ The "safe haven" of Item (k) is available to any WTO Member that complies with these provisions. The procedural requirements of the Arrangement such as notification are not "interest rates provisions", and in any event could not be complied with by non-

⁴¹ See Brazil's Response to Question 36, fifteenth to seventeenth paragraphs.

⁴² See Canada's First Submission, para. 56 and Canada's Oral Statement, para. 32.

⁴³ See Canada's First Submission, para. 49.

Participants. However, just as under the Arrangement a Participant must undertake due diligence when matching,⁴⁴ a WTO Member seeking to rely on the matching provisions must act in good faith and on the basis of reasonable due diligence.

85. Canada offered debt financing to Air Wisconsin on a matching basis, in good faith and following reasonable due diligence, in response to Brazil's offer. Government of Canada officials met with officials from Air Wisconsin and United Airlines on 19 December 2000 in Ottawa. The Government officials posed a variety of questions to Air Wisconsin. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support with [].

86. The information Canada received at the meeting was consistent with evidence that Brazil was continuing to offer prohibited export subsidies generally and in specific transactions. At approximately the same time as the Brazilian offer was made to Air Wisconsin, Brazil made similar offers of official support in the context of campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air System.⁴⁵

87. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Minister of Foreign Affairs, Luis Felipe Lampreia, who stated that: "[f]or us, the interest rate is the OECD rate, the coverage is 100 per cent and there are no limits on the length of terms".⁴⁶

88. In response to Brazil's financing offer to Air Wisconsin, Canada offered Air Wisconsin debt financing on a matching basis. Canada offered a [] rate with a repayment term of [] years and a loan-to-value ratio of [] per cent.⁴⁷ In the light of all the evidence from Air Wisconsin, other airlines and the admission of Brazil's own Minister of Foreign Affairs, Canada's offer to Air Wisconsin on a matching basis was made in good faith and on the basis of reasonable due diligence. Accordingly, Canada's offer to Air Wisconsin is in conformity with the "interest rates provisions" of the Arrangement.

(c) Canada's offer to Air Wisconsin on a matching basis meets the procedural requirements of the Arrangement.

89. If the Panel is of the view that some of the procedural requirements of the Arrangement are actually substantive provisions that determine what interest rates are permitted, and that affect the interest rate and what the amount of interest will be in a given transaction, or if some of the procedural requirements are actually "interest rates provisions", Canada's offer to Air Wisconsin is still in conformity with the "interest rates provisions" of the Arrangement.

90. Brazil puts forth four arguments why Canada's offer to Air Wisconsin on a matching basis does not meet the procedural requirements of the Arrangement.⁴⁸ Each of Brazil's arguments fails.

91. First, citing Article 53(a) of the Arrangement, Brazil argues that Canada did not "make every effort to verify" that the non-conforming terms offered by Embraer were "officially supported" by Brazil because Canada did not ask Brazil. Upon a review of Article 53(a) of the Arrangement, it is

⁴⁴ OECD Arrangement, Articles 50-53.

⁴⁵ See Confidential Exhibits CDA-4 and CDA-5.

⁴⁶ See Exhibit CDA-6.

⁴⁷ Air Wisconsin will have the option to choose between [] or a [] for each of the [] aircraft. In the case of a [] structure, with respect to [] aircraft, the Government of Québec is providing a guarantee to the equity investor for an amount equal to [] per cent of the sale price of each aircraft.

⁴⁸ See Brazil's Response to Question 36, fourth to seventh paragraphs.

immediately evident that the text of Article 53(a) does not require asking the non-Participant being matched if it is providing official support at terms more favourable than those generally envisaged under the Arrangement. The drafters of the Arrangement could have easily created such a requirement, if asking the non-Participant was required, as they did for Participants in Article 52.

92. Moreover, there was no reason to contact Brazil. Brazil is, even today, denying its involvement in the offer to Air Wisconsin. However, it is not plausible that Embraer could have arranged financing of the magnitude offered – [] – for a relatively low quality credit such as Air Wisconsin on the terms that Embraer was proposing without Brazilian official support. Indeed, the mention of [], and the past practice of the Brazilian government would have afforded no basis for anyone to doubt that Brazilian official support would be provided.⁴⁹

93. Brazil attempts to explain away the [].⁵⁰ However, Embraer by its own admission continues to rely heavily on official support from Brazil.⁵¹ Given this admission, it is highly likely that the financing of the magnitude offered on those terms was officially supported by Brazil.

94. Canada did exactly what the text of Article 53(a) requires. It made “every effort to verify that these terms and conditions are officially supported.” Canada did this by going directly to Air Wisconsin.⁵²

95. Brazil’s second argument is that Canada has not demonstrated that Canada has informed and notified other Participants. This argument is without merit and must fail. In response to Question 22 from the Panel, Canada provided a copy of its OECD Arrangement notification. By the notification, Canada fulfilled both the information and the notification requirements of Article 53 of the Arrangement.

96. Third, Brazil argues that non-identical matching is not permitted by Article 53 of the Arrangement. Matching of a non-Participant is explicitly permitted by the Arrangement. Non-identical matching is also explicitly permitted. Nowhere in Article 53 (Matching of Terms and Conditions offered by a Non-Participant) does it state that only identical matching is permitted. Matching in the form permitted under the Arrangement in general comprises both identical and non-identical matching. Matching of a non-Participant can generally be expected to be non-identical matching because non-Participants are not subject to the notification requirements of the Arrangement and have no other obligation to respond to Participants’ inquiries. In such instances, as in this case, it is often very difficult, due to confidentiality commitments, to know the precise terms of the initiating offer.

97. Fourth, Brazil argues that Canada’s offer to Air Wisconsin was more favourable than Embraer’s offer. While Canada’s offer was not identical to Brazil’s, Canada’s offer to Air Wisconsin was not more favourable than Brazil’s offer.⁵³

⁴⁹ See Exhibit BRA-56 and Brazil’s Response to Question 32.

⁵⁰ See Brazil’s Response to Question 32.

⁵¹ Without Brazilian official support, according to Embraer, Embraer’s “cost-competiveness” could decrease. Brazilian official support – now and in the future - seems to have a substantial impact on Embraer. See Note 32 in Embraer’s 1998-2000 Financial Statements (Exhibit CDA-57).

⁵² In Brazil’s Response to Question 34, Brazil seems to question the veracity of Air Wisconsin’s written statement (see Exhibit CDA-2) on the basis that Air Wisconsin was contractually obligated to make the statement. Rather than impugn the statement, the contractual obligation supports its veracity. When Air Wisconsin agreed to make the statement, it did so with the knowledge that the statement would be subject to scrutiny in a WTO dispute settlement proceeding. To put such a statement in writing – with knowledge of how it would be scrutinized – Air Wisconsin had to be absolutely certain that it was accurate. The contractual obligation simply reflects Air Wisconsin’s agreement to make the statement.

⁵³ See *supra*, para. 73.

98. Therefore, even if the “interest rates provisions” of the Arrangement include some of the procedural requirements of the Arrangement, Canada’s offer to Air Wisconsin on a matching basis is in conformity with the “interest rates provisions” of the Arrangement. Canada’s offer to Air Wisconsin therefore qualifies for the “safe haven” of the second paragraph of Item (k).

3. Canada’s interpretation of the “interest rates provisions” treats all Members equally

99. In its response to Question 36, Brazil argues that an interpretation of the “interest rates provisions” that includes matching removes clarity and certainty about the application of the SCM Agreement for those Members who are not Participants to the Arrangement.⁵⁴ Brazil’s rationale appears to be that non-Participants would not receive notice of the terms and conditions matched by Participants, and therefore, non-Participants would be disadvantaged vis-à-vis Participants. Brazil then proceeds in the next three paragraphs of its response to use this rationale as the basis for arguing that allowing matching would, in effect, violate Article I of the GATT.⁵⁵ All of these arguments can be summarized as follows: in Brazil’s view, allowing matching under Item (k) is more favourable to Participants than to non-Participants. As Canada noted in its Oral Statement, it is hardly a disadvantage for non-Participants that they can match without being subject to the transparency requirements of the Arrangement.⁵⁶

100. Brazil alleges that differing views exist among Participants about matching and suggests that those alleged differing views undermine the clarity and certainty concerning the application of the SCM Agreement.⁵⁷ Brazil misunderstands the position of the US and the EC. There is no disagreement amongst Participants that matching is an “interest rates provision”, and on how the matching provisions of the Arrangement operate.

4. Non-identical matching is an interest rates provision

101. Brazil argues that Canada is disingenuous to claim that non-identical matching is an “interest rates provision” because, in Brazil’s view, it leads to a “race to the bottom”.⁵⁸ As noted above at paragraph 96, Brazil’s view ignores that non-identical matching is permitted by, and in conformity with, the Arrangement. And by virtue of the matching provisions being “interest rates provisions”, non-identical matching is in conformity with the “interest rates provisions” of the Arrangement.

102. While Canada’s offer was not identical to Brazil’s offer to Air Wisconsin, Canada’s offer was not more favourable than Brazil’s, i.e., it did not undercut Brazil’s offer.⁵⁹ Contrary to what Brazil appears to suggest, the matching provisions of the Arrangement do not permit undercutting.⁶⁰ Brazil’s statement that non-identical matching is “not really matching at all” suggests that matching can only be considered if the matching offer was identical to the initiating offer.⁶¹ This is an impossible test to

⁵⁴ See Brazil’s Response to Question 36, eleventh to fourteenth paragraphs.

⁵⁵ See *id.*, fifteenth to seventeenth paragraphs.

⁵⁶ See Canada’s Oral Statement, paras. 37-40.

⁵⁷ See Brazil’s Response to Question 36, fourteenth paragraph.

⁵⁸ See *id.*, eighteenth paragraph.

⁵⁹ See *supra*, paras. 73 and 85-88.

⁶⁰ It is unclear to Canada whether Brazil believes that undercutting is or is not permitted by the matching provisions. Brazil’s argument that Canada’s offer must be equal to, and not more favourable than, Embraer’s offer, would seem to indicate that Brazil believes undercutting is not permitted. See Brazil’s Response to Question 36, seventh paragraph. However, Brazil’s “race to the bottom” argument seems to indicate that Brazil believes undercutting is permitted. *Id.*, eighteenth paragraph. In any event, in Canada’s view, under the matching provisions of the Arrangement, non-identical matching must not be more favourable, to the best of the Member’s knowledge, than the initiating offer.

⁶¹ See *id.*, eighteenth paragraph.

meet, as it would require competitors to “share” their offers and to use identical financing tools and structures. In fact, non-identical matching is permitted by the Arrangement both because a matching Participant may have imperfect information, for example, when matching a non-Participant, and because different credit agencies have different means of providing export credits.

103. Matching, by definition, implies equal or similar attributes. Therefore, a Member that intentionally or carelessly undercut an offer by another Member would not be matching and could not rely on the “safe haven” of Item (k). Canada did not undercut Brazil’s offer. Canada neutralized the unfair advantage for Embraer that resulted from Brazil’s support and allowed Air Wisconsin to make its decision solely on the merits of the aircraft.

104. Brazil’s “race to the bottom” argument is wrong. The “interest rates provisions” include matching, not undercutting. The success of the Arrangement in disciplining officially supported trade-distorting export subsidies demonstrates that the fears of a “race to the bottom” are misplaced. Matching is one of the key elements in the success of the Arrangement in imposing discipline on officially supported export subsidies. The strengthening of the export subsidy disciplines that matching provides to the Arrangement applies equally to the SCM Agreement because matching is an “interest rates provision” under the second paragraph of Item (k).⁶²

105. For all these reasons, the SCM Agreement permits Canada’s offer on a matching basis in response to Brazil’s offer to Air Wisconsin. Specifically, Canada’s offer to Air Wisconsin on a matching basis is in conformity with the “interest rates provisions” of the Arrangement. Canada’s offer to Air Wisconsin therefore qualifies for the “safe haven” of the second paragraph of Item (k).

III CONCLUSION

106. Brazil has failed to substantiate its claims in this dispute. It has failed to establish that Canada’s Corporate Account, Canada Account or IQ programmes are “as such” prohibited export subsidies. It has also failed to establish that specific transactions in which these programmes are applied involve prohibited export subsidies.

107. In the case of the Air Wisconsin transaction, Brazil has claimed that Embraer’s offer to Air Wisconsin did not involve Brazilian government support and that Canada therefore could not have made a matching offer under Item (k) of Annex I to the SCM Agreement. Brazil’s claim lacks all credibility. If this Panel finds that Embraer’s offer to Air Wisconsin did involve Brazilian government support, it should also find that Canada’s offer on a matching basis qualifies for the “safe haven” of Item (k).

108. Alternatively, if the Panel were to accept Brazil’s position that commercial credit was available to Air Wisconsin on the terms offered by Embraer, those terms would necessarily be market terms. Canada’s offer, being no more favourable than those terms, would not confer a benefit and would not be a subsidy within the meaning of Article 1 of the SCM Agreement.

109. Accordingly, Canada respectfully requests that this Panel dismiss each of Brazil’s claims.

⁶² See Canada’s Oral Statement, paras. 34–36.

ANNEX B-9

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(26 July 2001)

Following are Canada's answers to the Panel's Questions of 20 July 2001. Certain of the Panel's questions, particularly Questions 43 and 44, ask Canada to respond to specific arguments in Brazil's second written submission prior to the second substantive meeting with the parties. While Canada is pleased to provide responses as requested, in accordance with the working procedures, Canada reserves the right to elaborate on its answers by way of formal rebuttal at the second substantive meeting.

Question 37

Since 1 January 1995, was any government guarantee or support provided to Comair or Midway by EDC and / or IQ? If so, please provide full details of the terms and conditions of the relevant transaction(s), and all documentation regarding the review of the transaction(s) by EDC and / or IQ.

1. **Midway:** In its first submission, Brazil argued that EDC's involvement with Midway was a financial contribution. Canada responded that EDC had no involvement with the Midway transaction. Again: EDC was not involved in the Midway transaction.
2. At paragraph 66 of its second submission, Brazil seems to assert that it only learned in Canada's 6 July answer to the Panel's Question 14 that support for the Midway transaction came from IQ. Paragraph 91 of Brazil's 30 May first submission belies this assertion. There, Brazil states that it understands IQ to have been involved in the Midway transaction. In its answer to Question 14, Canada provided the Panel with the full details of the terms and conditions of IQ's involvement in the Midway transaction.
3. **Comair:** At paragraphs 43 and 59 of its first submission, Brazil appeared to assert that it was government guarantees by EDC Corporate Account to Comair that were the basis for some sort of claim in respect of that transaction, or possibly a part of what Brazil has since characterized as its "as such" claim against EDC. In response, Canada stated that EDC's Corporate Account has not provided guarantees to Comair. (Nor has IQ had any involvement in any Comair transaction).
4. In both paragraphs 43 and 59 of its first submission, Brazil put the emphasis on government guarantees, not Canada. Brazil even italicized the term in paragraph 43 so that there would be no doubt that such alleged guarantees were the basis of its complaint. Until its second submission, Brazil never suggested that it is challenging the Comair transaction other than in respect of government guarantees. Moreover, in citing the Comair Form10-K in its first submission, Brazil omitted a paragraph. The omitted paragraph makes clear that Comair's description of how it "expects" to finance certain aircraft relates not to the delivered aircraft identified by Brazil, but to the scheduled

delivery of other aircraft after 31 March 1998. It is only logical that Comair's financing *expectations* would apply to future deliveries, not aircraft already delivered.

5. EDC provided []. These Corporate Account transactions were authorized in 1996 and 1998 and [] for the ASA transactions described by Canada in its response to the Panel's Question 11.¹

6. Canada's Exhibits CDA-58 and CDA-59 contain the letters of offer and the documentation outlining the pricing for these loans. The documentation makes clear the efforts to which EDC went to ensure that the transaction was financed at market terms.

7. For ease of understanding, Canada also offers the following synopsis:

- ? Pricing for the first Letter of Offer was set in April 1996 and was based on an imputed rating of [], derived from the airline's most recent financial results – LA Encore was not introduced until mid-1997. At that time the Bloomberg Fair Market Curve (FMC)² indicated that [] rated US industrials were borrowing at 10 year US Treasury Bills (UST) + []. Today, given the availability of LA Encore, after inputting Comair's 1994, 1995 and 1996 results into LA Encore we find that the 1996 rating is calculated as []. The FMC for [] credits at the time of the transaction was 10 year UST + []. Then current market pricing for Comair, which was provided to EDC in confidence by a reputable financial institution, was also considered; EDC was advised that [] Comair deliveries at that time were priced by 3-4 European banks in the 10 year UST + [] range with similar repayment terms, average life and loan to value ratios as the EDC proposal. Finally, then current EDC pricing offered to other airlines was also considered. Based on all of the above, the first EDC Letter of Offer issued to Comair (16 July 1996) carried an interest rate of 10 year UST + []. This market-based pricing was [] bps below the [] and was authorized.
- ? Letters were issued to Comair in December 1996 and March 1997, which offered Comair a ten year repayment and an interest rate of 10 year UST + []. This pricing was offered as a result of Comair's strong financial performance and the fact that Comair had been able to receive bids for financing up to [] aircraft at UST+[] through a EETC with a [] year repayment term, although EDC estimated that all-in pricing, including all requisite fees, would actually be closer to UST + []. In addition, at the time of these offers [] rated credits were attracting rates of 10 year UST + [] and [] rated credits were trading at 10 year UST + [] according the []. This EDC market-based pricing was [] and was authorized.
- ? By the time of the next Letter in August 1997 LA Encore was operational and a rating of [] was calculated for Comair. The offered interest rate of 10 year UST + [] was based on Comair's continued strong performance as well as the previously noted benchmarks (banks, EETCs) and pricing offered by []. In addition, recent pricing for [] was also considered as this airline was deemed to be a similar risk. At the time of this Letter the FMC for [] rated credits indicated 10 year terms of 10 year UST + []. An [] of [] was required and authorized based on the above noted market benchmarks.

¹ [].

² The Bloomberg Fair Market Yield Curve or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating. FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

- ? On 18 August 1997 EDC agreed to allow Comair to stretch the average life of the debt component of the USLL transactions to [] years from []. Comair's request for this was reviewed by EDC based on the debt exposure over the term of the loan and a reduction in the loan-to-value ratio (LTV). EDC deemed acceptable the risk associated with this change, based on consideration of data available at that time from recognized aircraft appraisers of projected CRJ residual values in comparison with the exposure profile under the proposed financing. This option required the loan to value ratio to be reduced to [] per cent. All other terms and conditions remained unchanged.
- ? Similarly, a term included in EDC's 17 September 1997 Letter was up to a [] year average life with the LTV restricted to [] per cent. All other terms and conditions remained unchanged.
- ? On 31 March 1998 EDC issued a Letter of Offer which, in addition to the terms and conditions offered in previous Letters, offered a direct loan option with a ten year repayment and an interest rate of 7 year UST + [] or LIBOR + []. This pricing considered Comair's financial performance (then rated [] by LA Encore) and similar pricing offered to []. The floating rate was based on then current swap rates. The [] for 31 March 1998 indicated [] credits were attracting 7 year UST + []/10 year UST + [].
- ? On 14 April 1998, EDC offered up to a [] year repayment term under the direct loan option (though the direct loan option was never utilized by Comair). Financing under the USLL structure allowed up to an [] year average life, subject to a LTV of [] per cent. Also considered were: appraisers' residual value projections and the EDC debt profiles. Approval of an [] of [] basis points was duly authorized based on the commercial pricing benchmarks noted.
- ? In February 1999, EDC issued its most recent Letter to Comair. This Letter provided the airline with the option of a fixed rate (10 year UST + []) or a floating rate (six-month US dollar LIBOR + []) and tied the swap to a market-based benchmark for advances after March 2000. Pricing was based on the airline's credit quality, deemed [] and considered first among its peers in the industry. Also considered were pricing for similar credits both internal to EDC and available in the market (including airlines and industrials, e.g. the []) and then applicable swap rates between UST and LIBOR. Based on these market-based considerations an [] of [] bps was obtained for the fixed rate option ([] was met under the floating rate option).

Question 38

Please provide full details of the terms and conditions of any SDI support provided in respect of the Atlantic Southeast and Northwest transactions discussed at para. 91 of Brazil's first written submission. Please also provide all documentation regarding the review of any relevant transaction(s) by SDI. Please also provide the credit ratings of the airline(s) at the time of the relevant transaction(s).

1. SDI did not participate in either the Atlantic Southeast or the Northwest transactions. Nor did IQ, as Canada stated in its answer to Question 14 from the Panel.

Question 39

Please respond to the suggestion (in para. 132 of Brazil's second written submission) that Canada has failed to explain the use of \$135 million of the (approx.) \$300 million of IQ funding referred to in the press article cited in paragraph 85 of Brazil's first written submission.

1. Brazil contends that “[a]s a matter of simple math, the list of transactions included in Canada’s response to Question 14 cannot be complete.” Brazil is wrong. Canada has included all of the transactions in which IQ was involved. Brazil has failed to take into account that the newspaper article on which Brazil relies was using Canadian dollars, whereas the \$20 million that Brazil uses as the average price for a Bombardier aircraft is a US dollar amount. What Brazil describes as a difference of nearly \$135 million dollars is mostly due to its failure to adjust for the difference in the value of the Canadian and US dollars.

2. For example, at a current exchange rate of approximately CAD 1.545 per USD, Brazil’s estimate of USD \$164.6 million in committed funds becomes approximately CAD 254.3 million. Furthermore, it is IQ’s practice, whenever it does financing, to keep funds in reserve in order to guard against possible variations in exchange rates. This accounts for most, if not all, of the remaining difference.

3. In addition, as both the article and the Panel’s question make clear, the reference to \$300 million is an approximation by the author of the article. Thus, contrary to Brazil’s assertion, in paragraph 132, that Mr. Cyr “stated that \$300 million had been used”, the reference in the article is to “[a]bout \$300 million” and the article is careful not to attribute this estimate to Mr. Cyr. Finally, as Brazil has acknowledged, the average price of \$[] million that Brazil assigned to the Bombardier aircraft is also an approximation.

Question 40

Please provide the credit ratings for Air Littoral, Atlantic Coast Airlines and Air Nostrum at the time of the transactions referred to in Canada's reply to Question 14 from the Panel.

1. None of the airlines were public companies at the time of the transactions in question. [] conducted an internal credit assessment and arrived at the following credit ratings for Air Littoral and Air Nostrum at the time of the transactions:

Atlantic Coast Airlines: []

Air Littoral: []

Air Nostrum: []

2. These internal ratings are calibrated to ratings of international credit rating agencies such as Standard & Poor and Fitch IBCA. For example, ACA is now a public company with a Standard & Poor rating of [].

Question 41

Please provide the documentation requested in Question 14 from the Panel, particularly in respect of the specific guarantee fees involved, and any [], or explain why such documentation is not available.

In addition, please provide all documentation regarding the review by IQ of the Air Littoral, Atlantic Coast Airlines and Air Nostrum transactions referred to in Canada's response to Question 14 from the Panel.

1. Please see Exhibits CDA-60 to CDA-64. In respect of the documentation concerning any [], please see Exhibit CDA-65. This document, entitled [].

Question 42

Please respond to Brazil's comments in paragraphs 137-138 of its second written submission regarding Canada's reply to Question 17 from the Panel.

1. Paragraph 137: Whatever Brazil "suspects", there is no updated version of the "critères d'évaluation". They have remained the same since IQ superseded SDI in 1998.

2. Paragraph 138: Canada provided the "critères d'évaluation" included in its Exhibit CDA-51 in an effort to answer the Panel's question as comprehensively as possible, even though the "critères" do not fix terms and conditions. No other guidelines etc. exist fixing the terms and conditions of IQ support to the regional aircraft industry. As Canada has explained and as the facts and evidence bear out, subject to the "critères d'évaluation", IQ has very broad discretion in deciding whether to provide such support, and the terms and conditions on which it does so.

Question 43

Please respond to para. 153 of Brazil's second written submission.

1. When Canada stated in its answer to the Panel's Question 23 that, from 1 January 1995 to 31 May 2001, 70.04 per cent of Bombardier's order book was financed in the commercial market, Canada was not including orders in which Canadian government entities participated on what Brazil refers to as a "market window" basis. There was no involvement whatsoever of Canadian government entities.

Question 44

Please respond to paras. 62 and 63 of Brazil's second written submission.

1. **Para. 62:** Brazil asserts that the "question, therefore, is whether – in the absence of EDC – Bombardier could make equally attractive financing available to its customers." Canada understands Brazil to be arguing that Bombardier must show that it could arrange financing in the commercial market on terms as favourable as those offered by EDC to customers of Bombardier. Canada disagrees.

2. Bombardier is not the party requiring financing – the purchaser of the aircraft is. Brazil's proposition ignores the test used by the Appellate Body that a benefit 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.³ Regardless of whether EDC or another financial institution is providing the financing, the purchaser of the aircraft, not Bombardier must repay the financing. The terms on which it can do so are determined by the attributes of the purchaser, including its credit risk. The terms on which Bombardier could obtain financing are irrelevant to this determination.

³ *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 157.

3. Nor could it be argued that Bombardier receives a benefit if EDC provides financing on terms that the borrower could obtain in the marketplace. Since its first submission, Brazil has gone to great lengths in its argument against Corporate Account and IQ to avoid the “benefit” test applied by the Appellate Body. Brazil’s argument in paragraph 62 in respect of Corporate Account continues this pattern.

4. The implication of Brazil’s assertion in paragraph 62 is that EDC’s operations – or those of any export credit agency – are unnecessary when they offer no more than what the market does. When an ECA operates on market terms, it does not imply that the financing provided will not be attractive to its customers. By definition, all private sector financial institutions provide financing on market terms as well. By Brazil’s reasoning, most of these institutions are “unnecessary” as they do not provide anything on better terms than those otherwise available in the market.

5. Borrowers seek out financial institutions with the expertise that best meets their needs. EDC’s borrowers seek its depth of experience and specialized expertise in facilitating all aspects of export transactions. Relying entirely on innuendo, Brazil seeks to penalize EDC for being good at what it does. Brazil cannot in this manner avoid its obligation to demonstrate all the elements of a prohibited export subsidy.

6. By Brazil’s logic, any financing by an export credit agency would be *per se* illegal. However, that is not what Article 1 and 3 of the SCM Agreement provide. In particular, Article 1 requires not only a financial contribution by a government or a public body, but also that a benefit thereby be conferred. Brazil has not established that EDC Corporate Account financial contributions confer a benefit because its allegations are baseless.

7. In paragraph 62, Brazil also continues the practice of using the Air Wisconsin transaction to argue against Corporate Account. Brazil is fully aware that the Air Wisconsin transaction does not involve Corporate Account. Canada suggests that Brazil has engaged in this practice because Corporate Account transactions are on market terms.

8. Finally, even if Brazil’s definition of the issue were appropriate – and clearly it is not – Brazil would still have the onus to demonstrate the existence of a benefit by showing that Bombardier could not arrange “equally attractive financing” in the absence of EDC. Brazil has neither demonstrated this nor made any attempt to do so.

9. **Para. 63:** Throughout this dispute, Canada has confirmed that, as the panel found in *Canada – Aircraft I*,⁴ the EDC programme constitutes discretionary legislation. This finding was not based on Item (k). Nothing has changed since the finding of the *Canada – Aircraft I* panel, nor has Brazil submitted any arguments or evidence that show otherwise. Canada’s position is not in any way dependent on the affirmative defence in Item (k).

10. Moreover, Brazil’s assertion that “A measure that exists to provide export subsidies remains mandatory whether or not it may fall within the scope of the “safe haven” of item (k)” is irrelevant. Even if “existing to provide export subsidies” were the test for inconsistency “as such”, Canada has explained previously that EDC exists to provide financing assistance, not subsidies. However, “existing to provide export subsidies” is not the test. The test of whether a measure is “as such” inconsistent with the prohibition on export subsidies is whether the measure must necessarily, at least in some circumstances, result in the granting of prohibited export subsidies. Nothing in the Export

⁴ *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999.

Development Act⁵ or anywhere else, requires EDC, when providing financing, to grant prohibited export subsidies.

11. Brazil's argument in paragraph 63 is in no way relevant to the facts of this dispute or to Canada's arguments. Canada therefore wonders if the Panel has sought comment on paragraph 63 because Brazil has contradicted its own position in *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*. There, Brazil argued that once it “has established a *prima facie* case that PROEX III allows compliance with the interest rates provisions of the *OECD Arrangement*, PROEX III should, under the traditional mandatory vs. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise.”⁶

12. The panel in that proceeding has found that PROEX III is not “as such” inconsistent with the SCM Agreement because, *inter alia*, it allows Brazil to act in conformity with the second paragraph of Item (k). As the panel put it, “Thus, Brazil has successfully invoked the safe haven provided for in the second paragraph of item (k) in respect of PROEX III as such.”⁷ It is intriguing, if not surprising, that Brazil's position in this dispute amounts to an assertion that the panel in the PROEX III proceeding erred at law.

Question 45

At paras. 74 and 75 of its second written submission, Brazil argues in essence that, for the ASA transaction, “EDC financial contributions were granted on terms more favourable than those available on the market”. Please comment.

1. Contrary to Brazil's assertion, the fact that EDC provided Corporate Account financing to ASA at a rate below its usual [] does not “demonstrate that EDC financial contributions were granted on terms more favourable than those available on the market.” More particularly, it does not demonstrate that EDC's lending yield resulted in ASA receiving a financial contribution on terms more favourable than those available to it in the commercial marketplace. Nor could it demonstrate this, because the transaction was priced at market terms. EDC's [] is an internal requirement. It expressly provides for the possibility of exceptions. These exceptions may be sought to achieve market pricing as was done in the ASA transaction.

2. As noted in Canada's answer to the Panel's Question 11, at the time of the first Letter of Offer to ASA, LA Encore had not been developed but EDC was able to impute from Famas (commercial financial analysis software) a [] for ASA based on the company's financial results for the previous three years. EDC developed its pricing based on consideration of i) the then current [], ii) the rates paid by the airline on its other debt as well as iii) the rates obtained by a comparable airline, [], on a recent market financing of regional jets. In addition, EDC considered the then current EDC pricing offered to [].

3. As previously described, the [] or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating. FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and

⁵ *Export Development Act*, R.S.C. 1985, c. E-20, s. 10. (Exhibit BRA-17)

⁶ *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW/2, not yet adopted, para. 5.122.

⁷ *Id.*, para. 5.206.

evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

4. At the time of the first Letter of Offer to ASA, generic US industrials with a credit rating of [] were trading at 10 year UST + []. Had LA Encore been operation at the time of the letter, it would have generated a rating of [], based on the company's financial results of the previous three years. At that time, the FMC indicated that such credits were attracting 10 year UST + [].

5. According to ASA's financial statements, as at 31 December 1995, the company had a USD [] unutilized line of credit which was afforded a rate of L + [] (which swapped to fixed rate at the then appropriate spread was equivalent to 10 year UST + []).

6. At the time of the first Letter of Offer to ASA, EDC had previously offered financing to Comair on essentially the same terms. As discussed in Canada's answer to Question 37, at about the same time as EDC's first Offer to ASA, [] was able to attract pricing in the 10 year UST + [] range from a number of European banks for its CRJ acquisition programme and had received a bid for the issuance of a EETC at 10 year UST + [] (estimated to be 10 year UST + [] inclusive of fees and charges). In addition to the referenced face rates, the bank loans and the proposed EETC offered terms and conditions similar to those offered by EDC. At the time of the first Offer to ASA, EDC had previously offered [] financing on essentially the same terms.

7. As noted in Canada's answer to Question 11, the pricing offered in EDC's second Letter of Offer, dated 26 August 1998, was based on the airline's LA Encore rating of [], the then current FMC, EDC's concurrent pricing of its other borrowers (including [], which by then was similarly rated by LA Encore) and the company's continued strong performance. At the time, the FMC for similarly rated [] grade generic industrial credits was in the order of 10 year UST + [].

8. In March 1998 EDC presented a Letter of Offer to [] which provided a face rate of 10 year UST + []. This pricing was based on market benchmarks considered in the [] previous and then current pricing offerings.

9. ASA's financial performance continued to be strong, as demonstrated by its LA Encore credit rating and consistent profitability. It clearly warranted the pricing received from EDC.

10. Finally, as noted in Canada's answer to Question 11, through [] if ASA's deemed or published credit rating fell below certain benchmarks, [] would either purchase the ASA receivable or pay EDC a predetermined incremental interest margin as described therein.

Question 46

Please explain in more detail, (in addition to the statement by an Air Wisconsin official) why and how Bombardier's offers to Air Wisconsin "matched" the terms of Embraer's offer. Does Canada take the view that Bombardier's financing terms were "economically equivalent to Embraer's offer" (see para. 89, Brazil's second written submission)? If yes, please explain why and how.

1. As a preliminary matter, Canada wishes to clarify that the "matching" of offers at issue in this proceeding is Canada's matching of official support offered by Brazil, rather than Bombardier's matching of a commercial proposal by Embraer.

2. Canada decided to match in order to establish a level playing field and to ensure that the Canadian bidder was not disadvantaged by Embraer's subsidized financing offer. Canada sought to ensure that the buyer's decision in the Air Wisconsin transaction would not be made on the basis of

the “most favourable officially supported terms”.⁸ In its rebuttal submission, at paragraphs 85 to 88, Canada has explained the due diligence efforts that it took to ensure that its financing offer matched Brazil’s financing offer. These efforts succeeded.

3. Canada is not sure what Brazil means by “economically equivalent”, nor does Canada accept that there are any textual or other grounds for using “economic equivalence” as the basis for comparison of matching offers. The question is whether the financing offered by Canada is more favourable than the financing offered by Brazil. The answer is no. Thus, if “economically equivalent” means that each financing package, taken as a whole, has effectively the same value to the borrower (i.e. it is no more favourable), then the answer to the Panel’s question is that the terms of Canada’s offer were not more than “economically equivalent” to Brazil’s offer.

4. In the course of this proceeding, Brazil has been obliged to provide the Brazilian offer to Air Wisconsin. Canada’s comparison of the two financing offers, attached as Annex A, shows that there are differences in the two financing offers on a term-by-term basis. However, as Canada explained in paragraph 102 of its rebuttal submission, non-identical matching is permitted by the OECD Arrangement, both because a matching Participant may have imperfect information about the offer being matched and because different export credit agencies use different instruments to provide export credits.

5. The comparison of the two offers demonstrates that, taken in their entirety, the terms of Canada’s financing offer are not of more favourable value to Air Wisconsin and may indeed be of less value than the Brazilian offer. For example, the Brazilian offer does not specifically refer to collateral security requirements and proposes [], whereas Canada’s offer requires specific security and is limited to []. If this was Brazil’s commitment, then the Brazilian offer may well have been significantly more favourable than Canada’s. Thus, the comparison of the two offers confirms that, as Air Wisconsin stated in its letter, Canada’s offer, viewed in its entirety is no more favourable than that offered by Brazil.⁹

Question 47

In Canada's Rebuttal, para. 32, Canada argues that the guarantee fees charged by IQ when providing support to the regional aircraft industry are "at market". What is the basis of this argument? Also, Brazil argues that the most recent decree (Exhibit Cda 36) eliminates fees as a condition for the grant of a guarantee. Please comment on whether / how the elimination of such fees would make any difference to the Panel's analysis of "benefit" issues.

1. In response to Question 14 of the Panel, Canada explained that IQ “receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.”¹⁰ The “market rate” nature of the guarantee can only be demonstrated considering the value of the financial service that is being provided in the light of the risk exposure of the service provider.

2. Canada explained at paragraphs 67 and 68 of its Rebuttal Submission as well as in its responses to question 14 of the Panel that the effective risk exposure of IQ is key to the determination of what constitutes an appropriate fee. As a result of [], IQ risk exposure is greatly diminished. In

⁸ OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998), p. 5. (Exhibit BRA-42)

⁹ Letter from [], operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001. (Exhibit CDA-2)

¹⁰ Canada’s answer to Question 14 of the Panel, para. 7.

fact, [], the risk represented by a possible default of the aircraft purchaser is, in large part, replaced by [].

3. The market nature of the fee is further demonstrated by the commercial practice of the use of the guarantees. As mentioned by Canada in paragraph 9 of its answer to Question 14 of the Panel:

No Bombardier customer has ever made a regional aircraft purchase contingent on the presence of an IQ guarantee. Indeed, as can be seen in the above transactions, on average, Bombardier customers using IQ equity guarantees have chosen to do so on less than [] per cent of their unit volume.

4. This proves that in practice, IQ provides financing services in competition with other financial institutions interested in participating in the aircraft financing market and that for the great majority of aircraft sold by Bombardier, the IQ guarantee is not sufficiently attractive to Bombardier's customers. In other words, the fact that [] per cent of the aircraft being financed are financed without IQ equity guarantees demonstrates that most of the time, Bombardier's customers are, at best, indifferent to IQ equity guarantees. The necessary implication of these circumstances is that the fees charged by IQ in return for the guarantees are market rate; otherwise Bombardier's customers would not be so indifferent as to their availability.

5. Given that [] the fees that are charged [] are more than adequate to compensate it for its risk and service.

6. The second part of the Panel's question relates to Brazil's argument that Decree 1488-2000¹¹ (the most recent decree) eliminates fees as a condition for the grant of a guarantee. If by this argument, Brazil is implying that IQ no longer charges fees, Brazil is mistaken. Decree 1488-2000 does not eliminate fees as a condition for the grant of a guarantee. Decree 1488-2000 does not specify the nature or the amount of the fees that may be charged by IQ. Instead, the fees to be charged are subsumed into IQ's discretionary power, subject to the "critères d'évaluation" set out in Exhibit CDA-51, to stipulate whatever terms and conditions it requires before it will provide a guarantee. Indeed, if IQ did not charge an appropriate fee, it could not satisfy "Critère B", which provides that IQ's support will not be available if the remuneration IQ is called upon to receive is less than that offered in the market for an arm's length transaction of similar structure and risk.

7. The Air Wisconsin transaction is the best evidence that contrary to Brazil's contention, Decree 1488-2000 does not eliminate fees. As described in more detail in the answer to Question 48, below, IQ is charging fees for its participation in the Air Wisconsin transaction.¹² In fact, IQ has charged fees for every transaction in which it has participated and has provided for fees in every financing offer it has made.

8. Because the fees in question have not been eliminated the questions of whether and how the elimination of such fees would affect the Panel's "benefit" analysis are moot.

Question 48

At paras 66 and 67 of its second submission, Canada states that IQ charges an up-front fee of [] basis points, and an annual fee equivalent to [] basis points on its effective exposure. In addition, Canada asserts that IQ is provided with a []. In its letter of 25 June 2001, which

¹¹ Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 \$ d'Investissement-Québec pour la vente d'avions par Bombardier Inc. (Exhibit CDA-36)

¹² See Canada's 25 June 2001 Letter to the Panel, last sentence of "Investissement Québec Guarantee – Transaction Description": "[]."

includes details of IQ's participation in the Air Wisconsin transaction, there is no reference to either an annual fee, or to a []. Please explain why IQ's participation in the Air Wisconsin transaction does not appear consistent with the practice set forth in the above mentioned paras 66 and 67.

1. IQ's participation in the Air Wisconsin offer is consistent with the practice set forth in paragraphs 66 and 67 of Canada's second written submission. Canada's 25 June 2001 letter indicates that IQ charges a fee of [] basis points per annum.¹³ As explained above, in paragraph 5 of Canada's answer to Question 47, []. Furthermore, IQ's participation is subject to the usual conditions such as due diligence. Depending on the outcome of that due diligence, it is possible that IQ's fees could exceed [] basis points (on the [] per cent exposure) but they will not be lower than [] basis points.

2. The up-front [] basis point administration fee is always charged by IQ pursuant to its obligation to self-finance its operations, in accordance with Section 40 of the IQ Act.¹⁴ Such a [] basis point administrative fee is routinely charged by any commercial financial institution.

3. The lack of reference to a [] in the description of the Air Wisconsin offer is because that []. However, pursuant to Decree 879-97, [].¹⁵

ANNEX A

COMPARISON OF THE FINANCING OFFERS TO AIR WISCONSIN

Category	Canada	Brazil

¹³ See *id.*, last sentence of the last paragraph.

¹⁴ *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 40. (Exhibit BRA-18)

¹⁵ Décret 879-97, 2 juillet 1997, concernant la participation de la Société de développement industriel du Québec relativement à la vente d'avions par Bombardier Inc., pp. 2-3, sub-para. (c)(ii). (Exhibit CDA-34)

ANNEX B-10

ORAL STATEMENT OF CANADA AT THE SECOND MEETING OF THE PANEL

(31 July 2001)

I. INTRODUCTION

1. Mr. Chairman, distinguished members of the panel, the facts do not support Brazil's claims. Nor does the law.

2. The facts and the law do not support Brazil's contentions that Canada's programmes "as such" are inconsistent with its WTO obligations. The fact is that there is wide discretion in how each of these programmes is applied. The law is clear: because these programmes do not require Canada, in any circumstances, to grant prohibited export subsidies, they cannot be "as such" inconsistent with the prohibition on export subsidies. Brazil has offered nothing to indicate otherwise or to affect the previous findings of the *Canada – Aircraft I* (DS 70) panel.

3. The facts and the law also fail to support Brazil's contentions that these programmes have been applied inconsistently with Canada's WTO obligations. The law for the purposes of this dispute is clear: unless there is a financial contribution by a government or public body that thereby confers a benefit, there is no subsidy. A benefit is conferred if the recipient receives a financial contribution on terms more favourable than those available to it in the market. If it does not, there is no subsidy.

4. Due to the inadequacy of Brazil's claims and the lack of clarity in its submissions, Canada still does not know which Corporate Account or Investissement Québec transactions it is challenging "as applied". However, Brazil has failed to show that any of the transactions it has mentioned in its submissions involve a financial contribution that thereby confers a benefit. Brazil has failed to meet its burden of proof. Nevertheless, in response to the Panel's questions, Canada has adduced extensive evidence establishing that these transactions are on terms no more favourable than those available to the recipient in the market and therefore are not subsidies.

5. Brazil has challenged only one Canada Account transaction as applied: the Air Wisconsin transaction. There is strong evidence that Embraer's offers did involve Brazilian government support. If so, Canada's offer of support on a "matching" basis qualifies for the safe haven of Item (k), second paragraph. Canada bears the burden of proving this on a *prima facie* basis, and it has done so. Brazil contends that the SCM Agreement affords Canada no right to match Brazilian subsidy offers. Canada has demonstrated that this is wrong as a matter of law. Brazil also contends that even if Canada does have the right to match Brazilian subsidies, its offer to Air Wisconsin has failed to meet the requirements for matching Brazil's offer. As Canada has shown, Brazil's contention is wrong on the law and on the facts.

6. Should the Panel accept, as Brazil argues, that commercial credit rather than government support was available to Air Wisconsin on the terms Embraer offered to arrange through third party institutions, those terms would be, by definition, terms available to Air Wisconsin in the market. Brazil bears the burden of showing that the terms of the financing by Canada are more favourable

than those that Brazil argues were available to Air Wisconsin in the market. Brazil has failed to meet this test. On the contrary, Canada has demonstrated that the terms it offered were not more favourable than those allegedly available to Air Wisconsin in the market.

7. In this statement, Canada will do the following:

- ? First, Canada will address Brazil's attempt to avoid its burden of proof and its failure to set out its claims with sufficient clarity;
- ? Then, Canada will elaborate on Brazil's failure to make out its challenge to Canada's programmes "as such", and "as applied" in specific transactions;

8. In sum, Mr. Chairman, Canada will show that when the proper legal tests are applied to the facts of this dispute, Brazil's challenge cannot be sustained.

II. BRAZIL HAS SOUGHT TO AVOID ITS BURDEN OF PROOF

9. Brazil's request for the establishment of a panel claimed that three programmes, Canada Account, "EDC" (by which Brazil seems to mean Corporate Account since it distinguishes it from Canada Account), and Investissement Québec violate various provisions of the WTO Agreement, including Articles 1 and 3 of the SCM Agreement and Article 21.5 of the DSU. Brazil appeared to be claiming that the programmes "as such" violate these agreements. Where, as in its first submission, Brazil referred to certain transactions, it appeared to consider these to be evidence of the inconsistency of Canada's programmes "as such". Brazil's claims also challenged the Air Wisconsin transaction.

A. BRAZIL HAS NOT CLARIFIED ITS "AS APPLIED" CLAIMS

10. However, Brazil has only recently said that it is challenging specific transactions under Canada's programmes "as applied", and it has never said with any clarity, which transactions, or applications, it is challenging. Instead, Brazil has sought to enlist the panel to investigate whether there are applications that could be challenged.

11. As the complainant, Brazil has the responsibility of establishing its claims. With respect to each of the impugned programmes "as such", and each transaction "as applied", Brazil bears the burden of proving, on a *prima facie* basis, two distinct general elements. First, it must show that a subsidy exists within the meaning of Article 1 of the SCM Agreement. Second, it must show that the subsidy, if one exists, is contingent in law or in fact upon export performance. In the place of a *prima facie* case, Brazil has offered suppositions and rhetoric. Brazil seems to consider that if its rhetoric is loud enough, it can persuade the Panel to assist it in its fishing expedition.

12. Brazil persists in these efforts. Its approach to the Kendell transaction is typical. Brazil made blanket assertions that EDC, by definition, took risks that no bank would ever take and that EDC's financing was below market because the term offered to Kendell was []. Canada showed in the Kendell transaction that, in fact, EDC participated in a syndicate of commercial banks. Those banks took the same risks as EDC and provided financing on the same terms as EDC. In other words, the terms offered by EDC were not only not more favourable than those *available* to the recipient in the market, they were identical to those actually *provided* to the recipient by the market.

13. Now, in its response to Question 51, Brazil makes further unsubstantiated allegations about the Kendell transaction. It then asks the Panel to ask Canada to produce still more information.

Brazil's approach to its burden of proof has important implications for the integrity of the dispute settlement process.

B. THE DISCLOSURE OF BUSINESS CONFIDENTIAL INFORMATION

14. The Appellate Body has found that, although a panel cannot relieve a complaining Member of the task of establishing a *prima facie* case, a panel has the broad authority to ask for information. The Appellate Body has said that Members have a duty to comply, whether or not the opposing party has established a *prima facie* case, and that a Member that fails to comply risks having adverse inferences drawn.¹⁶ The Panel in this case has used its authority to make numerous requests for information, much of it of a business confidential and commercially sensitive nature.

15. Canada has complied with the Panel's requests. It has done so despite the unclear and shifting nature of Brazil's complaints, despite Brazil's manifest failure to establish a *prima facie* case, and despite the obvious risks that the sensitive and business confidential information Canada has provided regarding credit agencies and their clients will fall into the hands of their commercial competitors.

16. The information gathering authority found by the Appellate Body to exist in the DSU is not accompanied by confidentiality procedures whose effectiveness can be ensured or enforced. The risks that the business confidential information of a Member's businesses will fall into the hands of its competitors in a complaining Member are particularly high when the competitors in question are government agencies or private entities with close links to the complaining government.

C. BRAZIL SEEKS TO HAVE THE PANEL DEVELOP ITS CASE

17. Canada recognizes that the Panel is following the practice suggested by the Appellate Body with regard to information requests. Canada also realizes that requests for "preliminary rulings" are often dealt with at the end of arguments by the parties. Nevertheless, there is a serious problem with requesting sensitive information about transactions that did not appear to be subject to the complaint and about which there has been no showing of illegality. The problem is that a Member with little more than suspicion can use the dispute settlement process to get the panel to develop its case for it.

18. Brazil persists with its approach even now, when the information Canada has provided proves that neither the transactions in the Panel's questions nor the programmes "as such" involve prohibited subsidies. Brazil's response to Question 51 is a good example of the continuing effort by Brazil to promote a prosecutorial "fishing expedition" by the Panel. The Panel should reject this effort.

D. EXPORT RESTRAINTS DOES NOT EXCUSE BRAZIL'S FAILURE TO CLARIFY ITS CLAIMS

19. In its second submission, Brazil attempts to rely on *United States – Export Restraints* to excuse its failure to clarify what it now calls its "as applied" claims. In previous submissions, Canada has explained why Brazil's request for the establishment of a panel is inadequate and fails to meet the requirements of Article 6.2 of the DSU. Canada will not repeat those arguments here. However, it is relevant to the foregoing discussion to correct Brazil's assertions regarding the *Export – Restraints* case.

20. Whether a panel request adequately identified measures "as applied" was not genuinely at issue in *Export Restraints*, (despite the United States' efforts to make it an issue), because Canada in

¹⁶ *Canada – Aircraft I*, Appellate Body Report, WT/DS70/AB/R, paras. 192-194.

that dispute was only challenging US measures “as such”. This is set out clearly in the Panel’s findings.¹⁷

21. At this stage of this dispute, Brazil does contend that it is challenging Canada’s measures “as applied”. Nowhere, however, has it specified the applications that it is challenging. Unlike *Export Restraints*, there is no question here of whether the mandatory/discretionary distinction is a jurisdictional issue. It is not. The question is what exactly Brazil is challenging.

22. As the European Communities noted, it is possible to challenge a programme “as such”, or individual transactions under a programme “as applied” or even both. Both programmes and transactions may be the object of a claim in a panel request.¹⁸ However, Brazil seems to be attempting to create a new class of case, the “open-ended ‘as applied’ case”, in which the complainant asks the panel to figure out if there are applications that could be challenged. Brazil thereby seeks to relieve itself of its burden of proof and enlist the Panel as its prosecutor. In effect, Brazil has asked the panel to try to make its *prima facie* case for it.

III. THE FACTS AND THE LAW DO NOT SUPPORT BRAZIL'S AS SUCH CLAIMS

23. Canada has described, Brazil’s request for the establishment of a panel contains claims that Canada Account, “EDC” (Corporate Account) and Investissement Québec, “as such”, are inconsistent with Articles 1 and 3 of the SCM Agreement. To prove these claims, Brazil bears the burden of showing that each of the three programmes, at least in some circumstances, makes it mandatory for Canada to grant prohibited export subsidies. Brazil has failed to meet this burden. Brazil cannot meet its burden because none of the three challenged programmes require Canada to grant prohibited exports subsidies.

A. CANADA ACCOUNT, CORPORATE ACCOUNT AND INVESTISSEMENT QUÉBEC ARE DISCRETIONARY

24. The facts are indisputable that each of the Canada Account, Corporate Account and Investissement Québec (or IQ) programmes has wide discretion as to whether, and on what terms, it will offer financing assistance. Nothing in the Export Development Act, the Investissement Québec Act or anywhere else, requires these programmes, when providing financing or financing assistance, to grant prohibited export subsidies.

25. In the case of Canada Account and Corporate Account, Brazil has failed to offer any compelling reasons – because there are none – for this Panel to reverse the findings of the DS 70 panel that these programmes involve discretionary rather than mandatory legislation and therefore, “as such”, are not prohibited export subsidies.

26. In the case of IQ, which Brazil did not challenge in the DS 70 dispute, it is clear from the applicable legislation and regulations that the programme is discretionary, and in no circumstances requires Québec or Canada to grant prohibited export subsidies.

27. First, IQ generally, has broad discretion in the administration of its practices under the IQ Act. Second, Section 28 of the IQ Act, under which IQ can participate in regional aircraft transactions is also discretionary. It does not require IQ to act in a manner inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement.

¹⁷ WT/DS194/R, 29 June 2001, paras. 8.126, 8.130.

¹⁸ Third Party Statement of the European Communities, 28 June 2001, para. 10.

28. Section 28 enables the Government of Québec to delegate to IQ the authority to determine and administer any assistance to be provided under Section 28. Section 28 provides that “the [IQ] mandate may authorize the agency to fix the terms and conditions of the assistance.” It is obvious that “mandate” in this sense does not refer to what IQ must do, but to the scope of IQ’s authority. It does not require IQ to authorize financing assistance under any specific terms and conditions, let alone on terms and conditions that would amount to a prohibited export subsidy.

29. In the case of assistance in regional aircraft transactions, the terms of IQ’s mandate (i.e., the scope of its authority to act) under Section 28 are set out in the decrees filed as exhibits CDA-33 to 36. These decrees provide that IQ has broad discretion to accept or refuse to grant assistance in regional aircraft transactions. The decrees set out conditions that must be fulfilled in order for IQ to grant assistance and also specify that IQ can impose “any other conditions” for doing so.

30. Contrary to Brazil’s argument, under Section 28 and the applicable decrees, IQ is never required to provide financing assistance in any regional aircraft transactions, and, if it does offer financing assistance, it is never required to confer a benefit thereby. The IQ programme therefore does not mandate the granting of prohibited subsidies. Brazil “as such” claim must fail.

B. BRAZIL’S ALTERNATIVE “AS SUCH” TEST IS BASELESS

31. Confronted with the indisputable fact that none of Canada’s programmes make the granting of prohibited export subsidies mandatory, Brazil seeks to construct alternative tests for “as such” inconsistency out of whole cloth. Thus, Brazil argues that the Canada Account and Corporate Account programmes “as such” require the provision of export subsidies because they are export credit agencies “with the *raison d’être* of providing export subsidies”. This is factually incorrect. The *raison d’être* of Canada’s programmes is to provide financing assistance, not export subsidies. Brazil has no basis for its assertion.

32. Brazil attempts to argue that Item (k) exists as a recognition that all credits from export credit agencies are prohibited export subsidies, but this too is a baseless assertion. There is nothing in the SCM Agreement itself to support it. Nor does Brazil’s position find support in the journal article that Brazil has cited in paragraph 45 of its second submission.

33. Brazil’s argument is also legally incorrect. Brazil’s position appears to be that the SCM Agreement prohibits all government export credits, except those offered in conformity with the second paragraph of Item (k). Article 1.1 of the SCM Agreement makes clear that financial contributions by a government, including such practices as loans or loan guarantees are not necessarily subsidies. To be subsidies, the financial contributions must confer a benefit. Brazil’s argument would read out of existence Article 1.1(b) of the SCM Agreement as it relates to practices such as government loans and loan guarantees.

34. Not surprisingly, because it disregards the benefit element in Article 1, Brazil’s position would have perverse results if accepted. Brazil argues, in effect, that an export credit agency may offer export credits only when they conform to the OECD Arrangement, but may not do so when they are on market terms. In other words, under Brazil’s interpretation, export credits that do not confer a benefit and are not subsidies would be prohibited – an absurd result.

C. BRAZIL’S “GUARANTEES” EXAMPLE FAILS TO AID ITS CASE

35. Brazil also attempts to show that Canada’s programmes are “as such” prohibited by arguing that the guarantees they may provide are necessarily prohibited export subsidies. Since none of Canada’s programmes mandate the granting of guarantees, this argument cannot possibly demonstrate that the programmes are “as such” inconsistent.

36. Moreover, government guarantees are not necessarily subsidies at all. In its guarantee arguments, Brazil again seeks to avoid satisfying the second element of Article 1 of the SCM Agreement. According to Brazil, in the case of government guarantees, the mere existence of the financial contribution confers the benefit. Brazil's argument would conflate these two distinct elements of the definition of a subsidy.

37. In this respect, Brazil's argument regarding the transfer of a government's credit rating in favour of the purchaser or borrower misses the point. Any guarantee allows a borrower to obtain better rates or conditions than would be the case in absence of such a guarantee. This is true whether the guarantor is the government or a private financial institution.

38. To assess whether a benefit is conferred within the meaning of Article 1, one must look to whether the recipient is receiving the guarantee on terms more favourable than those available in the market. Brazil has failed to do this. Instead, Brazil seeks to reverse the burden of proof. For example, it contends in its second submission, at paragraph 52, that Canada has failed to demonstrate that the fees charged by EDC are commensurate with those charged by commercial guarantors. Brazil did the same thing this morning with respect to Investissement Québec. Brazil misses two points here. First, the initial burden lies on Brazil to show that Canada's guarantees confer a benefit; it is not Canada's burden to show that they do not. Second, to satisfy the "benefit" element of its "as such" case, Brazil would have to show that Canada's measures require conferral of a benefit, not that the measure could be used to confer a benefit.

39. As to Brazil's Item (j) argument, Brazil again ignores an essential element of the requirements in that provision. To be a "per se" prohibited subsidy under Item (j), a loan guarantee must be provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes". Brazil does not even attempt to demonstrate the existence of this requirement. For this reason alone, Brazil's argument must fail.

D. BRAZIL'S "FINANCIAL SERVICES" EXAMPLE FAILS TO AID ITS CASE

40. Brazil attempts to bolster its "as such" case against EDC (presumably Corporate Account) with the additional "example" of financial services. Brazil's argument seems to be that EDC's efforts in putting together financing packages should be regarded as distinct financial services. Brazil has never identified what precisely these services are, how they are distinct from the export credit practices it is challenging under Article 1.1(a)(1)(i), how they constitute a financial contribution or if they do constitute a financial contribution, how they thereby confer a benefit.

41. Insofar as these "services" seem to involve putting together a loan or guarantee deal, it is difficult to see how this is not covered by the granting of export credits under Article 1.1(a)(1)(i). Brazil argues that these EDC "services" confer a benefit because they are better than those offered by other financial institutions. However, Brazil has not explained how it would measure this alleged "benefit" other than the self-testimonials of agency officials. As Canada noted at paragraphs 82 and 83 of its first submission, Brazil has offered no evidence of the true test of a benefit: whether the "services" involved in providing a financial package are priced below market.

42. Finally, Brazil makes its services argument in the context of its "as such" claim. It therefore bears noting that Brazil has failed to show even a single case where the terms on which these "financial services" were offered were more favourable than those available in the market, let alone that they are necessarily offered on more favourable terms.

IV. THE FACTS AND THE LAW DO NOT SUPPORT BRAZIL'S "AS APPLIED" CHALLENGES

43. As Canada has explained, with the exception of the Air Wisconsin transaction, Brazil has failed to identify the specific transactions it is challenging when it argues that Canada's programmes have been applied inconsistently with the SCM Agreement. Air Wisconsin remains the only Canada Account transaction that Brazil is challenging. My colleague, Karl Blume, will address Brazil's Air Wisconsin arguments in a few minutes.

A. BRAZIL HAS FAILED TO DEMONSTRATE THAT ANY CORPORATE ACCOUNT TRANSACTION IS A PROHIBITED EXPORT SUBSIDY

44. In the case of Corporate Account, Brazil has focused on two transactions, ASA and Kendell. Brazil claims that both transactions involved prohibited export subsidies, but in neither case has Brazil demonstrated, as it is required to do, that Corporate Account financing was provided on terms more favourable than those available to the recipient in the market and therefore conferred a benefit. Brazil has failed to make out a *prima facie* case. Nevertheless, at the request of the Panel, in its response to Question 45, Canada has presented evidence and argument proving that these transactions did not confer a benefit within the meaning of Article 1 of the SCM Agreement. In fact, Canada's answer demonstrates that the interest rate given to ASA is within the range of rates that could have been obtained in the market for a similar transaction.

45. In its responses to the Panel's Question 50, Brazil makes two objections to Canada's evidence regarding ASA. First, Brazil states, with respect to the risk premium, that: "Presumably, a small airline such as ASA would have a higher credit risk than US Air or Northwest". Brazil offers no basis for this presumption, which is demonstrably incorrect. Brazil reiterated this presumption today. An airline's credit-worthiness is a function of its financial performance, not its size, as the failure of large airlines such as Pan American illustrates. For instance, Southwest, one of the smaller major US airlines, has a better credit rating than any other major US airline. Brazil has confirmed this. It notes that Southwest has a higher rating than, for example, British Airways, which is one of the largest airlines in the world.

46. Second, Brazil argues that the lack of [] identified in the offer to [] "appears" to illustrate how the transaction was on below-market terms. In fact, the absence of any []. The test of market pricing, as in the case in question, is the "all-in" cost of the financing to the borrower.

47. In the case of Kendell, as Canada has described in its discussion of burden of proof, Canada has provided evidence that the terms of the offer were identical to those of seven commercial banks participating in the transaction. Brazil's only response has been to make unsubstantiated allegations and suppositions and to ask the Panel to insist on further evidence from Canada.

48. Canada does not expect that the Panel will take Brazil up on its request. Nor should the Panel do so. Nevertheless, in the interest of fully refuting Brazil's charges, Canada offers the following responses.

49. First, the number of commercial banks participating was indeed seven. In a syndicated deal such as the Kendell transaction, many banks are invited to participate. At the time EDC prepared its pricing strategy, it knew of four banks that were participants. Three others also joined. In its answer to Question 11, Canada listed all seven banks but inadvertently counted them as five.

50. Second, Brazil contests the accuracy of Canada's statement that EDC participated on an equal risk-sharing basis. EDC participated on what is known as a "pari passu" basis. This means that it was equally exposed to the risk of non-payment of its loan and that it participated in the loan on the same

terms and conditions as the other commercial lenders. EDC was responsible for [] per cent, not [] per cent of the lending provided.

51. Third, the comparisons Brazil seeks to draw between other spreads and those offered to Kendell are irrelevant in the face of proof that EDC's financing to Kendell was on terms no more favourable than those available in the market. This is very interesting given the allegation Brazil has made this morning about appropriate market spreads. In fact, Kendell recently completed a second round of financing for [] more CRJ-200 aircraft. That financing was offered by a group of four commercial banks. According to a news report in *Airfinance Journal*, (exhibit CDA-66), those banks priced the senior tranche of debt to Kendell at Libor plus 70 basis points. That is, it was priced [] basis points below the financing in which EDC was involved. If one looks at Brazil's exhibits 65 and 66, the latter in particular states that the market spread for Kendell financing should be [] basis points. This calls into serious question the reliability of the assumptions and data in Brazil's new exhibits. Brazil cannot deny what was available to Kendell in the market. Brazil seems to be suggesting that commercial banks are wrong when their pricing differs from what Brazil thinks it should be.

52. Brazil also makes the unsubstantiated assertion that the terms set for the first Kendell transaction were "influenced by EDC's participation". EDC's participation had no influence on the terms, as evidenced by the second, lower-priced, Kendell financing, in which EDC did not participate.

53. One essential point remains true of both the Kendell and ASA transactions as well as every other Corporate Account transaction that Brazil has mentioned in its submissions: in no instance has Brazil established a *prima facie* case that Corporate Account financing is provided on terms more favourable than those available to the recipient in the market. That is, in no instance has Brazil demonstrated the existence of a benefit. The Panel must dismiss these "as applied" challenges, whichever they may be.

B. BRAZIL HAS FAILED TO DEMONSTRATE THAT ANY IQ TRANSACTION IS A PROHIBITED SUBSIDY

54. Brazil's "as applied" challenge to Investissement Québec seems to be limited to the assertion that IQ has, in specific transactions, provided guarantees that are allegedly prohibited export subsidies. However, Brazil has failed to establish that any such transactions either confer a benefit or are contingent upon export performance.

1. IQ Assistance Does Not Confer a Benefit

55. The arguments and evidence submitted by Canada in response to Question 47 of the Panel clearly demonstrate that IQ charges market fees for its guarantees. Brazil has not, at any point in this dispute, demonstrated the existence of a benefit in respect of any IQ transaction. Brazil's "as applied" arguments therefore fail.

2. IQ's Assistance Is Not Contingent Upon Export Performance

56. Even if the Panel were to accept Brazil's unsubstantiated argument that IQ has granted a subsidy in specific transactions, Brazil claims would still fail because Brazil has not established that the provision of IQ assistance is contingent upon export performance. Brazil has failed to identify any legal instrument establishing the export contingency of IQ. It has also failed to submit evidence establishing that IQ's assistance is, in fact, contingent upon export performance.

57. Neither the IQ Act nor any of the relevant decrees demonstrate any element of export contingency attached to the various forms of IQ's financial assistance. Accordingly, export

contingency cannot be established on the basis of the words of the relevant legal instruments. Nor has Brazil offered any evidence that export performance was a condition for the provision of the assistance in any IQ transaction.

58. Brazil's principal argument that IQ assistance is export contingent appears to be that it "suspects" that there is a more recent version of the "critères d'évaluation" used by IQ to authorize the granting of guarantees, which would establish that IQ's support is contingent upon export performance. That Brazil felt compelled to ask the Panel to seek additional information from Canada on this issue indicates that Brazil is well aware that it cannot establish *de jure* export contingency on the basis of the "critères d'évaluation" and the legal instruments. As Canada mentioned in its response to question 42 from the Panel, there is no updated version of the "critères d'évaluation" and no other guidelines that exist. Clearly, in law, export performance is not a criterion that can be taken into account by IQ when it provides guarantees.

59. Finally, in its rebuttal submission, Brazil alleges (for the first time) that IQ guarantees are also *de facto* contingent upon export performance. Brazil's only argument in support of its allegation is that Canada is aware that its domestic market cannot absorb Bombardier's production of regional aircraft and that the panel in *Australia – Automotive Leather* established that "a Member's awareness that its domestic market is too small to absorb domestic production of a subsidized product indicates the subsidy is granted on the condition that it be exported."¹⁹

60. Brazil's reference to the panel's finding in *Australia-Leather* is both inaccurate and taken out of context. Brazil implies incorrectly that the *Australia – Leather* panel consider a member's awareness that its market could not absorb subsidized domestic production to be sufficient to prove *de facto* export contingency. In fact, the subsidy in *Australia-Leather* was, conditioned in part on sales performance targets. Given that the Australian government was aware of the fact that the recipient of the subsidy would have to maintain or increase export sales in order to meet the sales performance targets, the panel considered that, in fact, sales performance targets were export performance targets. Those specific circumstances of the case led the Panel to find that there was, in fact, a close tie between anticipated exportation and the grant of the subsidies.²⁰

61. Moreover, Brazil has failed to apply the test established in *Canada-Aircraft I* for the purpose of determining whether a subsidy is contingent, in fact, upon export performance. In *Canada – Aircraft I*, the Appellate Body established that in order for a subsidy to be contingent in fact upon export performance, it must be "tied to" export performance. The Appellate Body found that the ordinary meaning of "tied to" necessarily implies a relationship of "conditionality or dependence" between the provision of the subsidy and export performance. The Appellate Body specifically stated, at paragraph 171 of its Report, that it is not sufficient for a complainant to "demonstrate solely that a government granting a subsidy anticipated that exports would result".

62. The Appellate Body also found that footnote 4 of the SCM Agreement 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".²¹ It appears that Brazil has chosen to ignore the test elaborated by the Appellate Body because its only argument remains Canada's "knowledge" of the export propensity of the Canadian regional aircraft industry. Clearly, this is not sufficient to demonstrate *de facto* export contingency. Brazil has not submitted any other evidence demonstrating that the provision of IQ guarantees is conditioned or dependent on export performance. Therefore, its *de facto* argument must also fail.

¹⁹ Second Submission of Brazil, 13 July 2001, para. 149.

²⁰ *Australia – Leather*, Panel Report, para. 9.67.

²¹ WT/DS70/AB/R, para. 173.

C. BRAZIL HAS FAILED TO DEMONSTRATE THAT THE AIR WISCONSIN TRANSACTION IS A PROHIBITED SUBSIDY

1. **Canada's Offer On A Matching Basis In Response To Brazil's Offer To Air Wisconsin Is Consistent With The SCM Agreement**

63 Canada considers that Embraer's offer involved, and indeed could not have been made without, Brazilian government support. The Air Wisconsin transaction is consistent with Canada's SCM Agreement obligations because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the Arrangement. Canada's offer therefore qualifies for the "safe haven" of the second paragraph of Item (k) to Annex I to the SCM Agreement.

64 If, however, as Brazil contends, commercial credit was available to Air Wisconsin on the terms Embraer offered to arrange, those terms would be, by definition, available in the market. Canada's offer is on terms no more favourable than those Embraer offered to arrange and therefore no more favourable than those available to Air Wisconsin in the market. Accordingly, Canada's offer would not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement.

65 [] Although Canada does not consider the latter possibility to have been plausible, Brazil cannot have it both ways. Brazil cannot argue that Embraer's offer did not involve Brazilian official support and at the same time argue that Embraer's offer did not constitute terms and conditions available to Air Wisconsin in the market.

(i) *The SCM Agreement Permits Canada's Offer on a Matching Basis in Response to Brazil's Offer to Air Wisconsin*

66. In its Rebuttal Submission and in its response to the Panel's Question 52, Brazil put forth three arguments on why Canada's offer to Air Wisconsin on a matching basis is inconsistent with the SCM Agreement. Brazil's first argument is that its offer to Air Wisconsin did not involve Brazilian official support. Second, Brazil argues that, if Brazilian official support was involved, Canada's offer was more favourable than Brazil's offer. Third, Brazil claims that matching is not in conformity with the "interest rates provisions" of the Arrangement. Canada refuted each of these arguments in previous submissions. Canada's comments today will focus on the inconsistencies and illogic of Brazil's arguments.

(a) *Embraer's Offer to Air Wisconsin Involved Brazilian Official Support*

67. With respect to its first argument, Brazil claims that Embraer's offer to Air Wisconsin did not involve Brazilian official support. At a minimum, Brazil or Embraer led Air Wisconsin to believe that Brazilian official support would be provided. Canada suggests that the only reasonable inference was that Brazilian official support was involved in Embraer's offer to Air Wisconsin.

68. It is not credible that [].

69. Embraer by its own admission continues to rely heavily on official support from Brazil. According to Embraer, without Brazilian official support Embraer's "cost-competitiveness" could decrease. Brazilian official support – now and in the future – impacts substantially on Embraer.²² Embraer could not have made its offer without Brazilian official support.

(b) *Canada's Offer was Made on a Matching Basis*

²² Embraer's 1998-2000 Financial Statements, note 32 (Exhibit CDA-57).

70. Brazil's second argument is that, if Brazilian official support was involved, Canada's offer was more favourable than Brazil's offer. In Canada's response to the Panel's Question 46, Canada explained how its financing offer to Air Wisconsin was on a non-identical matching basis and was no more favourable than Brazil's offer. Non-identical matching is permitted by the OECD Arrangement, both because a matching Participant may have imperfect information about the offer being matched and because different export credit agencies use different instruments to provide export credits.

71. Brazil attempts to explain away the fact that Canada's offer was no more favourable than Brazil's offer by excluding from the comparison a "special element" of its offer which Brazil claims is unrelated to financing.²³ However, this "special element" is indeed related to financing. In Brazil's letter to the Panel of 25 June, this [].

72. Brazil makes a secondary argument that Canada did not comply with Article 53 of the Arrangement. Canada carried out its due diligence and matched the Brazilian offer in good faith.

73. Canada's response to the Panel's Question 46 included a reference to the due diligence efforts that it took to ensure that its financing offer matched Brazil's financing offer. As Embraer's term sheet demonstrates, these efforts succeeded. Canada's due diligence included an extensive discussion with Air Wisconsin officials. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support [].

74. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Foreign Relations Minister, Luiz Felipe Lampreia, who stated, with respect to PROEX, that: "[f]or us, the interest rate is [the] OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."²⁴ Mr. Lampreia, although no longer the Foreign Relations Minister, is now a member of Embraer's Board of Directors. He is one of two Brazilian Government representatives that sit on Embraer's Board.²⁵

(c) Matching is in Conformity with the "Interest Rates Provisions" of the Arrangement

75. Brazil's third argument is that matching is not in conformity with the "interest rates provisions" of the Arrangement. Brazil refers the Panel to its response to the Panel's Question 36. Brazil's response to Question 36 does not address Canada's arguments. Canada has repeatedly demonstrated that:

- ? Matching is specifically "permitted" by, and in conformity with, the provisions of the Arrangement;
- ? The substantive provisions in the Arrangement that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be, in a given transaction, but excluding procedural requirements with which a non-Participant inherently could not comply, are logically "interest rates provisions". Matching provides one alternative permitted way of determining an interest rate and is consistent with the Arrangement. Therefore, matching is an "interest rates provision";
- ? Accordingly, matching is in "conformity" with the "interest rates provisions" of the Arrangement;
- ? Matching is consistent with the object and purpose of the SCM Agreement; and

²³ Second Submission of Brazil, para. 91 and Brazil's Response to the Panel's Question 52, last paragraph.

²⁴ Exhibit CDA-6.

²⁵ Exhibit CDA-67, pp. 66 and 73.

? The application of matching is not de facto more favourable treatment for WTO Members that are Participants in the Arrangement vis-à-vis WTO Members that are non-Participants because matching is available to all WTO Members.²⁶

76. In conclusion, Embraer's offer to Air Wisconsin involved Brazilian official support. Canada's offer was on a matching basis and was no more favourable than Brazil's offer to Air Wisconsin. Furthermore, Canada's offer was made in good faith and on the basis of reasonable due diligence in response to Brazil's offer to Air Wisconsin. Finally, matching is in conformity with the "interest rates provisions" of the Arrangement. Therefore, because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the Arrangement, Canada's offer qualifies for the "safe haven" of the second paragraph of Item (k) to Annex I to the SCM Agreement.

(ii) *If Embraer's Offer did not contain Brazilian Official Support, Canada's Offer was on Terms No More Favourable Than Those Available to Air Wisconsin in the Market*

77. Alternatively, if the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms Embraer offered to arrange without Brazilian government involvement, those terms would be, by definition, available in the market. It would be Brazil's burden to establish a *prima facie* case that Canada's offer was more favourable than Embraer's offer to Air Wisconsin. Brazil cannot do so. As Canada explained in its answer to the Panel's Question 46, its offer to Air Wisconsin is no more favourable than that which Embraer offered to arrange according to its term sheet. Canada's offer therefore is on terms no more favourable than those available to Air Wisconsin in the market. Accordingly, Canada's offer would not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement. Brazil's claims must fail.

V. CONCLUSION

78. Mr. Chairman, there's an old saying among lawyers, that I'm sure will be familiar to counsel for Brazil: "When the facts are against you, argue the law; when the law is against you, argue the facts; when both the facts and the law are against you, pound on the table."

79. Because the facts and the law are extremely unhelpful to its claims, Brazil has done its share of table pounding in this dispute. However, in the course of its submissions it has adopted other tactics more worthy of the Panel's attention. It has sought to avoid its burden of proof and it has avoided and misrepresented the facts and the law.

80. The panel must not permit this. It cannot, for example, allow Brazil's deficient claims to stand. It cannot allow Brazil to make open-ended claims and enlist the Panel as its prosecutor. It cannot allow Brazil to evade the well-established test for "as such" inconsistency, nor to pretend that Canada's programmes are anything but discretionary. It cannot allow Brazil to avoid the Appellate Body's test for the existence of a benefit by arguing that all government export credits are "as such" prohibited export subsidies or that Canada's transactions are illegal because they do not conform to the OECD Arrangement. It cannot allow Brazil to have it both ways on the Air Wisconsin transaction.

²⁶ Canada's First Submission, paras. 51–60; Canada's Oral Statement 27 July 2001, paras. 22–40; and Canada's Rebuttal Submission, paras. 74–78.

81. Mr. Chairman, distinguished members of the Panel, Brazil has sought to avoid its burden of proof, the correct legal tests and facts themselves, because it is apparent that when the appropriate legal standards are applied to the facts of this dispute, none of Brazil's claims can be sustained. Accordingly, Canada respectfully requests that all of Brazil's claims be dismissed.

82. I thank you for your patience and attention.

ANNEX B-11

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(8 August 2001)

Following are Canada's answers to the Panel's questions.

Questions to Both Parties

Question 54

In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

1. In the field of regional aircraft financing it is entirely possible that there may be several commercial transactions at a range of prices. Several commercial transactions may be with the same or similar borrowers. The specific price that a financial institution will typically offer will depend on that institution's assessment of a range of variables, including the creditworthiness of the purchaser, security, the size of the transaction, any precedents in respect of the same or similar borrowers, the term of the financing, the loan-to-value ratio, the existence and nature of any guarantees and the commercial appetite of the institution for the business. Indeed, the Appellate Body recognized that "the commercial interest rate with respect to a loan in a given currency varies according to the length of maturity as well as the creditworthiness of the borrower."¹ As far as the creditworthiness of a purchaser is concerned, in the absence of any public benchmark, a financial institution would use other assessment tools to establish a commercially sound benchmark for that particular borrower.
2. A "market price" can be determined, at least in part, by examining what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. Commercial transactions that feature different terms and conditions or different security, or that occurred in a different time period, are less relevant. Due to the range of variables, one will probably not be able to determine a precise, single "market price". Several transactions involving similar credit qualities, similar terms and similar security over a period of time leading up to the conclusion of the transaction may enable one to identify a range of prices that would be at "market". Moreover, different commercial financial institutions may price a transaction somewhat differently, even if the terms and security are the same, based, *inter alia*, on their familiarity with the borrower, the security and/or the sector. If it were otherwise, there would be no "market".

¹ *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 182 [hereinafter "*Canada – Aircraft I* Appellate Body Report"].

Question 55

If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

1. []. There is no evidence whatsoever to support this speculation. Moreover, Brazil's unsubstantiated speculation has been contradicted by:
2. [];
3. Embraer's recent Form 20-F filing with the US Securities and Exchange Commission (SEC) which states that Embraer does not provide direct financing to its customers (Exhibit CDA-69); and
4. Brazil's own representative, Mr. Azevedo, who acknowledged at the second meeting of the parties that aircraft manufacturers do not normally engage in such tactics because of the danger that subsequent customers would demand similar discounts.
5. As Canada describes in its answer to the Panel's Question 67, *all* of the evidence regarding Embraer's offer indicates that it did involve Brazilian government support and [].
6. However, as a hypothetical matter, a commercial transaction at a short-term loss for long-term commercial reasons should be considered as a "market transaction". Whether the commercial offer is influenced by a given pricing or marketing strategy does not change the fact that a private commercial party was willing to make a financing offer on those terms to that recipient. In that sense, the financing terms and conditions were terms and conditions available to the recipient in the "market".

Question 56

Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

1. The following compares those elements that Canada considers "significant" and that are contained in both the Canadian and Brazilian offers. However, there are also numerous elements, some of which could be considered "significant", for which no provision has been made in the Embraer offer. Although one would reasonably expect that Embraer would have provided for at least some of these elements, in the absence of any explicit reference to them in the Embraer offer it is not possible to compare them.

1. Number of Aircraft

Canada's offer provides for support for [].

Embraer's offer provides for support for [].

In the Article 22.6 arbitration in *Brazil – Aircraft*, the arbitrators assumed a conversion of options into firm orders at a rate of [].² Applying the same conversion rate to [].

² *Brazil – Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

2. Financed Amount:

Canada's offer provides for financing up to [] aircraft.

Brazil's offer provides for [].

3. Repayment Term:

Canada offered a repayment term of [] with maximum average life of [].

In respect of [].

4. Interest Rate:

Canada offered an interest rate of [] in effect at the time of delivery of each aircraft.

[]

5. Administration Fee:

Canada's offer requires payment of an up-front administration fee [] per cent of the financed amount payable at the time of financing of each aircraft.

[]

6. Security:

Canada's offer requires, *inter alia*, a first perfected security interest in the aircraft, assignment of insurance and manufacturer's warranties.

[]

It is reasonable to expect that had the sale materialized for Embraer, such provisions would have been incorporated in final loan agreements and would have been comparable to those included in Canada's offer. However, the absence of one or more of these provisions in Embraer's offer would render Embraer's offer more favourable to Air Wisconsin.

7. Other Financing Support:

[]

Based on the foregoing, and the assumption that Embraer would ultimately provide terms at least equally restrictive as Canada's for those provisions not specifically addressed in its offer, Canada concludes that Canada's financing offer was not more favorable to Air Wisconsin than Embraer's. This is also the judgement of the purchaser, as reconfirmed in Air Wisconsin's letter of 7 August 2001 (Exhibit CDA-68).

Questions to Canada

Question 63.

What is the legal status of the EDC Credit Risk Policy manual (Exhibit CDA-48)? Is it legally binding on the EDC?

1. EDC's Credit Risk Policy Manual is a set of credit risk management policies that was developed with the assistance of Oliver, Wyman & Co., a management consulting firm with expertise in the banking sector, including active portfolio management and pricing for credit assets. The manual was developed as part of EDC's continuous review of processes and systems in order to improve the administration and assessment of credit risk under EDC's contingent liability and lending programmes. It represents the various components of EDC's risk management structure for transactions under these programmes and is part of EDC's commitment to ensure that its policies for the assessment of credit risks under proposed transactions and the management of its portfolio of transactions embody relevant best-in-class practices within the private sector and the public sector.

2. As a self-governing, autonomous Crown corporation, EDC's operating practices and policies are the responsibility of its Board of Directors. The Credit Risk Policy Manual was approved by the Board of Directors, but it is not legislation and consequently is not binding on EDC in the same way as legislation would be. However, any transaction of EDC which is within the authority delegated to EDC management and which departs from the policies in the Manual is not duly authorized unless the transaction is in accordance with an exception to the relevant policy (as approved by the Board of Directors) or the Board approves the transaction itself.

Question 64

What is the legal status of the Government Response to the Standing Committee on Foreign Affairs and International Trade (Exhibit BRA-28)? Is it legally binding on the EDC?

1. Section 25 of the *Export Development Act* (the "Act") provides that the Minister for International Trade (the "Minister") will periodically cause a review of the provisions and operation of the Act to be undertaken. The first such review commenced in 1998. Subsequent reviews must be undertaken every ten years. The review report was submitted to the Parliament of Canada and referred to a standing committee of the House of Commons (the Standing Committee on Foreign Affairs and International Trade – "SCFAIT"). The SCFAIT made several recommendations when it reported to the House of Commons. The Government's Response to the SCFAIT report (Exhibit BRA-28) is the Government's report to the House of Commons regarding legislative and non-legislative actions being taken in response to the SCFAIT report and recommendations. These actions are underway.

2. The Government's Response is not legally binding on EDC. However, the legislative actions (proposed amendments to the Act) will, when passed, be legally binding on EDC. Furthermore, with respect to the non-legislative action, the Minister has instruments at his disposal (such as the issuance of directives and the approval of EDC's annual corporate plan) through which he can legally require EDC to conform to non-legislative measures that he finds necessary and appropriate.

Question 65

With reference to Exhibit CDA-66, what is a "letter of awareness"?

1. Exhibit CDA-66 is a published article on the second Kendell transaction in which, as stated previously, EDC was not involved. Canada, therefore, cannot comment on the specific letter referred to in that article, but can provide the following definitions:

LETTER OF AWARENESS:

A formal letter written by a parent company to a lender, acknowledging its relationship with another group company and its awareness of a loan being made to that company. It is [the] weakest form of a letter of comfort.³

LETTER OF COMFORT:

A letter to a bank from the parent company of a subsidiary that is trying to borrow money from the bank. The letter gives no guarantee for the repayment of the projected loan but offers the bank the comfort of knowing that the subsidiary has made the parent company aware of its intention to borrow; the parent also usually supports the application, giving, at least, an assurance that it intends that the subsidiary should remain in business and that it will give notice of any relevant change of ownership. See also letter of awareness.⁴

Question 66

Has the LA Encore programme used by the EDC been adapted for specific EDC considerations, or is it identical to the programme used by Lloyds Bank, Barclays Bank, and ABN-Amro?

1. FAMAS/- LA Encore is a computer-based company analysis software developed by a Certified Public Accounting firm and systems analyst company as a tool for analyzing financial risk and comparing, on a broad basis, the financial risks associated with different companies. The larger the database of companies, the greater the consistency of the rating with that of other companies in the industry. As previously noted by Canada, FAMAS/- LA Encore is now owned by Moody's Risk Management Services, one of the two largest rating agencies in the world. (As a result, the LA Encore software has been renamed Moody's Risk Advisor, or MRA).
2. One of the purposes of using such a tool is to generate ratings for companies that are not publicly rated by a rating agency and that are consistent with the ratings that are provided by such agencies.
3. Rating agencies, such as Moody's and Standard and Poor's, provide ratings at the request of the company being rated. The company must pay to obtain a rating. Companies are willing to make this expenditure when they intend to seek financing in the public debt markets. The fact that a company is not publicly rated is not necessarily an indicator of any financial weakness or defect nor is it an indicator of the size of the company; it simply indicates that the company does not require public debt financing. A lender must have an alternative method of assessing the financial risk of unrated companies that seek its financing.
4. Moody's maintains each user's system to ensure consistency with the public ratings that it publishes. Moody's permits LA Encore to be tailored using customization tools to establish or reflect an organization's own credit practices, policy guidelines or internal ratings approach based on its own lending preferences and portfolio.
5. The EDC has utilized the customization features of LA Encore to reflect EDC's own corporate risk methodologies. This recalibration of specific weightings has been undertaken to ensure all EDC generated ratings take into account a data-base of the current senior unsecured bond ratings

³ *A Dictionary of Accounting*, (Oxford: University Press, 1999) ("Letter of Awareness"), available online at www.xrefer.com (Exhibit CDA-70).

⁴ *A Dictionary of Accounting*, (Oxford: Oxford University Press, 1999) ("Letter of Comfort"), available online at www.xrefer.com. (Exhibit CDA-71)

of more than 900 S&P rated industrials. This allows EDC to calibrate its own internally generated ratings with these external market benchmarks. EDC's risk rating methodologies, which include the recalibration, have been reviewed in the context of EDC's credit risk management framework⁵ by the external risk management consultants Erisk. Erisk has deemed these methodologies to be in line with standard industry practice.

6. Canada cannot comment on the customizations that may have been undertaken by other financial institutions that use LA Encore. Nevertheless, the systems they purchased from the vendor would be the same as that purchased by EDC.

7. Canada has submitted as Exhibit CDA-72 a brochure further describing the LA Encore system and as Exhibit CDA-73 a recent Moody's research report on Moody's Risk Advisor which specifically discusses the use of knowledge-based systems in the context of commercial lending.

Question 67

With reference to paragraph 5 of Canada's oral statement of 31 July 2001, please identify the "strong evidence" of Brazilian Government support for Embraer's offers to Air Wisconsin.

1. []

2. []

3. However, it is simply not credible that [].

4. In addition to the term sheet itself, the evidence that Embraer's offer was predicated on Brazilian government support is:

? The [] declaration and contact report (Confidential Exhibit CDA-1), consisting of a declaration and an [], this exhibit shows that at the time Embraer's offer was made, Air Wisconsin understood that it involved Brazilian government support.

? A new letter, provided by Air Wisconsin (Exhibit CDA-68), stating that "[]."

? Similar offers of government support made by Brazil at about the same time in the context of campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air Systems.⁶

? []. The CIRR is the rate specified in the OECD Arrangement for purposes of official support. It is not a rate normally used for commercial offers, which refer to benchmarks such as US Treasury rates or LIBOR plus a spread to reflect credit risk. In a commercially financed transaction, negotiations with the purchaser would focus on the spread until an appropriate spread was agreed upon.

? At the time Embraer made its offer, Brazil took the position that offers of PROEX-supported financing down to the CIRR rate alone would be consistent with Article 3 of the SCM Agreement whether or not they satisfied the other "interest rates" provisions of the OECD Arrangement. Thus, Brazil's then Foreign Minister Lampreia, who now sits

⁵ See Exhibit CDA-48, p. 16.

⁶ Confidential Exhibits CDA-4 and CDA-5.

on Embraer's Board of Directors,⁷ stated with respect to PROEX, that "[f]or us, the interest rate is [the] OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."⁸ []

? Note 32 to Embraer's most recent financial statements (Exhibit CDA-57) makes clear that Embraer continues to rely heavily on Brazilian government support. According to Embraer, without Brazilian government support, Embraer's "cost-competitiveness" could decrease. The same note 32 refers to PROEX payments decreasing the effective interest rate to the "commercial interest reference rate", that is, the CIRR.

? In a response to a question from the panel in the PROEX III proceeding, Brazil stated that:

No aircraft manufacturer in the world tells airlines, "This is the price. Pay cash, or go borrow the cash from a bank." It is the custom in the trade, established long before Brazil began producing aircraft, for the manufacturers to have available a financing package for their sales, and these packages generally include *some form of official government support* for export credits. ... PROEX payments enable Embraer to avoid a competitive disadvantage *in the marketplace* by enabling it to offer financing *at the CIRR and market rates*.⁹ [emphasis added]

5. Brazil has not explained why Embraer's offer to Air Wisconsin would have been any different than the practice it described in the PROEX III proceeding.

6. Brazil has stated that Embraer's offer to Air Wisconsin could have been "on its own account" and has speculated that []. Brazil has offered no evidence whatsoever for this proposition, nor has it explained what the long-term gain may have been. On the contrary, on 31 July, Brazil's representative at the second meeting of the parties acknowledged that aircraft manufacturers do not normally engage in deep discounting because of the danger that subsequent customers would demand similar discounts.

7. Most important, Brazil's suggestion that [] offer is directly contradicted by Embraer's 2 July 2001 Form 20-F filing with the SEC. In that filing, Embraer states:

We do not provide direct financing to our customers. We assist our customers in obtaining financing arrangements through different sources such as leasing arrangements and the BNDES-*exim* programme. In addition, we help our customers qualify for the ProEx programme.¹⁰

8. []. According to its SEC filing, Embraer does arrange this, through BNDES-*exim* credits and/or PROEX.

⁷ Embraer, Securities and Exchange Commission Form 20-F, p. 66. (Exhibit CDA-67)

⁸ M.L. Abbott, "Parceria da Bombardier no país não altera negociação com Canadá" ("Bombardier's partnership in the country does not change negotiations with Canada") *Valor Econômico* (30 October 2000). (Exhibit CDA-6)

⁹ See Brazil's Response to the Panel's Question 4, *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, p. B-50.

¹⁰ Exhibit CDA-69, p. 34.

9. This conclusion is supported by Air Wisconsin's letter, [], Brazil's contemporaneous practice in other transactions, [], which correspond with Brazil's then position regarding official support terms, statements by Embraer in its SEC filings regarding its dependence on Brazilian government support, and a similar statement in the PROEX III proceedings in which Brazil described how Embraer generally does business with "some form of official government support for export credits."

10. By contrast, Brazil has offered no evidence whatsoever for its speculation that [] and Brazil's suggestion has been contradicted by, among other things, the Air Wisconsin letter and Embraer's own statements to the SEC. The only reasonable conclusion from the evidence before the Panel is that Embraer's offer involved Brazilian government support.

Question 68

11. Article 25 of the IQ Act refers to "export" activities. Is the term "export" defined in the IQ Act, or in some other legislative instrument? If so, please provide the relevant material. Does the term "export" mean export outside of Québec, export outside of Canada, or both?

12. The term "export" is not defined in the IQ Act or in another legislative instrument. However, in keeping with the jurisdiction of the IQ Act, which is limited to the territory of Québec, the term "export" as used in the Act is considered by IQ and Québec officials to refer to exports outside of Québec, which could include exports outside of Canada. Consistent with this interpretation, section 2 of Decree 572-2000 (Exhibit BRA-19), which was made pursuant to the IQ Act, defines "export" as:

« la vente de biens, la prestation de services et l'exécution de contrats à l'extérieur du Québec; »

2. Generally speaking, when the term "export" is used in Québec legislation, it is used to mean exports outside of Québec and not necessarily outside of Canada. For example, the *Loi sur l'exportation de l'électricité* (L.R.Q., c. E-23), does not define "export" but has been applied consistently to exportation outside of Québec.

Question 69

Could IQ Decrees 572-2000 and 841-2000 apply in principle to financing regarding sales of Bombardier regional aircraft?

1. Decree 841-2000 could not apply to financing of Bombardier regional aircraft because it applies only to small enterprises. Bombardier would not qualify. Decree 572-2000 applies, for the most part, to investments in Québec. However, one of the measures in the Decree provides for loan guarantees intended for buyers outside of Québec for the purchase of goods and services. Such loan guarantees cannot exceed 75 per cent of the Québec content of the products included in the transaction. Theoretically, this measure could be used to finance the sale of Bombardier regional aircraft. However, due to the Québec content limitation and other restrictions, Decree 572-2000 is not well suited to financing regional aircraft sales and has never been used to do so.

Question 70

Canada has informed the Panel that equity guarantees have been provided by engine manufacturers such as Rolls-Royce, GE, and Pratt & Whitney. Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions? For example, are EETCs packaged with equity guarantees? If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

(i) Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions?

1. Contrary to Brazil's general allegations, there is clear evidence of the existence of a private sector market for the transfer of risk in a manner similar to the guarantees provided by IQ. IQ provides "equity guarantees" or "deficiency guarantees" that cover the first level of risk assumed by a financial institution. This level of risk is commonly referred to as the "equity risk". Financial instruments similar to IQ equity guarantees are, in fact, available in the market.

2. Furthermore, Canada notes that the letters submitted by Brazil in support of its allegation that such guarantees would not be "economic" do not take into account the specific characteristics of the mechanisms used by IQ, []. These mechanisms are essential to making the IQ guarantees "economic" from a commercial point of view.

3. Exhibit CDA-74 demonstrates that Bombardier has, in fact, used private sector alternatives in precisely the same manner as IQ. []

4. Not only is this transaction analogous in structure to IQ guarantees, []. This has the effect of substantially lowering the risk assumed by the insurer (IQ).

5. Exhibit CDA-75 shows that aircraft manufacturers can create innovative financing mechanisms centred around risk and remuneration. []

6. This innovative structure shares many of common elements of the IQ model: the assessment of the risk of a default (based on the credit-worthiness of the operator of the asset), the assessment of changes in the market environment, the assessment of changes in the underlying value of the assets, and their repossession, refurbishment, remarketing costs. In this case, the private-sector insurance syndicate [] provided the guarantee in exchange for an up-front fee that would, in its estimation, cover its risk.

7. Moreover, Exhibit CDA-76, which contains letters from two respected financial services institutions, indicate that there is an active private sector market for "risk transfer", the technical term for transactions of this kind. The letters indicate that the private sector is not only capable of analyzing the risk and determining the appropriate fee to guarantee the risk, but is also ready to assume the risk of a portion of debt or equity in aircraft financing transactions in case of default.

(ii) Are EETCs packaged with equity guarantees?

8. No, EETCs are not packaged with equity guarantees. EETCs are instruments that are associated with debt financing, whereas "equity guarantees" are instruments that facilitate raising equity.

(iii) If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

9. If there were no private sector market for such instruments, contrary to what Brazil has suggested, the mere fact that a financial service would be provided only by a government entity could not be determinative of the existence of a benefit. As indicated by the Appellate Body in *Canada - Aircraft I*, whether a benefit has been conferred can be determined by whether a recipient has received a financial contribution on terms more favourable than those available to it in the market.¹¹

10. The Appellate Body found that Article 14 of the SCM Agreement is relevant context in interpreting Article 1.1(b) and supports its view that the marketplace is an appropriate basis for comparison.¹² However, there is no reason why Article 14(c) would be more relevant than any other part of Article 14, because Article 14(c) addresses loan guarantees, which are not at all equivalent to equity or first-loss deficiency guarantees.

11. As Canada argued at paragraph 38 of its 31 July 2001 Oral Statement, the question of whether or not a “benefit” is conferred by equity guarantees (first loss deficiency guarantees) provided by IQ is a function of whether or not the recipient (*i.e.* the aircraft purchaser) obtains the financial contribution on terms more favourable than those available to it in the market.

12. Clearly this is not the case. As Canada stated in its 26 July answer to Question 47 of the Panel, “[t]he ‘market rate’ nature of the guarantee can only be demonstrated considering the value of the financial service that is being provided in the light of the risk exposure of the service provider.” In its response, Canada established that, as a result of [], IQ is being properly remunerated for the effective risk it undertakes. Brazil has offered no evidence to the contrary.

13. Canada’s answer to the Panel’s question remains the same even when examined from the point of view of Bombardier as a potential recipient of the benefit. If the aircraft purchaser is not receiving the financial contribution on terms more favourable than would otherwise be available in the market, it cannot be argued, as suggested by Brazil, that it has been influential to Bombardier’s sales.

Question 71

With reference to paragraph 105 of Brazil's oral statement of 31 July 2001, please clarify the dates of the Air Nostrum transaction.

1. There is no discrepancy as to the date on which the IQ equity guarantee was provided. Canada’s answer to Question 14 from the Panel related to IQ’s involvement in the Air Nostrum sale. The first approval of an equity guarantee by IQ was given in December 1997 as described in Exhibit CDA-64. However, in its answer to Question 41 of the Panel, the documents that Canada provided as Exhibit CDA-64 did not reflect the final terms and conditions of the guarantee provided by IQ. A second approval was later provided in June 1998 (see Exhibit CDA-77 which contains the final recommendation and transaction summary). Canada was not previously aware of the existence of the second set of documents for this transaction and apologizes for this error.

2. As a result of this second approval, the IQ equity guarantee was [] per cent to [] per cent of the aircraft purchase price. As evidenced by Exhibit CDA-77, the applicable IQ equity guarantee is for a maximum of [] per cent of the aircraft purchase price. This equity guarantee is also subject to a

¹¹ *Canada – Aircraft I*, Appellate Body Report, para. 157.

¹² *Id.*, para. 158.

[], The [] per cent is also in a more secure position within the financing structure than the [] per cent that IQ would normally take in other transactions because Air Nostrum provided a []. In a normal transaction, after the [], IQ holds the tranche []. In this case, as a result of [], IQ holds a lesser-exposed tranche, [].¹³ IQ's guarantee is provided in exchange for a fee calculated in the usual manner.

3. The IQ Board of Directors approved the provision of its guarantee in January 1999. With respect to EDC's Canada Account involvement, the Government of Canada provided approval in principle in December 1997. Deliveries began in May 1999, not 1998, and were concluded in November 1999. Contrary to Brazil's assertion in paragraph 105, EDC and IQ supported the delivery of only five aircraft. They did not provide support for any options.

Question 72

Please comment on paragraph 135 of Brazil's second written submission.

1. To the best of its knowledge, Canada has provided all of the documentation that exists regarding the review of these transactions by IQ. Brazil's statements that additional documentation would have shed light on whether IQ guarantees conferred benefits and would have provided further information about conditions such as a requirement that the aircraft be exported are entirely conjectural. Canada has provided a detailed description of IQ's review of each transaction as well as the result of the internal credit analysis. That is, Canada has provided all available information relevant to the Panel's determination of the benefit and export contingency issues.

2. The statements in paragraph 135 are, moreover, an acknowledgement by Brazil that it has failed to establish whether IQ's guarantees did confer a benefit within the meaning of Article 1 of the SCM Agreement and also that it has failed to establish that the guarantees were contingent, either in fact or in law, upon exportation.

3. Brazil's request, in paragraph 136, that the panel reach these conclusions by way of "adverse inference" is unwarranted and insupportable and a further acknowledgement that the evidence does not support Brazil's claims. Brazil's request is particularly inappropriate because it would require the Panel to ignore the exculpatory evidence that Canada did provide at the Panel's request and despite Brazil's failure to establish a *prima facie* case. Brazil cannot offload its burden of proof to Canada and the Panel by making unsubstantiated allegations against Canada, calling on Canada to substantiate them, and then asking the Panel to draw adverse inferences when Canada fails to do so.

¹³ [].

ANNEX B-12

RESPONSE OF CANADA TO ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(13 August 2001)

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I. INTRODUCTION

1. This submission refutes the new arguments raised by Brazil in its 31 July 2001 second oral statement. The first part of the submission explains why Brazil's arguments alleging general shortcomings in EDC's pricing methodology are without foundation. The second part of this submission reviews EDC's pricing analysis and strategy in the transactions that Brazil has identified. It demonstrates that the factors EDC considered in establishing its pricing were entirely appropriate and resulted in pricing that was on terms available in the market. In fact, in some of the instances that Brazil has identified, involving Comair and Atlantic Coast Airlines, other commercial financial institutions were able to out-compete EDC to provide financing for Bombardier regional jet sales.¹ The third part of this submission refutes new allegations Brazil has made in its 31 July statement regarding Investissement Québec.²

2. This submission also includes two annexes. Annex I explains in detail the fundamental flaws in Exhibits BRA-65 and BRA-66, in which Brazil purports to show that EDC's pricing is below market by comparing it with EETCs. Annex II revisits and analyzes the data that Brazil relied on in its exhibits to its 31 July statement, including Exhibits BRA-65 and BRA-66. Annex II reviews EDC pricing in terms of market comparables and again demonstrates that EDC's offers involving ASA, Comair, ACA and Kendell were on market terms.

II. BRAZIL'S CHALLENGE TO EDC'S PRICING METHODOLOGY IS WITHOUT MERIT

3. In its 31 July statement, Brazil makes a number of arguments as to why EDC's pricing methodology for specific Corporate Account transactions was incorrect. In essence, Brazil is asking the Panel to second guess both the manner in which EDC developed its pricing strategies and, more important, the pricing that EDC provided in specific transactions. There are two fundamental problems with Brazil's position.

4. First, Brazil's data and arguments purporting to show errors in EDCs methodologies and pricing are misleading, irrelevant or simply incorrect. In this submission, Canada reviews the data that Brazil has used in the transactions in question and demonstrates that when the correct benchmarks are applied, it is clear that EDC's pricing was very much at "market".

5. Second, Brazil is asking the Panel to substitute Brazil's judgement as to the appropriate pricing in these transactions for the judgement exercised at the time by EDC. The pricing of aircraft financing offers by commercial financing institutions is a highly technical and specialized exercise requiring both the objective and subjective consideration of a large number of factors. Canada has included in this response a comprehensive summary of the analysis and pricing of the transactions identified by Brazil, which confirms that these transactions were on market terms and that Brazil's attempts to show otherwise are baseless.

6. The Panel should consider, for example, the Kendell transaction, which offers excellent empirical proof that Brazil's constructed "market spreads", based on EETCs, are completely unfounded. The Kendell transaction was priced by commercial banks. EDC was simply a participant. According to Exhibit BRA-66, a "market spread" for the Kendell transaction should have been [] bps over US Treasury. However, the uncontroverted evidence shows that Kendell was able to arrange financing for that transaction in the commercial marketplace for [] basis points less than what Brazil claims was an "appropriate" market spread. Brazil cannot seriously be suggesting that the Panel

¹ See *infra*, paras. 15 and 86.

² Brazil's 31 July statement makes no new arguments concerning either Canada Account generally or the Air Wisconsin transaction.

should rely on Brazil's construction of what it asserts the market spreads should have been, when the empirical evidence proves that EDC's customers were actually able to obtain far lower interest rate spreads in the commercial marketplace.

A. EDC's Credit Ratings

7. In its 6 July submission, Canada noted that in establishing its pricing, EDC considers the credit rating generated by the LA Encore (now Moody's Risk Advisor) software for each borrower or the third-party credit rating in the event that a public credit rating was available.³

8. In its 31 July statement, Brazil attempts to challenge the validity of EDC's credit ratings, as well as the other benchmarks EDC uses. Brazil's challenge is groundless.

9. At paragraph 54 of its statement, Brazil asserts that LA Encore overstates airlines' credit ratings because they are higher than those EDC generated before it had access to LA Encore. Brazil ignores a fundamental difference between the nature of the LA Encore ratings generated by EDC and the ratings EDC generated before LA Encore was available. Prior to LA Encore, EDC did not attempt to assign precise credit ratings for potential customers. It simply determined whether the borrower []. Thus, Brazil is mistaken in asserting that EDC's pre-LA Encore ratings for Comair and ASA were []. EDC's pre-LA Encore ratings meant that Comair and ASA were at least []. EDC's subsequent LA Encore ratings were more accurate than those EDC was previously able to generate and demonstrated that EDC's pre-LA Encore ratings were conservative.

10. Although Brazil has offered no credible substantiation for its assertions that LA Encore itself or as used by EDC is flawed, Canada has, nevertheless, provided additional documentation of the reliability of this credit rating tool and EDC's application of it, in its 8 August answer to the Panel's Question 66.

B. Other Common Pricing Sources Used By EDC

11. Canada also described in its 6 July submission that in addition to credit ratings, in establishing pricing EDC considers common industry pricing sources to determine pricing for comparable credit rating situations. Industry sources for such pricing data include, *inter alia*, Bloomberg Fair Market Curves, pricing offered to comparable bank pricing, bond market pricing, structured transaction pricing (i.e. EETCs), as well as on-going contacts with financial institutions.⁴

12. In its 31 July statement, Brazil takes issue with individual elements of EDC's pricing strategies. In so doing, Brazil appears to treat each element as though it were determinative and to ignore the other elements described in the documentation Canada has provided. Brazil's approach therefore is misrepresentative of EDC's methodology and cannot demonstrate that the pricing EDC offered was more favourable than that available in the market. Moreover, the assertions Brazil makes regarding these isolated elements do not stand up to scrutiny.

(i) EDC's Consideration of Its Previous Transactions

13. For example, at paragraph 57 of its 31 July statement, Brazil asserts that EDC acted inappropriately by considering its own previous transactions in the course of developing a pricing strategy. Brazil also asserts that EDC's actions demonstrate that Canada falsely stated that it defines the "market" exclusive of export credit agencies in its answer to the Panel's Question 4. This is yet another example of Brazil's unfortunate tendency to take evidence out of context.

³ Canada's Answer to the Panel's Question 4.

⁴ *Id.*

14. EDC does consider its previous transactions. However, EDC does not use these transactions to determine what a borrower has recently paid in the “market”. Moreover, EDC neither relies exclusively on its own pricing of previous credits nor does it simply apply the same price to new credits. Rather, EDC considers its own previous pricing in order to ensure consistency and completeness in new transactions. Thus, EDC reviews, among other things, the pricing methodology it used for previous transactions and the benchmarks it used in those transactions and compares them to its methodology and benchmarks for the new transaction.

(ii) Other Comparables

15. Brazil also takes issue with other comparables that EDC has used in pricing its transactions. Brazil has failed to explain why EDC should not have considered industrial bonds. As well, Brazil suggests that EDC should have used the data regarding Bombardier regional jet transactions that did not involve government support.⁵ Where such information is available, EDC does consider it to the extent that it is relevant. Although Brazil seems to assert, at paragraph 56 of its 31 July statement, that EDC has never considered the rates offered by commercial banks financing Bombardier’s aircraft, the evidence shows otherwise. Thus for example, Canada’s Exhibit CDA-59 shows that EDC considered a competitive bid that Comair had received at US Treasury plus [] in determining its pricing and the fact that EDC was not selected by the airline to provide the financing for [] previous aircraft due to a more favourable offer by European commercial banks.

16. However, it is often difficult to obtain complete information on the financing provided by banks and other financial institutions due to their confidentiality policies. As a result, lenders must often consider in their analyses, statements by airlines, loan arrangers and other participants relating to previous financing offers.

17. To the extent that such information is available, as for example in the second Kendell financing (Exhibit CDA-66), it confirms that EDC’s pricing was at or even above commercial market financing. Similarly, as described in Annex II to this statement, EDC’s 1999 financing to Atlantic Coast Airlines (ACA) was priced [] to [] than financing ACA arranged at approximately the same time with [] and well higher than earlier financing ACA had received from other commercial sources.⁶ Moreover, the February 1996 term sheet by EDC to ACA, on which Brazil relies, was rejected by ACA because it could – and did – obtain better pricing in the private commercial market than the price EDC was prepared to indicate at that time.

18. In paragraph 60 of its 31 July statement, Brazil suggests that EDC was wrong to use the financing of a [] as one comparative element in the Kendell financing. Brazil fails to explain why this comparison was irrelevant other than to assert that it is “obvious”. Contrary to Brazil’s assertion, it is relevant to compare a proposed USD [] million financing “to a small non-US regional airline” (i.e., Kendell) with the financing of USD [] million sale to a like-rated US airline, i.e. []. Moreover, Brazil fails to acknowledge that the pricing and all other terms EDC offered Kendell were the same as those offered by the seven commercial banks that participated in the transaction along with EDC.

19. Finally, in paragraph 61 of its 31 July statement, Brazil takes issue with the fact that one of the elements EDC sometimes considered was financing offered by []. In that paragraph, Brazil repeats an assertion it made in the *Canada- Aircraft I* dispute that []. Brazil knows this allegation is untrue. When Brazil first made it, Canada stated: []

⁵ Brazil’s 31 July Statement, paras. 55 and 56.

⁶ Annex II, p. 6.

20. At the time, Canada submitted documents proving that [] was a for-profit company created by a [], as an instrument for commercial regional aircraft financing involving institutional investors. It has no ties whatsoever to the Governments of Canada or Quebec or to EDC. Canada resubmits the exhibits that show this, as Exhibit CDA-78.

(iii) Brazil Misrepresents the Relevance of Other Airlines' Debt Financing

21. Brazil also attempts to show that EDC's rates are below market with reference to statements that Canada made, in the *Brazil – Aircraft* dispute, regarding the risk premiums for certain debt financing by certain major airlines.⁷ In so doing, Brazil misrepresents and distorts Canada's argument in that dispute.

22. The essence of Canada's argument was that the rate offered under PROEX II, US Treasury plus 20 bps, was not available in the market.⁸ Moreover, Canada cautioned that although that rate was under no circumstances available, the other rates to which it referred – and to which Brazil now refers in its 31 July statement – do not establish a hard limit for the international aircraft financing market. As Canada explained:

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 to which Canada referred in that proceeding].⁹

23. Nevertheless, in paragraphs 48 and 49 of its 31 July statement and Exhibit BRA 64, Brazil attempts to attribute to Canada the position that: "For a 'representative' airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill +250 bps." This is patently false. Exhibit BRA-64 describes the weighted average of particular tranches of airline debt. It does not describe a generically appropriate interest-rate spread based on an airline's credit rating.¹⁰

24. Nowhere in the submissions Brazil cites, did Canada argue on the basis of that data that airlines from AAA to BBB- would have to pay spreads of up to 250 bps over US Treasury. Moreover, while Canada pointed out the rates that British Airways was paying at the time as the best-rated non-sovereign airline, Canada did not argue that highly rated airlines would have to pay US Treasury plus 125 bps or more. Canada could not have made such an argument: the data Canada provided (now Brazil's Exhibit BRA-64) shows that American Airlines, which at the time was rated BBB- by Standard & Poor's, was paying, on a weighted average basis, 111 bps over US Treasury.

25. In addition, Brazil has failed to recognize that the market for the debt of these and other externally-rated airlines is dynamic; it depends on such factors as company performance, the underlying assets and the general economic climate. These factors, among others, can and do affect the creditworthiness of these airlines, and consequently, the financing terms they can be expected to receive. Brazil has made no attempt to link these rates to the specifics of the EDC transactions nor to the time at which EDC made its offers.

(iv) Other Considerations

⁷ Brazil's 31 July Statement, paras. 47-50.

⁸ *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, Annex I-2, Rebuttal Submission of Canada, para. 51; WT/DS46/RW, Annex I-5, Canada's Comments on Brazil's Responses to Questions of the Panel, para. 10.

⁹ *Id.*, para. 11.

¹⁰ Nor did Canada suggest that the representative airlines to which it referred in Exhibit BRA-64 were rated at or above BBB-. Standard & Poor's rated Northwest as BB and rated US Air even lower: B.

26. Brazil's misleading attempts to isolate single considerations and present them as determinative are similarly in evidence in paragraphs 58 and 60 of its 31 July statement. In paragraph 58, Brazil argues that "it seems reasonable to assume that" one of EDC's considerations in the 1996 Comair transaction, [], was a "determining" factor in deciding which transactions to finance and at which rates. Thus, Brazil attempts, without evidence, to extend this consideration to all EDC financing.

27. Furthermore, although Brazil contends that [] has nothing to do with the market rate for the deal", a review of Annex-2 in Exhibit CDA-59 makes clear that [] was very much related to the market rate. The first sentence of Annex-2 states that the [] Bombardier to offer Comair []. Thus in order to be competitive on the financing, EDC would have to price its offer in the US Treasury plus [].

28. Canada's Exhibit CDA-59 also shows that the transaction's [] was just one of several considerations for EDC. Among the others were that EDC had been underbid by commercial banks on previous Comair financings, that Comair had received another bid at US Treasury plus [] and the good quality of the credit risk and asset security involved.

C. Brazil's Use of EETCs Is Fundamentally Flawed

29. A substantial part of Brazil's new argumentation in its 31 July submission attempts to show, with reference only to Enhanced Equipment Trust Certificates (EETCs), that specific EDC corporate account transactions were priced below market and thereby conferred a benefit.¹¹ Brazil's Exhibits BRA-65 and BRA-66 both purport to show this. Brazil contends that its reliance on EETCs in attempting to make out its case is akin to Canada's references to EETCs in the *Brazil – Aircraft* dispute. This assertion is disingenuous. Brazil's position is also contrary to its own position in the *Brazil – Aircraft* dispute.

30. In *Brazil – Aircraft*, Canada referred to EETCs to show that the CIRR alone – that is, the CIRR independent of other terms and conditions such as the loan-to-value ratio and the length of financing – is not an appropriate market benchmark and to refute Brazil's assertion that it is.¹²

31. Canada never suggested that EETCs could identify the "market" spread for a particular regional aircraft financing transaction, nor did it rely on EETCs for that purpose. Brazil too, considered that EETCs were an unreliable benchmark for particular loan transactions. This is what Brazil said about EETCs:

Brazil would point out that the securitization of aircraft *leases* is an operation that does not directly reflect the terms of the *original loan* itself. This complex and recently developed financial operation involves a number of additional steps.¹³

The securities of the EETC structure are offered in the secondary market and their prices then oscillate according to the financial market trends, with spreads that respond to various economic and market indicators (such as the behavior of the markets of stocks and bonds) that maintain no relationship whatsoever with the original financial structure of the loan obtained by the lessor when purchasing the aircraft. The spreads mentioned by Canada reflect nothing more than investors [sic]

¹¹ See, e.g., Brazil's 31 July Statement, paras. 62-76.

¹² *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, Annex A-2, para. 88.

¹³ *Id.*, Brazil's Comments on Responses to Questions by Canada and Third Parties, Annex B-6, para. 19.

return expectations based on a range of commercial papers, with comparable coupons, yields, maturities, credit ratings, etc.¹⁴

32. Brazil also argued in that dispute that the spread on EETCs at a given point in time, “is misplaced”. According to Brazil, “[t]hat spread simply represents the current yield on the instrument. It has nothing to do with the original spread, at the time the EETCs were issued.”¹⁵

33. Brazil noted that the data in the 10 February 2001 Morgan Stanley Dean Witter Report on which Canada relied (Exhibit CDA-17 in that dispute), “itself shows [that] many of the original spreads were below CIRR. This is the case for the very first transactions listed, for America West. It is also the case for a number of the Continental Airlines transactions listed.”¹⁶

34. Canada does not dispute the use of EETC’s as *one* among several benchmarks for establishing pricing in spite of the fact that only a small percentage of regional aircraft have been financed to date utilizing this financing instrument. However, according to two leading arranger/advisors to the regional aircraft industry, the interest rates offered to the airlines through not only export credit agencies but also by private banks and finance companies have been more favourable (i.e. lower) than EETC’s.¹⁷ Brazil’s exclusive use of EETCs as a sole bench mark for establishing pricing for the regional aircraft industry is not appropriate, as Brazil itself recognized in its submissions in the *Brazil – Aircraft* dispute.

35. In Annex I to this submission, Canada sets out precisely why Exhibits BRA-65 and 66, in which Brazil purports to show that EDC’s pricing is below market by comparing it with EETCs, are fundamentally flawed.

36. For example, Brazil uses the weighted average of all EETC issues for a particular year. Nowhere has Brazil indicated that it has considered the varying underlying credit ratings of the individual airlines or EETC loan tranches. Neglecting to consider the creditworthiness of different borrowers is a fundamental flaw. Nor does it appear that Brazil has considered the varying age or type of the underlying assets (for example, whether they are jets at all), or the market’s appetite for these assets. Brazil’s analysis also fails to address terms to maturity, loan-to-value ratios, liquidity features and cross-collateralization of the various issues.

37. Taken together, these methodological flaws render Brazil’s analysis meaningless.

38. BRA-66 also cites “industry sources” for the addition of 20 basis points in calculating a benchmark for non-US EETCs. However, EETCs have met with only limited success outside of the US market for various tax and cost reasons. Well-rated, non-US airlines such as British Airways, SAS and Lufthansa, whose credit ratings rival those of the higher rated EETC tranches, are able to fund themselves at attractive rates outside of a EETC structure.

39. In Brazil’s 8 August response to questions from the Panel, it noted that a 8 June 2001 Salomon Smith Barney report cited a number of reasons for the yield premium enjoyed by EETCs over the generic bond market. Though Salomon Smith Barney has correctly identified this spread, a 9 May 2001 report from the same brokerage house cited quite different reasons for this apparent

¹⁴ *Id.*, para. 21.

¹⁵ *Id.*, para. 23.

¹⁶ *Id.*

¹⁷ See letter from [], to N. Taylor, Vice President, Sales Finance, Structured Finance, Bombardier Inc., dated 7 August 2001; and letter from [], to N. Taylor, Director of Structured Finance, Bombardier Capital, Inc., dated 8 August 2001. (Exhibit CDA-79).

gap.¹⁸ These reasons included perceptions that this sector is not very liquid, or at least not as liquid as other corporate sectors, EETCs' relatively new appearance in the fixed income arena, and that the EETC market does not yet have the same depth and, thus, liquidity characteristics as some of the most actively traded corporate sectors such as bank and finance, oil and gas, and media and telecommunications.

40. Based on the foregoing, it does not appear there is consensus, even within Salomon Smith Barney, as to the reason for the apparent spread between EETC issues and generic bond spreads. This is not surprising. In the 8 June report submitted by Brazil, Salomon Smith Barney admits to its "limited knowledge of the asset-backed, mortgage backed, and collateralized debt obligations markets."¹⁹

III. SPECIFIC TRANSACTIONS

41. The foregoing review demonstrates that none of Brazil's arguments regarding EDC's methodology or pricing stand up to scrutiny. It is still uncertain if Brazil is challenging any transactions "as such". (In its response to the Panel's Question 60, Brazil states that its "challenge is to how the measures [Corporate Account, Canada Account and Investissement Quebec] are applied generally, the evidence of which is found in specific transactions.") Nevertheless, in order to demonstrate once and for all that the transactions Brazil has identified in its 31 July statement, involving ASA, Comair, ACA, Air Nostrum and Kendell were priced at market, Canada offers the following review of these transactions.²⁰ This review examines the market benchmarks EDC employed in each transaction as well as providing further insight into the market at the time the pricing strategy for each transaction was developed.

42. In addition, in Annex II to this submission, Canada has revisited and analyzed the data that Brazil relied on in its exhibits to its 31 July statement, including Exhibits BRA 65 and BRA-66. Annex II, which analyses EDC pricing in terms of market comparables, again demonstrates that EDC's offers involving ASA, Comair, ACA and Kendell were at market.

A. Atlantic Southeast Airlines (ASA)

Pricing Strategy	Letter of Offer
December 1996	March 1997
August 1998	August 1998

43. In its 31 July attack on the Corporate Account pricing of ASA, Brazil discusses only the issue of EDC's credit rating for ASA and the EETC market at the time of the individual pricing strategies.

44. As previously explained, Brazil's challenge to EDC's rating for ASA stems from a fundamental misunderstanding. At the time of EDC's first offer, LA Encore had not been developed and EDC had been satisfied that on the basis of the airlines most current and previous financial information the airline's *unsecured* rating was *at least* []. This did *not* mean that EDC rated ASA as [].

¹⁸ Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, pp. 7. (Exhibit CDA-80)

¹⁹ Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 36. (Exhibit BRA-71)

²⁰ As described in this section, the Air Nostrum transaction is anomalous in that it matched an offer of financing by the Government of Brazil. Canada's offer was structured as a matching Canada Account tranche (offered at what would be below market terms) as well as a Corporate Account tranche offered on market terms.

45. As Brazil has noted, aircraft-secured US airline debt qualifies for special protection under Section 1110 of the US Bankruptcy Code. Section 1110 allows the lessor/conditional vendor to repossess its collateral security within 60 days of a bankruptcy claim if the collateral is an aircraft or aircraft parts.

46. The major credit rating agencies recognize legal support afforded under Section 1110 for continuing payment that does not depend directly on collateral value. As such this debt can receive a higher rating than standard secured debt. For example, Standard & Poor's differentiates by one rating designation secured debt under Section 1110 versus standard secured debt for investment grade borrowers, and differentiates by two rating designations for sub-investment grade borrowers.²¹

47. Brazil also disregards the elements that EDC took into account in addition to the LA Encore rating. The December 1996 ASA pricing strategy considered the pricing developed for Comair earlier the same month (discussed in greater detail below but which considered a number of non-EDC benchmarks) and compared the relative performance of each airline, as well as a number of other regional airline peers. The comparison in the ASA strategy included *inter alia* a review of revenue, net income, shareholder's equity, market capitalization and operating statistics (e.g. revenue passenger miles, available seat miles, load factors and break even load factors).

48. EDC also considered the ASA's 1994 acquisition of [] for which ASA was able to obtain financing at [] and an unconfirmed report it had received of a recent Comair financing of [] CRJ aircraft at [].

49. The pricing offered by EDC to ASA was above both these market benchmarks.

50. EDC also noted that at the time of the airline's most recent financial statements ASA had a secured, unutilized USD [] million line of credit with its local bank at [] (which would have been equivalent to 10 year UST + [] based on then current swap rates).

51. The pricing offered by EDC to ASA was above this market benchmark.

52. It is also noteworthy that Brazil chose to ignore the backstop support offered to EDC by [] which compensated EDC by [] bps should the airline's (external or EDC's internally generated) credit rating [] or [] during the disbursement period. Further compensation was to be negotiated should the ASA rating [] during the disbursement period.

53. Finally, at the time of the pricing strategy, which resulted in EDC offering 10 year UST + [] bps to the airline, the Bloomberg Fair Market Curve (FMC) indicated the following rates for *unsecured* credits of US rated industrials:

Rating ²²	Fair Market Yield Curves ²³	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

54. The EDC pricing was above the FMC market benchmarks for all [] credits.

²¹ Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 22. (Exhibit CDA-81)

²² A rating scale comparison of Bloomberg to Moody and Standard & Poors is provided in Exhibit CDA-82.

²³ See Exhibit CDA-83. Ten-year US Treasury is [].

55. In August 1998, EDC undertook a further review of ASA's pricing and prepared another pricing strategy which confirmed the existing UST + [] bps pricing. By this time, LA Encore was operational and generated an *unsecured* rating of "[]" for ASA.

56. Once again, EDC's pricing strategy considered the recent performance of ASA in comparison with its peers. The pricing strategy also discussed the airline's successful implementation of the CRJ aircraft into its operations and the company's improved financial stability.

57. EDC also referred to an August 1997 pricing strategy for Comair (discussed below) as well as the FMC. As well, EDC's assessment considered that in spite of the availability of an average life of up to [] years, ASA's ten most recent EDC supported deliveries had an average life of only [] years. Therefore EDC used as a comparable an interpolated [] year UST FMC spread for unsecured credits of US rated industrials.

58. The relevant FMC data were:

Rating	Fair Market Yield Curves ²⁴	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	9 year UST + [] (interp)
[]	[]	9 year UST + [] (interp)
[]	[]	9 year UST + [] (interp)

59. The EDC pricing was higher than the FMC market benchmark for all [] rated credits.

60. As before, [].

B. Comair

Pricing Strategy	Letter of Offer
April 1996	July 1996
December 1996	December 1996
December 1996	March 1997
August 1997	August 1997
August 1997	August 1997
August 1997	September 1997
March 1998	March 1998
March 1998	April 1998
January 1999	February 1999

61. In its 31 July attack on the Corporate Account pricing for Comair, Brazil again discusses only the issue of EDC's credit rating for Comair and the EETC market at the time of the individual pricing strategies.

62. In April 1996, EDC developed pricing for Comair. LA Encore was not available at that time. EDC determined that Comair's financial performance would warrant an *unsecured* [], based on EDC's internal methodology which considered Comair's current and previous financial statements.

²⁴ See Exhibit CDA-84. Ten-year US Treasury is [].

63. As previously noted, the confidential nature of the financial services sector makes exact market comparables difficult to obtain or verify. However, as described in the documentation Canada previously submitted, EDC had been advised by a leading arranger in the regional aircraft industry, [], that [] had been recently financed by [] at an all-in rate of UST + [].²⁵ In addition, EDC was advised that a Dutch bank had financed an additional [] purchases at UST + [] all-in.

64. EDC's strategy also noted EDC pricing that had been indicated to other regional airlines and was in turn supported by similar pricing benchmarks. The strategy considered the performance of these airlines in comparison with Comair (in particular, the Atlantic Coast Airlines pricing indication, which is described in more detail below).

65. The then-current FMC data for unsecured credits of US [] rated industrials were as follows:

Rating	Fair Market Yield Curves ²⁶	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

66. EDC's offered pricing of UST + [] was consistent with all of these market benchmarks and well above the then-current [] FMC benchmarks.

67. In December 1996, Comair asked EDC to reconsider its pricing. EDC conducted a further review which resulted in it offering UST + [] to Comair. Though LA Encore was still not available, EDC determined, based on Comair's continuing strong performance, that Comair's rating would not be any less than previously determined, i.e. [].

68. This review considered not only the previous bank financings but also the financing of [] additional [] purchases by a number of European banks at [], on [] year terms.²⁷

69. At the time EDC developed this pricing strategy (6 December 1996), the FMC data for unsecured credits of US rated industrials were as follows:

Rating	Fair Market Yield Curves ²⁸	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

70. The pricing offered by EDC exceeded all of these FMC market benchmarks.

71. In August 1997, Comair again asked EDC to reconsider its pricing. By this time the LA Encore system was in operation and generated an *unsecured* rating of [] for Comair.

72. The pricing strategy EDC developed considered the CRJ financings by European banks, recent [] closings, as well as the indication that Comair had financed [] CRJs at LIBOR + [].

²⁵ See Exhibit CDA-59, p. 4.

²⁶ See Exhibit CDA-85. Ten-year US Treasury is [].

²⁷ Exhibit CDA-59, p. 6.

²⁸ See Exhibit CDA-86. Ten-year US Treasury is [].

73. EDC also undertook a financial comparison between ASA and Comair. It concluded that Comair was at least as creditworthy as ASA and should therefore command similar pricing. This comparison also noted the previously mentioned non-EDC ASA financings.

74. The FMC data for unsecured credits of US rated industrials at this time (8 August 1997) were as follows:

Rating	Fair Market Yield Curves ²⁹	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

75. EDC's offered pricing of UST + [] bps was in excess of all the [] FMC market benchmarks.

76. In March 1998, at the airline's request, EDC also offered to provide Comair [] financing with a [] year repayment term at 7 year UST + []. EDC deemed this appropriate based on the then-current performance of Comair itself and in comparison with ASA.

77. The FMC data for unsecured credits of US rated industrials at this time (10 March 1998) were as follows:

Rating	Fair Market Yield Curves ³⁰	Spread
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []

78. EDC's offered pricing was in excess of all the [] FMC market benchmarks.

79. In early 1999, EDC developed its most recent Comair pricing strategy. At this time LA Encore had generated an unsecured rating of [] for Comair.

80. EDC's pricing strategy considered a basket of US industrials including banks, industrials and consumer goods companies with a like credit rating and actively trading bonds with a similar term to maturity as the average life of the proposed financing. The average spread on these bonds was UST + [].

81. This market-based average was less than the EDC offered pricing of UST + [].

82. EDC also considered a number of pass-through certificates (i.e. loan notes) and EETCs, including those of []. The average spread of those certificates and EETCs, which had a similar average life ([]) as that in the EDC offer to Comair, was [] bps over the ten year UST. This was less than EDC's offered pricing.

²⁹ See Exhibit CDA-87. Ten-year US Treasury is [].

³⁰ See Exhibit CDA-88. Seven-year US Treasury is [].

83. The FMC data for unsecured credits of US rated industrials at the time of the strategy were as follows:

Rating	Fair Market Yield Curves ³¹	Spread
□	□	10 year UST + □
□	□	10 year UST + □
□	□	10 year UST + □

EDC's offered pricing of UST + □ bps was in excess of the □ to □ rated FMC market benchmarks.

C. Atlantic Coast Airlines (ACA)

Pricing Strategy	Term Sheet
February 1996	February 1996
Pricing Strategy	Letter of Offer
January 1999	March 1999

84. In its 31 July attack on the Corporate Account pricing for ACA, Brazil discusses EDC's credit rating for ACA and the EETC market at the time of the individual pricing strategies. In addition, Brazil mentions an EETC issue of ACA.

85. EDC has provided financing for the delivery of □ CRJ aircraft for Atlantic Coast Airlines (ACA) and □ CRJs for Atlantic Coast Airlines Holdings (ACAH).

86. EDC issued an indicative term sheet to ACA in 1996 at UST + □.³² However, in spite of on-going discussions with the airline, agreement could not be reached regarding terms and conditions of the EDC financing structure and ACA secured financing elsewhere.

87. Subsequent to the issuance of this term sheet, EDC was advised by □, a leading aircraft financing arranger, that ACA would likely be able to secure a private placement in the UST + □ bps range or arrange debt in a USLL structure in the UST + □ bps range.

88. The EDC term sheet's indicative pricing was higher than these market benchmarks.

89. In September 1997, ACA completed a EETC for a number of its CRJs and turbo-prop aircraft in the UST + □ bps range, exclusive of fees.³³

90. The pricing terms and conditions for EDC's financing of ACA were established by a letter of offer dated 3 March 1999. The pricing strategy for this letter of offer was principally developed in January 1999. It provided floating rating financing at LIBOR + □ or fixed rate financing for aircraft delivered prior to 1 January 2000, at UST + □ (based on then current swap rates the fixed rate equivalent of L + [] was UST + □). Fixed financing rate for aircraft delivered after 1999 would be available at LIBOR + □ plus the applicable premium to swap floating rate to fixed rate debt.

³¹ See Exhibit CDA-89. Ten-year US Treasury is □.

³² An indicative term sheet is for discussion purposes only and is subject to further due diligence. It does not represent the final terms and conditions, including relevant pricing, which may be offered by EDC.

³³ This small, illiquid EETC is not frequently traded and with the exception of the issue price does not provide a good "on the run" benchmark. For this reason, Salomon Smith Barney does not include this issue in its EETC data base. (Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 33 (Exhibit CDA-81).

91. By this time LA Encore was available and generated an *unsecured* rating of [] for ACAH, the []. EDC's pricing considered these factors as well as the financial and operating performance of the airline relative to its peers, and past and current EDC pricing for other US regional airlines.

92. The FMC data for unsecured credits of US rated industrials at the time of the strategy (12 January 1999) were as follows:

Rating	Fair Market Yield Curves ³⁴	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

93. EDC's offered pricing of UST + [], plus an up-front administration fee of [] (equivalent to UST + [] all-in), was consistent with the then current [] rated FMC market benchmarks.

94. In May 2000, EDC agreed to the airline's request to a minor amendment of the [] of the March 1999 letter of offer. At that time EDC also confirmed its pricing of the credit based on a pricing review undertaken in November 1999 for ACAH. At the time of this review, ACAH had an *unsecured* LA Encore rating of [].

95. By November 1999, EDC had financed [] of ACA's [] CRJs. ACA had financed the balance by a combination of EETCs ([] aircraft), [] ([] aircraft), [] ([] aircraft) and [] ([] aircraft). EDC's pricing strategy noted that the EETC was not trading, so the current market spread was not available. However, EDC was advised that the [] aircraft were financed in 1998 at a rate of UST + [] with a [] year term. In addition, [] committed to finance up to [] CRJs in early 1999 at LIBOR + [] (or approximately UST + [] based on November 1999 swap rates). []'s financing was to be made available into a USLL structure with a []-year term and a []-year average life or a direct loan with a [] year payout.

96. EDC's offered pricing was greater than all of these active market benchmarks.

97. In addition, ACA had informed EDC that it had received interest from a number of banks for its upcoming deliveries and, as such, it expected to use EDC financing for only [] of the airline's [] remaining deliveries. Clearly, if EDC pricing was below market, ACA would have sought to use EDC financing for *all* of its remaining deliveries.

98. At the time of the second pricing strategy (24 November 1999) the applicable FMC data for unsecured credits of US rated industrials were as follows:

Rating	Fair Market Yield Curves ³⁵	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

³⁴ See Exhibit CDA-90. Ten-year US Treasury is [].

³⁵ See Exhibit CDA-91. Ten-year US Treasury is [].

99. EDC's offered pricing of UST + [], plus an up-front administration fee of [] (equivalent to UST + [] all-in) was greater than all the then-current [] FMC market benchmarks.

D. Air Nostrum

Pricing Strategy	Letter of Offer
March 1998	October 1998

100. Air Nostrum is a regional airline based in Valencia, Spain. As such, US benchmarks were not applicable. Both Embraer and Bombardier competed for this order. Air Nostrum confirmed to EDC that the Government of Brazil had offered long term financing for the Embraer contract, which was not consistent with OECD Consensus terms. Air Nostrum told EDC that Brazil's terms were:

? Price: USD 14.8 million (January 1998 \$)

? Financing: 100 per cent from BNDES at 5.13 per cent per annum (after a Proex I buydown) for 15 years to a balloon of 35 per cent.

? This equated to a monthly lease rate of USD 98,451.

101. On the basis of this information, EDC, with Canada Account support, provided a financing proposal which attempted to match the lease payment structure required by Air Nostrum but with a higher all-in rate than that being offered by Brazil. EDC notified the OECD of its intention to match Brazil's offer.

102. EDC's Corporate Account tranche ([] per cent loan-to-value) is the senior tranche in this transaction. It is secured by, *inter alia*: a first priority mortgage on each aircraft; an assignment of all manufacturer's warranties, and EDC being first loss payee under appropriate insurance policies. EDC's Corporate Account tranche is fully covered by the residual value of the assets.

103. Though the overall pricing was driven by Canada's desire to match the Brazilian offer and to meet Air Nostrum's lease payment structure requirements, it was also based on a review of the airline's financial and operating performance. The Corporate Account pricing was included a market-based interest rate of the [].

E. Kendell Airlines

104. Pricing Strategy	Signing of Participant Accession Agreement (EDC commitment)
June 1999	August 1999

105. Kendell Airlines is the largest Australian regional airline. It is owned by Ansett Holdings Limited (AHL) which also owns and operates Ansett Australia (AA) and Ansett International Airlines. AHL and AA [] which was arranged by [] and [].

106. AHL is Australia's second largest airline. At the time of the transaction, it held a [] per cent domestic market share and had annual revenues in excess of AUD [] (approximately USD []). The airline is a member of the Star Alliance, one of the world's leading airline alliances.

107. At the time of the development of the pricing strategy for this airline, no USD benchmarks existed for Kendell or AHL and AA, []. EDC pricing largely depended upon the input of the lead arrangers [] and [] who had extensive experience in such transactions.

108. EDC's pricing was exactly the same as the other participants in the transaction. Indeed, all terms and conditions of this credit were shared on a *pari passu* basis by all the participants. None of the terms and conditions, including pricing in the public offering or the final agreement relied on EDC's participation. Contrary to Brazil's claim, EDC was a price taker, not a price maker in this transaction. The participating private commercial banks set the interest rates.

109. Accordingly, the Kendell transaction offers an excellent empirical standard against which to test the credibility of Brazil's assertions in its 31 July 2001 statement that EDC's financing below certain EETC related data (as selected by Brazil) is necessarily below market. According to Exhibit BRA-66, a "market spread" for the Kendell transaction should have been [] over US Treasury. However, the evidence shows that, by Brazil's own estimate, Kendell was able to arrange financing for that transaction in the commercial marketplace for [] less than that. The Kendell transaction proves that Brazil's construction of "market spreads" is simply not credible.

110. EDC was also invited to participate in the second Kendell transaction by [], the transaction's arranger. At that time, EDC concluded that the risks associated with the transaction were too great in relation to the total return and declined to participate. A commercial bank syndicate, led by [], ultimately provided the requisite financing.

IV. INVESTISSEMENT QUÉBEC

111. Most of the arguments Brazil makes in its 31 July 2001 statement regarding Investissement Québec (IQ) repeat arguments Brazil has made elsewhere and which Canada has already addressed. For example, Brazil contends that IQ has provided guarantees without charging a fee. This, as Canada has previously noted, is not correct.³⁶ Even when Brazil acknowledges that IQ has charged fees, as in the case of the Midway Airlines and Mesa Air transactions, it asserts that the pricing was simply [] basis points, whereas Canada has explained that the [] basis point fee is an up-front fee in addition to an annual fee of [] basis points. In its 31 July statement, Brazil does allege for the first time that CQC provided direct financing in the Midway transaction.³⁷ This is not correct. Brazil appears to have confused the equity guarantee with direct financing.

112. Brazil also argues, in its 31 July statement that the uniformity of IQ's fee is indicative of a failure to follow the market because "no market guarantor would charge the same fee to recipients with wildly varying credit ratings."³⁸ This assertion ignores the nature of the IQ guarantee and the [].³⁹ As Canada explained in its 26 July 2001 answer to the Panel's Question 47 as well as at paragraphs 67 and 68 of its Rebuttal Submission and in its answer to the Panel's Question 14, the [] does more than just greatly diminish IQ's risk exposure. In large part, the risk represented by the possible default of a particular aircraft purchaser is [], it is entirely appropriate that the fee charged to different purchasers would be the same.

V. CONCLUSION

113. Canada has demonstrated throughout these proceedings that EDC and Investissement Québec operate on a financially-self sustaining basis and provide products that are structured and priced commercially. At the request of the Panel, Canada has provided extensive documentation, much of it commercially sensitive, demonstrating clearly that EDC goes to great lengths to establish the appropriate terms and conditions for each transaction and that these terms and conditions are

³⁶ See Canada's Rebuttal Submission, para. 66 and Canada's Answer to Question 14, para. 7.

³⁷ Brazil's 31 July Statement, para. 119.

³⁸ Brazil's 31 July Statement, para. 23.

³⁹ []. (Exhibit CDA-65).

consistent with those which a borrower is able to obtain for a comparable transaction in the commercial markets. Canada provided this information despite Brazil's abject failure to present a *prima facie* case that any of EDC's Corporate Account transactions were not offered on market terms. In its 31 July oral statement, Brazil attempted to manufacture a case against these transactions, and against EDC, by misrepresenting and taking out of context the evidence that Canada provided in this and other disputes. As this submission demonstrates, Brazil's case against these transactions is entirely without merit and must fail. The evidence is overwhelming that these transactions were priced on terms no more favourable than those available to the recipients in the market.

114. Canada has also provided extensive evidence regarding the operations of IQ. Brazil said very little about IQ in its 31 July statement that it had not said previously and that Canada had not already refuted. Brazil's new arguments concerning IQ are either factually incorrect or fail to recognize that IQ's risk exposure is both limited and []. Brazil has offered no credible basis, in its 31 July statement or its previous submissions, for its claim that IQ guarantees are prohibited export subsidies. This claim must also fail.

ANNEX I

BRAZIL’S PRICING METHODOLOGY IN BRA-65 IS FLAWED

I. BRAZIL’S STATED METHODOLOGY:

“Brazil compared the spreads offered by Canada with the weighted-average of the spreads at which all EETCs issued by each airline were trading at the time of the Canadian offer.”

There are several problems with this methodology outlined below.

Brazil’s Methodology	Reasons Brazil’s Methodology is Flawed	Recommended Approach
1. Use of All EETCs	The use of all EETCs tracked by Morgan Stanley Dean Witter (MSDW) has meant that non-airline EETCs have been included. These non-airline EETCs include []. Brazil violated its own stated methodology.	Only airline EETCs should have been considered.
2. Use of all Tranches Within an EETC to Create a Weighted Average Credit Spread	<p>By their nature, EETCs are made up of several debt tranches, all with different credit ratings and terms. This has several implications.</p> <p>(i) It is inappropriate to compare tranches with credit ratings significantly different from the EDC financing.</p> <p>(ii) It is inappropriate to compare tranches with repayment terms significantly different from the EDC financing.</p> <p>(iii) It is inappropriate to compare tranches with loan-to-value terms significantly different from the EDC financing.</p>	<p>A pricing methodology must compare debt financing that is substantially similar to the loan being considered. Canada’s methodology compares the EDC financing to []</p> <p><u>A Note on EETC Leverage:</u> EETCs may appear to have lower loan-to-value (LTV) ratios and therefore be less risky compared to bank financing. However, in the EETC market aircraft values are established by independent appraisal. In the bank market LTV ratios are established relative to aircraft price. Appraisal values tend to be higher than actual aircraft selling prices. Therefore on a net basis the total dollar amount being financed is almost equal between the two sources of financing. For example: EETC: aircraft appraisal \$20 million * 70% LTV = \$14 million financing Bank Loan: aircraft selling price \$17.5 million * 80% LTV = \$14 million financing</p>
3. Use of EETC Pricing During 1996-1999	As Brazil correctly states at paragraph 62 of its 31 July statement, EETCs are a relatively new financial instrument for debt financing in the aircraft sector. The EETC market lacks liquidity (trading volume), which may in part explain why EETC pricing is are higher than other forms of commercial financing. There is a large gap between the EETC pricing and the pricing obtained from comparable corporate bond spreads and the Fair Market Curve spreads.	<p>Canada’s methodology incorporates []. The [] reflect pricing available in a liquid market and the [] pricing reflects pricing that is unbiased with regard to pricing that is negotiated with the [].</p> <p>Where Canada does show EETC pricing, it uses the tranche’s pricing spread at the date the EETC was issued. This avoids any further distortion to the spread caused by trading in an illiquid market. However, this does not eliminate the pricing problem caused by an illiquid EETC market since the spread at issue was determined under the same conditions.</p>
4. Use of one Pricing Source	The reliance on any one piece of research, in this case EETC spreads, to complete a pricing strategy can misrepresent the facts surrounding the pricing attributable to a given credit rating.	In order to reduce the reliance on any one pricing source Canada’s pricing methodology incorporates [].

BRAZIL'S PRICING METHODOLOGY IN BRA-66 IS FLAWED

I. BRAZIL'S STATED METHODOLOGY:

“Brazil compared the spreads offered by Canada with an estimate of the likely spread for that transaction based on the average spreads for all EETCs in the year in which the transaction took place. For this comparison, Brazil took the average offering spreads from all EETCs issued in the year of each Canadian transaction as its starting point. We then added the impact of the credit rating of the [airline] based on Canada’s ratings...this impact was calculated as plus or minus 15bps based on an analysis of all EETCs offered during the period 1996 - 1999”

There are several problems with this methodology outlined below.

Brazilian Methodology	Reasons Brazilian Methodology is Flawed	Recommended Approach
1. Timeline for Pricing EETCs	<p>Brazil has attempted to compare pricing issued at one point in time with comparables from the future.</p> <p>It is normal practice in the debt markets to price a given transaction in the immediate present. This pricing may be based on comparables using historical information and an expectation of possible future economic changes. Actual pricing from the future is not available and could not be used by EDC when it issued its financing offers.</p>	<p>Market pricing is achieved by reviewing market benchmark data reflective of the transaction being considered. Data by its nature is historic and therefore only past transactions and currently available data can be used.</p> <p>In reviewing EETCs as a potential market benchmark, Canada considered EETCs that were issued within the past 120 days from the date of the EDC offer of financing.</p> <p>In reviewing [], Canada considered [] spreads available at the approximate date of the EDC offer of financing.</p> <p>In reviewing [], Canada considered [] at the approximate date of the EDC offer of financing.</p>
2. Adjustment of EETC Spreads to Account for Credit Rating Differences	<p>Canada agrees that the spreads reflected in pricing benchmarks of one credit rating class can be adjusted to estimate a corresponding spread to another credit rating. However, the EETC pricing being used by Brazil was flawed making any further adjustment to the data useless.</p> <p>These flaws are set out in the foregoing critique of BRA-65.</p>	<p>Canada’s methodology attempts to use EETC tranches that are within [] of the rating assigned to the EDC loan.</p> <p>There is no attempt to manipulate each benchmark’s pricing, but it is understood that there is a pricing difference (up or down) as a given debt product has its credit rating reduced or improved. Appendix 1 to Annex II illustrates how credit spreads increase as credit ratings worsen. Appendix 1 also provides the rating scale used by Standard & Poors (S&P) and Moody’s Investor Service (Moody’s).</p>

ANNEX II

□

Appendix 1

Credit Rating Correlation

<u>Standard & Poor's</u>	=	<u>Moody's</u>
AA+	=	Aa1
AA	=	Aa2
AA-	=	Aa3
A+	=	A1
A	=	A2
A-	=	A3
BBB+	=	Baa1
BBB	=	Baa2
BBB-	=	Baa3
BB+	=	Ba1
BB	=	Ba2
BB-	=	Ba3

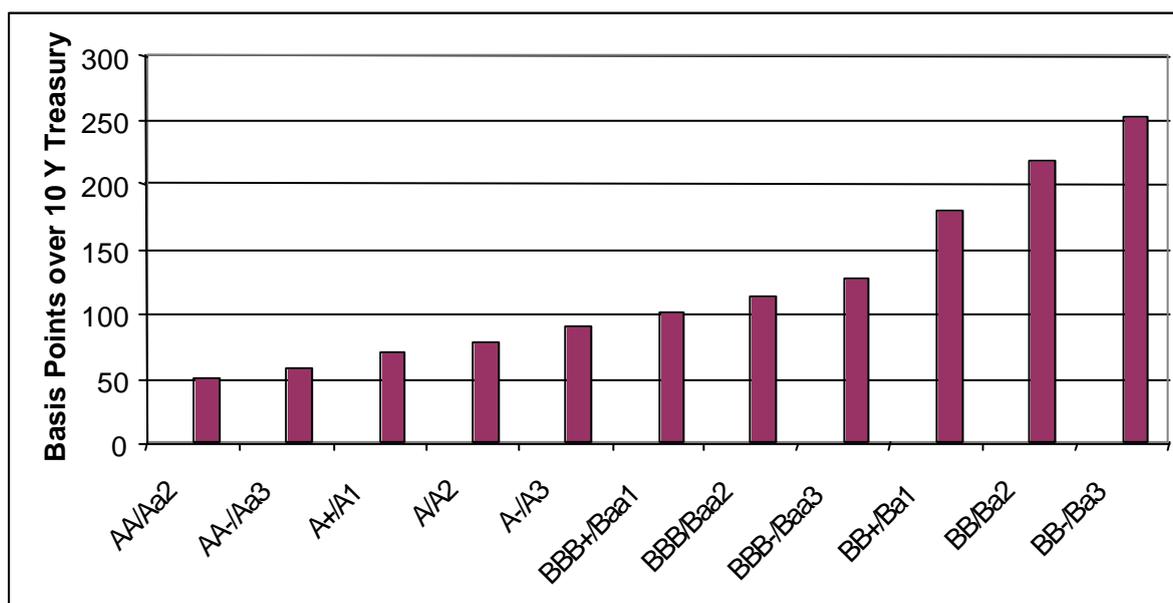
A Note on Split Ratings It is not uncommon for a rated debt instrument (eg. EETC tranche) to have a split credit rating. This is where two rating agencies have given the same security different ratings where one rating is lower than the other. For example, S&P could provide a rating of BBB+ and Moody's could rate the same security one rating notch lower at Baa2. In such instances, the lower credit rating is likely to cause the debt instrument's yield over US T to be higher.

Industrial Indices (Bloomberg Fair Market Curve History) - August 14, 1998

Credit Rating (S&P / Moody's) **Industrial Spreads in bps over 10 Year U.S. Treasury**

AA/Aa2	51
AA-/Aa3	58
A+/A1	70
A/A2	78
A-/A3	91
BBB+/Baa1	102
BBB/Baa2	113
BBB-/Baa3	129
BB+/Ba1	180
BB/Ba2	219
BB-/Ba3	252

Note: One of the main tenets of finance is the concept of risk and return. As the risk of return increases so does the required return. As the credit rating for a debt instrument decreases (eg. moves from AA to BB) the required spread over US T increases. The graph below illustrates the incremental spread for the Fair Market Curve - Industrial Index as one moves down the credit scale. As one moves from BBB to BBB- the incremental spread is 16bps.



Appendix 2

Comments on the Relevance of EETC Pricing

EETC's Exhibit Pricing Volatility

“Throughout our observation of spread behaviour among the different EETC baskets we have created out of our database, we found that in any given month it is not uncommon to observe spread “anomalies” that defy common logic. This is reconcilable with the notion that EETCs are complex securities whose spread behaviour cannot be fully explained by any single variable.”

Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, p. 16. (Exhibit CDA-80)

EETCs are Not Priced Consistently Even When They Are Priced At the Same Time

Airline / EETC Issue	Tranche / Coupon	MSDW* April 30, 2001 Tranche Spread (bps)	SSB** April 30, 2001 Tranche Spread (bps)	Difference (bps)
America West / 1998-1	A / 6.870%	205	215	10
	B / 7.120%	270	290	20
	C / 7.840%	300	320	20
Continental / 1997-1	A / 7.461%	170	165	-5
	B / 7.461%	230	215	-15
	C / 7.420%	220	215	-5
Northwest / 1994-1	A / 8.26%	210	175	-35
	B / 9.36%	285	245	-40
United Airlines / 2000-1	A1 / 7.783%	170	163	-7
	A2 / 7.730%	172	160	-12
	B / 8.030%	230	235	5
US Air / 1998-1	A / 6.850%	240	215	-25
	B / 7.350%	310	305	-5
	C / 6.820%	390	370	-20

*Source: Morgan Stanley Dean Witter, *EETC Market Update*, 7 June 2001, pp. 18-21. (Exhibit CDA-101)

**Source: Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, pp. 37-41. (Exhibit CDA-80)

ANNEX B-13

RESPONSES OF CANADA TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(15 August 2001)

Following are Canada's answers to the Panel's 10 August 2001 additional questions to the parties:

Question 74

Please comment on Brazil's contention (in response to Question 56) that under the Bombardier offer there would be "significantly lower semi-annual payments" than under the Embraer offer. Please calculate the amount of semi-annual payments for both offers, assuming a loan amount of \$1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that 20 per cent of the loan amount would be for [].

1. Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments" than under the Embraer offer, is not accurate. To assess Brazil's contention, the Panel has requested that the parties calculate a "semi-annual payment" on the basis of certain assumptions. However, this too poses problems, because a number of the assumptions proposed by the Panel are not valid.
2. The assumption of an identical interest rate may be appropriate, but the assumption of an identical loan amount is not. The total loan amount will necessarily affect the amount of semi-annual payments on that loan. The total loan amount will depend on the price of the aircraft, as well as the number of aircraft being financed. Thus, in order to assess Brazil's contention, one cannot ignore the [] under Embraer's offer. As Canada has pointed out previously, one would need to compare the Bombardier offer, which involves a loan on [] aircraft, with the Embraer offer, [], as assumed in the *Brazil – Aircraft* Article 22.6 arbitration.¹ [] As a result, the payments under the Embraer offer would be greater than under the Bombardier offer.
3. A number of other factors also make the comparison envisaged by the Panel untenable, and illustrate the problems with Brazil's contention. For example, Brazil's contention in its response to Question 56 is necessarily based on a leveraged lease structure rather than a direct loan structure. Under a leveraged lease, loan payments and the average life of the loan are structured to optimize the costs to the borrower and the benefits to the equity investors. There is a vast array of possible repayment profiles, both in terms of amount and timing, associated with any given average life constraint. Airlines and equity investors employ very sophisticated software models to calculate and optimize the costs and benefits associated with various aircraft financing proposals. Many variables factor into these calculations, including the average life constraints imposed by lenders. The

¹ Canada's Answers to the Panel's Question 56, 8 August 2001, para. 1, referring to *Brazil – Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

repayment profile associated with loans made under a US Leveraged Lease structure can vary substantially between loans even when their average life constraints are the same.

4. Brazil has alleged in its response to Question 56, that the average life under Bombardier's offer is [] years. This is not correct. Bombardier's offer permits a repayment profile that results in an average life of *up to* [] years, but this does not mean that the repayment profile chosen by Air Wisconsin under Bombardier's offer will have an average life of [] years. Often, airlines and equity investors will determine, on the basis of the software model they use, that they will achieve optimal benefits (i.e. the airline will achieve the lowest cost and the equity investor will achieve the highest benefit) under a repayment profile that will result in an average life lower than [] years. A lower average life constraint would result, on average, in higher periodic payments (e.g. the semi-annual payments assumed by the Panel).

5. Furthermore, unless the lender specifically requires principal payments to be made semi-annually, the amount of the loan payments in a leveraged lease structure would be very unevenly spread throughout the term and could result in no principal repayment in some years or, alternatively, periodic payments that are higher at the beginning of the term or at the end of the term. []

6. For all of the foregoing reasons, Brazil is incorrect in contending that the Bombardier offer would result in significantly lower semi-annual payments. For the same reasons, it is impossible to directly compare semi-annual loan payments under the two offers on the basis of the Panel's assumptions.

7. Nevertheless, in order to illustrate some of the problems with Brazil's contention and with the assumptions proposed by the Panel, Canada has sought to make the calculations requested by the Panel. Canada has asked for assistance from [] which, in its capacity as an advisor to airlines and equity investors, uses a software model of the sort described above.

8. Holding all other variables constant, Canada instructed [] to calculate the loan repayment profile for two offers, assuming an interest rate of 6 per cent, an average life constraint of [] years in one case and [] years in the other, and an identical loan amount of \$1 billion in each case. Even this is problematic, and less than fully realistic, because the software models used to optimise payment structures calculate the economics of a transaction on an aircraft-by-aircraft basis rather than on the gross loan amount basis in the Panel's assumption. Canada did not ask [] to incorporate the Panel's assumption that, "[]", both because it is unclear what is meant by this assumption and how it might be incorporated into the calculation.

9. The results of the calculations provided by [] in its model (attached as Exhibit CDA-102) show very different repayment profiles for the two offers. During certain years, principal repayments may not be made at all. The calculations show that in some years, the payments of principal and interest would be higher under an offer with a [] year average life constraint than one with a [] year average life constraint. Although the payments under a \$1 billion loan with the longer average life would be slightly lower on average (\$52.6 million as compared to \$53.1 million), because of the longer repayment term the airline would incur additional interest costs of some \$90 million under the offer with a [] year average life constraint as compared to the offer with the [] year average life.

Question 75

Relating to Canada's answer to panel question 67, is Canada of the view that the showing of the "possibility", "probability" or "expectation" of the future Brazilian government support would be sufficient to satisfy a legal element of "official support" under the OECD Arrangement in respect of "matching" provisions?

10. Canada is not clear what the Panel means by a “legal element” of official support under the OECD Arrangement. However, if, as in this case, there is a well-founded basis for concluding that Embraer’s offer was to be officially supported by the government of Brazil, that is sufficient to entitle Canada to make a matching offer under the OECD Arrangement.

11. In order to satisfy the requirements under the OECD Arrangement to match a non-Participant, one must respect the provisions of Article 53 of the OECD Arrangement, “Matching of Terms and Conditions Offered by a Non-Participant”. Article 53 requires Participants to undertake the following actions: (i) to “make every effort to verify” official support, (ii) to “inform other Participants of the nature and outcome of these efforts”, and (iii) to notify the other Participants.²

12. Article 53 does not require Participants to be completely certain that the initiating offer was officially supported. The drafters of the OECD Arrangement recognised that it may be impossible in a matching situation involving a non-Participant to be certain that the matched terms and conditions were officially supported because non-Participants are not subject to the notification and transparency requirements of the OECD Arrangement.

13. Instead, Article 53 requires Participants to “make every effort to verify” official support. At the end of this due diligence exercise, the Participant intending to match would be in one of the following three situations:

- ? The due diligence exercise would demonstrate that the initiating offer is not officially supported. In such a situation, there would be nothing to match.
 - ? The due diligence exercise would raise doubt as to whether the initiating offer is officially supported. Although Article 53 does not specifically address this situation, it is implicit that Participants use “good faith” when matching. This “good faith” test is consistent with the status of the OECD Arrangement as a “Gentlemen’s Agreement”. Proceeding with matching in this situation would not be in “good faith” and would thus be inconsistent with the OECD Arrangement.
 - ? The evidence obtained in the course of the due diligence exercise would lead to the conclusion that the initiating offer is officially supported, even though the existence of official support might not be established with 100 per cent certainty. Matching in this situation would be in “good faith” and would be consistent with the OECD Arrangement in general and the requirements of Article 53 in particular. Moreover, under the Arrangement, all other OECD Participants have an opportunity to provide their views on the appropriateness of the matching. This peer review discipline acts as a third-party check on Participants’ use of matching.

14. In the Air Wisconsin transaction, Canada is in the third situation. Canada has explained how it made every effort to verify in good faith that Embraer’s financing offer to Air Wisconsin was officially supported by Brazil.³ Canada’s efforts met the requirements of Article 53. The peer review discipline did not result in any comments by other Participants on Canada’s matching notification or on the nature or outcome of its due diligence efforts. Furthermore, as described in Canada’s answer to the Panel’s Question 67, the evidence is very strong that Embraer’s offer was to be officially supported by Brazil. Indeed, Embraer confirmed to Air Wisconsin that it expected its offer to be supported by the Government of Brazil, as described by Air Wisconsin in its letter of 7 August 2001 (Exhibit CDA-68).

² Canada has fulfilled both the information and notification requirements of Article 53 of the Arrangement. See Rebuttal Submission of Canada, at para. 95.

³ Most recently at paragraphs 72 – 74 of Canada’s Second Oral Statement. See also Rebuttal Submission of Canada, paras. 83 – 94.

15. Therefore, because Canada undertook “every effort” within the meaning of Article 53 of the Arrangement to verify Brazilian official support, and because, as a result of those efforts, Canada had a well-founded basis for concluding that Embraer’s offer was to be officially supported by the Government of Brazil, Canada was entitled to make a matching offer under the OECD Arrangement.

Question 76

In response to panel question 67, Canada states that "it is simply not credible that []." Does this mean that Embraer offered financing terms and conditions that were not available in the "market"? If so, could Embraer's offer be used as a "market benchmark" in determining the "benefit" issue? Please explain.

16. []

17. As Canada demonstrated in its 8 August 2001 answer to the Panel’s Question 67, all of the evidence before the Panel points to the Brazilian Government’s involvement in Embraer’s offer. The only reasonable conclusion from the evidence before the Panel is that Embraer’s offer was to involve Brazilian government support. That conclusion is reinforced by the fact that it is not credible that [].

18. Nevertheless, if the Panel does not consider that Embraer’s offer involved or was to involve Brazilian government support, []. Such financing would be, by definition, on terms available in the market.

19. Accordingly, if the Panel considers that Embraer’s offer involved Brazilian government support or was to do so, it is not a “market benchmark”. However, if the Panel considers that [], the offer is a “market benchmark” in determining the “benefit” issue.

ANNEX B-14

COMMENTS OF CANADA ON RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(20 August 2001)

The following are Canada's comments on Brazil's responses to the Panel's Questions 54-62 and 73.

Question 54

In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

1. Brazil's response does not answer the Panel's question. Brazil seeks to distinguish between sales price and the price of financing but does not explain why the Panel's question does not apply to the price of financing terms. Canada notes that Brazil does agree that the market can be determined by comparing the financing terms of a transaction with the financing terms that a commercial institution would provide for a similar transaction. In the case of Air Wisconsin, [].

Question 55

If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

2. As Canada has noted, there is absolutely no evidence to support Brazil's speculation that [].

3. Even if Embraer had been engaging in such behavior, Brazil recognizes in its response to the question that "if it is the 'commercial practice' of a significant number of the sellers in a trade to sell below cost, then, arguably, the market has moved to that level." Presumably, how many sellers constitute a "significant number" will depend on the number of sellers in the market. In the regional jet aircraft market, where there are effectively only two players and one of them, Embraer, has approximately half of that market, the commercial practice by that one player will be "a significant number". In such an oligopolistic market, classical economic theory provides that where one of the main players lowers its price, whether or not it results in a short-term loss, that price sets the market, because the other main player is compelled to meet that lower price. In this situation, transactions at a short-term loss for long-term commercial reasons would be market transactions.

Question 56

Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

4. Canada has replied to this question in its own answer to Question 56.

Question 57

Brazil has expressed concern regarding the use of indices of general industrial bonds. In particular, Brazil has asserted that such ratings do not take account of the fact that there may be different risks involved in an airline company as opposed to an industrial company. Why would such different risks not be dealt with by the fact that companies are rated, so that if an airline company is higher risk than an industrial company, it will typically be rated lower?

5. Brazil's response to this question highlights, to some extent, the difficulty in determining a single "market rate" for a transaction. As Brazil observes in the third paragraph of its response, even companies with the same credit rating could qualify for different financing spreads due to such things as collateral arrangements and competitiveness within the industry. As Brazil notes, these factors "are largely left to the discretion of the market."

6. Brazil contends that the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. It observes that:

In the event of a change in the performance of a particular bond issuer or its industry, the market will react much more immediately than will the credit ratings agencies. The result will be a discrepancy between the spreads at which similarly rated companies in different industries may trade.

7. Brazil offers no explanation as to why similar considerations could not explain the differences in terms offered to airlines with different ratings on the basis of EDC's transaction-specific assessment of risk. By assessing the individualized risk of a particular airline in a specific transaction, EDC is able to take into account what Brazil seems to consider the inaccuracies inherent in more generalized credit risk assessments.

8. Much of Brazil's response to Question 57 turns on its assertion that smaller companies will not have access to financing at the same rates as larger companies, even when they have the same credit rating. This is incorrect. Ratings are not correlated to size. For example, an airline such as Southwest, with total revenues of USD 5.6 billion is rated A by Standard & Poors and A3 by Moody's. United, a much larger airline with total revenues of USD 19.3 billion has a sub-investment grade rating of BB+/Ba1.¹ Continental, with market capitalization of USD 2.9 billion is rated by Moody's as Ba2 but Northwest, with market capitalization of USD 2.3 billion is rated several notches lower at B1.

9. As Canada has previously noted, rating agencies, such as Moody's and Standard and Poor's (S&P), provide ratings at the request of and are paid for by the rated firm. Companies are willing to make this expenditure when they intend to seek financing in the public debt markets. The fact that a company is not publicly rated is not necessarily an indicator of any financial weakness or defect nor is it an indicator of the size of the company; it simply indicates that the company does not require public debt financing. Many large firms, including a number of large international airlines (such as Virgin and Singapore Airlines), carry no external rating. In such cases lenders must have an alternative method of assessing the financial risk of unrated companies. Banks such as Barclays Bank, ABN

¹ In its Second Oral Statement, Canada referred to Southwest as one of the smaller U.S. airlines, but obviously this is in relation to the other major U.S. airlines. Southwest is smaller than American, United, Delta, Northwest and Continental. Canada did not mean to suggest that Southwest was equivalent in size to some of the regional airlines, although as the Merrill Lynch commentary notes, some regional airlines, including Comair and ASA, may have equity valuations exceeding those of major U.S. airlines (Merrill Lynch, "Regional Airline Update: In Times of Economic Uncertainty, Look to Regional Airlines," 30 May 2001, p. 6 (Exhibit CDA-103)).

Amro, LloydsTSB and EDC utilize LA Encore/Moody's Risk Advisor automated rating software to generate internal ratings in these cases.

10. Though most regional airlines are not rated, it is false to assume that their ratings would necessarily be lower than the US majors. Indeed, as the following Merrill Lynch commentary notes, in many respects the regional airlines present a lower risk than their major airline counterparts:

Historically, regional airlines have been consistently more profitable than their major counterparts. As such, the stock market has "awarded" them premium valuations vis-à-vis their major partners reflecting their materially better earnings performance and prospects. For example, *SkyWest with only 23 RJs, 90 turboprops and \$530 million of annual revenue has an equity market value of \$1.7 billion – more than Alaska and America West's combined \$1.1 billion!* And those two major airlines generate annual sales, in aggregate of \$3.8 billion, with a combined fleet of 233 large, jet aircraft!

We can only speculate what Comair (and ASA) would be worth at current multiples. *However, we do know that the implied equity value for 100% of ASA and Comair was roughly \$3 billion based on Delta's purchase price a few years ago – which compares to Delta's current equity value of only \$5.8 billion.*² [emphasis in original]

11. Although these comments are meant to reflect equity performance, the underlying facts are relevant to Brazil's assertions. The regional airlines have outperformed the majors in a number of key areas including revenue growth and, in terms of market capitalization, a number of the regional airlines – including Comair and ASA – are the same size if not larger than some of the US majors.

12. For all of these reasons, Brazil is wrong to suggest that regional airlines should pay more for financing than the major US airlines simply because of their sales revenues.

13. In the latter part of its response, Brazil again takes out of context Canada's discussion in the *Brazil – Aircraft* dispute of the relevance of EETCs.³ Canada referred to EETC's to refute Brazil's contention that offering interest rates at the CIRR alone would never provide a material advantage to a borrower. Canada noted that certain EETC tranches are usually rated well above an airline's unsecured debt rating, but this, of course, does not mean that certain airlines cannot obtain financing in the market at interest rate spreads below those available to other airlines, depending on, among other things, the borrower's rating and the security of the debt.

14. It therefore is not at all surprising that ASA, which received an LA Encore generated unsecured rating of [], could obtain secured financing *in the market* at rates [] (see paras. 48 and 50 of Canada's Response to New Arguments in Brazil's Second Oral Statement) or that EDC would offer it financing at [], while [], which had a [] credit rating, would have a EETC tranche trading at [].

Question 58

What proportion of Embraer export sales of regional aircraft have not involved BNDES and / or PROEX support?

15. Brazil states that approximately []% of Embraer's export sales of regional jets to date have involved neither BNDES nor PROEX support. On the basis of information provided by Brazil in the

² *Id.*

³ See also Canada's 13 August 2001 Response to New Arguments in Brazil's Second Oral Statement, paras. 24 and 29-34.

Brazil - Aircraft dispute and by Embraer to potential investors, Canada has considerable reservations regarding the accuracy of Brazil's response.

16. In the Article 22.6 Panel proceeding in *Brazil - Aircraft*, Brazil submitted an exhibit (Exhibit Br-A-15) entitled "Embraer Order Book as of 18 November 1999 – Subsidy Per Aircraft". Canada understands that all the numbers indicated in Exhibit Br-A-15 are in respect of export sales. That exhibit, (which is provided as Canada's Exhibit CDA-104) indicates that as of 18 November 1999, Brazil had committed to provide PROEX support on []. In the 22.6 Arbitration in *Brazil - Aircraft*, the arbitrators assumed a conversion of options into firm orders at a rate of 85%.⁴ Applying the same conversion rate to the options referred to in Brazil's exhibit results in []. This would mean PROEX subsidies alone (i.e. without including BNDES financing) being provided on a total amount of [].

17. The order book included in Embraer's Prospectus of 12 June 2001,⁵ indicates that as of that date, Embraer had firm orders (including aircraft already delivered) for 955 regional jets. Canada understands that all of those firm orders represent export sales.

18. A simple calculation demonstrates that the [] that would receive PROEX subsidies on the basis of Exhibit Br-A-15 (now CDA-104) represent approximately []. Even assuming a more conservative 50 per cent conversion rate of options into firm orders, the numbers in Exhibit Br-A-15 indicate that PROEX subsidies would be provided on []. This would represent approximately [] per cent of Embraer's export sales.

19. As indicated, these numbers are in respect of PROEX support alone. They do not take into account BNDES-exim direct financing which, according to Exhibit CDA-105,⁶ represents approximately [] per cent of Embraer's backlog (in terms of value).⁷ Thus, it is impossible for Canada to reconcile Brazil's response with the foregoing data on Embraer's order books.

Question 59

Brazil has argued that, in considering whether or not a benefit is conferred by Canadian support, the Panel should also consider the possibility of benefit to Bombardier. To what extent is the benefit to Bombardier different from the benefit to its customers? Could there be a benefit to Bombardier in the absence of any benefit to its customers?

20. Canada has addressed this line of argument at paragraphs 1 to 8 of its answer to the Panel's Question 44, and has no additional comments.

Question 60

In response to Question 25 from the Panel, Brazil asserted that it is seeking findings in respect of specific EDC / IQ transactions. Is that still Brazil's position?

⁴ *Brazil - Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

⁵ Embraer Prospectus, 12 June 2001, pp. 74-75. (Exhibit CDA-105)

⁶ *Id.*, pp. 12-13.

⁷ In the second Article 21.5 proceeding in *Brazil - Aircraft*, Canada put into evidence a Preliminary Prospectus of Embraer, which stated, at p. 12, that, as of March 31, 2000, approximately 51.1% of Embraer's backlog (in terms of value) was subject to financing by the BNDES-exim program. (*Brazil - Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, Annex A-2, para. 13). The same Preliminary Prospectus also gave a 57.5% figure (p. 77).

21. Brazil's response to this question, is that its "challenge is to how the measures [Corporate Account, Canada Account and Investissement Quebec] are applied generally, the evidence of which is found in specific transactions." Brazil's response continues to obfuscate. Brazil seems to be asserting that it can challenge Canada's programs "as such" on the basis of how they are applied in specific transactions. It cannot do so.⁸ Moreover, Brazil has still refused to state clearly if it is challenging any specific transactions "as applied". The Panel should find that it is not.

Question 61

If one assumes that the second Embraer offer to Air Wisconsin was not officially supported, and that the offer was available in the market, how would the Canada Account offer to Air Wisconsin confer a benefit on Air Wisconsin?

22. If, as the evidence strongly suggests, Embraer's offer was dependent on Brazilian government support, Canada bears the burden of showing that its offer in response was made on a matching basis. However, the question starts from the premise that the second Embraer offer to Air Wisconsin was available in the market. If the second Embraer offer to Air Wisconsin was available in the market, the burden is on Brazil to show that Canada's offer is more favourable than the second Embraer offer and is therefore more favourable than that available to the recipient in the market. Brazil has avoided answering the question as posed and has attempted instead, in the third paragraph of its response, to reverse the burden of proof. It has no legal basis for doing so.

Question 62

The second page of the [].

23. Canada has no comment.

Question 73

In Canada's answer to the Panel's question 56, with respect to repayment term, Canada argues that "[]". Please comment, taking into account Brazil's statement (in response to the Panel's question 56) that "[]".

Please also explain Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments. Please demonstrate this, assuming a loan amount of \$1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that [].

1. For the reasons set out below, Canada disagrees with the methodology Brazil has used in its calculations and the conclusions it has drawn from them. Among other things:

- ? Having made its assertion with respect to semi-annual payments, Brazil now bases its calculations on monthly payments;
- ? As Canada explained in its answer to Question 74, Brazil's contention in response to Question 56 was necessarily based on a leveraged lease structure. However, Brazil has based its calculations in part on a direct loan structure;

⁸ See Canada's Rebuttal Submission, para. 52.

? Brazil has arbitrarily assigned certain variables differently to Embraer's offer than to Bombardier's. This makes the payments under the Embraer offer seem lower and those under Bombardier's offer seem higher.

2. Brazil contended in its response to the Panel's Question 56 that under Bombardier's offer, the borrower would make significantly lower semi-annual payments. However, when asked by the Panel to explain its contention, Brazil has chosen to compare the two offers based on monthly blended loan payments in the case of the direct loan structure, and monthly lease payments in the case of the leveraged lease structure. Bombardier's offer required *semi-annual* blended loan payments under the direct loan structure, not blended monthly payments as assumed by Brazil in its calculations.

3. In its response, Brazil also makes reference to a "[]", for Canada's direct loan, which is also incorrect. As Brazil itself states in the second paragraph of its response to Question 73, "reference to an [] is generally required by lenders in a US leveraged lease structure; however, this is not required in a structure such as the straight loan." This comment is accurate. It applies to the [].

4. However, in the case of a US leveraged lease structure, the market practice is to allow the repayment profile to be "optimized" by the lessee and the equity investor (as described in Canada's response to question 74). In such cases an [] will be imposed to ensure repayment is made over an acceptable period of time.

5. In its response to Question 56, Brazil argued that there would be "significantly lower semi-annual payments" under Canada's offer. It made this assertion in the context of the difference in the [] between the two offers. As stated in paragraph 3 of Canada's response to Question 74, Brazil's contention is necessarily based on a [], for the same reasons outlined in paragraph 1 above. Accordingly, Brazil's comparison of the [] in its offer, with Canada's [] is not relevant.

6. Furthermore, it is highly unrealistic to assume that Air Wisconsin will choose to finance a significant number of aircraft (if any) under Bombardier's [] because it would wish to avoid the necessity of making the required [] down payment. The same is not true of the Embraer offer, which [], making the Embraer offer more generous in this respect.

7. Brazil's calculations of payments under the [] structure in the respective offers is also misleading. First, by making its comparison on the basis of monthly [] payments, Brazil has made it difficult for the Panel to compare the calculations provided by Canada and Brazil.

8. Second, as Canada explained in its response to Question 74, there is a vast array of possible repayment profiles under a US leverage lease structure and many variables factor into the optimization models employed in the industry. Interestingly, the calculations provided by Canada and Brazil were done using the same software model. However, while Canada held all other variables constant as requested by the Panel, and compared the repayment profiles by only changing the average life, Brazil did not hold all other variables constant.

9. For example, Brazil assumed [], compared to [] per cent for Bombardier's offer. Brazil also assumed a longer lease term for Bombardier's offer ([]) than for Embraer's ([]). Then it further constrained the average life under the Embraer offer to [], although it has stated that the correct constraint is []. Each of these factors have the effect of increasing the required payment under Brazil's offer and reducing the payments under Canada's offer, thus exaggerating the difference.

10. To illustrate the effect of what Brazil has done, Canada has calculated "monthly" lease payments under both offers. Canada has employed the same model used by Canada and Brazil, has assumed an average life of [] years for Bombardier's offer and [] for Embraer's offer and has eliminated the differential assumptions Brazil made regarding [].

11. Based on \$1 billion loan amount, the result of these calculations (below) show a monthly rent payment of \$[] for Bombardier’s offer compared to \$[] for Embraer’s. The difference, \$[], is much lower than the difference of \$[] calculated by Brazil. On a per aircraft basis (assuming [] aircraft) the difference amounts to just \$[] per month.

Brazil’s Calculations With Lease Variables Held Constant

Embraer’s offer	Bombardier’s Offer
Loan amount: \$1 billion	Loan amount: \$1 billion
Debt rate: 6%	Debt rate: 6%
Debt Term:	Debt Term:
Average Life:	Average Life:
Lease Term:	Lease Term:
Residual value:	Residual value:
Monthly rent:	Monthly rent:

112. Brazil’s manipulation underscores the difficulty in comparing the respective payments under the two offers and dispels Brazil’s assertion that the difference is “significant”. It also underscores Canada’s point, in paragraph 3 of its answer to Question 74, that there is a wide range of variables that can affect the actual payments under each offer.

13. Brazil’s contention regarding payment amounts ignores these variables, making the comparison envisaged by the Panel problematic. Focusing for comparison, as Brazil has done, on only one element of the offer, is an inadequate basis for comparing complex financing proposals. Although any such comparison is inherently flawed, Brazil has further undermined its assertion by adjusting some of these variables to exaggerate the difference in payments under the two offers.

ANNEX B-15

COMMENTS OF CANADA ON INTERIM REPORT OF PANEL

(26 October 2001)

SECTION 1

SUBSTANTIVE COMMENTS

Para. 7.18

The second to last sentence states that “the legal framework under which the Canada Account is operated has changed”. This is not correct. The legal framework has not changed, as Canada explained in its oral response to a question by the Panel at the second meeting with the parties.

Para. 7.106

In the second line, “whether Canada Account” should read “whether Corporate Account”.

Para. 7.145

In the last sentence, “... Canada assumes that because the Embraer offer was not supported by the Brazilian Government ...” should be changed to “...Canada assumes that if the Embraer offer was not supported by the Brazilian Government ...”. This would more accurately reflect Canada’s argument, which was made in the alternative to Canada’s principal position that Embraer’s offer was supported by the Brazilian Government.

Para. 7.147

In the fourth line, [].

Paras. 7.152 and 7.316

It is not correct that Canada Account (or Corporate Account) financing is only available for export transactions. In respect of both Corporate and Canada Account, EDC may, pursuant to the *Export Development Act* and the *Export Development Corporation Exercise of Certain Powers Regulations*, enter into “domestic financial transactions”, as defined in the regulations, provided that in doing so, EDC is supporting and developing, directly or indirectly, Canada’s export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.

Para. 7.160

The first sentence of paragraph 7.160 suggests, incorrectly, that Canada considered the Embraer offer to be a “derogation” from the *OECD Arrangement*. Canada did not refer to the Embraer offer as a “derogation”. “Derogation” is a term of art used in the *Arrangement* to refer to breaches by Participants of Article 27 of the *Arrangement*, entitled “No Derogation Engagement For Export Credits”. It is not possible for Brazil or Embraer to “derogate” from the *Arrangement* because

neither is a party to the Arrangement. Accordingly, Canada asks that the first sentence of paragraph 7.160 be changed to read: “Neither party disputes that the Embraer offer to Air Wisconsin is not consistent with the *OECD Arrangement* ...”

Para. 7.231

In the fourth last sentence, it appears that “is not determined” should be “is determined”.

Para. 7.247

On the basis of statements made by Canada in the first *Brazil - Aircraft* Article 21.5 proceeding, the Panel appears to have incorrectly understood that Canada regards the premium on regional aircraft as a static and definitive statement. Canada did not mean to infer that for all cases all lenders would always deem that credits secured by regional aircraft merit a premium of 20-30 bps over credits secured by large aircraft. Variations in pricing between similar but non-identical asset classes are dynamic and subject to change due to, *inter alia*, increased familiarity with various asset classes, supply and demand and geo-political events.

Para. 7.255

Canada did not, and does not, reject Brazil’s observation that the FMC represents an average of current pricing levels of the bonds of a wide range of similarly rated companies. However, nor was it Canada’s contention that the FMC should be the *sole* benchmark for pricing transactions if other benchmarks are available. In cases where no precise benchmarks exist, the FMC can be used to demonstrate general market trends for borrowers with similar ratings. Furthermore, as Canada noted,¹ information regarding specific terms and conditions (including pricing) offered by other financial institutions to individual regional airlines is often limited due to the confidential nature of such financing agreements. Such information may need to be obtained from the airlines themselves or other interested parties. In these cases, the FMC may also be used to assist lenders in validating an appropriate pricing level based on information provided by the interested parties based on previous benchmarks and general market trends.

Para. 7.276

On the basis of the [], the Panel has concluded, incorrectly, that EDC financing [] does not include an []. To clarify, the [] provides that the [] will include []. The [] further allows for the lowering of the fixed margin for credit risk identified in the [] on the authority of the President or Senior Vice President Finance and Chief Financial Officer. Thus, an authorized margin below the identified fixed margin is the [] for that transaction.

Para. 7.293

In the last sentence, “ASA” should read “Comair”.

Para. 7.392, footnote 303

The footnote states that the existence of the IQ loan guarantee in the Air Wisconsin transaction only “came to light” in material provided to the Panel subsequent to the second substantive meeting. It suggests, incorrectly, that Canada failed to provide information when requested to do so by the Panel. In fact, the [] IQ loan guarantee is described in the details of the EDC offer, which Canada provided in the attachment to its 25 June letter to the Panel (see page 12 of the attachment).

¹ Canada’s Response to New Arguments in Brazil’s Second Oral Statement, 13 August 2001, para. 16.

Para. 7.387

It appears that the last word of the second last sentence, “excluded”, should read “included”.

Para. 7.402, footnote 309

The Panel's statement at footnote 309 is inaccurate. []

Paras. 7.403 and 7.404

As described at page 12 of the attachment to Canada's 25 June letter, the [].

SECTION 2

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
	As a general comment, we note that foreign phrases (such as <i>de facto</i> , <i>prima facie</i> , <i>ex post</i> and <i>a fortiori</i>) have not always been italicized. In addition, we note that Article 21.5 Panel and Appellate Body reports have not been referred to in a consistent manner.
1.5, line 7	“panellists” should be “panelists”.
3.1, item 2, line 1	“Panel” should be “panel”.
3.1, item 7, line 1	“Investissement Québec” should be italicized.
7.3, item 1, line 1	The comma after “2” should be deleted.
7.15, line 2	“ <i>Canada-Aircraft</i> ” should be “ <i>Canada – Aircraft</i> ”.
7.15, line 6	“terms” should be “term”.
7.16, line 5	Add a period to the end of the quote.
7.17, lines 16/17	Emphasis added is indicated but not shown.
7.18, line 3	It appears that the word “subject” should be inserted immediately before “of”.
7.29, line 2	“Investissement Québec” should be italicized.
7.39, line 8	“ <i>EC – Bananas</i> ” should be “ <i>European Communities – Bananas</i> ”
7.47, line 6	There is an extra space between “B” and “e” in “ <i>Bed</i> ”.
7.48, line 2	“in light” should be “in the light”.
7.53, line 2	“Investissement Québec” should be italicized.
7.63, line 2	Insert a comma following the word “subsidies”.
7.63, line 4	Delete the word “whether”.
7.71, line 2	As “ECAs” does not appear in the quotation, replace the parenthesis with square brackets. In addition, “with the <i>raison d’être</i> ” should be “that have as the <i>raison d’être</i> ”.
7.76, line 3	As “ECAs” does not appear in the quotation, replace the parenthesis with square brackets or, in this instance, delete it. In addition, “with the <i>raison d’être</i> ” should be “that have as the <i>raison d’être</i> ”.
7.82, line 3	“realised” should be “realized”.
7.93, line 3, footnote 57	It appears that the reference to footnote 43 should be a reference to footnote 38.
7.107, line 7, footnote 65	It appears that the reference to footnote 43 should be a reference to footnote 38.
7.122, line 3, footnote 77	The reference should be to the First Written Submission of Canada.
7.125, lines 7 and 8	In the statement as it appears in Canada’s Answer to Question 42, no square brackets around the “s” in line 7 are required. Further, in line 8, a comma should be inserted after the word “support”.
7.130, line 4	“panel” should be “Panel”.
7.131, last line, footnote 89, lines 3, 4 and 7	In line 3, “in this standard” should be added after the word “use”. In line 4, the quotation marks around “ensure” and “future” should be single rather than double. In line 7, the word “unknowable” should be inserted between “the” and “future”.
7.134, line 5	“organisations” should be “organizations”.
7.135, line 10	The word “limited” should be inserted before the word “exception”.
7.141, line 2	The word “that” should be inserted after the word “stated”. In addition, the comma after the word “loan” should be inside the quotation mark.
7.147, line 8, footnote	The reference should be to Exhibit CAN-68.

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
105	
7.149, line 4	“per cent” should be “%”.
7.153, line 3, footnote 114	“Exhibit BRA-16” should be in brackets.
7.151, last line	The word “to” should be inserted before “respond to international business...”.
7.152, line 4	The word “to” should be inserted before “respond to international business...”.
7.152, line 6	The word “was” should be in square brackets.
7.164, line 8, footnote 126	“47b)” should be “47(b)”.
7.168, last line, footnote 136	The footnote does not note that the emphasis was included in the original.
7.175, line 6	The word “the” following “undercut” should be deleted.
7.184, line 8	The word “was” should be in square brackets.
7.184, last line, footnote 148	EDC 2000 Annual Report is Exhibit BRA-22.
7.185, line 1	Quotation marks should follow the word “contribution”.
7.197, lines 9, 10 and 11	The words “customisation” and “organisation” on these lines should be “customization” and “organization”.
7.206, line 4, footnote 164	The footnote does not note that the emphasis was included in the original.
7.207, lines 21 and 28	In line 21, “per cent” should be “%”. In line 28, “capitalisation” should be “capitalization”.
7.210, line 10, footnote 172	“1997” should be inserted before “Shadow Bond...”.
7.218, line 5 and 7.219, line 13	The comma after the word “conservative” should be inside the quotation mark.
7.218, last line, footnote 177 and 7.221, line 6, footnote 179	The reference should be to Comments of Brazil on Canada’s Response to New Arguments in Brazil’s Second Oral Statement.
7.236, last line, footnote 187	The footnote does not note that the emphasis was included in the original.
7.243, line 6, footnote 196	The footnote does not note that the emphasis was included in the original.
7.275, line 3	The word “to” should be replaced with “for”.
7.281, line 4	“the [] banks” should be “[t]he [] banks”.
7.282, last line	There should be a period inserted at the end of the sentence.
7.302, lines 6 and 7	“per cent” in both lines should be “%”.
7.304, line 6, footnote 249	“[t] Joint” should be “[t]he Joint”. There should be quotation marks after the word “Facility”. In line 4, the word “financing” should be “pricing”.
7.313, line 1	The word “was” should be in square brackets.
7.315, line 4 and 7.316, line 4	The word “to” should be inserted before the word “respond” in both instances.
7.316, line 6	The word “was” should be in square brackets.
7.329, line 4, footnote 265, line 4	Exhibit CAN-65 should be in brackets.
7.334, line 2, footnote 266	There should be a quotation mark after “guarantees”.

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
7.358, line 10	Add a space to “toCCC”.
7.366, line 11	The word “anticipated” was emphasized in the Appellate Body Report.
7.374, line 15	“penalise” should be “penalize”.
7.380, line 9, footnote 297	The reference should be to para. 9.340.
7.385	Brazil’s original comment references Canada’s exhibits as “Cda-XX”, whereas the references in the quote are to exhibits “Can-XX”.
7.385, line 32	“95 per cent” should be “95%”.

ANNEX B-16

COMMENTS OF CANADA ON COMMENTS OF BRAZIL ON INTERIM REPORT OF THE PANEL

(2 November 2001)

Canada offers the following responses to three of Brazil's comments on the Interim Report of the Panel. The responses are keyed to the numbers used by Brazil in its 26 October 2001 submission.

Comment 4, re. para. 7.221

Brazil suggests that it was not using data in the same manner, or "exactly the same manner" as Canada did in the *Brazil – Aircraft – Second Article 21.5* proceeding. However, as the Panel notes in paragraph 7.221, Brazil twice cites its use of the same data in the same manner as Canada:

Thus, in April of this year, Canada considered the highest-rated EETC tranche to be a "conservative relative benchmark when compared against the spreads required for financing regional aircraft." Now that its own transactions are being measured against this standard, however, Canada describes the use of this benchmark as "fundamentally flawed."¹ [emphasis added]

In addition, Canada recalls that Brazil noted a number of times in its oral responses at the second meeting with the parties that it had used the same data as Canada in the same manner as Canada had.

Brazil also comments in respect of paragraph 7.221 that: "it would be inaccurate for the Panel to imply that Canada has never previously used weighted average EETC spreads as a benchmark." However, that is not what paragraph 7.221 says. The last sentence of the paragraph states that: "Canada has not sought to rely (either in these proceedings, or in *Brazil – Aircraft – Second 21.5*) on the weighted average spreads of all EETC tranches." [emphasis added]

Comment 5, re. para. 7.226

Canada opposes the addition of a footnote to paragraph 7.226 as requested by Brazil. The comparison of Brazil's submission, at the Panel's request, of details concerning the Embraer offer to Air Wisconsin, with EDC's lack of access when pricing a deal to confidential information on the commercial financing of Bombardier aircraft is neither analogous nor appropriate. Moreover, EDC's arm's length relationship with Bombardier stands in contrast to the Brazilian government's position as a major shareholder in Embraer (including the so-called "golden share") and its participation on Embraer's Board of Directors.²

¹ Comments by Brazil on Canada's Submission of 13 August 2001, 20 August 2001, para. 15. (Canada notes that the Interim Panel Report incorrectly cites this as "Comments of Brazil on Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel".)

² Exhibit CAN-67, pp. 64, 66 and 72-3.

Comment 10, re. para. 7.352 (footnote 278)

Contrary to Brazil's comments, the Panel's statements in footnote 278 are accurate. Investissement Québec (IQ) did not provide financing to Midway. Brazil attempts to equate equity participation with "financing" and alleges that CQC was an equity participant in the Midway transaction. This is not correct. Neither IQ nor CQC were equity participants in the Midway transaction. Canada's confirmation of the accuracy of the Panel's statements in footnote 278 is offered without prejudice to the distinct issue of whether equity participation by IQ or CQC would fall within the terms of reference of the Panel, given the wording of Brazil's claim 7. However, the lack of IQ or CQC equity participation makes this issue moot, and the Panel does not have to decide it.
