

**CANADA – MEASURES AFFECTING THE EXPORT
OF CIVILIAN AIRCRAFT**

Recourse by Brazil to Article 21.5 of the DSU

Report of the Panel

The report of the Panel on Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 9 May 2000 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND FACTUAL BACKGROUND.....	1
II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES	3
III. ARGUMENTS OF THE PARTIES AND THIRD PARTIES	3
IV. INTERIM REVIEW.....	3
A. COMMENTS BY BRAZIL.....	3
B. COMMENTS BY CANADA	4
V. FINDINGS.....	4
A. TECHNOLOGY PARTNERSHIPS CANADA	4
1. Summary of original <i>Canada - Aircraft</i> findings on TPC.....	4
2. Description of the measures taken by Canada to implement the DSB’s recommendations	5
3. Summary of the parties' arguments.....	5
(a) Brazil	5
(b) Canada	6
4. Evaluation by the panel.....	6
(a) Scope of the disagreement between the parties	6
(b) Burden of proof	7
(c) Substantive analysis	8
(i) <i>Eligible industries remain specifically targeted because of their export orientation</i>	8
(ii) <i>Interest in near-market projects</i>	9
(iii) <i>Export performance as an implicit selection and assessment criterion</i>	12
(iv) <i>Documentation</i>	14
(d) Alternative implementation methods	15
(e) Repayment of prior TPC assistance to the Canadian regional aircraft industry.....	16
(f) Summary.....	17
B. CANADA ACCOUNT	17
1. Summary of original <i>Canada - Aircraft</i> findings on Canada Account	17
2. Summary of the parties' arguments.....	18
(a) The measure at issue.....	18
(b) Standard for assessing Canada’s implementation.....	19
(c) Sufficiency of the Policy Guideline	20
3. Evaluation by the Panel.....	21
(a) Textual analysis of the second paragraph of item (k)	22
(i) <i>What are “export credit practices” in the sense of item (k) of the Illustrative List of Export Subsidies?</i>	23
(ii) <i>What are the Arrangement’s “interest rates provisions”?</i>	24
(iii) <i>Which types of “export credit practices” could conceptually be “in conformity with” the “interest rates provisions” of the OECD Arrangement in its current form?</i>	26
(iv) <i>What provisions and considerations are relevant to judging “conformity” with the Arrangement’s “interest rates provisions” and hence qualification for the safe haven in item (k)?</i>	30

(b)	Considerations based on the context of the second paragraph of item (k) and the object and purpose of the SCM Agreement.....	35
(c)	The sufficiency of the Policy Guideline to ensure that future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k), and that prohibited export subsidies under Canada Account thereby have ceased.....	39
(i)	<i>Substance of the Policy Guideline</i>	39
(ii)	<i>Form of the Policy Guideline</i>	41
(d)	Summary.....	42
VI.	CONCLUSION	43
	ANNEX 1-1 (FIRST SUBMISSION OF BRAZIL)	44
	ANNEX 1-2 (REBUTTAL SUBMISSION OF BRAZIL)	60
	ANNEX 1-3 (FIRST ORAL STATEMENT OF BRAZIL)	81
	ANNEX 1-4 (CONCLUDING STATEMENT OF BRAZIL)	88
	ANNEX 1-5 (RESPONSES BY BRAZIL TO QUESTIONS FROM THE PANEL)	92
	ANNEX 1-6 (COMMENTS OF BRAZIL ON CANADA'S RESPONSES TO QUESTIONS FROM THE PANEL)	101
	ANNEX 2-1 (FIRST SUBMISSION OF CANADA)	102
	ANNEX 2-2 (REBUTTAL SUBMISSION OF CANADA)	122
	ANNEX 2-3 (ORAL STATEMENT OF CANADA)	127
	ANNEX 2-4 (ANSWERS TO QUESTIONS POSED TO CANADA BY THE PANEL AND BY BRAZIL)	142
	ANNEX 2-5 (COMMENTS OF CANADA ON BRAZIL'S RESPONSES TO THE QUESTIONS FROM THE PANEL)	160
	ANNEX 3-1 (SUBMISSION OF THE EUROPEAN COMMUNITIES)	162
	ANNEX 3-2 (SUBMISSION OF THE UNITED STATES)	168
	ANNEX 3-3 (ORAL STATEMENT OF THE EUROPEAN COMMUNITIES)	174
	ANNEX 3-4 (ORAL STATEMENT OF THE UNITED STATES)	183
	ANNEX 3-5 (ANSWER OF THE UNITED STATES TO QUESTIONS POSED BY BRAZIL)	186
	ANNEX 3-6 (ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL)	187
	ANNEX 3-7 (RESPONSES BY THE EUROPEAN COMMUNITIES TO THE QUESTIONS FROM THE PANEL AND FROM BRAZIL)	193

I. INTRODUCTION AND FACTUAL BACKGROUND

1.1 On 20 August 1999, the Dispute Settlement Body (“the DSB”) adopted the Appellate Body Report in WT/DS70/AB/R and the Panel Report and recommendations in WT/DS70/R as upheld by the Appellate Body Report in the dispute *Canada – Measures Affecting the Export of Civilian Aircraft* (“*Canada – Aircraft*”). In its report, the Panel found, regarding Canada Account, that the Canada Account debt financing at issue constituted “subsid[ies] contingent in law ... upon export performance” prohibited by Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”), and that in granting this prohibited export subsidy, Canada had necessarily acted in violation of Article 3.2 of the SCM Agreement, i.e., that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constituted export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement. The Panel found with regard to Technology Partnerships Canada (“TPC”) that TPC assistance to the Canadian regional aircraft industry constituted “subsidies contingent ... in fact ... upon export performance”, contrary to Articles 3.1(a) and 3.2 of the SCM Agreement.

1.2 The Panel recommended that Canada withdraw these subsidies within 90 days. The Appellate Body recommended that the DSB request that Canada bring its export subsidies found in the Panel Report, as upheld by the Appellate Body Report, to be inconsistent with Canada’s obligations under Articles 3.1(a) and 3.2 of the SCM Agreement into conformity with its obligations under that Agreement. Specifically, the Appellate Body recalled that the Panel had recommended that Canada withdraw the subsidies identified in sub-paragraphs (b) and (f) of paragraph 10.1 of the Panel Report within 90 days.

1.3 On 18 November 1999, Canada submitted to the Chairman of the DSB, pursuant to Article 21.6 of the Dispute Settlement Understanding (“the DSU”), a status report (WT/DS70/8) on implementation of the recommendations of the DSB in the dispute. The status report described measures taken by Canada which in Canada’s view implemented the DSB’s rulings to withdraw the measures within 90 days.

1.4 With respect to Canada Account debt financing for the export of Canadian regional aircraft, which was found to be inconsistent with Canada’s obligations under the SCM Agreement, the status report indicated that there would be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account financing. In addition, the Minister for International Trade had approved a policy guideline requiring that all Canada Account transactions after that date for all sectors, not only those involving the regional aircraft sector, comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (the “*OECD Arrangement*”). By this policy, the Minister undertook not to authorize any transaction under the Canada Account unless it complied with the *OECD Arrangement*, and no Canada Account transaction may proceed without such Ministerial authorization.

1.5 Concerning TPC assistance to the Canadian regional aircraft industry which was found to be inconsistent with Canada’s obligations under the SCM Agreement, the status report stated that Canada would not make any disbursements pursuant to any existing TPC Contribution Agreement for the Canadian regional aircraft industry effective 18 November 1999. In this respect, Canada had amended TPC’s Contribution Agreements pertaining to the Canadian regional aircraft industry in order to terminate all obligations to disburse funds effective 18 November 1999. As a result, some \$16.4 million of funding pursuant to those agreements would go undisbursed. In addition, Canada had cancelled the conditional approval given prior to the Appellate Body report for two other regional aircraft industry projects. Canada attached to this communication letters confirming cancellation of

such funding. Canada also had taken steps to restructure TPC in order to bring the structure and administrative practices of the Agency into conformity with the SCM Agreement and so to avoid future disputes in this matter. TPC had been re-mandated by the government and now operated under revised Terms and Conditions and Framework Document. The revisions covered such core activities as project eligibility, assessment criteria, and repayment principles.

1.6 On 23 November 1999, Brazil submitted a communication to the Chairman of the DSB (WT/DS70/9) seeking recourse to Article 21.5 of the DSU. In that communication, Brazil indicated its view that the measures taken by Canada to comply with the recommendations and rulings of the DSB were not consistent with the SCM Agreement and the DSU, and that therefore Canada had not implemented the recommendations of the DSB concerning either Canada Account or TPC. In particular, regarding Canada Account, Brazil recalled that there were a large number of provisions in the *OECD Arrangement* that allowed for derogations from its general rules. Therefore, in Brazil's view, Canada's vague statement that the new policy guideline complied with the *OECD Arrangement* was inconsistent with the recommendations and rulings of the DSB and Article 3 of the SCM Agreement. In addition, Brazil had not received any documentation with the revised policy guidelines of Canada Account. Regarding TPC, Brazil had no information on the new administrative framework for the programme, and since TPC payments were contingent in fact upon export performance, compliance by Canada with Article 3 of the SCM Agreement required more than a mere reformulation of some of the TPC rules and regulations.

1.7 Accordingly, Brazil indicated, because "there [was] a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB" between Brazil and Canada, within the terms of Article 21.5 of the DSU, Brazil sought recourse to Article 21.5 in the matter and requested that the DSB refer the disagreement to the original panel, if possible, pursuant to Article 21.5. Brazil attached¹ the terms of an agreement reached by Brazil and Canada concerning the procedures to be followed pursuant to Articles 21 and 22 of the DSU. Brazil stressed that such agreement did not prejudice its rights concerning an appeal of the review panel report.

1.8 At its meeting on 9 December 1999, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Brazil in document WT/DS70/9. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS70/9, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.9 The Panel was composed as follows:

Chairperson: Mr. David de Pury

Members: Mr. Maamoun Abdel-Fattah

Mr. Dencho Georgiev

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

1.11 The Panel met with the parties and third parties on 6 February 2000.

¹ See Annex to document WT/DS70/9.

1.12 The interim report of the Panel was sent to the parties on 31 March 2000. The parties submitted written comments on the interim report on 7 April 2000. On 14 April 2000, Canada responded to two comments made by Brazil. Brazil chose not to respond to Canada's comments on the interim report. Neither party requested an interim review meeting with the Panel. The final report of the Panel was sent to the parties on 28 April 2000.

II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

2.1 Brazil requests the Panel to "determine that Canada has not implemented the recommendations and rulings of the DSB or otherwise complied with its obligations under the Subsidies Agreement".

2.2 Canada requests the Panel to "reject Brazil's claim".

III. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

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

IV. INTERIM REVIEW

4.1 On 7 April 2000, both parties requested the Panel to review, in accordance with Article 15.2 of the DSU, precise aspects of the interim report issued on 31 March 2000. Neither party requested an additional meeting with the Panel. Canada responded to two of the comments made by Brazil.

A. COMMENTS BY BRAZIL

4.2 Brazil identified two typographical errors in the interim report, which have been corrected.

4.3 Regarding para. 5.32, Brazil asked us to state that sales forecasts will in some instances be used in the context of "new" TPC assistance to the Canadian regional aircraft industry. There is nothing in the record to suggest that sales forecasts will definitely be used in the context of the new TPC. Furthermore, in responding to Brazil's comment, Canada asserted that "[I]t is not certain that sales forecasts will *ever* be used in the context of the 'new' TPC assistance to the regional aircraft industry". Accordingly, we have not made the change requested by Brazil.

4.4 In respect of para. 5.33, Brazil asserted that the third sentence of this paragraph does not accurately reflect the factual record in these proceedings. Brazil argued that documentary evidence that it submitted establishes that "increased export performance" is in fact identified by Industry Canada as a "net economic benefit" to Canada as that term is defined by the "new" TPC. However, it is possible for a transaction to have "net economic benefit" without export performance. Although export performance may well provide net economic benefit, the opposite is not necessarily true. We have amended the third sentence of this paragraph, in order to clarify that nowhere in the "new" TPC Investment Decision Document or the "new" TPC Investment Application Guide (the two documents referred to in that paragraph) is export performance identified as a "technological" or "net economic benefit".

4.5 With regard to para. 5.37, Brazil questioned our finding that "Brazil has failed to cite to any Canadian submission to the Panel which contains any such argument". Brazil referred to Exhibit

CAN-9 in support. However, Exhibit CDN-9 does not contain any argument by Canada that it has implemented the DSB recommendation on TPC by removing the word "export" from the "old" TPC documents referenced therein. It simply includes a list of TPC documents in effect prior to 17 November 1999. Indeed, some of the "old" TPC documents cited in Exhibit CDN-9 do not even contain the word "export" (see, for example, Repayment of Contributions Policy Guidelines, Project Summary Form, and Statement of Work). We have made no change to this paragraph.

4.6 In order to avoid any misstatement of Brazil's arguments concerning the Appellate Body report in *Chile - Alcohol* (WT/DS87/AB/R and WT/DS110/AB/R), we have deleted former footnote 45.

4.7 Brazil requested the inclusion of a new footnote at the end of the first sentence of paragraph 5.50. Brazil asked the Panel to include text taken from para. 45 of Canada's first written submission (Annex 2-1) and para. 15 of Canada's second written submission (Annex 2-2). In response, Canada asserted that Brazil's proposed footnote "takes language from Canada's submission out of context. This could lead to the perpetuation of the misunderstanding of Canada's position on this point." We agree with Canada. In any event, we note that the relevant text is included in the aforementioned Annexes to the Panel's report. We have therefore not included the new footnote requested by Brazil.

B. COMMENTS BY CANADA

4.8 Regarding our findings on Canada Account, Canada indicated that it understood the reference in paragraph 5.147(d) of our report to Article 24 of Annex III of the *OECD Arrangement* to mean that humanitarian tied aid falls within the safe haven of the second paragraph of item (k) and therefore can be provided under Canada Account. Canada requested that we insert a statement in our findings to clarify this. We have made no finding in respect of humanitarian tied aid, and therefore have inserted footnotes 102 and 127 to so indicate.

4.9 Canada further noted regarding our findings on Canada Account that in a given transaction, there could be a combination of a guarantee or an insurance policy by an export credit agency issued in favour of a lending bank and the provision of interest rate support by the participating country to the lending bank. Canada stated that Canada understood us to consider that such a transaction would fall within the safe haven of the second paragraph of item (k) because it includes "official financing support", and requested that we insert a statement in our findings to clarify this point. We have inserted footnotes 97 and 103 to reiterate and clarify our finding as to the provisions of the *Arrangement* that would need to be respected in order for such a transaction to be in conformity with the interest rate provisions of the *Arrangement*, and to recall our finding that conformity with the SCM Agreement of a guarantee or insurance as such could only be judged on the basis of Articles 1 and 3 of that Agreement.

4.10 Canada requested that we insert an introductory sentence before paragraph 81 of its oral statement (Annex 2-3). We have inserted the requested sentence at the beginning of that paragraph.

V. FINDINGS

A. TECHNOLOGY PARTNERSHIPS CANADA

1. Summary of original *Canada - Aircraft* findings on TPC

5.1 In the original *Canada - Aircraft* proceeding, Brazil adduced evidence concerning five TPC transactions in the regional aircraft sector. The Panel noted that "three [of the five] transactions accounted for 68% of TPC contributions to the aerospace and defence sector during the period 1996-1997." The Panel found "that Brazil's arguments concerning these three specific contributions

establish a *prima facie* case that TPC assistance to the Canadian regional aircraft industry confers 'benefits' within the meaning of Article 1.1(b) of the SCM Agreement". The Panel therefore found that "TPC assistance to the Canadian regional aircraft industry constitutes 'subsidies' within the meaning of Article 1.1 of the SCM Agreement". The Panel then found, on the basis of a number of "considerations" / "facts", that "TPC assistance to the Canadian regional aircraft industry is ... 'contingent ... in fact ... upon export performance' within the meaning of Article 3.1(a) of the SCM Agreement". In light of the above, the Panel concluded that "TPC assistance to the Canadian regional aircraft industry constitutes 'subsidies contingent ... in fact ... upon export performance', contrary to Articles 3.1(a) and 3.2 of the SCM Agreement".

5.2 The Appellate Body upheld the Panel's finding that "TPC assistance to the Canadian regional aircraft industry" is contingent on export performance, within the meaning of Article 3.1(a) of the SCM Agreement.

2. Description of the measures taken by Canada to implement the DSB's recommendations

5.3 Canada has taken two types of action in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. First, Canada has terminated existing TPC activities in the Canadian regional aircraft sector. Thus, Canada (1) has cancelled funding under five TPC transactions identified by Canada, (2) has withdrawn approvals-in-principle for two new TPC funding projects in the regional aircraft sector, and (3) has closed all TPC files in the regional aircraft sector.

5.4 Second, Canada has restructured the TPC programme and documentation so that, in its opinion, most of the factual considerations forming the basis for the Panel's finding of *de facto* export contingency no longer apply. According to Canada, the only factual consideration still applicable is the export orientation of the Canadian regional aircraft industry.

3. Summary of the parties' arguments

(a) Brazil

5.5 Brazil notes that, consistent with Article 4.7 of the SCM Agreement, the Panel and the DSB recommended that Canada "withdraw" its prohibited export subsidies. Brazil recalls that the Panel found that prohibited export subsidies were provided in the form of TPC assistance to the Canadian regional aircraft industry. Accordingly, Brazil considers that Canada should withdraw the TPC programme altogether with regard to the Canadian regional aircraft industry. At a minimum, Brazil considers that Canada's TPC implementation measures must ensure that prohibited export subsidies cannot be granted to the regional aircraft industry, and not merely that they might not be granted. Brazil states that withdrawal of the prohibited TPC subsidy programme should consist of measures that make it clear to the Panel that Canada is not simply going to continue the same TPC programme as before once the present Article 21.5 proceedings are completed. Brazil asserts that Canada's implementation measures change only the superficial evidence of export contingency (by purging from TPC documents any express reference to the word "export"), but make no substantive change whatsoever in the underlying programme.

5.6 As an argument in the alternative, Brazil also requests repayment of prior TPC assistance to the Canadian regional aircraft industry, if either (1) the Panel considers itself required to follow the reasoning of the *Australia - Leather Article 21.5 panel*², or (2) the Panel finds that there can be no

² *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW, adopted 11 February 2000, hereinafter "*Australia - Leather Article 21.5*".

grounds for making a finding concerning *de facto* export contingency under the "new" TPC programme in the absence of actual financial contributions granted under the "new" TPC.

(b) Canada

5.7 Canada submits that the measures it has taken fully satisfy the requirement to withdraw the TPC assistance to the Canadian regional aircraft industry that was found to constitute prohibited export subsidies. Canada considers that these measures "ensure" - through programmatic changes - that any future assistance under the TPC programme with respect to regional aircraft will be consistent with the SCM Agreement. Canada denies Brazil's assertion that it is obliged to withdraw / abolish the TPC programme in respect of the Canadian regional aircraft industry. Canada asserts that it can implement the Panel's recommendation by replacing the "old" WTO-inconsistent TPC programme with a "new" WTO-consistent programme.

5.8 With regard to Brazil's qualified request for repayment, Canada asserts that it was the operation of TPC in the regional aircraft sector that was at issue in the previous proceeding, and that it is the operation of TPC, as newly constituted, that is at issue in this Article 21.5 proceeding. Canada asserts that since there is no evidence, and, indeed, no suggestion, that new subsidies have been granted to "circumvent" a Panel ruling, repayment of subsidies, even if such a remedy were available under the SCM Agreement, is not warranted.

4. Evaluation by the panel

(a) Scope of the disagreement between the parties

5.9 Brazil's primary³ claim concerns the measures taken by Canada to restructure the TPC programme insofar as it will apply in the future to the Canadian regional aircraft industry. In particular, Brazil's primary claim raises issues concerning the substance of the prospective implementation action undertaken by Canada. With respect to Brazil's primary claim, therefore, there is no disagreement between the parties resulting from the fact that, in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry, Canada has taken prospective action. The parties agree that to "withdraw" the subsidy in this case requires some sort of prospective action on the part of Canada.

5.10 We recall that Article 21.5 disputes arise "[w]here there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings"⁴ of the DSB. Since there is no disagreement between the parties⁵ that, in order to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry, Canada is required to take some form of prospective action, we do not consider it necessary to provide a comprehensive interpretation of what is required for an implementing Member to "withdraw" a prohibited export subsidy. Rather, it is sufficient to conclude (and we note that the parties seem to agree with this) that a Member cannot be understood to have withdrawn a prohibited subsidy if it has not *ceased to provide* such a subsidy, as that Member therefore would not have ceased to violate its WTO obligations in respect of such a subsidy. In our view, therefore, Canada's obligation arising from the DSB's recommendation in this dispute includes the obligation to cease providing prohibited export subsidies to the regional aircraft sector under the TPC. We note that in the circumstances of

³ Only in the alternative does Brazil raise any claims concerning past TPC assistance to the regional aircraft industry. However, Brazil has explicitly stated that a remedy concerning (exclusively) future TPC assistance to the regional aircraft industry is preferred (see para. 5.45 below).

⁴ Emphasis supplied.

⁵ We recall that we are not, at this juncture, addressing Brazil's alternative claim regarding repayment of past TPC assistance to the Canadian regional aircraft industry.

this Article 21.5 proceeding concerning TPC, such an assessment is by nature forward-looking. Accordingly, we shall focus on Canada's restructuring of the TPC programme insofar as it will apply to the Canadian regional aircraft industry in the future. If necessary, we shall then examine Brazil's alternative claim regarding past TPC assistance to the regional aircraft industry.

5.11 With regard to the future, Brazil claims that Canada should abolish / withdraw the TPC programme in respect of the Canadian regional aircraft industry. At a minimum, though, Brazil asserts that Canada must "ensure" that *de facto* export subsidies cannot be granted to the regional aircraft industry, and not merely that they might not be granted.⁶ According to Brazil, if Canada maintains funding to the Canadian regional aircraft industry under the "new" TPC, Canada must ensure that the program will operate in full compliance with the SCM Agreement.⁷ Canada denies that it is required to abolish / withdraw the TPC programme in respect of the Canadian regional aircraft industry, but asserts that it "has taken the steps within Canada's control to ensure that any assistance that TPC may provide in the future to the Canadian regional aircraft industry will not be contingent on export performance in law or in fact".⁸

5.12 Thus, Brazil and Canada effectively agree on the need for Canada to satisfy Brazil's minimum implementation standard, *i.e.*, to "ensure" that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance. The parties disagree, however, on whether Canada has taken sufficient steps to satisfy that standard. To resolve this disagreement, we must examine whether or not Canada has taken sufficient steps to ensure that future TPC assistance to the regional aircraft industry will not be *de facto* contingent on export performance.

(b) Burden of proof

5.13 In examining this issue, we note that "Brazil recognises that it bears the burden of showing that Canada has failed to implement. ... It then becomes Canada's burden to explain how Brazil was wrong and how Canada's purported changes actually constitute effective implementation."⁹ Canada agrees that the initial burden of proof falls on Brazil.

5.14 We agree that Brazil, as the complaining party, bears the burden of proof in this proceeding. We agree with the Appellate Body's statement in *EC - Hormones* that "[t]he initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency ...",¹⁰ and consider that this should apply in the context of Article 21.5 proceedings. Since the burden is on Brazil (*i.e.*, the complaining party) to show that Canada has failed to implement the recommendation of the DSB (by reference to the minimum implementation standard agreed on by the parties), Brazil must establish that Canada has failed to "ensure" that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance.

⁶ Brazil could be understood to have proposed an impossible implementation standard, since no sovereign state will ever be able to provide an absolute guarantee that it will not in the future provide *de facto* export subsidies. Any such guarantee would effectively eliminate the totality of a state's discretionary authority. Brazil acknowledges this point, by stating that "[o]bviously, a sovereign state cannot [eliminate all of its discretionary authority] and remain a sovereign state" (Brazil's reply to TPC question 1(a) from the Panel). In light of Brazil's acknowledgement, we understand Brazil to argue that Canada need only ensure that *de facto* export subsidies cannot be granted to the regional aircraft industry within the context of the "new" TPC programme. This understanding is confirmed by Brazil's assertion that "Canada must *ensure* that the program will operate in full compliance with the [SCM] Agreement" (Second written submission of Brazil (Annex 1-2), para. 19, underline emphasis supplied).

⁷Id.

⁸ Canada's reply to the Panel's TPC question 2, para. 57 (Annex 2-4), emphasis supplied.

⁹ Brazil's reply to the Panel's TPC question 1(a) (Annex 1-5).

¹⁰ *EC - Hormones*, WT/DS26/AB/R, WT/DS48/AB/R, para. 98, adopted 13 December 1998.

(c) Substantive analysis

5.15 Brazil considers that it has discharged its burden of proof by demonstrating "that all the essential elements of the [TPC] program remain unchanged, and that many of these elements will never change".¹¹ In this regard, Brazil claims that the facts surrounding the "new" TPC still support an inference of *de facto* export contingency. In particular, Brazil refers to the following four factors which, in its opinion, lead to an inference that future TPC assistance to the Canadian regional aircraft industry continues to be *de facto* export contingent:

- eligible industries remain "specifically targeted" because of their export orientation;
- eligible activities continue to betray an interest in near-market projects;
- export performance is an implicit selection and assessment criterion; and
- many TPC documents have not yet been replaced or amended.

We shall examine each of these factors in turn.

(i) Eligible industries remain specifically targeted because of their export orientation

5.16 Brazil argues that the continued *de facto* export contingency of TPC may be inferred from the fact that the Canadian regional aircraft industry continues to be "specifically targeted" for TPC assistance because of its undisputed export orientation.¹² Brazil asserts that "[n]othing, in short, has changed - neither the industries eligible for TPC contributions, nor the recognized export-orientation of the industry that enjoys the lion's share of those contributions, nor the significance of that industry's export orientation to Canadian government officials, nor that industry's prospects for continued dominance of TPC's treasury. None of these factors is destined for change."¹³ Brazil asserts that, to maintain the export orientation of the Canadian regional aircraft industry, "the Canadian aerospace industry receives the vast majority of the rapidly increasing pool of TPC funds available".¹⁴ Brazil further argues that "in choosing which industry would receive the lion's share of 'old' and 'new' TPC funds, Canada was not casually indifferent to the trading patterns of that industry. Instead, Canada chose, as TPC's showcase, an industry that exports significantly more than others, *because* it exports significantly more than others. The 'new' TPC retains a focus on contributions to the aerospace industry."¹⁵ According to Brazil, "the targeted industries of the 'old' TPC are the same recipients under the 'new' TPC".¹⁶

5.17 Thus, we understand Brazil to argue that "nothing has changed" because TPC assistance continues to be "specifically targeted" at the Canadian aerospace or regional aircraft industries, in the sense that these industries will continue to receive the "vast majority", or "lion's share", of TPC assistance. In addressing this argument, we recall that the "specific targeting" concept (in those or other words) did not form part of our reasoning regarding contingency in fact on export performance in that dispute. While we do not exclude the possibility that, in a given case, a factual circumstance of "specific targeting" might be considered by a panel to be part of the totality of facts leading to an inference of export contingency, this was not the case in the original *Canada - Aircraft* dispute. That is, of the factual considerations enumerated by us at para. 9.340 of our Report, **none** concerned the

¹¹ Brazil's reply to TPC question 1(a) from the Panel (Annex 1-5) (emphasis supplied).

¹² Brazil's reply to TPC question 2 from the Panel (Annex 1-5).

¹³ Brazil's first written submission, para. 22, Annex 1-1).

¹⁴ Brazil's first written submission, para. 23 (Annex 1-1).

¹⁵ Brazil's second written submission, paras 32 and 33 (Annex 1-2).

¹⁶ Brazil's concluding remarks, para. 9 (Annex 1-4).

alleged targeting of the Canadian aerospace industry generally, or the Canadian regional aircraft industry in particular, by TPC, **none** concerned the amount of total TPC funding directed at the Canadian aerospace or regional aircraft industries,¹⁷ and **none** concerned the fact that the aerospace or regional aircraft industries were eligible for TPC assistance. Arguing a failure to implement on the grounds that there has been no change in alleged factual circumstances, which themselves were not part of our original ruling, is of questionable merit and logic. Indeed, we consider that the question of whether TPC assistance is "specifically targeted" to the aerospace and regional aircraft industries is not relevant to the present dispute, which concerns the issue of whether or not Canada has implemented the DSB recommendation on TPC assistance to the Canadian regional aircraft industry. That recommendation cannot have required Canada to take implementation action to ensure that TPC assistance is not "specifically targeted" at the aerospace and regional aircraft industries, because such alleged "specific targeting" did not form part of the basis for the finding of *de facto* export contingency that gave rise to that recommendation.¹⁸ The fact that "nothing has changed" concerning the alleged "specific targeting" of the aerospace and regional aircraft industries therefore has no bearing on the present dispute.

5.18 For these reasons, we do not consider it necessary to examine Brazil's argument that "nothing has changed" because TPC assistance continues to "specifically target" the Canadian aerospace and regional aircraft industries.

(ii) *Interest in near-market projects*

5.19 Brazil argues that the *de facto* export contingency of future TPC funding to the Canadian regional aircraft industry should be inferred from the fact that the available descriptions of eligible activities under the "new" TPC betray an interest in "near market" projects with high commercialization potential. Brazil also argues that essentially the same projects continue to be eligible for "new" TPC contributions as were eligible under the "old" TPC, such that "if funding for the development of commercial products was available in the 'old' TPC, it is similarly available in the 'new' TPC, and as it did before contributes to an *inference of de facto* export contingency".¹⁹

¹⁷ We recall that, in our original findings, we referred to the fact that three specific transactions examined by us accounted for approximately 68 per cent of TPC contributions to the aerospace and defence sector during the period 1996-1997 (see para. 9.307 of *Canada - Aircraft*, WT/DS70/R). However, we made this factual reference in the context of our original findings on subsidization. This factual reference played no part whatsoever in our original findings on *de facto* export contingency.

¹⁸ We note the statement of the *Australia - Leather Article 21.5* panel (which Brazil has quoted in its reply to the Panel's TPC question 5 (see Annex 1-5)) that "[t]he specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance ... do not, in our view, determine what is required in order to 'withdraw the subsidy' within the meaning of Article 4.7 of the SCM Agreement" (WT/DS126/RW, adopted 11 February 2000, note 24). We do not understand this statement to mean that factual considerations underlying a panel's finding that a subsidy is *de facto* export contingent are irrelevant for determining what action must be taken to remove that *de facto* export contingency. Indeed, the context in which that statement was made by the *Australia - Leather Article 21.5* panel was altogether different. In that case, the question of implementation of the DSB's recommendation was addressed, in the first instance by the parties, on the basis of the "subsidy" element, rather than the "export contingency" element, of the prohibited subsidy. Specifically, the parties both made arguments concerning the *amount of the subsidy* that should be repaid, and Australia based its arguments concerning this point on its interpretation of the panel's original finding of *export contingency*. The quoted statement of the panel was made in addressing this argument, and we believe was intended to express the view that the basis for the original finding of *de facto* export contingency was not useful or relevant for calculating the amount of the subsidy to be repaid.

¹⁹ First written submission of Brazil (Annex 1-1) at para. 30.

5.20 We recall that our earlier findings in *Canada - Aircraft* were based in part on the express recognition in the 1996/1997 TPC Business Plan that "TPC's 'approach' in the aerospace and defence sector is to [d]irectly support the near market R & D projects with high export potential".²⁰

5.21 In its review of our findings, the Appellate Body asserted that, if a panel takes the "nearness-to-the-export-market factor" into account, "it should treat it with considerable caution". ... [T]he mere presence or absence of this factor in any given case does not give rise to a presumption that a subsidy is or is not *de facto* contingent upon export performance". Accordingly, we shall proceed with caution when addressing Brazil's arguments regarding the alleged nearness-to-the-export-market of "new" TPC projects in the regional aircraft sector.

5.22 We note that the 1996-1997 TPC Business Plan, which contained the aforementioned reference to "near market R & D projects with high export potential" is no longer valid, and no longer exists for the purposes of TPC as it is now constituted.²¹ The 1996-1997 TPC Business Plan is therefore irrelevant when considering whether future TPC assistance to the Canadian regional aircraft industry will be *de facto* contingent on export performance.²²

5.23 In order to substantiate its claim that eligible activities for "new" TPC funding betray an interest in near-market projects, Brazil states that, according to "new" TPC documentation, TPC will fund "projects 'aimed at the discovery of knowledge, with the objective that such knowledge may be useful in *developing new products*,' and those projects leading to 'translation of industrial research findings into a plan, blueprint or *design for new, modified or improved products* ...'".²³ In response, Canada asserts that the inclusion of Industrial Research as an Eligible Activity "permits TPC to support earlier stage research and development that is further removed from the production and sale of specific products. The pre-competitive development category of eligible activity enables TPC to support the development of horizontal technologies that cut across the operations of recipient firms ... rather than the development of specific products".²⁴

5.24 In our view, the mere fact that the results of a project may in the future be useful in the development of new products, or the modification / improvement of existing products, does not by itself render the project near-market. This view is confirmed by former footnotes 28 and 29 to former Article 8.2(a) of the SCM Agreement²⁵, concerning non-actionable subsidies, which appears to have strongly influenced Canada's choice of wording in the "new" TPC documents cited by Brazil.²⁶ In our

²⁰ *Canada - Aircraft*, WT/DS70/R, para. 9.340, emphasis in original findings.

²¹ Oral statement of Canada (Annex 2-3) at para. 45.

²² For the reasons set forth at para. 5.40, we see no reason to draw any inferences concerning Canada's failure to provide the 2000/2001 - 2001/2002 TPC Business Plans, which are still under development.

²³ Second written submission of Brazil (Annex 1-2) at para. 35 (emphasis in Brazil's submission). Brazil is referring to the "new" TPC Terms and Conditions, and the "new" TPC Investment Application Guide, at this juncture.

²⁴ First written submission of Canada (Annex 2-1) at para. 34.

²⁵ Pursuant to Article 31 of the SCM Agreement, Articles 8 and 9 of that Agreement applied for an initial period of five years, ending 31 December 1999, and could have been extended beyond that date on the basis of a consensus by the SCM Committee. As of 31 December 1999, no such consensus had been reached.

²⁶ Former footnote 28 provided:

The term "industrial research" means planned search or critical investigation aimed at discovery of new knowledge, with the objective that such knowledge may be useful in developing new products, processes or services, or in bringing about a significant improvement to existing products, processes or services.

Former footnote 29 provided:

The term "pre-competitive development activity" means the translation of industrial research findings into a plan, blueprint or design for new, modified or improved products, processes or services whether intended for sale or use, including the creation of a first prototype which would not be capable of commercial use. It may further include the conceptual formulation and design of products, processes or services alternatives and initial demonstration or pilot

view, the non-actionable subsidy projects referred to in former footnotes 28 and 29 concerned "industrial research" and "pre-competitive development activity" projects that were sufficiently removed from the market to suggest that their impact on the market was likely to be minimal. As a result, it would be incongruous for us to find similarly defined TPC projects to be "near-market".

5.25 Brazil has also argued that "new" TPC eligible activities betray an interest in "near market" projects because they are similar to "old" TPC eligible activities which were found to be "near market". In this regard, Brazil relies exclusively on a description of "old" TPC activities contained in a January 1998 TPC website excerpt.²⁷ According to Brazil, the description of "new" TPC eligible activities is similar to the description of "old" TPC eligible activities found in the January 1998 TPC website excerpt. We do not consider it necessary to pursue this argument, since our original finding that TPC funding in the aerospace & defence sector (and therefore in the regional aircraft industry component thereof) was focused on "near market" projects was based on the aforementioned statement in the 1996-1997 TPC Business Plan, and not the January 1998 TPC website excerpt. We therefore do not see the relevance of comparing the "new" description of eligible activities with the "old" description of TPC eligible activities contained in the January 1998 TPC website excerpt. Of far greater relevance, however, is the fact that the 1996/1997 TPC Business Plan, which contained the explicit reference to "near market" projects ("with high export potential") is no longer valid for the "new" TPC. Aerospace & defence activities eligible for "new" TPC funding will necessarily differ from aerospace & defence activities eligible for funding under the "old" TPC, since - as provided for in the 1996/1997 TPC Business Plan - "old" TPC funding in the aerospace & defence sector was explicitly and exclusively focused on "near-market projects", which - on the basis of the evidence before us - is not the case for "new" TPC funding in the aerospace & defence sector²⁸.

5.26 Accordingly, Brazil has failed to demonstrate that the available descriptions of eligible activities under the "new" TPC betray an interest in "near market" projects with high commercialization potential, or that activities eligible for funding under the "new" TPC are essentially the same as those eligible for funding under the "old" TPC.²⁹

projects, provided that these same projects cannot be converted or used for industrial application or commercial exploitation. It does not include routine or periodic alterations to existing products, production lines, manufacturing processes, services, and other on-going operations even though those alterations may represent improvements.

²⁷ First written submission of Brazil (Annex 1-1) at para. 29.

²⁸ We note as well the Industry Canada press release concerning the "new" TPC (Exhibit BRA-18), which was cited by Brazil in connection with its "specific targeting" argument (First oral statement of Brazil (Annex 1-3) at para. 20). Although this document has not been identified by Brazil in connection with its "near market" argument, nonetheless we have examined it in this context to determine the extent to which it might be relevant to the question of whether the same projects or similarly "near market" projects as were funded under the "old" TPC would continue to be funded under the "new" TPC. We conclude that this document does not contain information relevant to this question. In particular, this document indicates that the same companies are "free" to apply for funds under the "restructured" TPC on the basis of a new application form. In our view, this cannot be construed as meaning that the same projects would be considered eligible, specifically *because* of the reference to the fact that TPC has been restructured and the application form revised.

²⁹ We note Brazil's argument that "[r]emoving 'commercialization' or the 'near market R&D' focus from TPC's focus ... and shifting instead to a focus on 'industrial research and pre-competitive development,' would not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy" (First written submission of Brazil (Annex 1-1) at para. 25). We agree. For that reason, our conclusion in the preceding paragraph does not preclude us from examining other factual arguments adduced by Brazil to demonstrate that future TPC assistance to the regional aircraft industry will be *de facto* contingent upon export performance.

(iii) *Export performance as an implicit selection and assessment criterion*

5.27 Brazil notes that the goals and objectives of the "new" TPC, like those of the "old" TPC,³⁰ concern the creation of Canadian jobs, the increase of Canadian economic growth, or the increase of Canadian wealth. Brazil asserts that an inference of *de facto* export contingency may be drawn from an intimate "link" between (1) the fulfilment of these goals and objectives and (2) exports. Brazil asserts that, because of this "link", TPC assistance to the regional aircraft industry will be implicitly conditioned on, or tied to, export performance.

5.28 Canada notes that the mandate and overall programme objective of the restructured TPC provide that "TPC is a technology investment fund established to contribute to the achievement of Canada's objectives of increasing economic growth, creating jobs and wealth, and supporting sustainable development".³¹ According to Canada, the restructured TPC's mandate and objectives do not encompass the enhancement of exports or Canada's export base.

5.29 We recall that our original findings were based in part on the Terms and Conditions of the "old" TPC, which stated that the Aerospace & Defence component of the TPC would be "directed to projects that will maintain and build upon the ... **export base** extant in the aerospace and defence sector".³² We note that the Terms & Conditions of the "new" TPC no longer explicitly direct the Aerospace & Defence component thereof at projects that maintain and build upon the "export base" of the aerospace & defence sector. It is presumably for this reason that Brazil refers to the alleged implicit conditionality between the grant of "new" TPC assistance to the Canadian regional aircraft industry and the export performance of that industry.

5.30 While it is certainly true that the provision of funds on the basis of the "new" TPC's mandate and objectives could result in additional exports by funded sectors, we recall the Appellate Body's ruling that the mere knowledge, or anticipation, that exports will result from a subsidy does not by itself render that subsidy *de facto* contingent on export performance, because it does not by itself demonstrate conditionality.

5.31 Brazil has argued that the requisite conditionality may be inferred from the fact that recipients of "new" TPC assistance implicitly "commit to export performance". In this regard, Brazil has sought to draw an analogy with the facts of the *Australia - Leather* case³³ where the panel, in Brazil's own words, "determined that requesting undifferentiated sales performance targets led to an inference of *de facto* export contingency because the Australian government knew that in order to reach those targets, the recipient would have to export".³⁴ According to Brazil, "[t]he same logic applies in the case of the Canadian regional aircraft industry; the Canadian government knows that the industry exports virtually all its products, and thus to reach sales forecasts, it must export".³⁵

5.32 Without taking any view on the findings of the *Australia - Leather* panel, we note that Brazil has adduced no evidence that "new" TPC assistance to the Canadian regional aircraft industry will be

³⁰ First written submission of Brazil (Annex 1-1) at para. 32.

³¹ TPC Terms & Conditions, and SOA Framework (see First written submission of Canada (Annex 2-1) at para. 22).

³² *Canada - Aircraft*, WT/DS70/R, para. 9.340, bullet 12 (emphasis supplied).

³³ *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather* (hereinafter "*Australia - Leather*"), WT/DS126/R, adopted 16 June 1999.

³⁴ Second written submission of Brazil (Annex 1-2) at footnote 62.

³⁵ *Id.*

conditioned on the fulfilment of sales targets (as was found to be the case in *Australia - Leather*³⁶). Brazil claims instead that the grant of "new" TPC assistance to the regional aircraft industry is contingent on the fulfilment of sales forecasts. However, in response to a question from the Panel, Brazil was unable to adduce any evidence to substantiate its claim of contingency on sales forecasts. Brazil only adduced evidence to the effect that sales forecasts will be used in the context of the "new" TPC programme.³⁷ In response, Canada explicitly denied that the granting of TPC assistance to the regional aircraft sector is contingent on the fulfilment of sales forecasts.³⁸ In the absence of any evidence to the contrary, we see no reason to doubt Canada's explicit denial. Furthermore, although sales forecasts may be used in the context of "new" TPC assistance to the regional aircraft industry, as they were under the "old" TPC,³⁹ this does not by itself mean that "new" TPC assistance to the Canadian regional aircraft industry will be contingent on fulfilment of those sales forecasts. The fact that a subsidy repayment schedule may be based on royalties from forecast sales does not mean that compliance with the sales forecast becomes a condition for the bestowal of the subsidy; it simply means that a sales forecast was used to fix the repayment schedule.⁴⁰ This situation is different from that before the *Australia - Leather* panel, where the relevant payments were "conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets".⁴¹ For these reasons, we disagree with Brazil that the logic of the *Australia - Leather* panel applies in the present case.

5.33 Furthermore, we note that Part 4 of the "new" TPC Investment Decision Document requires TPC administrators to record the "[b]enefits [of the project] to Canada". Section 5 of the "new" TPC Investment Application Guide defines "technological and net economic benefits to Canada" as "increasing economic growth, creating jobs and wealth, and supporting sustainable development". Nowhere in these documents is increased export performance identified as a "technological" or "net economic benefit" to Canada. Indeed, Part 4 of the aforementioned Investment Decision Document explicitly provides that "TPC will not accept or consider information concerning the extent to which a company does or may export". The only conclusion that we can reach from the face of these documents is that projects will be compared against one another, and eventually selected for funding, on the basis *inter alia* of the amount of technological and/or net economic benefits to which they are expected to give rise. While it is clear that for some projects, these benefits will derive largely or exclusively from exports, there is no factual basis in the documents (which are at this point the only available evidence) on which to conclude that projects generating the most *exports* will be those selected for funding. Indeed, the documents indicate that the administrators simply will not have specific information about the volume of exports that might result from any project for which TPC

³⁶ The *Australia - Leather* panel found that relevant payments were "conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets" (see *Australia - Leather*, WT/DS126/R, para. 9.71).

³⁷ Brazil's reply to the Panel's TPC question 3 (Annex 1-5).

³⁸ Comments of Canada on Brazil's replies to questions (Annex 2-5) at para. 11.

³⁹ According to an Industry Canada News Release dated 18 November 1999 (Exhibit BRA-18, page 4) repayment schemes will be based on "e.g. royalties on total company or division sales ...". We note that the use of sales forecasts in the context of royalty-based financing schemes in the civil aircraft sector is not uncommon, and on its own appears to have no particular implications under the SCM Agreement, as evidenced by footnote 16 of that Agreement ("Members recognize that where royalty-based financing for a civil aircraft programme is not being fully repaid due to the level of actual sales falling below the level of forecast sales, this does not in itself constitute serious prejudice ...").

⁴⁰ Furthermore, we note that the royalties that will form the basis of any royalty-based financing scheme will be "royalties on total company or division sales", and not "royalties tied to product sales" (see 18 November 1999 Industry Canada press release (Exhibit BRA-18)). Presumably, therefore, the sales forecasts referred to by Brazil will be company- or division-wide. We are reluctant to conclude that the fulfilment of company- or division-wide sales forecasts could constitute a condition for the grant of product- or project-specific assistance.

⁴¹ *Australia - Leather*, para. 9.71.

funding is sought. Thus, whereas TPC assistance is conditional on a project having certain technological or net economic benefits to Canada, in our view this simply cannot be assumed to be synonymous with export performance, and therefore it does not mean *ipso facto* that such assistance is contingent on export performance. This remains true even though TPC administrators know that fulfilment of net economic benefits in certain cases may be likely to result in increased exports. The fact that they will have no concrete quantifiable information on exports in our view will act in practical terms to limit their discretion to select projects on the basis of export performance.

5.34 For the above reasons, we are not persuaded that "new" TPC assistance to the regional aircraft industry will be implicitly conditioned on, or tied to, export performance as a result of an intimate "link" between (1) the fulfilment of the "new" TPC goals and objectives and (2) exports.

(iv) *Documentation*

5.35 Brazil notes that a large proportion of "old" TPC documents, some of which were relied on by the Panel in our original findings of *de facto* export contingency, have not yet been replaced or amended or, if they have, they have not yet been provided to the Panel. Brazil considers that these documents have therefore not been cleansed of references to the term "export", despite Brazil's understanding that Canada claims to have implemented the recommendations and ruling of the DSB "by removing references to the term 'export' from TPC documents".⁴² Brazil claims that the failure to replace or amend the relevant "old" TPC documents demonstrates that Canada has failed to implement the DSB's recommendation by failing Canada's own measure of what constitutes effective implementation, namely the removal of references to "export" from TPC documents. In the alternative, Brazil claims that Canada's failure to provide certain "new" TPC documents supports a presumption that as-yet-unreplaced TPC documents supporting the Panel's original inference of *de facto* export contingency still apply.

5.36 Canada acknowledges that not all TPC documents have yet been replaced. However, Canada asserts that the key TPC documents (the Terms and Conditions and the Special Operating Agency ("SOA") Framework Document) are in place, and that all subsidiary TPC documents must respect the authority provided in these key documents. This authority explicitly requires that TPC be administered in accordance with Canada's international obligations, including its WTO obligations. Canada further asserts that no "old" TPC documents are valid under the "new" TPC programme, and that "old" TPC documents no longer exist for the purposes of the "new" TPC programme.

5.37 As a preliminary matter, we do not understand Canada to have argued that it has implemented the DSB recommendation on TPC assistance to the Canadian regional aircraft industry by, in Brazil's own words, "removing references to the term 'export' from TPC documents". Brazil has failed to cite to any Canadian submission to the Panel which contains any such argument. We therefore reject Brazil's claim that Canada has failed to implement the DSB recommendation by Canada's own measure of what constitutes effective implementation.

5.38 It is regrettable that Canada has not yet been able to finalize all documents concerning the operation of the "new" TPC programme, since those documents may have provided useful insight into the operation of the "new" TPC programme in respect of the Canadian regional aircraft industry. However, we note that the two key TPC documents are in place, and that Brazil has failed to demonstrate⁴³ that anything in these documents leads to an inference of export contingency. We also

⁴² Second submission of Brazil (Annex 1-2) at para. 51.

⁴³ As discussed above, we are not persuaded by Brazil's arguments concerning the alleged "link" between export performance and fulfilment of the TPC goals and objectives set forth in the Terms and Conditions.

note Canada's assertion that all subsidiary TPC documents must respect the authority contained in those two key documents.

5.39 Furthermore, we note Canada's assertion that "old" TPC documents are no longer valid, and "no longer exist for the purposes of TPC as it is now constituted".⁴⁴ In the absence of any evidence from Brazil leading us to doubt this assertion, we see no reason why we should presume that as-yet-unreplaced -- but invalid -- TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. Indeed, we recall that the "new" TPC Investment Application Guide provides that "TPC will not accept or consider information concerning the extent to which your company does or may export". The continued application of any of the "old" TPC documents relied on by the Panel in our original findings of *de facto* export contingency would be manifestly at odds with this statement.

5.40 In light of the above, we see no basis for relying on previous TPC documents, which are no longer applicable, and which were a contributory factor that helped to demonstrate the *de facto* export contingency of "old" TPC assistance to the regional aircraft industry, to conclude that "new" TPC assistance to the regional aircraft industry will also be *de facto* contingent on export performance.

5.41 For these reasons, we are unable to find that Canada has failed its own measure of what constitutes effective implementation (*i.e.*, the removal of references to "export" from TPC documents), and we are equally unable to presume that as-yet-unreplaced -- but invalid -- TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. Indeed, with regard to the "new" TPC documentation that has been made available by Canada, we find it difficult to imagine what additional elements could usefully have been included by Canada to demonstrate that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance.

Conclusion

5.42 For the above reasons, we are unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. Our conclusion is based on our analysis of those facts currently surrounding the application of the restructured TPC programme which are relevant to Canada's implementation of the DSB recommendation on TPC assistance to the regional aircraft industry. Of course, the facts surrounding the application of the restructured TPC programme may change. The above conclusion in no way prejudices the issue of whether TPC assistance to the regional aircraft industry granted in the context of changed factual circumstances would, or would not, be *de facto* contingent on export performance in the future.

(d) Alternative implementation methods

5.43 We recall Brazil's argument that Canada be required to implement the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry by withdrawing the TPC programme altogether with regard to the Canadian regional aircraft industry. We note that withdrawal of the TPC programme from the Canadian regional aircraft industry would exceed the minimum implementation standard agreed on by the parties (*i.e.*, to ensure that future TPC assistance to the Canadian regional aircraft industry will not be *de facto* contingent on export performance). Since we have concluded that Canada has fulfilled the minimum implementation standard agreed on by the parties, the question of whether or not Canada should do more (by withdrawing the TPC programme altogether from the Canadian regional aircraft industry) is not a relevant issue.

⁴⁴ Oral statement of Canada (Annex 2-3) at para. 45.

5.44 In addition, Brazil also argued that Canada could implement the DSB recommendation on TPC assistance to the Canadian regional aircraft industry either by making TPC generally available, or by ensuring that future assistance did not take the form of a subsidy. However, we do not understand Brazil to argue that Canada has failed to implement the DSB recommendation by failing to take either course of action. It is therefore not necessary for us to consider this matter further.

(e) Repayment of prior TPC assistance to the Canadian regional aircraft industry

5.45 We recall that Brazil made a conditional request for repayment of prior TPC assistance to the Canadian regional aircraft industry. Brazil has clearly stated that this "is an alternative, though not a preferred, remedy".⁴⁵

5.46 Brazil's request for repayment is conditional on either or both of two scenarios materialising: first, if the Panel considers itself required to follow the interpretation of Article 4.7 of the SCM Agreement offered by the panel in *Australia - Leather Article 21.5*; second, if the Panel considers that it cannot render a judgement concerning Brazil's allegations of *de facto* export contingency under the restructured TPC programme as a result of the absence of any financial contributions made under the restructured programme. In the latter case, Brazil considers that it will be left without an "effective remedy" apart from the retroactive repayment of past TPC assistance to the Canadian regional aircraft industry.

5.47 With regard to the first condition, we are aware that the *Australia - Leather Article 21.5* panel recently found that a DSB recommendation to "withdraw" a prohibited export subsidy under Article 4.7 of the SCM Agreement "is **not** limited to prospective action only but may encompass repayment of the prohibited subsidy".⁴⁶ However, Brazil has explicitly expressed the "hope"⁴⁷ that the Panel does not consider itself bound to follow *Australia - Leather Article 21.5*. Indeed, Brazil "believes that the Panel in *Australia - Leather [Article 21.5]* reached a result that is not required by the language of the [SCM] Agreement"⁴⁸, and "does not believe that this or any other Panel should follow *Australia - Leather [Article 21.5]*".⁴⁹

5.48 In light of these comments by Brazil, we consider that Brazil does not in fact want us to make any finding along the lines of *Australia - Leather Article 21.5*. The same is more obviously true of Canada⁵⁰. As noted above, we consider that a panel's findings under Article 21.5 of the DSU should be restricted to the scope of the "disagreement" between the parties. In the present case, therefore, we do not consider it necessary to make any finding as to whether Article 4.7 of the SCM Agreement may encompass repayment of subsidies found to be prohibited.

5.49 The second condition attached to Brazil's request for repayment of past TPC assistance to the Canadian regional aircraft is based on Brazil understanding Canada to argue that the Panel is precluded from finding whether "new" TPC assistance to the regional aircraft industry will be *de facto* contingent on export performance because Canada has not provided any such assistance under the "new" TPC programme. Brazil considers that if the Panel were to follow such an approach, Brazil would be left without any "effective remedy" other than repayment of past assistance.

⁴⁵ Brazil's reply to the Panel's TPC question 6 (Annex 1-5).

⁴⁶ *Australia - Leather Article 21.5*, para. 6.39, emphasis in original.

⁴⁷ Oral statement of Brazil (Annex 1-3) at para. 30.

⁴⁸ *Id.* at para. 27.

⁴⁹ *Id.* at para. 34.

⁵⁰ Canada informed the Panel that, in the *Brazil - Aircraft Article 21.5* proceedings, Canada "indicated very clearly that its interpretation of the obligation to withdraw export subsidies under Article 4.7 of the [SCM] Agreement does not allow for a retroactive withdrawal of subsidies that have already been granted" (Oral statement of Canada (Annex 2-3) at para. 88).

5.50 We are in no doubt that Brazil has misunderstood Canada's position. Canada has asserted that it "manifestly did not take" the position understood by Brazil. Canada has confirmed that it "believes that this Panel can - and indeed should - assess whether the restructured TPC programme implements the DSB's rulings and recommendations regarding de facto export contingency".⁵¹ Thus, both Canada and Brazil agree that the Panel should examine the "new" TPC programme, even in the absence of any assistance to the Canadian regional aircraft industry having been granted under that "new" programme.

5.51 In light of the above, neither of the conditions attached to Brazil's alternative request for repayment have been met. We therefore do not consider it necessary to address the substance of that request.

(f) Summary

5.52 In summary, we are unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry. Moreover, we have found that it is not necessary to consider the alternative implementation methods identified by Brazil. Finally, we have found that neither of the conditions attached to Brazil's request for repayment have been met.

B. CANADA ACCOUNT

1. Summary of original *Canada - Aircraft* findings on Canada Account

5.53 The Canada Account operates under the mandate of the EDC, and, per EDC's 1995 annual report, is used to "support export transactions which the federal government deems to be in the national interest but which, for reasons of size or risk, [the EDC] cannot support through regular export credits"⁵².

5.54 Regarding whether the Canada Account financing conferred subsidies, we found, on the basis of evidence concerning two financing transactions at "close to commercial" terms, that Canada Account financing in the regional aircraft sector provided subsidies, as, in our view, the reference to "close to commercial" terms constituted evidence which Canada failed to rebut that the financing was provided on below-market terms. Concerning the question of export contingency, the Panel found, on the basis of an admission by Canada that all debt financing from EDC (under which the Canada Account operates) in the civil aircraft sector since January 1995 had taken the form of export credits, and on the basis of the EDC's announced purpose in providing financing to support and develop directly or indirectly Canada's export trade, that Canada Account financing was contingent in law on export performance. Thus we found that "the Canada Account debt financing at issue constituted prohibited export subsidies", and that "Canada Account financing since 1 January 1995 for the export of Canadian regional aircraft constitute[s] export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement"⁵³.

5.55 Neither party raised an appeal specifically concerning our finding on Canada Account, but Canada did appeal as a horizontal issue our determination that the existence of a "benefit" in the sense of SCM Article 1 should be determined on the basis of a comparison with the market. The Appellate Body upheld this market-based approach.

⁵¹ Oral statement of Canada (Annex 2-3) at para. 30.

⁵² EDC 1995 Annual Report, "Canada Account Profile" (cited in para. 9.211 of our report in the original dispute (WT/DS70/R)).

⁵³ We recall that Canada did not seek to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies in Annex 1 of the SCM Agreement.

2. Summary of the parties' arguments

(a) The measure at issue

5.56 Canada identifies two types of measures concerning Canada Account which it states implement the Panel's recommendation, mandated by SCM Article 4.7, to "withdraw the subsidies without delay".

5.57 Canada argues *first*, that the two transactions examined by the Panel have been completed (in 1996 and 1998), so that there will be no further deliveries of regional aircraft under these transactions, and that no new Canada Account financing has been granted in the regional aircraft sector since 18 November 1999 (*i.e.*, the expiry of the 90-day period for withdrawal of the prohibited Canada Account subsidies⁵⁴). Thus, Canada asserts that it has completed the (past) financing transactions under the Canada Account found by the Panel to be subsidies contingent in law upon export performance⁵⁵. Brazil does not challenge this assertion, nor does Brazil seek further action by Canada with respect to these past subsidies. Given that there is no "disagreement" between the parties concerning Canada's implementation in respect of the past Canada Account subsidies, we do not consider further this aspect of that implementation.⁵⁶

5.58 *Second*, Canada indicates that it has adopted a new Policy Guideline to the effect that any future Canada Account financing for regional aircraft will comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* ("the *OECD Arrangement*" or "the *Arrangement*")⁵⁷. In Canada's view, the Policy Guideline means that any such financing would *not* be considered prohibited export subsidies pursuant to the second paragraph of item (k) of the Illustrative List of Export Subsidies ("the Illustrative List") found in Annex I to the SCM Agreement. The specific wording of the Guideline is that any transaction or class of transactions under Canada Account "which does not comply with the *OECD Arrangement on Guidelines for Officially Supported Export Credits* would not be in the national interest"⁵⁸. Canada states that the Guideline operates such that any future Canada Account transactions that do not comply with the *OECD Arrangement* would not be in the national interest. Given that under the EDC legislation, the Minister for International Trade, whose authorization is required, can only authorize financing under the Canada Account that is found to be in the national interest, and as financing that does not comply with the *OECD Arrangement* will be deemed by the Minister not to be in the national interest, Canada argues that prohibited export subsidies can no longer be provided under Canada Account. That is, Canada maintains, to the extent that any future Canada Account financing constitutes export subsidies in the sense of SCM Articles 1 and 3, it will be covered by the "safe harbour" of the second paragraph of item (k) of the Illustrative List, under which (in Canada's words) export credits that "comply" with "the interest rates provisions" of the *OECD Arrangement* are not to be considered prohibited export subsidies⁵⁹.

⁵⁴ WT/DS70/R, para. 10.4.

⁵⁵ First submission of Canada (Annex 2-1) at para. 62.

⁵⁶ We recall that the scope of Article 21.5 proceedings is in principle defined by the scope of the "disagreement" between the parties as to implementation (see para. 5.10 above).

⁵⁷ Although the Panel's ruling concerned Canada Account financing only in the regional aircraft sector, according to Canada the new policy guideline applies to all Canada Account financing.

⁵⁸ Exhibit CDN-13.

⁵⁹ See, e.g., Oral statement of Canada (Annex 2-3) at para. 68. We note that Canada uses the term "comply with" in the Policy Guideline and in certain of its arguments, while the second paragraph of item (k) uses the term "conformity with". We understand Canada's argument to be that any future Canada Account transactions will be eligible for the safe haven in the second paragraph of item (k). Thus we assume that Canada intends to refer to "conformity with" when it uses the term "comply with". This assumption appears to be confirmed by Canada's assertion that the Policy Guideline "does ensure that any future Canada Account

5.59 We note that the scope of our ruling in the original dispute of necessity determines the nature/scope of the measures that Canada needs to take in order to implement our recommendation to withdraw the subsidy. In particular, the question is whether our ruling was limited to the two transactions that we examined in the original dispute⁶⁰ or covered the Canada Account programme as a whole (at least in respect of the regional aircraft sector), as applied.

5.60 In this regard, Brazil argues that our ruling was not limited to the two transactions that we examined in the original dispute. Rather, Brazil believes that our ruling went beyond these transactions and covered the Canada Account programme as a whole, as applied. Thus, Brazil argues, Canada has an obligation to do more than simply complete the two transactions and refrain from providing new financing, and must at a minimum demonstrate that prohibited export subsidies *cannot* be provided via the Canada Account in the *future*. Thus, for Brazil, the measure at issue in this dispute is the action taken by Canada in respect of the *future application* of the Canada Account *programme*.

5.61 We note that Canada's view concerning the scope of our original ruling and thereby the scope and nature of the measure at issue is consistent with that of Brazil. In particular, Canada states that "[a]lthough the Panel's conclusion concerned the programme as applied, it did not appear to be limited by its terms to the two transactions that had been before the Panel. Consequently, Canada understood the Panel ruling to mean that it was essential to take steps to ensure that any future financing transactions involving regional aircraft would be consistent with Canada's obligations under the SCM Agreement". Canada argues that it has done so, by issuing the Policy Guideline "making clear that any financing transaction not in compliance with the *OECD Arrangement* (necessarily including the interest rates provisions thereof), will not be approved for Canada Account financing"⁶¹. Thus, Canada argues, future Canada Account transactions will be consistent with Canada's obligations under the SCM Agreement in that they will qualify for the safe haven in the second paragraph of item (k) of the Illustrative List⁶².

5.62 We agree with the parties concerning the scope of our original ruling. Specifically, that ruling covered Canada Account as applied in the regional aircraft sector. In our view, therefore, this gives rise to an obligation on Canada's part to address elements of the Canada Account *programme* in order to implement the DSB's recommendation. Thus, the measure at issue in this dispute is the actions taken by Canada in respect of the Canada Account *programme*, namely, the Policy Guideline.

(b) Standard for assessing Canada's implementation

5.63 Our task is to assess whether the Policy Guideline is inconsistent with Canada's obligation to "withdraw" the prohibited subsidies under the Canada Account. We do not believe that it is necessary for us to develop a comprehensive definition of the term "withdraw the subsidy" (the only available remedy for prohibited subsidies pursuant to SCM Article 4.7) to be able to make this assessment. Rather, it is sufficient to conclude (and we note that the parties seem to agree with this) that a Member cannot be understood to have withdrawn a prohibited subsidy if it has not *ceased to provide* such a

financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement ..." (see para. 5.72 below).

⁶⁰ These were the only two Canada Account transactions involving the regional aircraft sector during the period covered by our initial review in this dispute (1 January 1995 - 30 June 1998).

⁶¹ Canada's reply to the Panel's Canada Account question 5 (Annex 2-4).

⁶² We note here that there is no disagreement between the parties that Canada Account financing remains contingent on export performance, as Brazil has argued that this is the case and Canada has not contested this argument. In fact, Canada does not even argue that *subsidies* will not continue to be provided in the regional aircraft sector. Rather, Canada's argument is that any future Canada Account subsidies for regional aircraft will not be *prohibited* by virtue of qualifying for the safe haven of the second paragraph of item (k).

subsidy, as that Member therefore would not have ceased to violate its WTO obligations in respect of such a subsidy. In our view, therefore, Canada's obligation arising from the DSB's recommendation concerning prohibited subsidies under the Canada Account includes the obligation to cease providing prohibited export subsidies to the regional aircraft sector.

5.64 We note that in the circumstances of this Article 21.5 proceeding concerning Canada Account, such an assessment is by nature forward-looking. That is, the simple absence of new Canada Account transactions in the regional aircraft sector since 18 November 1999 does not provide a sufficient basis for us to conclude one way or another as to whether prohibited export subsidies under that programme have ceased. Rather, to be able to reach a conclusion on this issue, we must consider the Policy Guideline in terms of its effects on the *future application* of the Canada Account *programme*. Here again, we note that the parties do not disagree.

5.65 This raises the question of what standard we should use to make such a determination. We note that the parties' arguments indicate that both consider the correct standard to be whether or not the Policy Guideline "ensures" that prohibited subsidies have ceased. Brazil states, for example, that Canada is required, through implementation, "at a minimum to *ensure* that prohibited export subsidies via the Canada Account *cannot* be granted"⁶³. Canada for its part also accepts the appropriateness of the "ensure" standard, as it argues that the Policy Guideline "*ensure[s]* that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)"⁶⁴.

5.66 Since there is no disagreement between the parties on this matter, we consider that the standard put forward by the parties, that of "ensuring" the cessation of prohibited export subsidies in the future, is appropriate in this case. Thus, we shall examine whether the Policy Guideline is sufficient to "ensure" that in future the Canada Account programme, as it will be applied, will not provide prohibited export subsidies to the Canadian regional aircraft industry.

(c) Sufficiency of the Policy Guideline

5.67 The parties disagree over the sufficiency of the Policy Guideline as a means of ensuring that in future Canada Account will not provide prohibited export subsidies to the regional aircraft sector, as to both its substance and its form.

5.68 As noted, Brazil argues as a general matter that Canada is required, through implementation, "at a minimum to ensure that prohibited export subsidies via the Canada Account *cannot* be granted"⁶⁵. In other words, Brazil seeks an assurance that prohibited export subsidies through Canada Account have definitively ceased. Brazil argues that the Policy Guideline lacks any precision and therefore is inadequate to constitute such an assurance. We recall as set forth in para. 5.14 that Brazil, as the complaining party, bears the burden of proof in this dispute, specifically to establish that Canada has failed to "ensure" that future Canada Account transactions in the regional aircraft sector will not provide prohibited export subsidies.

5.69 Brazil argues that the Guideline simply states that as a policy matter, the Minister for International Trade will not approve transactions that are not in compliance with the *OECD Arrangement*. For Brazil, the Policy Guideline is a "vague hortatory statement[]" regarding Canada's intentions. Brazil specifically takes issue with Canada's argument that the Guideline states an intention to meet the criteria to qualify for an exception under the second paragraph of item (k) of the Illustrative List of export subsidies through conformity with the "interest rates provisions" of the

⁶³ Second written submission of Brazil (Annex 1-2) at para. 19. Emphasis supplied.

⁶⁴ Oral statement of Canada (Annex 2-3) at para. 67. Emphasis supplied.

⁶⁵ Second written submission of Brazil (Annex 1-2) at para. 19. Emphasis supplied.

OECD Arrangement. Brazil argues that the Guideline does *not* say this, and that even if it did, Canada does not define the interest rate provisions with which it intends to comply, or how it will apply those provisions. Without such precision, it is not evident to Brazil that Canadian practices would qualify for the specific “safe haven” in the second paragraph of item (k). In particular, Brazil points to the fact that, whereas the second paragraph of item (k) refers specifically to conformity with “the interest rates provisions” of the *OECD Arrangement*, the Policy Guideline refers to compl[iance] with “the OECD Arrangement” more generally. In Brazil’s view, this difference in terminology, along with the absence of any detail in the Policy Guideline as to what Canada means by compliance with “the OECD Arrangement” and the basis on which eligibility of Canada Account transactions for the safe haven in the second paragraph of item (k) will be judged, means that the Policy Guideline is insufficient to implement the DSB’s recommendation.

5.70 In Brazil’s view, Canada’s “minimum burden” with respect to implementation concerning the Canada Account is to “explain with some precision what ‘comply with the OECD Arrangement’ will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in future”; and Canada has failed to discharge this burden. In other words, for Brazil, Canada has the burden of demonstrating its entitlement to the “positive defense” offered by the second paragraph of item (k).

5.71 Concerning the question of substantive compliance with the *OECD Arrangement*, Canada agrees with Brazil that the burden would be on Canada, as the one making use of the “exception” to the SCM Agreement set forth in the second paragraph of item (k) of the Illustrative List, to prove that it is entitled to that exception. Canada appears to differ with Brazil concerning the timing, however. Whereas Brazil believes that this burden exists now, Canada argues that it would need to be satisfied only at such future point as Canada invoked the second paragraph of item (k) and were challenged with respect to that defense.

5.72 In terms of effectiveness, however, Canada argues that the Policy Guideline “does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)”. That is, Canada argues that any future Canada Account financing that otherwise would constitute an export subsidy will fall within the safe haven of the second paragraph of item (k) and thus not be prohibited under the SCM Agreement.

3. Evaluation by the Panel

5.73 As noted, Canada’s defense to Brazil’s claim is that the Policy Guideline ensures that all future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k). Thus, to be able to determine whether this is the case, we must resolve basic interpretational issues concerning that provision.

5.74 First, we must determine what constitute “export credit practices” in the sense of the second paragraph of item (k). Thereafter, we must consider how to make a determination in respect of the “conformity” of such practices with the “interest rates provisions” of the relevant “international undertaking”, specifically, the *OECD Arrangement*. In considering this issue, we turn to a detailed examination of the *text*⁶⁶ of the *OECD Arrangement*⁶⁷, as whatever the scope of the term “export

⁶⁶ We recall that Article 31.1 of the *Vienna Convention on the Law of Treaties* provides that a treaty shall be interpreted “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.

⁶⁷ We recall that the *EC - Bananas III* panel found it necessary to interpret certain provisions of the *Lomé Convention*, since it was referred to in the WTO General Council’s *Lomé waiver* (WT/DS27/R/USA, para.

credit practices” in the sense of the second paragraph of item (k), at present only such practices that are “in conformity with the interest rates provisions” of that *Arrangement* qualify for the safe haven of the second paragraph of item (k).

5.75 After our review of the *Arrangements* text, we next consider a number of systemic issues that arise in the context of the second paragraph of item (k). In particular, we evaluate our conclusions drawn from the texts of item (k) and of the *Arrangement* in the light of the context of item (k) and the object and purpose of that provision and the SCM Agreement. In particular, we consider whether our conclusion based on the texts is consistent with the overall object and purpose of the SCM Agreement of disciplining trade distorting subsidies while at the same time maintaining special and differential treatment for developing countries in respect of export subsidies.

5.76 In the light of our conclusions on the above issues, we then need to consider whether the Policy Guideline does, as Canada argues, ensure in respect of the Canada Account programme that any future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k).

(a) Textual analysis of the second paragraph of item (k)

5.77 Before commencing our detailed textual analysis, we recall that the second paragraph of item (k) reads as follows:

"Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement".

5.78 It is well accepted that the *OECD Arrangement* is an "international undertaking on official export credits" in the sense of the second paragraph of item (k).⁶⁸ Moreover, in practice the *OECD Arrangement* is at present the only international undertaking that fits this description. Thus, we understand the essence of the second paragraph of item (k) at least at present to be that "an export credit practice" which is in "conformity" with "the interest rates provisions" of the *OECD Arrangement* "shall not be considered an export subsidy prohibited by" the SCM Agreement⁶⁹.

7.97). We likewise consider it necessary to interpret certain provisions of the *OECD Arrangement*, since it is referred to in the second paragraph of item (k) of Annex I of the SCM Agreement.

⁶⁸ This was confirmed by the Appellate Body in *Brazil - Aircraft*, WT/DS46/AB/R, para. 180, adopted 20 August 1999.

⁶⁹ We take note of the reference to "a successor undertaking" in the second paragraph of item (k). In this regard, first, it is clear from this reference that to the extent that the *Arrangement* today is the only undertaking of the kind referred to in the second paragraph of item (k), if in the future a "successor undertaking" were to take effect, export credit practices conforming with the interest rate provisions of that undertaking also would be eligible for the safe haven in that paragraph. Thus, our detailed analysis of the *Arrangement* in its *present* form is not in any way intended to exclude this possibility. Second, for purposes of our analysis of the *Arrangement*, we assume that the *Sector Understandings* on Export Credits for Ships, for Nuclear Power Plant, and for Civil Aircraft, contained in Annexes I-III of the *Arrangement*, form an integral part of the *Arrangement* itself. Even if in the strict sense this were not the case (an issue that we do not here decide), in our view these *Sector Understandings* at a minimum would constitute "successor undertakings" in the sense of the second paragraph of item (k), as the *Arrangement* as originally implemented in 1979 did not contain these Annexes. Rather, its very brief sector-specific provisions (which at the time pertained to conventional power plants, to ground satellite communications stations, and to ships) were contained in paragraph 4 of its main text. The

5.79 Given this, in practice eligibility for item (k)'s safe haven from the prohibition on export subsidies is defined entirely in terms of the *OECD Arrangement*, at least for the time being. Thus, the critical element of our analysis must be to examine the *Arrangement* in detail, to determine what it applies to and how conformity with its interest rate provisions can be determined. We consider therefore that before we can come to any judgement as to the sufficiency or insufficiency of the Policy Guideline to ensure that all transactions under the Canada Account will be eligible for the safe haven in item (k), as Canada argues, we must determine the answers to the following questions: (1) what are "export credit practices" in the sense of item (k) of the Illustrative List; (2) what are the "interest rates provisions" of the *OECD Arrangement*; (3) which types of export credit practices conceptually could be in conformity with the interest rate provisions of the *Arrangement* in its current form; (4) what provisions and considerations are relevant to judging conformity with the *Arrangement's* interest rates provisions? Only once we have answered these questions will we be in a position to judge whether the Canada Account Policy Guideline is sufficient to ensure that Canada Account transactions in the future will qualify for the safe haven of the second paragraph of item (k) (or at any rate should be presumed to qualify therefor, in the absence of evidence to the contrary).

(i) What are "export credit practices" in the sense of item (k) of the Illustrative List of Export Subsidies?

5.80 Because at the most basic level the safe haven in the second paragraph of item (k) is available only for certain "export credit practices", we must first consider the definition and scope of this term. We consider that in its ordinary meaning, this must be a relatively broad term. That is, this term on its own suggests any practices that might be associated in some way with export credits (i.e., export financing). This certainly would involve export credits as such, but presumably other sorts of practices as well. The first paragraph of item (k) provides useful context in this regard. In particular, we note that the first paragraph refers exclusively to "export credits" and "credits", in contrast to the second paragraph's reference to "export credit practices". This supports the conclusion that the second paragraph of item (k) concerns a *broader* range of "practices" than export credits as such.

5.81 In our view, the *OECD Arrangement* provides further context for understanding the term "export credits", particularly in view of the role of the *Arrangement* in determining qualification of the safe haven in the second paragraph of item (k). Here we note in particular the stated "scope of application" of the *Arrangement*, found in its Article 2, namely "all official support for exports of goods and/or services, or to financial leases" with repayment terms of two years or more, as well as tied aid⁷⁰. This supports our view of the broad meaning of "export credit practice". Furthermore, we can conceive of no basis to consider any practice associated with export credits as *a priori* not constituting an "export credit practice" in the sense of the second paragraph of item (k).⁷¹

Sector Understandings were negotiated and implemented later, and incorporate by reference provisions of the *Arrangement*. Thus, if they are not formally integral to the *Arrangement*, there is no doubt that these *Understandings* at a minimum constitute successor undertakings, and thus, conformity with the "interest rates provisions" of the *Understandings* would qualify an export credit practice for the safe haven in the second paragraph of item (k).

⁷⁰ Canada states that, pursuant to the *Arrangement's Sector Understanding on Export Credits for Civil Aircraft*, tied aid for aircraft is not permitted except for humanitarian purposes. (Oral statement of Canada (Annex 2-3) at Attachment, footnote 1.)

⁷¹ As discussed below, this does not mean that all such practices can be "in conformity with" the interest rate provisions of the *OECD Arrangement*. However, while there may be no basis in the *Arrangement* in its current form to judge the "conformity" of all such practices with the *Arrangement's* "interest rates provisions" (i.e., those provisions simply may not apply to all such practices), this clearly does not *a priori* exclude the possibility that new provisions or undertakings might be developed in the future that would permit such a judgement in respect of such practices.

(ii) *What are the Arrangement's "interest rates provisions"?*

5.82 Before considering in detail the question of the *OECD Arrangement's* "interest rates provisions" and "conformity" therewith, we note that in its own words, the *Arrangement* is a "Gentlemen's Agreement" among its participants, which "seeks to encourage competition among exporters from the OECD-exporting countries based on quality and price of goods and services exported rather than on the most favourable officially supported export credits", by placing "limitations on the terms and conditions of export credits that benefit from official support", including minimum premium benchmarks, the minimum cash payments to be made at or before the starting point of credit, maximum repayment terms and minimum interest rates which benefit from official financing support. Thus, it "sets out the *most generous* repayment terms and conditions that may be supported". The *Arrangement* applies to officially supported export credits with repayment terms of two years or more, relating to exports of goods and/or services or to financial leases, and addresses the circumstances in which official support in the form of trade-related tied and partially untied aid may be given and/or mixed with officially supported export credits⁷². It contains, in addition to its main text, special *Sector Understandings* which apply to aircraft, ships and nuclear power plant. The Participants to the *Arrangement*, as listed in Article 1(a) thereof, are "Australia, Canada, the European Community (which includes the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom) Japan, Korea, New Zealand, Norway, Switzerland, and the United States"⁷³.

5.83 To answer the question of which are the interest rate provisions of the *Arrangement*, we once again turn to its ordinary meaning. Here we note that there is no section of the *Arrangement* entitled "Interest rates provisions", nor does the *Arrangement* use or define this term. Nevertheless, we note that there are a number of provisions that specifically address interest rates as such. These are Article 15 – Minimum Interest Rates; Article 16 – Construction of CIRRs; Article 17 – Application of CIRRs; Article 18 – Cosmetic Interest Rates; and Article 19 – Official Support for Cosmetic Interest Rates. (In addition, in the specific context of this dispute, Article 22 of the *Sector Understanding on Export Credits for Civil Aircraft*⁷⁴ covers minimum interest rates with respect to all new aircraft except large aircraft⁷⁵, along with spare engines, spare parts, maintenance and service contracts in respect of those aircraft⁷⁶, and Article 28(b) covers minimum interest rates with respect to used aircraft.)

5.84 Among these provisions, Article 15 appears to contain the basic interest rate provisions of the *Arrangement*, as the other provisions identified that specifically address interest rates seem to be dependent on and thus subordinate to it. Specifically, Article 15 establishes the basic rule that "minimum interest rates" are to be applied, i.e., respected, by all Participants when providing "official financing support". After establishing as a general principle the application of "minimum interest rates", Article 15 goes on to specify that the Commercial Interest Reference Rates ("CIRRs"), "shall"

⁷² *OECD Arrangement*, "Introduction" section. Emphasis added.

⁷³ Article 1(b) further provides that "[o]ther countries willing to apply these Guidelines may become Participants following prior invitation of the existing Participants".

⁷⁴ Annex III of the *OECD Arrangement*.

⁷⁵ We note that, according to the list of aircraft models in the *Sector Understanding* on civil aircraft, aircraft with up to 70 seats are classified as other than large aircraft. This is consistent with information provided during the original dispute, i.e., that regional aircraft generally are in the 30-70 seat range. (WT/DS70/R, at footnote 535).

⁷⁶ Spare engines, spare parts, maintenance and service contracts are covered by Part 3 of the *Sector Understanding* concerning civil aircraft. Article 27 of that *Understanding* provides that except as specifically set forth in Part 3, the relevant provisions of Parts 1 and 2 apply to spare engines, spare parts, and maintenance and service contracts. As there are no specific provisions in Part 3 concerning interest rates, the applicable interest rates for spare engines, spare parts, maintenance and service contracts in respect of regional aircraft thus would be those in Part 2 (i.e., the CIRRs).

be applied. Specifically in respect of regional aircraft, Articles 22 and 28(b) of Annex III (the *Sector Understanding* for civil aircraft) provide that the CIRRs “shall” apply.

5.85 We note that the basic rule, that “minimum interest rates shall apply” is worded in a general manner, suggesting the possibility that more than one framework or system of “minimum interest rates” (i.e., other than the CIRRs) could be agreed under the *Arrangement*, and that to the extent that this is the case, these other systems also would constitute particular “minimum interest rates” in the sense of the *Arrangement*. Indeed this is the case with respect to the *Sector Understandings* for ships (which applies a minimum interest of 8 per cent in all cases) and for nuclear power plant (which applies “Special Commercial Interest Reference Rates”). We note further, however, that at present, the only “minimum interest rates” referred to in (and thus covered and regulated) by the main text of *Arrangement* are the CIRRs, and that as indicated, the CIRRs apply to regional aircraft, pursuant to the Articles 22 and 28(b) of the *Sector Understanding* for civil aircraft.

5.86 With respect to the CIRRs, Article 15 contains a number of general rules, all essentially oriented toward ensuring that the CIRRs reflect commercial fixed-interest lending rates and practices. In particular, Article 15 states that the CIRRs should represent final commercial lending interest rates in the domestic market of the currency concerned, that they should closely correspond to the rate for first-class domestic borrowers, that they should be based, where appropriate, on the funding cost of fixed interest-rate finance over a period of no less than five years, that they should not distort domestic competitive conditions, and that they should closely correspond to a rate available to first-class foreign borrowers.

5.87 Article 16 puts into concrete technical terms how CIRRs are to be constructed, i.e., on the basis of a fixed margin over government bond yields of varying maturities. More specifically, this Article provides that the CIRR for a currency generally should be at a fixed margin of 100 basis points above a base rate, which in turn is set at either a three-year, five-year or seven-year government bond yield, depending on the repayment terms of the financing in question, or at a five-year government bond yield for all maturities, at the option of the country providing the support⁷⁷. Article 16 also provides that countries lending in a currency other than their own shall apply the CIRRs for that currency. Finally, Article 16 contains provisions whereby a country can change the base rate system that it applies, and whereby a CIRR can be established for the currency of a non-Participant (if a Participant wishes to provide official support in that currency).

5.88 Article 17, concerning the application of CIRRs, limits the amount of time in which interest rates can be fixed, and imposes an additional margin over the CIRR where financing terms are fixed in advance of the contract date. In addition, where official financing support for floating rate loans is provided, the lender is not allowed to offer the borrower the option of applying the lower of the CIRR at the time of the contract or the short-term lending rate, over the life of the loan. That is, the borrower is not permitted during the life of a loan to switch between the CIRR as of the contract date and a short-term rate, depending on which is lower at a given time⁷⁸.

5.89 Finally, Articles 18 and 19 impose limits on “cosmetic interest rates”, which the *Arrangement* describes as rates below the relevant CIRR which benefit from official support, and which may involve a compensatory measure including a corresponding increase in the contract value or other

⁷⁷ Specific exceptions are set forth for the Yen and for the Euro.

⁷⁸ Canada argues in its answers to questions (see Canada’s replies to the Panel’s Canada Account questions 2(b), 2(d) (Annex 2-4)) that Article 17(b) of the *Arrangement* means that official support in the form of floating rate financing is in conformity with the *Arrangement*. While Article 17(b) does refer to floating rate financing, it contains no minimum interest rate rule in respect of such financing, and indeed makes clear that the CIRR is not applicable thereto. The issue of floating rate financing and Article 17(b) is discussed in more detail in paras. 0 - 5.106, *infra*.

contractual adjustment. These Articles provide, *inter alia* that official financing support by means of direct financing *shall not* be provided at rates below the CIRR, and that other official financing support also shall not be offered at below-CIRR (cosmetic) rates. Thus, these provisions appear to be intended to prevent Participants from offering official financing support for lower-than-CIRR financing, whether or not the below-CIRR rate is achieved directly through the face interest rate or through adjustment of the other terms and conditions of the financing to circumvent the CIRR minimum.

5.90 In particular, we note that pursuant to Article 19(c), a Participant intending to support a transaction should clarify, in response to an inquiry from another Participant, the "*financial terms and mechanisms, including the compensatory measure*" (emphasis supplied), while pursuant to Article 19(d) a Participant with information suggesting that "non-conforming terms" may have been offered by another Participant shall try to determine whether the transaction benefits from official financing support and whether or not the terms of the support conform to the provisions of Article 15 ("minimum interest rates"). An important conclusion that we draw from this is that the mechanism in 19(c) and (d) clearly implies that *conformity with the CIRR* cannot be judged unless *all terms and conditions* of a transaction, including any "compensatory measures", are known.

5.91 There are no other provisions of the *Arrangement* that directly or explicitly pertain to the interest rate, and thus it would seem that the natural reading of the *Arrangement* is that the above-mentioned articles constitute the entirety of the *Arrangement's* "interest rates provisions" (at least in respect of regional aircraft). Clearly the central one of these provisions is the CIRR, which as noted is the only minimum interest rate system defined and thus regulated by the *Arrangement* in this sector⁷⁹.

5.92 We note that our view as to which are the interest rate provisions of the *Arrangement* is very different from that of Canada. Canada presented a list of what it considers those provisions to be⁸⁰, which, as Canada explains, encompasses all provisions of the *Arrangement* that in Canada's view affect the interest rate as such or the amount of interest paid in a transaction. In support of its position, Canada argues that compliance with the CIRR alone should not be enough to qualify an "export credit practice" for the safe haven in item (k)⁸¹. We agree that this is an important consideration, and as noted above, Article 19 (which both we and Canada have identified as one of the "interest rate provision") seems to suggest a way to address this question of "circumvention". Thus, it is by no means evident to us that the best or only way to address this question is through an expansive definition, such as that proposed by Canada, of what constitute the "interest rates provisions" of the *Arrangement*. (This issue is discussed in detail in paras. 5.107-5.114, *infra*.)

(iii) *Which types of "export credit practices" could conceptually be "in conformity with" the "interest rates provisions" of the OECD Arrangement in its current form?*

5.93 Having identified the "interest rates provisions" of the *OECD Arrangement*, we are next faced with the question of the types of "export credit practices" in respect of which interest rate provisions exist and therefore apply. This is a critical question, because, as noted above, qualification for the safe haven of the second paragraph of item (k) at present is exclusively determined by the conformity of an "export credit practice" with the interest rate provisions of the *Arrangement*. Thus, before we

⁷⁹As noted, the other *Sector Understandings* (on export credits for ships and for nuclear power plant) also have interest rate rules, which are specific to those sectors.

⁸⁰ See, Oral statement of Canada (Annex 2-3) at paras. 69-80 and Attachment. In this list, Canada identifies the following Articles of the *Arrangement* as its interest rates provisions relevant to regional aircraft: 2, 3, 7, 9, 10, 13, 14, 15, 16, 17, 19, 21(a), 26, and 29, and identifies as well the following Articles of the *Sector Understanding*: 21, 22, 23, 24, and 25 of Annex III, Part 2 (new aircraft other than large aircraft), and 28, 29, 30 and 31 of Annex III, Part 3 (spare engines, spare parts, maintenance and service contracts).

⁸¹ Oral statement of Canada (Annex 2-3) at para. 76.

can be in a position to determine the conformity of a given export credit practice with those interest rate provisions, we will need to know whether it is of the type that conceptually could be subject to, and thus in conformity with, those provisions. This means, as a matter of logic, that conformity with the interest rate provisions is a meaningful issue only in respect of types of export credit practices for which such provisions exist.

5.94 Thus, we return to Article 15 which, as we noted, is the *Arrangement's* central interest rate provision in that it sets forth the basic minimum interest rate rule. The chapeau of Article 15 reads in relevant part as follows:

"The Participants providing official financing support through direct credits/financing, refinancing and interest rate shall apply minimum interest rates; the Participants shall apply the relevant Commercial Interest Reference Rates (CIRRs)."

5.95 Thus Article 15 makes very clear what is subject to its minimum interest rate rule. That is, Article 15 states explicitly that what is subject to the minimum interest rate rules is not all forms of "official support" covered by the *Arrangement* but rather "official *financing* support", which is limited to "*direct credits/financing, refinancing or interest rate support*"⁸². In other words, this provision of the *Arrangement* seems to specify that at present these, and only these, forms of "official support" covered by the *Arrangement* are subject to the minimum interest rate rule.

5.96 We note that the minimum interest rate rule specifically applicable to regional aircraft⁸³ (i.e., paragraph 22 of Part 2 of Annex III of the *Arrangement*, the part of the *Sector Understanding* on civil aircraft other than large aircraft), is identical to that in Article 15 of the *Arrangement*. In particular, this provision states:

"The Participants providing official financing support shall apply minimum interest rates; the Participants shall apply the relevant CIRR set out in Article 15 of the *Arrangement*".

5.97 Thus, we conclude that in the case of regional aircraft, as is the general rule under the *Arrangement*, what is subject to the minimum interest rate rule is official financing support – direct credits/financing, refinancing or interest rate support.

5.98 On the basis of our identification of the *Arrangement's* "interest rates provisions" and of the types of "export credit practices" to which those provisions apply, the only logical conclusion that we can draw is that the only *forms* of export credit practices which at present are potentially eligible for the safe haven are those subject to the interest rate provisions of the *Arrangement* in its current form, namely *direct credits/financing, refinancing and interest rate support*⁸⁴. By implication, this means that the other forms of official support for export credits covered by the *Arrangement* (e.g., guarantees and insurance), are simply not eligible for the safe haven, because they are not covered by the existing interest rate rule, and therefore cannot be "in conformity" or out of conformity with it. Thus, for now,

⁸² The Introduction section of the *Arrangement* contains the same definition of "official financing support" as that in Article 15.

⁸³ Canada, in its list of *Arrangement* provisions that it considers to be the interest rate provisions, refers to this provision as relevant in the context of regional aircraft. As noted in footnote 75 above, this is consistent with information provided in the original dispute.

⁸⁴ With repayment terms of two years or more, recalling that the *Arrangement's* coverage is limited to transactions of this maturity.

there is no safe haven from the prohibition on export subsidies for these forms of official support⁸⁵. Rather, their conformity with the SCM Agreement can only be judged on the basis of Articles 1 and 3 of that Agreement.

5.99 We note that Canada takes a very different position, arguing that export credit insurance and guarantees (“pure cover”) also are subject to the “interest rates provisions” of the *Arrangement* and thus are eligible for the safe haven. Specifically, Canada argues that export credit guarantees involve an interest rate in respect of the underlying loan, and that the guaranteed loan itself must respect the relevant interest rate provisions, which for Canada means that the “interest rates provisions” apply to guarantees/insurance as such⁸⁶. On the basis of the above discussion, however, Canada’s reading of the *Arrangement* does not seem to be supported by the text thereof, given that Article 15 explicitly omits from its own scope of application guarantees and insurance.

5.100 Moreover, we note that the *Arrangement* establishes explicit rules concerning guarantees and insurance, specifically by establishing minimum premium benchmarks. The minimum benchmarks are set with respect to adequacy of premiums to cover the “sovereign” and “country” credit risk involved in supported transactions. These benchmarks also apply explicitly to official financing support. Thus, both the minimum premium rule and the minimum interest rate rule on their faces make clear whether or not they apply to guarantees and insurance.

5.101 The conclusion that *only* official financing support is potentially eligible for the safe haven does not necessarily mean, however, that *all* official financing support would be eligible. Rather, continuing the logic of the analysis, it would appear that the safe haven could only be potentially available to those specific kinds of official financing support to which the CIRRs (or if applicable, the special minimum interest rates under the *Sector Understandings*) apply, given that these are the only *existing* systems of minimum interest rates under the *Arrangement*. Thus, in the case of regional aircraft, as the CIRRs are the relevant minimum interest rates, it is only support that is subject to the CIRRs with respect to which “conformity” with minimum interest rates – which are exclusively defined in terms of the CIRRs – even would be relevant and could be judged. Thus, the question of which export credit practices pertaining to regional aircraft are potentially eligible for the safe haven in the second paragraph of item (k) cannot be fully answered without considering the nature of the CIRRs.

5.102 Perhaps the most important aspect of the CIRRs⁸⁷ in this regard is that they are *fixed* interest rates established for various currencies, rather than floating rates. In particular, under Article 15 of the *Arrangement*, as a general principle CIRRs are to be established on the basis of fixed interest rate finance over a period of no less than five years. Article 16 provides more specifically that CIRRs generally are to be set at 100 basis points above the medium- to long-term yields on government bonds issued in the relevant currencies. Given that they are expressed solely as *fixed* interest rates, the CIRRs can only meaningfully be applied to transactions with fixed interest rates. That is, there is simply no practical or meaningful way to apply rules concerning minimum *fixed* interest rates to *floating* rate transactions⁸⁸. Thus, we conclude that only official financing support at fixed interest rates is subject to minimum interest rates, given that the CIRRs are expressed as, and thus can only apply to, fixed rate transactions.

⁸⁵ As noted above, this by no means rules out the possibility that in the future interest rate provisions might be developed for other types of export credit practices, in which case the safe haven would potentially be available for such practices.

⁸⁶ Canada’s reply to the Panel’s Canada Account question 2(b) (Annex 2-4) at para. 9.

⁸⁷ As is the case as well for the other specific interest rates in certain of the *Sector Understandings*.

⁸⁸ Canada also is of this view. (Canada’s reply to the Panel’s Canada Account question 2(b) (Annex 2-4) at para. 8.)

5.103 As noted above, Canada argues that Article 17(b) of the *Arrangement* authorizes, and thus makes eligible for the safe haven of item (k), official financing support at floating rates, even where such financing is at a below-CIRR interest rate. In particular, Canada states that Article 17(b) establishes that “the minimum floating interest rate is the ‘short-term market rate’”⁸⁹, and further argues that this is “generally understood to refer to international benchmarks such as LIBOR”.

5.104 Article 17(b) reads as follows:

- "b) Where official financing support is provided for floating rate loans, banks and other financing institutions shall not be allowed to offer the option of the lower of either the CIRR (at the time of the original contract) or the short-term market rate throughout the life of the loan."

Thus, as Canada notes, Article 17(b) does contain a reference to official support for floating rate loans. In our view this text does not, as Canada argues, clearly *authorize* official support for floating rate financing at rates below CIRR⁹⁰, or establish that any such financing is “in conformity” with the interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven in item (k).

5.105 Indeed, Article 17(b) does not set forth *any* specific rules with respect to the absolute or relative levels of interest rates at which floating rate financing can be offered. Rather, Article 17(b) appears exclusively to pertain to (and to prohibit) the possibility that a lender could offer a borrower the option to switch between an interest rate at the CIRR that was prevailing on the date of the original contract and the short-term market rate prevailing at any given moment during the life of the loan. Thus, in our view, the reference to the “short-term market rate” is only a descriptor of the prevailing floating interest rate. In our view, this provision simply recognizes that, over the life of a loan, short-term interest rates may move above and/or below the fixed interest rate that was prevailing at the original date of the loan contract, and establishes a rule prohibiting switching between fixed and floating-rate financing throughout the life of the loan to take advantage of such movements. This is not the same as affirmatively authorizing the provision of floating rate financing at interest rates below the relevant CIRR, or indeed as establishing *any* rule whatsoever concerning minimum levels for floating interest rates. We can find no basis for reading into this provision any such rule, let alone any implicit reference to LIBOR or any other putative “minimum” floating interest rate.

5.106 Thus, on the basis of the foregoing analysis we conclude that the safe haven in the second paragraph of item (k) at present is potentially available *only* to export credit practices in the form of direct credits/financing, refinancing, and interest rate support at fixed interest rates with repayment terms of two years or more⁹¹. In other words, any such practices involving floating interest rates, as well as official support for export credits with shorter maturity or in the forms of guarantees and insurance, because none are *subject to* the *Arrangement’s* “interest rates provisions”, most especially the CIRR but also the sector-specific minimum interest rates in the *Sector Understandings*, would not

⁸⁹ Canada’s reply to the Panel’s Canada Account question 2(b) (Annex 2-4) at para. 8.

⁹⁰ We are aware that the subject of official support at floating interest rates has been under discussion among *Arrangement* Participants for some time (See, e.g., Canada’s reply to the Panel’s Canada Account question 2(b) (Annex 2-4) at para. 8). Our understanding is that some Participants believe that such support is fully authorized and fully qualifies for the safe haven in the second paragraph of item (k), while others believe that it is permitted but not subject to any minimum interest rate rule, and still others believe that it is outright prohibited under the *Arrangement*. We note that in any case, Canada has indicated that “except in cases of matching or humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed-rate financing at interest rates at or above CIRR.” (Canada’s reply to the Panel’s Canada Account question 3(d) (Annex 2-4) at para. 1.)

⁹¹ Here, we again emphasize that in our view, it would be perfectly possible for minimum interest rates to be negotiated in respect of floating rate transactions. Were this to be done, such transactions in our view would be potentially eligible for the safe haven.

be eligible for the safe haven, as it simply would not be possible to judge their “conformity” with the relevant interest rate provisions of the *Arrangement*, all of which pertain exclusively to fixed rates.

(iv) *What provisions and considerations are relevant to judging “conformity” with the Arrangement’s “interest rates provisions” and hence qualification for the safe haven in item (k)?*

5.107 Having determined which export credit practices are *potentially* eligible for the safe haven in the second paragraph, we recall that of course, not every individual transaction that is so eligible will necessarily qualify for that safe haven. Rather, to take advantage of the safe haven, eligible export credit practices must be “in *conformity* with the interest rates provisions”⁹² of the *Arrangement*. Thus, we turn next to the question of how, i.e., on the basis of what provisions and considerations, conformity with the interest rate provisions should be judged.

5.108 It is in this context of “conformity”, rather than the context in which it was provided by Canada, that Canada’s list of the provisions that it considers to be the “interest rates provisions”⁹³ arguably is most relevant. That is, as noted above, Canada has identified a sizeable list of provisions which it argues must be considered part of the *Arrangement*’s “interest rates provisions”, because these provisions directly or indirectly affect the amount of interest charged and the timing of when it is paid. In Canada’s view, the fact that item (k) refers to “interest rates provisions” and not simply to the “interest rate” means that it must refer to more than the CIRR standing alone. In other words, Canada argues, if this term referred only to the CIRR, the benefit of the safe haven would be extended to financing transactions that apply the CIRR, but do not abide by *any* of the other *Arrangement* rules, such as those relating to maximum terms and minimum risk premiums, thereby circumventing the disciplines of the SCM Agreement⁹⁴.

5.109 As discussed above, the text of the *Arrangement* itself seems to define its “interest rates provisions” much more narrowly than argued by Canada. Nevertheless, Canada’s basic point is very important, and seems to us to go to the issue of *conformity*. That is, if not *supported* and *reinforced* by provisions related to the financing terms and conditions other than the interest rate, a minimum interest rate rule standing alone could exercise no real discipline on the generosity of terms of official support for export credits. Obviously, any financing transaction has a number of terms and conditions, many of which do directly or indirectly affect the interest rate. These include, as Canada points out, the amount of the cash down payment, the maximum repayment term, the timing of principal and interest payments, maximum “holding periods” or lock-in periods for interest rates, risk premiums, and similar terms. To use an example, if the interest rate of a transaction were fixed at CIRR, but for example the repayment term was 30, 50 or 100 years, or no amortization of principal was required over the life of the loan, the fact that the interest rate respected the CIRR would not in any real sense discipline the terms of the financing. Thus, if the generosity of the other terms and conditions were unlimited, such terms and conditions could completely circumvent any limiting effect that the minimum interest rate rule was intended to exercise.

5.110 Of course, the *Arrangement* does address and set limits with respect to many such terms and conditions, not limited to the minimum interest rate. Thus, in developing an approach for determining whether a given “official financing support” transaction qualifies for the safe haven of the second paragraph of item (k), it would seem appropriate to adopt an approach to the question of “conformity” with the interest rate provisions that is sufficiently broad to capture *not just* conformity with the CIRR standing alone, but *also* respect for the *Arrangement*’s limits on the generosity of the other financing

⁹² Second paragraph, item (k), emphasis supplied.

⁹³ Oral statement of Canada (Annex 2-3) at paras. 69-80 and Attachment.

⁹⁴ *Id.* at paras. 75-77.

terms having an effect on the interest rate. That is, recalling⁹⁵ that the stated purpose of the *Arrangement* is, *inter alia*, to “encourage competition among exporters...based on quality and price of goods and services exported rather than on the most favourable officially supported terms”, by placing “limitations on the terms and conditions of export credits that benefit from official support”, it would not make sense from the standpoint of the *Arrangement* to so narrowly interpret the concept of “conformity” with the interest rate provisions as to provide an exemption under the SCM Agreement for transactions that unabashedly circumvent that purpose. Nor would such a narrow interpretation make sense from the standpoint of the SCM Agreement, as doing so would have the effect of exempting from the prohibition on export subsidies practices that respected the CIRRs in name only, even if their other terms were so generous as to remove any limiting effect of the minimum interest rate rule.

5.111 In our view, Articles 19(c) and (d) of the *Arrangement* (which concern official support for cosmetic interest rates) appear in effect to establish this very approach to judging conformity with the *Arrangement's* interest rate provisions. That is, as discussed above⁹⁶, Articles 19(c) and (d) provide for an evaluation by a Participant of *all terms and conditions* of a transaction in order to judge whether it “conform[s] to the provisions of Article 15”, i.e., the minimum interest rate rule.

5.112 Article 27 of the *Arrangement*, concerning the “no derogation engagement”, provides further contextual support for this approach to judging conformity with the interest rate provisions, in the sense that it refers to all elements of a financing transaction as parts of a single package. Specifically, under this provision, Participants are not to *derogate* from “maximum repayment terms, minimum interest rates, premium benchmarks, the six-month limitation on the validity period for export credit terms and conditions, or extend the repayment term by extending the repayment date of the first instalment of principal set out in the *Arrangement*”. Thus, the *Arrangement* seems to recognize that financing terms and conditions must be treated as a package, and that derogation from one will undercut the others.

5.113 By the same token, however, we do not agree with the very broad reading advocated by Canada of what “conformity” with the interest rate provisions would be, as this reading would sweep in *inter alia* all of the provisions that permit various kinds of exceptions and derogations from some provisions of the *Arrangement* that affect interest rates. In particular, we cannot reconcile identifying as “conforming” with the interest rate provisions any practice that on its face *breaks*, i.e., *does not conform with*, the interest rate rules (even where this is tolerated as matching). Such a reading would seriously undermine the disciplines of the SCM Agreement in the field of export credits. (We discuss the provisions of the *Arrangement* concerning exceptions and derogations in more detail in paragraphs 5.120 - 5.125, *infra*.)

5.114 Thus, we conclude that full conformity with the “interest rates provisions” – in respect of “export credit practices” subject to the CIRR – must be judged on the basis not only of full conformity with the CIRR but in addition full adherence to the other rules of the *Arrangement* that operate to support or reinforce the minimum interest rate rule by limiting the generosity of the terms of official financing support.

Provisions of the *Arrangement* imposing disciplines or limits that reinforce the minimum interest rate rule

5.115 A review of the *Arrangement* in the light of the above discussion suggests that the provisions that would need to be respected in order for official financing support to be in full conformity with the interest rate provisions would include, in addition to the provisions concerning the CIRR, most of the

⁹⁵ See para. 5.82 *supra*.

⁹⁶ At paras. 5.89-5.92, *supra*.

articles of Chapter II of the *Arrangement*, along with (for this dispute) most of the articles of Annex III, Parts 2 and 3 (*Sector Understanding* on Export Credits for Civil Aircraft, All New Aircraft Except Large Aircraft (Part 2) and Used Aircraft, Spare Engines, Spare Parts, Maintenance and Service Contracts (Part 3)). These provisions are discussed in detail in this section.

5.116 Taking Chapter II of the *Arrangement* first, the first provision thereof, Article 7 on cash payments, limits the generosity of financing terms by establishing a minimum percentage that must be paid in cash (i.e., a maximum percentage that can be financed). Article 8 defines the starting and ending point of the repayment term, Article 9 defines the starting point of credit for different types of contracts, and Article 10 establishes specific maximum repayment terms for different categories of countries. Article 12 establishes criteria and procedures for classifying countries for maximum repayment terms. Article 13 establishes rules concerning the schedule for repayment of principal. Again, the underlying purpose of all of these provisions is to set limits on the generosity of the financing terms.

5.117 Article 14 establishes rules governing the schedule and other aspects relating to the payment of interest, with a view to ensuring that interest is paid at regular intervals over the life of a loan, rather than deferred, again imposing limits on the generosity of the financing terms. Article 20 requires the application of risk premiums at least sufficient to cover sovereign credit risk and country credit risk⁹⁷. (Subsidiary to Article 20, Articles 21, 22, 23, and 24 establish various rules and procedures for setting and verifying the minimum premium benchmarks, on a Participants'-wide basis.) Article 25 sets limits on the amount and kind of official support that can be provided for so-called "local costs"⁹⁸. (According to Canada, the local cost provision is not relevant in the context of aircraft finance⁹⁹.) Finally, Article 26 establishes the maximum validity period for credit terms and conditions for an individual export credit or line of credit, again limiting the generosity of the financing terms and thus reinforcing the minimum interest rate rule.

5.118 Similar provisions pertaining directly to regional aircraft are found in Part 2 of the *Sector Understanding* for civil aircraft (Annex III), pertaining to new aircraft other than large aircraft¹⁰⁰, as well as in Part 3 of that *Understanding*, which pertains to used aircraft (of all sizes), spare engines, spare parts, maintenance and service contracts¹⁰¹. Specifically, Article 21 of the *Sector Understanding* fixes maximum repayment terms for different categories of new "non-large" aircraft and Article 28 does the same for different categories of used aircraft. In addition, Article 23 of the *Sector Understanding*, pertaining to "non-large" aircraft, provides that the insurance premium or guarantee fee shall not be waived in whole or in part. Article 24 of that Annex prohibits aid support except in the form of untied grants, although it appears to permit tied aid for humanitarian purposes¹⁰². Article 29 (a) – (c) of the *Sector Understanding* establish limits on the financing terms for spare engines and spare parts, while Article 30 establishes limits on official financing support for maintenance and service contracts.

⁹⁷ The *Arrangement's* risk premium rules apply equally to direct financing, refinancing, guarantees and insurance.

⁹⁸ Article 25 defines local costs as expenditures for goods and services in the buyer's country that are necessary either for executing the contract or for completing the project of which the exporter's contract forms a part, which costs exclude commissions payable to the exporter's agent in the buyer's country.

⁹⁹ Canada's reply to the Panel's Canada Account question 2(a) (Annex 2-4) at para. 4

¹⁰⁰ As indicated above, regional aircraft, i.e. aircraft with no more than 70 seats, are covered by Part 2 of the *Sector Understanding* on civil aircraft.

¹⁰¹ There are also similar provisions in the other *Sector Understandings*, but these are not relevant to this dispute and so are not mentioned here.

¹⁰² We note that in our view it is unlikely that any tied aid for truly humanitarian purposes would be challenged under the SCM Agreement as a prohibited subsidy. As this issue is not before us, we do not consider it necessary to make a finding regarding whether any such aid would qualify for the safe haven of the second paragraph of item (k).

5.119 Thus, all of the provisions identified above limit the generosity of some aspect of the financing terms where official financing support is provided, and thereby reinforce the minimum interest rate rule. While not all of these provisions would necessarily apply in respect of any given instance of official financing support, under the approach described, those that did apply would need to be respected fully for that transaction to be “in conformity” with the *Arrangement’s* interest rate provisions and thus to qualify for the safe haven in the second paragraph of item (k) of the Illustrative List of Export Subsidies¹⁰³.

Provisions of the *Arrangement* providing for exceptions and derogations

5.120 The final Articles of Chapter 2 (in particular Articles 27 and 29), as well as Articles 25, 29(d) and 31 of Annex III, concern *inter alia* various situations in which certain variations, exceptions and derogations from the *Arrangement’s* terms are foreseen and explicitly permitted or not prohibited. Articles 47-53 contain procedures (notifications, etc.) to be followed in these situations. In our view, it is not obvious on its face that sweeping *all* of these provisions into the group of provisions that must be respected for a transaction to be in “conformity” with the interest rate provisions would be consistent with the approach outlined above. This is because these provisions essentially run counter to, rather than reinforcing, the *Arrangement’s* minimum interest rate rule and other limits on the generosity of financing terms. Thus, the issue is whether a transaction that makes use of flexibilities and/or outright departures from the rules through any or all of these Articles or any part(s) thereof can be considered to be “in conformity” with the interest rate provisions in the sense of item (k). On the one hand, an argument could be made that anything that is explicitly not prohibited by the *Arrangement* must be *ipso facto* “in conformity” with it, even if it is recognized as a derogation. (This is in fact what Canada argues¹⁰⁴.) On the other hand, if even matched derogations (i.e., *non-conforming* departures from the rules) are considered to be “in conformity”, then the notion of “conformity” cannot be understood to represent a discipline or limitation of any kind.

5.121 We note in this context as an initial matter that not all exceptions under the *Arrangement* are necessarily equal. In this regard, Canada itself makes a distinction between “variations”, which are “permitted” “within limits” under the *Arrangement*, and the “matching” of terms and conditions that are “outside of the *Arrangement’s* rules”¹⁰⁵. In its answers to questions, Canada confirms that this distinction is the same as that in the *Arrangement’s* Chapter IV (procedures) between “permitted exceptions” and “derogations”¹⁰⁶. Chapter IV makes clear on the one hand that permitted exceptions in fact refer to certain variations in terms that are foreseen and permitted, subject to limits, under various specific provisions of the *Arrangement*. Chapter IV further makes clear on the other hand that derogations are terms and conditions that depart from the *Arrangement’s* provisions, i.e., in a way not foreseen and not permitted, even within limits, under the plain language of the *Arrangement*.

5.122 We turn to the specifics of the Articles in question while bearing in mind all of these general considerations. Article 27 of Chapter 2, entitled the “no derogation engagement for export credits”, in fact envisages certain deviations. That is, as noted, this Article provides that Participants shall not derogate from maximum repayment terms, minimum interest rates, minimum premium benchmarks,

¹⁰³ In this connection, we note that a transaction that involved interest rate support and a guarantee or insurance would need to respect the interest rate provisions of the *Arrangement*, as well as the requirements pertaining to minimum premia and all of the other provisions identified above that applied to the transaction, for that transaction to be “in conformity” with the interest rate provisions of the *Arrangement*. As noted above (at para.5.98) the conformity of insurance or guarantees as such with the SCM Agreement can only be judged on the basis of Articles 1 and 3 of the Agreement.

¹⁰⁴ See, e.g., Canada’s reply to the Panel’s Canada Account question 3(i) (Annex 2-4).

¹⁰⁵ Oral statement of Canada (Annex 2-3) at Attachment, introductory paragraph and paragraph concerning Article 29.

¹⁰⁶ Reply of Canada to the Panel’s Canada Account questions 3(k) and 3(l) (Annex 2-4).

the limitation on the validity period for credit terms and conditions, and shall not extend the repayment term by extending the repayment date of the first instalment of principal per Article 13(a).

5.123 Nevertheless, Article 27 goes on to provide that countries may go below the relevant minimum premium benchmark in certain cases where the country credit risk is “externalised/removed or limited/excluded for the entire life of the debt repayment obligation”. Chapter IV (Article 48) explicitly refers to this deviation as a “permitted exception”. Article 49 identifies a list of “permitted exceptions” having to do *inter alia* with maximum repayment terms, principal and interest payments, and discounts to minimum sovereign risk premium benchmarks.

5.124 Article 29, on matching, further clarifies the distinction between “derogations” and “permitted exceptions”. In particular, while under this Article there is a general permission to match terms and conditions offered by both Participants and non-Participants, some matching, i.e., where Participants “match credit terms and conditions by supporting terms that *comply* with the Arrangement”¹⁰⁷ is not considered a derogation. Rather, this seems to refer to matching another country’s offer of terms that are within the permitted variations that exist under certain provisions. (For example, under Article 10, there is a certain amount of permitted variation concerning maximum repayment terms, which is explicitly recognized in Article 49 as a permitted exception. Article 51 specifically deals with the matching of permitted exceptions.) Thus, if a country offers terms that are within permitted variations, the *Arrangement* appears to consider that such terms “comply” with the provisions of the *Arrangement*, and that any matching of those terms therefore also “complies”. Canada agrees with this interpretation¹⁰⁸.

5.125 On the other hand, Article 29 further provides that if an initiating offer “*does not comply* with the Arrangement”¹⁰⁹, competing Participants are permitted to match those non-complying terms. The *Arrangement* defines “derogation” as terms and conditions that “depart from” the rules of the *Arrangement*¹¹⁰; thus, this reference in Article 29 equates non-compliance with derogation. This reading is confirmed in Article 47(b), which refers to derogations as “*non-conforming* terms and conditions”. That is, these parts of the matching provisions confirm that, although matching of derogations is in certain cases not prohibited, this does not alter the fact that both the original derogation and the matching remain, by the *Arrangement’s* own terms *out of conformity* with the provisions of the *Arrangement*¹¹¹. We note that Canada takes the opposite view, namely that the initial derogation does not comply with the *Arrangement*, but that matching, because tolerated, does fully comply therewith¹¹². For the reasons discussed above, however, we disagree. In our view, Canada’s approach would directly undercut real disciplines on official support for export credits¹¹³.

¹⁰⁷ Emphasis supplied.

¹⁰⁸ Canada’s reply to the Panel’s Canada Account question 3(k) (Annex 2-4).

¹⁰⁹ Emphasis supplied.

¹¹⁰ *OECD Arrangement* Article 47(a).

¹¹¹ We also note, in the context of “derogations”, Article 28 of the *Arrangement* which allows action to avoid or minimise losses, i.e., establishment of more favourable terms and conditions than *permitted*, after the contract award, where the sole intention is to avoid or minimise losses from events which could give rise to non-payment or claims. In other words, where a default or similar event has occurred or is likely, renegotiation of more favourable terms than permitted is not prevented by the *Arrangement*. Under the approach outlined, if there were such a renegotiation, a transaction that had previously qualified for the safe haven would fall outside of it to the extent that the renegotiated terms were in fact “more favourable than permitted”.

¹¹² Canada does not appear to disagree with the reading that both derogations and matching are out of accord with the *Arrangement’s* rules, but nevertheless argues that matching is “compliant” with the *Arrangement* (Canada’s replies to the Panel’s Canada Account questions 3(i) and 3(l) (Annex 2-4)).

¹¹³ Our analysis of matching of derogations and permitted exceptions applies equally to the relevant provisions of Parts 2 and 3 of the *Sector Understanding* for civil aircraft (i.e., its Articles 25, 29(d) and 31).

Conclusion based on textual analysis

5.126 As the foregoing discussion indicates, the text of the *Arrangement* provides considerable guidance concerning how the term “conformity” in the second paragraph of item (k) of the Illustrative List should be understood. In the first place, the *Arrangement* text provides explicitly that derogations from provisions of the *Arrangement*, and the matching of such derogations, do not “conform” with the provisions of the *Arrangement*.¹¹⁴ Thus, any transaction that involves derogations or matching of derogations by definition cannot be in conformity with the *interest rate provisions* of the *Arrangement*, as under the approach outlined above, conformity with the interest rate provisions requires conformity not just with the minimum interest rate rule but also with the other provisions that support/reinforce that rule. As such, an otherwise eligible transaction¹¹⁵ involving derogations or matching of derogations could not qualify for the safe haven of the second paragraph of item (k). On the other hand, the *Arrangement* explicitly defines permitted exceptions and the matching of permitted exceptions, within the allowed limits, to be in compliance, i.e., in conformity with the relevant provisions of the *Arrangement*. Therefore, under this approach, making use of permitted exceptions, within the specified limits, would not disqualify an eligible transaction from the safe haven, so long as the transaction conformed with the minimum interest rate and all of the other applicable disciplines.

5.127 Through the above textual analysis, we have arrived at a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or matching of derogations.

(b) Considerations based on the context of the second paragraph of item (k) and the object and purpose of the SCM Agreement

5.128 It is clear from the above that a textual analysis leads us to a tentative conclusion that the safe haven in the second paragraph of item (k) of the Illustrative List of Export Subsidies is considerably narrower than argued by Canada. That is, the textual analysis suggests that a number of export credit practices covered by the *Arrangement* would not qualify for the safe haven because of their form or maturity alone (i.e., those not in the form of official financing support, and those with repayment terms of less than two years). The textual analysis also suggests that application of the CIRR (or relevant sector-specific minimum interest rate) by itself, while a necessary condition for “conformity with the interest rates provisions” of the *Arrangement*, is not a sufficient condition therefor; in addition, the other provisions supporting the minimum interest rate rule, to the extent that they apply to a given transaction, also would need to be fully respected for a transaction to be “in conformity” with the interest rate provisions. Thus to the extent that a transaction derogated in some respect from

¹¹⁴ Canada does not appear to disagree with the reading that both derogations and matching are out of accord with the *Arrangement*’s rules, but nevertheless argues that matching is “compliant” with the *Arrangement* (Canada’s replies to the Panel’s Canada Account questions 3(i) and 3(l)).

¹¹⁵ That is, a transaction at a fixed interest rate involving official financing support.

any of those provisions, or involved matching of another country's derogation, that transaction would not be "in conformity" with the *Arrangements* interest rate provisions.

5.129 In our view, this reading of the text of the second paragraph of item (k) and of the *OECD Arrangement* is the most natural and logical reading, as it flows from the words of those texts. We recognize, however that there is another possible reading of these provisions, namely the broad reading advocated by Canada. In considering this alternative reading, we note that it is incumbent upon us to try to resolve any ambiguities in the texts in a manner which is the most consistent possible with the object and purpose of the SCM Agreement and of the WTO Agreement. In our view, the object and purpose of the SCM Agreement and the WTO Agreement do not support the textual analysis proposed by Canada. Rather, they support the textual analysis developed by the Panel above.

5.130 In particular, under Canada's approach, all *substantive* provisions of the *OECD Arrangement* would be considered its "interest rates provisions" and all "export credit practices" which conformed to those of the "interest rates provisions" applicable to them would be "in conformity with" the interest rate provisions of the *OECD Arrangement*. That is, under this approach, the term "interest rates provisions" would be understood as a means of distinguishing the *substantive* from the *procedural* provisions of the *Arrangement*, in recognition of the fact that non-Participants cannot use those procedural provisions. In other words, the safe haven would be understood to apply to all types of practices covered by the *Arrangement* that are in compliance with the relevant substantive provisions of the *Arrangement*, whether or not any minimum interest rate applied in respect of the export credit practice in question¹¹⁶.

5.131 One implication of the broad approach in this context is that any practice that *is not out of conformity* with the relevant provisions of the *Arrangement*, whether or not even covered by provisions explicitly pertaining to interest rates, would qualify for the safe haven in item (k)¹¹⁷. In this regard, matching of derogations, because tolerated although not in compliance, would be considered to be "in conformity" under this approach. We note that the main argument in support of this sort of a broad reading of the term "in conformity with the interest rates provisions", would be that the Participants to the *OECD Arrangement* would not have on the one hand negotiated for themselves a set of rules in the OECD with a broad scope, covering, regulating in different ways, and permitting a variety of practices, and on the other hand negotiated a safe haven in item (k) of the SCM Agreement covering only a subset of those practices.

¹¹⁶ Thus, under Canada's approach, in addition to direct financing, refinancing and interest rate support, which are subject to the minimum interest rate rule, guarantees and insurance, which are subject to other rules but not to the minimum interest rate rule, would be eligible for the safe haven. In addition, Canada argues that "matching" of "derogations" also would be eligible for it, on the basis that such matching is not prohibited. Derogations are terms and conditions that do not comply with the *Arrangement*. As noted, the *Arrangement* does not prohibit Participants from matching the terms of such derogations/non-compliant terms offered by Participants as well as non-Participants.

¹¹⁷ One example is that of export credit guarantees, which as discussed above, are subject under the *Arrangement* to rules concerning minimum premiums, but are not subject to any specific provision on interest rates. Under this broad approach, so long as this general rule was respected, such guarantees would qualify for the safe haven, even if the provision of the guarantee allowed the interest rate to fall below the minimum interest rate (the CIRR). Because the minimum interest rate rule does not apply to guarantees, under this interpretation that rule would not act to limit the eligibility of the guarantee for the safe haven, in spite of the guarantee's effect on the interest rate. Another example would be the provision of floating rate financing. Here again, because the CIRR is only expressed in terms of fixed interest rates, it cannot be applied to floating rate financing. Thus, this approach would say that floating rate financing which respected other provisions concerning financing (e.g., cash payments, maximum financing terms, etc.) would qualify for the safe haven, even if the interest rate were set far below the market rate, on the basis that by not being covered by the CIRR it was not out of conformity with it, and thereby was in conformity with it.

5.132 In considering this alternative approach, we note first that the second paragraph of item (k) is quite unique in the sense that it creates an exemption from a prohibition in a WTO Agreement, the scope of which exemption is left in the hands of a certain *subgroup* of WTO Members – the Participants, all of which as of today are OECD Members – to define, and to change as and when they see fit. Given this, it is important that the second paragraph of item (k) not be interpreted in a manner that allows that subgroup of Members to create for itself *de facto* more favourable treatment under the SCM Agreement than is available to all other WTO Members. The *OECD Arrangement*, as a plurilateral arrangement to which most WTO Members are not Participants, clearly has the *potential* to give rise to such differential treatment of Participants and non-Participants.

5.133 Related to this, i.e., because the *Arrangement* as such is in the hands of a subgroup of WTO Members, it is important that any interpretation of the second paragraph of item (k) provide clarity and certainty concerning what the (SCM Agreement) rules are and how to comply with them. Thus, any interpretation should be clear and transparent, and capable of application by all Members, rather than left to the discretion of individual Members or groups of Members.

5.134 In our view, the reading advocated by Canada would pose serious problems in respect of these important considerations. In particular, information about the actions of Participants is available *only* to Participants. None of this information is published, nor can it be obtained upon request by non-Participants. Thus, a reading that would, for example, include within the safe haven in the second paragraph of item (k) a transaction involving matching of a derogation, would put all non-Participants at a systematic disadvantage as they would not have access to the information about the terms and conditions being offered or matched by Participants. This concern obviously is relevant as well to the issue of transparency and clarity of the rules. We note that the CIRRs and the sector-specific interest rates are published. Therefore, all WTO Members, whether Participants or not, can offer financing on terms consistent with the minimum interest rates¹¹⁸. Similarly, the text of the *Arrangement* itself sets forth the limits to most of the permitted exceptions. Thus these as well can be applied by all WTO Members, whether Participants or not¹¹⁹. Financing terms and conditions known only to Participants clearly cannot be universally applied.

5.135 We note further in this context the particular potential for different, indeed *stricter*, rules *de facto* applying to developing than to developed countries, or at a minimum for developed countries to be able *de facto* to enjoy the same less strict rules as are provided *de jure*, through the SCM Agreement's special and differential treatment provisions, to developing countries. Arguably, such situations would be out of keeping with one of the key stated purposes of the WTO Agreement,

¹¹⁸ We note that, by contrast, no information is published on the minimum premium benchmarks. Thus, only Participants have access to this information. Given this, it is at present impossible for a non-Participant to have any idea whether a given transaction respects the rules concerning minimum premiums. Thus, until such time as the Participants make this information publicly available, non-Participants should be presumed to be respecting the minimum premium rules in the context of any analysis under the second paragraph of item (k). Canada also has recognized this issue and come to the same conclusion. In particular, Canada states that “it would be unreasonable to expect a non-OECD WTO Member to charge a premium level which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the *Arrangement*. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second paragraph of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants” (Canada’s reply to the Panel’s Canada Account question 3(h)).

¹¹⁹ As in the case of minimum premiums, however, where the *Arrangement* text does not set forth explicit limits to permitted variations (e.g., Article 49(a)(2) of the *Arrangement*) and no information is published concerning specific cases of such variations, non-Participants should be presumed to be respecting such limits in the context of any analysis under the second paragraph of item (k).

namely the need for positive efforts on behalf of developing countries (which is the basis for the extensive special and differential treatment provisions of the SCM Agreement)¹²⁰.

5.136 In particular, the broad approach advocated by Canada would in fact raise the issue of structural inequity in respect of developing countries. Specifically, this approach could result in either more favourable treatment, *de facto*, for developed compared to developing countries, or the *de facto* elimination of special and differential treatment for developing countries. An example of the first case would be provision of a government guarantee, which on its face is not subject to any interest rate rule. In practical terms, an interpretation of item (k) that would allow any government to make available to a borrower its own cost of borrowing through the provision of a guarantee and have that guarantee qualify for the protection of the second paragraph of item (k), irrespective of the interest rate applied, would generate a result that was systematically skewed in favour of developed countries. This is because developing countries' cost of borrowing will normally be higher than that of developed countries, meaning that the former arguably could never meet the financing terms offered by the latter. An example of the second case would be a reading of item (k) whereby a developed country could match the (subsidized, but because of SCM Article 27 not prohibited) terms offered by a developing country, and qualify for the protection of the second paragraph of item (k). In this case, special and differential treatment *de facto* would be eliminated.

5.137 Third, it is important to keep in mind the role of the safe haven in the second paragraph of item (k) in the overall context of the prohibition on export subsidies. In particular, we note that export subsidies are prohibited because of their direct trade-distortive effects, and that among the various forms of export subsidies, subsidized export credits arguably have the most immediate and thus greatest potential to distort trade flows. In view of this, we believe that an interpretation of item (k) that would create a very broad exemption from prohibition in respect of export credits would not be consistent with the purpose of that prohibition in the context of the SCM Agreement. In particular, the broad reading would significantly weaken any actual disciplines on export credits and related practices. In effect, this approach would say that practices not explicitly subject to the CIRR but in conformity with other provisions of the *Arrangement* could have effective interest rates well below CIRR and nevertheless be protected by the second paragraph of item (k). Under this approach as well, matching of derogations no matter how low the interest rate or how generous the other terms also would qualify for that protection, even where the initiator of the derogation was not a WTO Member. In such circumstances, there would be no real disciplines of any kind on export credits. Such a reading of the *Arrangement* and of item (k) at a minimum would raise the question of why either of these sets of rules was necessary.

5.138 Moreover, this latter situation would have the unheard-of result of allowing WTO Members to opt out of WTO rules on the basis of the behaviour of non-WTO Members. An interpretation that would excuse non-conformity with the SCM Agreement on the grounds that such behaviour was necessitated by the behaviour of non-WTO Members, would be unacceptable¹²¹, and would represent a radical and unjustifiable departure from all practice under GATT and WTO. In no case to date has any Member's conformity with GATT/WTO rules been defined by the behaviour of non-Members.

5.139 Finally, in our view the negotiating history of this provision does not support the broad reading advocated by Canada. In particular, we note that an early (if not the first) Tokyo Round

¹²⁰ The Preamble to the WTO Agreement states that "there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development". Article 27 of the SCM Agreement, special and differential treatment of developing country Members, makes operational this principle in the context of the WTO rules on subsidies.

¹²¹ E.g., if there were no limits on offering equivalent terms and conditions to those offered by a non-WTO Member.

proposal concerning this provision referred to the broad term "substantive guidelines", rather than the narrower term "interest rates provisions". (Proposal of the United States dated 6 December 1978.) The proposal did not identify or define this term, however. The reference to "substantive" provisions was not pursued in the negotiations, as the first version to be included in a Chairman's draft text of the Tokyo Round Subsidies Code of what became the second paragraph of item (k) (dated 15 December, 1978, just two weeks after the US proposal), already referred to the narrower term "interest rates provisions".

5.140 In sum, we recognize that there is another possible reading of the second paragraph of item (k) and of the *OECD Arrangement*. In our view, however, such a reading generates a result that in addition to being much more difficult to sustain on the basis of a textual analysis, is simply inconsistent with the overarching principles and purposes of the WTO Agreement and the SCM Agreement, including by introducing an imbalance of Members' rights and obligations to the detriment of developing countries.

(c) The sufficiency of the Policy Guideline to ensure that future Canada Account transactions in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k), and that prohibited export subsidies under Canada Account thereby have ceased

(i) Substance of the Policy Guideline

5.141 Having confirmed our approach to determining whether an individual transaction qualifies for the safe haven of the second paragraph of item (k), we turn now to the question at the heart of this dispute in respect of Canada Account, namely whether the Policy Guideline is sufficient to ensure that future Canada Account transactions in the regional aircraft sector will qualify for that safe haven, and that prohibited export subsidies under Canada Account in that sector thereby have ceased. We note as an initial matter the case-by-case nature of the required analysis outlined above. Because of this, there is a limit on the extent to which we can judge definitively today whether a given future Canada Account transaction in the regional aircraft sector will qualify for the safe haven of the second paragraph of item (k).

5.142 This being said, however, we recall that in Brazil's view, "the minimum burden accorded to Canada must be to explain with some precision what 'comply with the OECD Arrangement' will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in the future". Given that Canada has stated that the Policy Guideline "ensure[s] that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)"¹²², in our view it is incumbent upon Canada to provide an explanation not only of what in its view constitutes conformity with the interest rate provisions of the *OECD Arrangement*, but also how the Policy Guideline ensures such conformity.

5.143 We note that Canada has in fact provided certain explanations on these points¹²³. As discussed in the previous sections, the approach to this question that we have adopted differs considerably in substance from the approach advocated by Canada, however. Thus, even if the Policy Guideline contained all of the details that Canada has provided in its arguments concerning "conformity" with the "interest rates provisions" of the *Arrangement*, we would find on substantive grounds that it would not ensure that future Canada Account transactions would so conform. We note, however, that in fact the Policy Guideline contains no details at all, but simply indicates that transactions that "do not comply" with "the OECD Arrangement" will not be considered to be in the

¹²² Oral statement of Canada (Annex 2-3) at para. 67.

¹²³ Id. at paras. 69-80 and Attachment.

national interest. Thus, we find that the Policy Guideline is insufficient to accomplish what Canada says it will accomplish, namely to “ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)”.

5.144 In particular, the Policy Guideline is both generally worded and worded in the negative. In both of these aspects it seems to fall considerably short of what might reasonably be considered the minimum sufficient assurance which Canada wishes to provide. Concerning the generality of the wording, as just noted, the Policy Guideline simply refers to compliance with the *OECD Arrangement*. As has been discussed in detail, however, general conformity with whichever provisions of the *Arrangement* happen to apply to a given transaction would not appear to be sufficient to qualify for the relatively narrow safe haven in the second paragraph of item (k). Rather, only conformity with the *Arrangement's* interest rate provisions, *which presupposes that those provisions apply* (i.e., that the practice in question is in the form of official financing support at fixed interest rates), along with conformity with the *Arrangement's* other disciplines on financing terms, would qualify a practice for the safe haven.

5.145 The negative wording of the Policy Guideline raises a similar concern. Specifically, the Guideline provides that any transaction or class of transactions that “*does not* comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits *would not* be in the national interest”¹²⁴, which under the governing legislation means that they cannot be authorized. This is not necessarily the same thing, however, as saying that *only* transactions that *do* comply *will* be considered to be in the national interest (and thereby can be authorized). In particular, this wording leaves open the possibility that transactions that are *not subject* to the interest rate provisions of the *Arrangement* (i.e., the CIRR) might be authorized on the grounds that they could not be deemed to be *out of compliance*, as the relevant provisions would not even apply. As discussed, however, we have found that any such transactions would not qualify for the safe haven.

5.146 In response to a question from the Panel concerning the negative wording of the Guideline, Canada argues that the use of the negative is necessary to preserve the discretion of the Minister not to authorize a transaction even if it does comply with the *Arrangement*, if the transaction is otherwise considered not to be in the national interest. We are not persuaded by this answer, however, as in our view it would be possible to craft affirmatively-worded language that would leave open this discretion¹²⁵.

5.147 We consider that for Canada to reasonably ensure (which it indicates is its intention) that future Canada Account transactions in the regional aircraft sector *will* qualify for the safe haven of the second paragraph of item (k) and therefore will *not* be prohibited export subsidies, a great deal more detail than is contained in the Policy Guideline would be needed, in particular, the following:

- (a) That all Canada Account transactions in the regional aircraft sector would take the form of either direct credits/financing, refinancing or interest rate support (i.e., official financing support) with repayment terms of two years or more;
- (b) That such official financing support would be at fixed interest rates;

¹²⁴ Exhibit CDN-13. Emphasis supplied.

¹²⁵ An example of such language could be along the lines that conformity with the interest rate provisions of the *Arrangement* would be treated by the Minister as a *necessary* but not necessarily sufficient condition for a Canada Account transaction to be considered to be in the national interest.

- (c) That the net interest rates¹²⁶ of all such transactions would be at or above the relevant CIRR;
- (d) That all applicable provisions of Articles 7-10 and 12-26 of the *Arrangement*, and of Articles 18-24¹²⁷ and Articles 27-29(a)-(c) of Annex III would be respected in full;
- (e) That any permitted exceptions would be within the limitations specified in the relevant provisions of the *Arrangement*;
- (f) That no derogations would be made, either at Canada's initiative or via matching.

5.148 Given the lack of such detail, therefore, we find that Canada has not accomplished what it states it intends to accomplish through the Policy Guideline, namely to ensure cessation of prohibited export subsidies to the regional aircraft under Canada Account by ensuring that all future Canada Account transactions in the regional aircraft sector will qualify for the safe haven in the second paragraph of item (k).

(ii) *Form of the Policy Guideline*

5.149 In conjunction with its substantive criticisms of the Policy Guideline, Brazil appears also to consider its *legal form* inadequate, as in Brazil's view it contains only a general hortatory intention to comply with the *OECD Arrangement*. That is, Brazil argues that "at the implementation stage of dispute settlement proceedings, when a Member has already been found to be in violation of its WTO obligations, ... unelaborated policy guidelines offering vague hortatory statements regarding the Member's intentions do not constitute effective implementation"¹²⁸. In answer to a Panel question seeking clarification of why Brazil believes the Guideline to be only hortatory, Brazil argues that under Canadian law, Policy Guidelines are not binding and cannot fetter Ministerial discretion. That is, they provide guidance on how decision makers will exercise their discretion but they are not binding and do not require a specific outcome. In Brazil's view, for the Guideline to become mandatory under Canadian law, at a minimum mandatory language would need to be used, and provision would need to be made for consequences in the event of non-compliance¹²⁹.

5.150 Canada argues that through the Policy Guideline, the Minister for International Trade has adopted the policy that "*only* those transactions that comply with the *OECD Arrangement* will be considered to be in the national interest"¹³⁰. Canada further argues that "by this policy, the Minister informs EDC *and the world* that he will not authorize any financing transaction under the Canada Account programme unless it complies with the *OECD Arrangement*"¹³¹.

5.151 In response to a question from the Panel as to whether Canada considers that it has "undertaken" to respect all of the provisions of the *OECD Arrangement* and whether Canada considers that any such undertaking is legally binding on Canada, Canada states that Canada has "undertaken" to respect all of the provisions of the *OECD Arrangement* with respect to financing transactions under the Canada Account, and that through the Policy Guideline the Minister has

¹²⁶ In the case of interest rate support, the concept of *net* interest rates is key, as it is the interest rate *after* the support that must respect the CIRR.

¹²⁷ The reference to Article 24 of Annex III in this context is in respect of the requirement that no aid support be provided except in the form of an untied grant. As indicated above (at footnote 102) we make no finding concerning tied aid for humanitarian purposes.

¹²⁸ Second submission of Brazil (Annex 1-2) at para. 72.

¹²⁹ Brazil's answer to the Panel's Canada Account question 1 to Brazil (Annex 1-5).

¹³⁰ First submission of Canada (Annex 2-1) at para. 57. (Emphasis in original.)

¹³¹ *Id.* at para. 58. (Emphasis supplied.)

“undertaken” not to authorise any financing transaction under Canada Account that does not comply with the *OECD Arrangement*. In Canada’s view, for all practical purposes the effect of the Guideline is “almost the same” as that of a legislative instrument, because the exercise of discretion under the Canada Account programme is in the hands of the Minister and it is the Minister who has given the undertaking. Canada states that in addition, officials administering the programme and/or referring financing transactions to the Minister for authorization will act in accordance with the Guideline. In Canada’s view, the Guideline is effective in *requiring* that all Canada Account financing transactions in the regional aircraft sector will comply with the *OECD Arrangement* and thereby comply with the interest rates provisions of the *Arrangement*¹³². Thus Canada emphasizes that, contrary to Brazil’s argument, the Guideline is “serious and effective” and “not at all hortatory”¹³³.

5.152 We recall Brazil’s statement concerning what it believes Canada’s implementation obligation to be in respect of Canada Account, namely that “vague hortatory statements of a Members intentions” are not enough, and that Canada’s “*minimum burden* ... must be to explain with some precision what ‘comply with the OECD Arrangement’ will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in the future”¹³⁴. Thus, Brazil’s arguments concerning the Guideline’s form are closely linked to its arguments concerning the Guideline’s substance. As discussed above, we have found that the Policy Guideline’s *substance* is not sufficiently precise to accomplish what Canada claims it will accomplish, that is, to *ensure* the definitive cessation of prohibited export subsidies to the regional aircraft sector under Canada Account. Accordingly, we do not need to, and do not, make a separate finding concerning the sufficiency of the legal *form* of the Guideline. We do note in principle, however, that whatever form a Member’s implementation of a Panel ruling takes, it should involve sufficient limitation of discretion as to render that implementation legally effective.

(d) Summary

5.153 In summary, we have established a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). This process is based on the text of the SCM Agreement and the *OECD Arrangement*, read in the light of the object and purpose of the SCM Agreement. Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or matching of derogations. We have applied this process to the Policy Guideline, and found that the Policy Guideline is not sufficient to ensure that future Canada Account transactions in the regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and thereby qualify for the safe haven in the second paragraph of item (k) of Annex I of the SCM Agreement.

¹³² Canada’s reply to the Panel’s Canada Account question 4 (Annex 2-4).

¹³³ Canada’s comments on Brazil’s answers to question 1 from the Panel to Brazil (Annex 2-5).

¹³⁴ Second submission of Brazil (Annex 1-2) at para. 76. (Emphasis supplied.)

VI. CONCLUSION

6.1 For the reasons set forth in this Report, and on the basis of those facts currently surrounding the application of the restructured TPC programme which are relevant to Canada's implementation of the DSB recommendation on TPC assistance to the regional aircraft industry, we conclude that Canada has implemented the DSB recommendation in respect of TPC assistance to the Canadian regional aircraft industry. However, we conclude that the measures taken by Canada to comply with the DSB recommendation on the application of the Canada Account programme are not sufficient to ensure that future Canada Account transactions in the Canadian regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and are therefore not sufficient to ensure that such Canada Account transactions will not be prohibited export subsidies.

6.2 Accordingly, we conclude that (1) Canada has implemented the 20 August 1999 DSB recommendation that Canada withdraw TPC assistance to the Canadian regional aircraft industry within 90 days, and that (2) Canada has failed to implement the 20 August 1999 recommendation of the DSB that Canada withdraw the Canada Account assistance to the Canadian regional aircraft industry within 90 days.

6.3 Canada requests that we suggest, pursuant to Article 19.1 of the DSU, the establishment of verification procedures in respect of Canada's future arrangements to bring any subsidies in respect of Canada Account financing transactions for regional aircraft into compliance with the SCM Agreement, provided that such procedures are also applicable to Brazil with respect to its implementation of the rulings and recommendations in *Brazil- Export Financing Programme for Aircraft*. Canada asks only that the Panel endorse the establishment of such verification procedures, and is not proposing an ongoing role for the Panel should a verification process be established. Brazil does not, in principle, oppose the establishment of such verification procedures, but considers that they are not compatible with the spirit, if not the letter, of Article 19 of the DSU. Brazil believes that such procedures are better agreed to by the parties in the course of bilateral consultations.

6.4 We note that, by virtue of Article 19.1 of the DSU, the Panel "may suggest ways in which the Member concerned could implement the recommendations". In our view, Article 19.1 envisions suggestions regarding what could be done to a measure to bring it into conformity or, in the case of Article 4.7 of the SCM Agreement, what could be done to "withdraw" a prohibited subsidy. It does not address the issue of surveillance of those steps. For that reason, we decline to make the suggestion requested by Canada.¹³⁵

¹³⁵ This does not mean that the Panel in any way discourages agreements between WTO Members that may facilitate transparency with regard to the implementation of WTO obligations.

ANNEX 1-1

FIRST SUBMISSION OF BRAZIL

(23 December 1999)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	45
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	45
A. CANADA SHOULD WITHDRAW THE TPC PROGRAMME ENTIRELY, AS IT RELATES TO THE REGIONAL AIRCRAFT INDUSTRY.....	45
B. CANADA'S IMPLEMENTATION STRATEGY DOES NOT CHANGE THE STATUS OF TPC CONTRIBUTIONS AS SUBSIDIES UNDER ARTICLE 1 OF THE SUBSIDIES AGREEMENT	46
C. THE AMENDMENTS TO THE TPC PROGRAMME ARE COSMETIC, AND DO NOT CHANGE THE STATUS OF TPC CONTRIBUTIONS TO THE CANADIAN REGIONAL AIRCRAFT INDUSTRY AS <i>DE FACTO</i> EXPORT CONTINGENT UNDER ARTICLE 3 OF THE SUBSIDIES AGREEMENT	47
1. The Canadian Regional Aircraft Industry Remains Export-Oriented, and the Canadian Government's Recognition of the Significance of that Export-Orientation Is Still Evident	48
2. Canada's Removal of the "Near to Market" Terminology from TPC Documents Is Irrelevant	50
3. The Goals and Objectives of the TPC Programme Remain Intimately Linked to Export	52
4. Canada Has Failed to Provide Many Documents Necessary to Determine Whether the 'New' TPC Programme Remains <i>De Facto</i> Contingent on Export	54
III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	55
IV. CONCLUSION.....	57
LIST OF EXHIBITS	58
I. INTRODUCTION	

1. In *Canada – Measures Affecting the Export of Civilian Aircraft*¹, subsidies by the Canadian government to the regional aircraft industry *via* two programmes – Canada Account and Technology Partnerships Canada (“TPC”) – were determined by this Panel and the Appellate Body to constitute prohibited export subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (“Subsidies Agreement”). Pursuant to Article 4.7 of the Subsidies Agreement, the Panel and the Appellate Body identified the subsidies to be withdrawn by Canada: Canada Account debt financing for the export of Canadian regional aircraft, and TPC assistance to the Canadian regional aircraft industry.²

2. The Panel’s and the Appellate Body’s recommendations and rulings regarding Canadian withdrawal of these subsidies were adopted by the Dispute Settlement Body (“DSB”) on 20 August 1999. On 18 November 1999, the 90-day period for implementation of the DSB’s recommendations and rulings expired. On 19 November 1999, Canada announced measures ostensibly constituting implementation of the DSB’s recommendations and rulings. Brazil has attached Canada’s 19 November 1999 letter to the DSB, and its 19 November 1999 statement to the DSB, as Exhibits Bra-1 and Bra-2, respectively.

3. The Canadian measures do not adequately implement the DSB’s recommendations and rulings, and the impugned programmes remain inconsistent with the Subsidies Agreement. As a result, and under Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”), Brazil requested that the DSB refer the matter to this Panel for resolution.³ Pursuant to that request, the Panel was established on 9 December 1999.

4. Brazil will demonstrate in this submission that the measures heralded by Canada as effective implementation of its obligations under the Subsidies Agreement are little more than cosmetic, and make no substantive changes to the underlying subsidy programmes. Accordingly, Brazil reiterates its request that the Panel resolve, in these proceedings, the disagreement between Brazil and Canada regarding “the existence or consistency with [the Subsidies Agreement] of measures taken to comply with the recommendations and rulings of the DSB.”⁴

II. CANADA’S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB’S RECOMMENDATIONS AND RULINGS

A. CANADA SHOULD WITHDRAW THE TPC PROGRAMME ENTIRELY, AS IT RELATES TO THE REGIONAL AIRCRAFT INDUSTRY

5. Canada’s amendments to the TPC programme neither implement the recommendations and rulings of the DSB, nor bring TPC into conformity with the Subsidies Agreement. First, Canada’s actions do not remove TPC contributions from the category of government financial contributions that confer a “benefit” and constitute a “subsidy.” Second, *de facto* export contingency is still “*inferred*” from the total configuration of the facts constituting and surrounding” any TPC contributions to the Canadian regional aircraft industry.⁵

¹ WT/DS70/R (14 April 1999) (Adopted as modified by the Appellate Body, 20 August 1999) [hereinafter “Panel Report”]; WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999) [hereinafter “Appellate Body Report”].

² Panel Report, paras. 10.1 ((b) and (f)), 10.3; Appellate Body Report, para. 221.

³ Brazilian Letter to DSB, 23 November 1999 (Exhibit Bra-3).

⁴ DSU, Article 21.5.

⁵ Appellate Body Report, para. 167.

6. Particularly with regard to *de facto* export contingency, the cosmetic changes undertaken by Canada and described below are simply not enough. Were they sufficient, the entire purpose behind the prohibition of *de facto* export contingency in Article 3.1(a) of the Subsidies Agreement – to prevent circumvention of the provision prohibiting *de jure* export contingency – would be undermined.⁶ Withdrawing a *de facto* export subsidy like TPC, the very design and structure of which betrays its *de facto* export contingency, cannot adequately be achieved without complete and total abolition of the TPC programme altogether, as it applies to the Canadian regional aircraft industry.

7. The facts surrounding TPC's structure, objectives and economic backdrop, and the facts surrounding assistance to the regional aircraft industry, require this result to rid the programme of any remaining "inference" of *de facto* export contingency. This result, in fact, is also supported by the textual interpretation of the term "subsidy" proposed by Canada itself. Before the Appellate Body, Canada argued that the terms "[s]ubsidy" and "subsidy programme" are used interchangeably" in the Subsidies Agreement, and that TPC was a "subsidy programme" cognizable under the Subsidies Agreement.⁷ If this is the case, then the DSB's recommendation, pursuant to Article 4.7 of the SCM Agreement, that Canada "withdraw the subsidy," further confirms that Canada is required to withdraw TPC, in its entirety, as it relates to the regional aircraft industry.

B. CANADA'S IMPLEMENTATION STRATEGY DOES NOT CHANGE THE STATUS OF TPC CONTRIBUTIONS AS SUBSIDIES UNDER ARTICLE 1 OF THE SUBSIDIES AGREEMENT

8. The status of TPC contributions as "subsidies" under Article 1 of the Subsidies Agreement remains unchanged by Canada's implementation strategy. TPC contributions are still "financial contribution[s] by a government," under Article 1.1(a)(1) of the Subsidies Agreement. TPC's Special Operating Agency Framework Document ("TPC Framework Document") – the document that replaced, with only slight modifications, the "old" TPC Charter⁸ – states that "TPC's activities are funded through Parliamentary appropriations."⁹ Canada's announcements regarding implementation also do not suggest that TPC contributions are no longer provided in one of the forms listed in subparagraphs (i) through (iv) of Article 1.1(a)(1) to the Subsidies Agreement.

9. Canada has not, moreover, demonstrated that TPC contributions will no longer confer a "benefit" within the meaning of Article 1.1(b). The "benefit to recipient" standard adopted by the Panel, and affirmed by the Appellate Body, states that a "benefit" exists if a recipient has "received a 'financial contribution' on terms more favourable than those available to the recipient in the market."¹⁰ Indeed, the Panel determined that while TPC's rate of return on its contributions to the regional aircraft industry was projected at a maximum of [] per cent,¹¹ a commercial investor would expect a rate of return of 19.91 – 21.92 per cent on a similar investment. TPC contributions, therefore, are still on terms more favourable than those available to the recipient on the market.

10. TPC's most recent annual report, moreover, distinguishes TPC from commercial financial lenders: "[U]nlike commercial financial institutions that measure return solely in financial terms, the return to TPC is also measured in terms of a broad range of non-financial benefits to Canada that flow

⁶ Appellate Body Report, para. 19.

⁷ Submission of Appellant Canada, 13 May 1999, paras. 45-46 (Exhibit Bra-28).

⁸ Superseded TPC Charter (*in* TPC Interim Reference Binder, March 1998) (Exhibit Bra-4).

⁹ TPC Special Operating Agency Framework Document, pg. 6 (Exhibit Bra-5) [hereinafter "TPC Framework Document"].

¹⁰ Appellate Body Report, para. 157; Panel Report, para. 9.112.

¹¹ Panel Report, para. 9.312. *See also* Canada's reply to questions from the Panel, dated 21 December 1998, reply to question 33.

from successful projects.”¹² The annual report also notes that given the failure of some TPC-funded projects, “TPC’s expected repayment may be less than nominal.”¹³

11. Under these circumstances, TPC contributions, even after implementation of Canada’s purported compliance measures, continue to confer “benefits” and continue to constitute “subsidies” under Article 1.1(b) of the Subsidies Agreement.

C. THE AMENDMENTS TO THE TPC PROGRAMME ARE COSMETIC, AND DO NOT CHANGE THE STATUS OF TPC CONTRIBUTIONS TO THE CANADIAN REGIONAL AIRCRAFT INDUSTRY AS *DE FACTO* EXPORT CONTINGENT UNDER ARTICLE 3 OF THE SUBSIDIES AGREEMENT

12. Canada’s amendments to TPC are merely cosmetic, and do not constitute effective implementation of its obligations under the Subsidies Agreement. Even after the amendments to TPC:

the same three industry sectors will receive TPC assistance;

- the same types of projects will be eligible for TPC funds;
- the same objectives and fundamental economic realities underlie TPC’s creation and continued existence;
- the aerospace industry continues to receive far and away the greatest share of TPC contributions and disbursements; and,
- the Canadian aerospace industry in general, and the regional aircraft industry in particular, remains export-oriented.

13. The only real difference – apart from the fact that Canada forecasts available TPC funds to increase by 396 *per cent* between now and 2003¹⁴ – is that the word “export” is less ubiquitous than it was previously, at least in those documents made publicly available by the Canadian government.

14. This is not enough. As the Panel is aware, subsidies provided to the Canadian regional aircraft industry under the auspices of the TPC were found to be prohibited export subsidies *in fact*, rather than in law. A determination that subsidies are “contingent . . . in fact . . . upon export performance,” in the words of the Appellate Body, “must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy . . .”¹⁵ This is distinct from a determination of *de jure* export contingency, which is demonstrated “on the basis of the words of the relevant legislation, regulation or other legal instrument.”¹⁶

15. Merely sanitizing publicly-released documents to remove references to the word “export” is not sufficient to bring Canada into compliance with this Panel’s determination of *de facto* export contingency. According to the Appellate Body, demonstration of *de facto* export contingency depends not upon uncovering express reference to “export” as a condition for receipt of a subsidy (although such references abound in Canadian materials), but rather depends on the *inference* of

¹² TPC Annual Report, 1998-1999, pg. 20 (Exhibit Bra-6).

¹³ *Id.* at pg. 21.

¹⁴ TPC Annual Report, 1998-1999, pg. 28 (row titled “Total funds available for new contributions in future years,” comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6).

¹⁵ Appellate Body Report, para. 167 (emphasis in original).

¹⁶ *Id.*

export contingency drawn from the totality of the facts. This is the entire purpose of the *de facto* export contingency provision – to prevent Members from circumventing the prohibition of *de jure* export contingency by merely purging all references to the term “export.”¹⁷ It is this question of proof – demonstrating *express* contingency on export versus *inferred* contingency on export – that defines the very difference between a *de jure*, as opposed to a *de facto*, case.

16. Canada’s implementation measures change only the superficial evidence of export contingency, but make no substantive change whatsoever in the underlying programme. *De facto* export contingency is still, in the words of the Appellate Body, “*inferred* from the total configuration of the facts constituting and surrounding” any TPC contributions to the Canadian regional aircraft industry, regardless of Canada’s efforts to purge from its documents express reference to the word “export.”¹⁸ TPC’s structure, objectives and economic backdrop require this inference, and thus require a determination that Canada has not complied with the recommendation and ruling of the DSB that Canada “withdraw the subsidy.”

17. Canada may assert, as it has previously, that Brazil’s claim of Canadian non-compliance rests solely on the fact that TPC subsidies are granted to “enterprises that export,” a fact that, while certainly relevant to the Panel’s review,¹⁹ cannot (under footnote 4 to the Subsidies Agreement) form the entire basis of a determination of *de facto* export contingency. In the sections to follow, however, Brazil will describe a *series of facts* both related to and apart from the export orientation of the Canadian regional aircraft industry. These facts, together, lead to the very same inference derived by the Panel in its original decision: TPC contributions to the Canadian regional aircraft industries remain *de facto* contingent upon and in fact tied to export performance.

1. The Canadian Regional Aircraft Industry Remains Export-Oriented, and the Canadian Government’s Recognition of the Significance of that Export-Orientation Is Still Evident

18. An expert report included with Brazil’s submissions to the Panel, and the Panel itself, noted the export orientation or the export propensity of the Canadian regional aircraft industry.²⁰ This fact remains unchanged. Brazil has attached, as Exhibit Bra-7, a series of tables and supporting documentation updating the results of this expert report. This update demonstrates that during the period from 23 October 1998 (the end date for the earlier expert report) through 15 December 1999, every sale of Canadian regional aircraft – without exception – was for export.

19. Moreover, the appeal of this export orientation to the Canadian government has not been eliminated by Canada’s amendments to TPC:

- TPC has previously justified its support to its main beneficiary by pointing out that the industry is “highly *export* oriented”;²¹
- The Canadian Minister of Industry has justified particular instances of TPC support with the statement that “[a]erospace is a crucial sector for Canada’s economy, with *exports* growing at 10 per cent per year.”²²

¹⁷ *Id.* The European Communities initially proposed the *de facto* contingency prohibition “since experience has shown that government practices may be easily manipulated or modified in order to avoid this [*de jure*] prohibition ,” which on its own is therefore “open to circumvention.” *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989).

¹⁸ Appellate Body Report, para. 167.

¹⁹ Appellate Body Report, para. 173.

²⁰ Panel Report, para. 9.325 (footnote 623).

²¹ TPC Annual Report, 1996-1997, pg. 5 (emphasis added) (Exhibit Bra-8).

²² Industry Canada News Release, 10 January 1997 (emphasis added) (Exhibit Bra-9).

- The Leader of the Government in the House of Commons has stated that a key “output” of a TPC-supported project – the Dash 8-400 – is “the building of exports,” which he argued was, along with job creation, “just what the government had in mind when we established” TPC.²³
- As recently as October 1999, the Canadian government touted the Canadian aerospace industry as “[g]lobally competitive with exports exceeding 70 per cent of output,” and as “Commercial market focused/Export Oriented.”²⁴ TPC, which “invests with industry in near-market opportunities,” is listed among those government programmes supporting this export-based industry.²⁵
- Industry Canada’s 1998/99 Survey of the Canadian Aerospace and Defence Industry, published on 29 November 1999, projects that the Canadian aerospace industry’s exports will increase to 70 per cent of total sales in 2000.²⁶
- a June 1999 study sponsored in part by Industry Canada concludes that the Canadian aerospace industry exported 78 per cent of its production in 1998, and projects a 90 per cent increase in export sales during the period 1991-2001.²⁷ The same study notes that “rapid growth of the value of export sales” was achieved by a shift from exports of “manufactured components and sub-systems” to exports of “complete aircraft and systems.”²⁸
- The Aerospace Industries Association of Canada projects that 71 per cent of the industry’s sales revenue will be derived from exports in 2000,²⁹ and that the industry’s “exports continue to be the principal engine of [its] growth”³⁰ – factors that surely did not escape Industry Canada when it succumbed to the Association’s “advocacy efforts [to] secur[e] an additional \$150 million in funding for [TPC].”³¹

20. Like any other “fact” relevant under footnote 4 to the Subsidies Agreement, the Canadian government’s acknowledgement of the overwhelming export orientation of the industry, and its admission that this factor drives the government’s commitment to fund that industry, can serve in part as the basis for an *inference* that, without that export orientation, the abundant funding sources of TPC would not be available to the industry.

21. The crucial role the regional aircraft industry specifically, and the aerospace industry generally, play in Canada is translated into the funding priorities of Canadian subsidy programmes: as before the amendments announced by the Canadian government on 19 November, TPC continues to provide contributions to the same three categories of industry as before (Aerospace and Defence,

²³ Industry Canada News Release, 17 December 1996 (emphasis added) (Exhibit Bra-10).

²⁴ “Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment,” October 1999, pgs. 3, 33 (emphasis added) (Exhibit Bra-11).

²⁵ *Id.* at pg. 20.

²⁶ Industry Canada, “Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry,” 29 November 1999 (emphasis added) (Exhibit Bra-12).

²⁷ “Canadian Aerospace Suppliers Base Strategy for Change,” 25 June 1999, pgs. 1, 16-17 (relevant excerpt included at Exhibit Bra-13).

²⁸ *Id.* at pg. 17(emphasis added).

²⁹ Aerospace Industries Association of Canada Annual Report, 1999, pg. 4 (Exhibit Bra-14).

³⁰ *Id.* at pg. 13 (emphasis added).

³¹ *Id.* at pg. 12.

Enabling Technologies, and Environmental Technologies),³² and continues, as before, to be captive to the regional aircraft and the aerospace industry. Since inception of the programme, 65 per cent of TPC contributions have gone to the aerospace industry;³³ in the period 1998-1999, 76 per cent of TPC disbursements went to that industry.³⁴ The economic significance of this bias will become increasingly relevant to the industry in the coming years, since available TPC funds are slated to increase by 396 per cent between now and 2003.³⁵

22. Nothing, in short, has changed – neither the industries eligible for TPC contributions, nor the recognized export-orientation of the industry that enjoys the lion’s share of those contributions, nor the significance of that industry’s export orientation to Canadian government officials, nor that industry’s prospects for continued dominance of TPC’s treasury. None of these factors is destined for change.

23. When the Canadian government grants TPC funds to the Canadian regional aircraft industry – today as in the past – it is eminently aware, as its statements reveal, of that industry’s overwhelming export-orientation. To keep it that way, the Canadian aerospace industry receives the vast majority of the rapidly increasing pool of TPC funds available. These facts lead directly to the unavoidable conclusion that, without exceptional export performance, the Canadian regional aircraft industry would not receive TPC subsidies. The inescapable inference is, therefore, that continued receipt of those subsidies is in fact tied to export performance.

2. Canada’s Removal of the “Near to Market” Terminology from TPC Documents Is Irrelevant

24. As part of its implementation strategy, Canada announced that it will now “focus on promoting technological innovation and enhancing the technological capability of Canadian industry, rather than commercialization,” and that eligible activities will now be for “industrial research and pre-competitive development.”³⁶ Canada then goes on to specify three categories of TPC “Eligible Activities” – “industrial research,” “pre-competitive development,” and “studies.”³⁷ Brazil makes the following three observations regarding this aspect of Canada’s implementation strategy.

25. **First**, TPC’s “new” emphasis on “technological innovation” rather than “commercialization” is presumably in response to the Panel’s identification of TPC’s focus on “near market R & D” projects as one factor supporting a finding of *de facto* export contingency.³⁸ This “new” emphasis, however, does not immunize TPC from characterization as a prohibited export subsidy. The Appellate Body noted that “[i]t is. . . no *less* . . . *possible*’ that the facts, taken together, may demonstrate that a pre-production subsidy for research and development is ‘contingent . . . in fact . . . upon . . . export performance.’”³⁹ Removing “commercialization” or the “near market R & D” focus from TPC’s focus, therefore, and shifting instead to a focus on “industrial research and pre-

³² See Framework Document, pgs. 5-6 (Exhibit Bra-5). See also TPC Terms and Conditions, pg. 1 (Exhibit Bra-15); TPC Investment Application Guide, pgs. 3-4 (Exhibit Bra-16).

³³ TPC Current Statistics, 6 December 1999 (Exhibit Bra-17).

³⁴ TPC Annual Report, 1998-1999, pg. 27 (Exhibit Bra-6).

³⁵ *Id.* at pg. 28 (row titled “Total funds available for new contributions in future years,” comparing 1999-2000 figure with 2002-2003 figure).

³⁶ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

³⁷ TPC Terms and Conditions, pg. 2 (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (Exhibit Bra-16).

³⁸ Panel Report, paras. 9.339, 9.340, 9.341.

³⁹ Appellate Body Report, para. 174.

competitive development,”⁴⁰ would not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy.⁴¹

26. **Second**, and to the extent that this factor is still relevant as one among many contributing to an *inference of de facto* export contingency,⁴² Canada’s amendments to TPC do not in fact rid it of considerations regarding “commercialization.” TPC’s most recent “Current Statistics,” published on the TPC website on 6 December 1999, state that “TPC contracted projects, if successful, are forecasted to *generate sales of more than \$89.6 billion . . .*”⁴³ TPC still considers that its subsidies are to be used to “generate sales” – a virtual synonym for “commercialization.”

27. Moreover, two of the categories of TPC “eligible activities” betray an interest in projects linked to actual products. Under the category of “Industrial research,” TPC funds projects “aimed at the discovery of new knowledge, with the objective that such knowledge may be useful in *developing new products, processes or services, or in bringing about a significant improvement to existing products, processes or services.*”⁴⁴ Eligible projects in the category of “Pre-competitive development” specifically include the “*translation of industrial research findings into a plan, blueprint or design for new, modified or improved products, processes or services.*”⁴⁵

28. Finally, immediately after noting that “Canada’s aerospace and defence industries supply regional and business jet and turboprop aircraft, commercial helicopters, propulsion and major avionics systems, and electronics parts and components, and aviation support systems such as air traffic control systems,” TPC’s website states that “[i]nvestments by Technology Partnerships Canada help this vital part of the Canadian economy maintain and expand its position of technological excellence and so contribute to the country’s well-being.”⁴⁶ The industry’s successful commercialization of broad product lines, and TPC’s role in “helping” the industry “maintain and expand” its position through commercialization of those products, are two factors that do not escape the Canadian government.

29. **Third**, the three categories of TPC “eligible activities” are remarkably similar pre- and post-implementation. Brazil has attached as Exhibit Bra-20 an excerpt from the TPC website, dated 21 January 1998, describing certain of the prerequisites for TPC assistance:

The project activities must include one of the following: *development or demonstration* of a product, process and/or technology; certain *preproduction activities*; technical or marketing *feasibility studies*.⁴⁷

30. These descriptions exhibit considerable similarity to the “new” TPC categories of eligible activities: what was previously “development or demonstration” or “preproduction activities,” for example, is now “pre-competitive development”; what was then the category of “feasibility studies” is now simply “studies.”⁴⁸ Nothing of substance has changed; if funding for the development of commercial products was available in the “old” TPC, it is similarly available in the “new” TPC, and as it did before contributes to an *inference of de facto* export contingency.

⁴⁰ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

⁴¹ Appellate Body Report, para. 167.

⁴² *Id.*

⁴³ TPC Current Statistics, 6 December 1999 (emphasis added) (Exhibit Bra-17).

⁴⁴ TPC Terms and Conditions, pg. 2 (emphasis added) (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (emphasis added) (Exhibit Bra-16).

⁴⁵ *Id.* (emphasis added).

⁴⁶ TPC website, “Aerospace and Defence,” pg. 1 (Exhibit Bra-19).

⁴⁷ TPC website, “Project Identification and Description,” 21 January 1998 (Exhibit Bra-20).

⁴⁸ *Compare Id. with* TPC Terms and Conditions, pg. 2 (Exhibit Bra-15).

3. The Goals and Objectives of the TPC Programme Remain Intimately Linked to Export

31. Canada's materials regarding the "new" TPC are replete with references to the programme's objectives, most commonly phrased as "increasing economic growth, creating jobs, and supporting sustainable development."⁴⁹ These same objectives are at times characterized as the "new" TPC's "programme objectives,"⁵⁰ but are repeated elsewhere in the TPC materials as part of the programme's mandate,⁵¹ selection criteria,⁵² assessment criteria,⁵³ or examples of strategic benefits to be established by an applicant to secure TPC funds.⁵⁴

32. These same objectives were also central to the "old" TPC. TPC's Charter and its Business Plan formerly stated that the programme's mandate was "to stimulate economic growth and create jobs in Canada," and that two of its objectives were "to increase growth and wealth creation."⁵⁵ The "Terms and Conditions" document for the "old" TPC stated that the programme was to "contribute to achieving Canada's objectives of: (a) increasing economic growth and wealth creation; (b) supporting sustainable development," etc.⁵⁶ Similarly, the closing paragraph of Industry Canada News Releases announcing contributions under the "old" TPC included a statement that TPC "is a central element of the government's agenda to promote technological development as a catalyst for economic growth and job creation, through increased productivity and competitiveness."⁵⁷

33. More importantly, achieving these objectives – increasing or creating economic growth, wealth and jobs – has been expressly linked, by the Canadian government itself, as well as by other organizations, to the *export performance* of Canadian industry:

⁴⁹ Industry Canada News Release, 18 November 1999, pg. 3 (Exhibit Bra-18).

⁵⁰ TPC Framework Document, pg. 4 (Under section titled "Program Objectives," Canada states that "[c]ontributions under TPC will be administered in a way that will contribute to: increasing economic growth and creating jobs and wealth; supporting sustainable development . . ." etc.) (Exhibit Bra-5).

⁵¹ *Id.* at pg. 4 (Under section titled "Mandate," Canada states that "TPC is a technology investment fund established to contribute to the achievement of Canada's objectives such as increasing economic growth, jobs and wealth creation, and supporting sustainable development.").

⁵² TPC Investment Application Guide, pg. 6 (Under section titled "What are the criteria that TPC uses for selecting investments," Canada notes that investment outlines and proposals are assessed on the extent to which they demonstrate, among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada (increasing economic growth, creating jobs and wealth, and supporting sustainable development).") (Exhibit Bra-16).

⁵³ TPC Terms and Conditions, pg. 2 (Under section titled "Assessment Criteria," Canada states that applications for TPC funds will be assessed according to the extent to which they demonstrate, among other things, "that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada.") (Exhibit Bra-15).

⁵⁴ TPC Investment Application Guide, pg. 8 (Under section titled "What is the format for preparing a TPC investment outline," Canada states that certain information regarding "strategic benefit" must be demonstrated, including "[p]otential economic benefit to Canada (for example, jobs created or maintained, economic growth, wealth creation, sector or supplier development, contribution to sustainable development, new corporate mandates, leveraged investments, strategic alliances, etc.)." (Exhibit Bra-16).

⁵⁵ Superseded TPC Charter (*in* TPC Interim Reference Binder, March 1998), pg. 3 (Exhibit Bra-4); TPC Business Plan, 1996-1997, pg. iii (Exhibit Bra-21).

⁵⁶ Superseded TPC Terms and Conditions (*in* TPC Interim Reference Binder, March 1998), pg. 1 (Exhibit Bra-22).

⁵⁷ *See, e.g.*, Industry Canada News Release, 10 January 1997 (Exhibit Bra-9); Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

- Industry Canada's International Business Strategy ("CIBS") makes clear that "exports are critical to Canada's economic and social well-being, and serve as the engine that is driving Canada's economy."⁵⁸
- In particular, the CIBS makes explicit the connection between job creation and exports, arguing that "[i]ncrease [sic] trade means new and better jobs for Canadians – it is estimated that for every \$1 billion of exports, 11,000 Canadian jobs are created or sustained."⁵⁹
- In describing its "Jobs Strategy," the aim of which is "to co-ordinate efforts to create more and better jobs for Canadians," Industry Canada states that "[w]ith one in three Canadian jobs dependent on exports, a critical component of the Jobs Strategy is to encourage more Canadian firms to export . . ."⁶⁰
- Industry Canada affirms that "Canada's economic growth and job creation in the past three years have been driven by exports to the United States."⁶¹
- In its review of the Aerospace and Defence sector, Industry Canada emphasizes that

[t]he Canadian aerospace and defence industry is a vital and growing component of our national economy. It is a major contributor to research and development (R&D); employment; national income; exports; national defence; and international prestige. It is also one of Canada's leading advanced-technology sectors, and its innovative products are recognized around the world. *It ranks fifth among world exporters of aircraft and aircraft parts, and could well achieve fourth place, if present trends continue. However, the continued growth of the aerospace and defence industry, and its contribution to the wealth and job creation in Canada, will depend largely on its ability to capture a growing share of world aerospace and defence markets.*⁶²

In other words, to achieve wealth and job creation in Canada – two of TPC's objectives – aerospace exports have been, are, and will be necessary.

- The Canadian Minister of Industry has identified the close relationship between Canadian aerospace exports, Canadian economic growth and the creation of Canadian jobs. According to the Minister, "[a]erospace is a crucial sector for Canada's economy, with exports growing at a rate of 10 per cent per year," with the result that "TPC's investment in [aerospace industry] projects will help increase the global competitiveness of this industry, while supporting jobs in Montreal, in Halifax and across the country, generating economic growth and export dollars."⁶³
- The Conference Board of Canada also acknowledges the link between exports and TPC's goals of job creation and increasing economic growth, noting that:

⁵⁸ Industry Canada, CIBS Overview, "Executive Summary," pg. 2 (emphasis added) (Exhibit Bra-23).

⁵⁹ *Id.* at pg. 1 (emphasis added).

⁶⁰ Industry Canada, CIBS Strategic Overview, "International Business Development Priorities," pg. 1 (emphasis added) (Exhibit Bra-24).

⁶¹ Industry Canada, CIBS Geographic Overview, pg. 1 (emphasis added) (Exhibit Bra-25).

⁶² Industry Canada, CIBS Aerospace and Defence, pg. 1 (emphasis added) (Exhibit Bra-26).

⁶³ Industry Canada News Release, 10 January 1997 (emphasis added) (Exhibit Bra-9).

Exports have been a driving force in the [Canadian] economy over the past 10 years, with real growth averaging 7 per cent on an annual basis – well ahead of the average 2 per cent annual real GDP growth. One in three jobs in Canada is dependent on trade. If Canadian business cannot continue to access markets abroad for their products, services and investments, the continued growth of the Canadian economy will be threatened.⁶⁴

34. The significance of the link between export performance and growth, wealth or jobs has not changed with Canada's amendments to TPC. When TPC makes the increase or creation of economic growth, wealth and jobs part of its selection criteria,⁶⁵ its assessment criteria,⁶⁶ or a "strategic benefit" to be demonstrated by an applicant to secure a TPC subsidy,⁶⁷ the Panel should infer that it is implicitly conditioning receipt of that subsidy on export performance. Without committing to export performance, an applicant cannot meet TPC's selection or assessment criteria, cannot demonstrate that it will provide the requisite strategic benefits imposed by the TPC programme, and will not receive a TPC subsidy.

4. Canada Has Failed to Provide Many Documents Necessary to Determine Whether the 'New' TPC Programme Remains *De Facto* Contingent on Export

35. Although Canada has made certain documents regarding the "new" TPC publicly available, many others have not been provided. The Panel's decision regarding TPC's *de facto* export contingency relied, for example, upon the TPC Business Plan, the TPC Aerospace and Defence Generic Model Agreement, TPC Project Summary Forms, and the two-volume, 350-page TPC Interim Reference Binder.⁶⁸ "Business confidential" documents provided by Canada with its replies to questions from the Panel in the original proceedings, moreover, were also relevant to a review of the question of *de facto* export contingency. These documents include Programme Forecasts and Progress Reports.⁶⁹

36. Yet, none of these documents has been made publicly available with regard to the "new" TPC. Since Canada has not produced replacements for these documents, the Panel should consider that the original documents still apply, and still, as before, constitute facts demonstrating that TPC subsidies are contingent in fact on export performance, as detailed in paragraph 9.340 of the Panel Report.

37. The "new" TPC Framework Document, moreover, refers to several new documents that Canada has not provided, including the Treasury Board's "repayable contributions policy,"⁷⁰ TPC's "Evaluation Framework,"⁷¹ any "specialized reports" developed for the TPC Advisory Board,⁷² "case

⁶⁴ Conference Board of Canada, *Performance and Potential 1999*, "Working Smarter, Not Harder," pg. 107 (footnote omitted) (emphasis added) (Exhibit Bra-27).

⁶⁵ TPC Investment Application Guide, pg. 6 (Section titled "What are the criteria that TPC uses for selecting investments") (Exhibit Bra-16).

⁶⁶ TPC Terms and Conditions, pg. 2 (Section titled "Assessment Criteria") (Exhibit Bra-15).

⁶⁷ TPC Investment Application Guide, pg. 8 (Section titled "What is the format for preparing a TPC investment outline") (Exhibit Bra-16).

⁶⁸ Panel Report, para. 9.340.

⁶⁹ These documents were included behind "BCI Tab 1" and "BCI Tab 2," respectively, to Canada's 21 December 1998 replies to questions from the Panel.

⁷⁰ TPC Framework Document, pg. 7 (Exhibit Bra-5). The press release announcing Canada's implementation strategy suggests that TPC's repayment policies have in fact been changed. Industry Canada News Release, 18 November 1999, pg. 4 ("Repayments will no longer be primarily based on royalties tied to product sales but will take different forms depending on the project . . .") (Exhibit Bra-18).

⁷¹ TPC Framework Document, pg. 10 (Exhibit Bra-5).

⁷² *Id.*

evaluation” forms,⁷³ the “Memorandum of Understanding” between TPC and the Industry Sector,⁷⁴ “records of decisions” issued by the Secretariat of the Programmes and Services Board,⁷⁵ minutes of Interdepartmental Advisory Committee meetings and TPC Management Board meetings,⁷⁶ and “sector strategies, technical assessments, priorities and technology roadmaps” developed by the Sector Branches.⁷⁷

38. Canada cannot seriously claim compliance with the DSB’s recommendations and rulings on the basis of amendments made to TPC – a programme judged to be a prohibited export subsidy – without actually demonstrating that those changes were made. As demonstrated in paragraph 9.340 of the Panel Report, the devil is indeed in the details of the TPC programme. Canada’s failure to provide the documents listed in the preceding paragraph – which presumably detail its efforts at compliance – should lead the Panel to presume that the documents do not in fact demonstrate compliance.⁷⁸

III. CANADA’S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB’S RECOMMENDATIONS AND RULINGS

39. Although Canada’s 19 November 1999 statement to the DSB first claims that “there will be no deliveries of regional aircraft after 18 November 1999 benefitting from such Canada Account financing,” it goes on to say that “any delivery of regional aircraft after 18 November 1999 which benefits from Canada Account financing will comply with the [OECD] Arrangement.”⁷⁹ Brazil presumes, therefore, that Canada intends to retain the discretion to support sales or deliveries of Canadian regional aircraft with Canada Account financing.

40. Canada Account financing is still, under Article 3.1(a), contingent in law on export. Canada Account debt financing “takes the form of export credits and, in Canada’s own words, was granted ‘for export of goods’.”⁸⁰ Canada Account export credits are issued, moreover, “‘for the purpose of supporting and developing, directly or indirectly, Canada’s export trade.’”⁸¹

41. Confirming the Panel’s conclusion of *de jure* export contingency, the President of the Export Development Corporation, which administers the Canada Account, has stated that “Canada Account funds are used to support *export transactions* which the federal government deems to be in the national interest but which, for reasons of size or risk, the Export Development Corporation (EDC) cannot support through regular export credits.”⁸²

42. The materials submitted by Canada to the DSB purportedly demonstrating implementation do not speak to, much less alter, Canada Account’s *de jure* export contingency. Brazil submits,

⁷³ *Id.* at pg. 18, 20.

⁷⁴ *Id.* at pg. 18.

⁷⁵ *Id.* at pg. 19.

⁷⁶ *Id.*

⁷⁷ *Id.* at pg. 20.

⁷⁸ The Panel may, of course, request these documents from Canada. Any refusal to provide these documents should lead to the inference and presumption that the documents reveal something short of Canadian compliance with the recommendations and rulings of the DSB regarding TPC.

⁷⁹ Exhibit Bra-2, pg. 2.

⁸⁰ Panel Report, para. 9.230.

⁸¹ *Id.*

⁸² Export Development Corporation, *Chairman and President’s Message* (emphasis added) (Exhibit Bra-29). *See also* Panel Report, para. 6.149.

therefore, that the Panel should maintain its previous ruling that Canada Account financing is *de jure* contingent on export, within the meaning of Article 3.1(a) of the Subsidies Agreement.

43. Regarding the status of Canada Account financing as a “subsidy” under Article 1 of the Subsidies Agreement, Canada’s comments do not suggest that its implementation strategy removes such financing from the category of “financial contribution[s] by a government,” under Article 1.1(a)(1) of the Subsidies Agreement. The press release announcing Canada’s implementation, for example, states that “the collection risk” for Canada Account transactions “ultimately rests with the Government of Canada.”⁸³ Similarly, Canada’s announcements do not suggest that Canada Account financing is no longer provided in one of the forms listed in sub-paragraphs (i) through (iv) of Article 1.1(a)(1) to the Subsidies Agreement.

44. Canada’s statements outlining its implementation strategy do not, moreover, directly address the Panel’s finding that Canada Account financing could be at rates “below the market,”⁸⁴ and thus on terms constituting a “benefit” under Article 1.1(b) of the Subsidies Agreement, *i.e.*, terms “more advantageous for the recipient than those available on the market.”⁸⁵

45. To implement the DSB’s recommendations and rulings, Canada simply states that under a “policy guideline” issued by the Minister for International Trade, no Canada Account transactions will be authorized unless they “comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits.”⁸⁶

46. Canada appears to suggest that even if Canada Account financing otherwise constitutes a prohibited export subsidy, it is exempted by the so-called “safe harbor” in item (k) of the Illustrative List of Export Subsidies, included as Annex 1 to the Subsidies Agreement. This rather cryptic suggestion, however, is not sufficient to satisfy Canada’s significant burden of establishing entitlement to what is an *affirmative* defence. Had Canada opted for this defence in the original Panel proceedings, it would have carried the significant burden of proving entitlement to it; leaving reliance on this defence to the implementation phase of dispute settlement proceedings does not change Canada’s burden. Mere assertion of the defence, without more, is not enough.

47. For example, the OECD Arrangement on Guidelines for Officially Supported Export Credits – to which item (k) refers – includes 88 articles covering a wide variety of issues, along with an annex dedicated to aircraft. Canada has not specified which articles of the Arrangement or which portions of the aircraft annex are relevant under item (k), or precisely how it will maintain compliance with those provisions. Nor has Canada provided the Minister of International Trade’s “policy guideline,” under which future Canada Account financing allegedly compliant with the terms of the OECD Arrangement will apparently be issued.⁸⁷

48. For these reasons, Canada has not brought itself into compliance with either the recommendations and rulings of the DSB, or the terms of the Subsidies Agreement, with regard to the Canada Account.

⁸³ Industry Canada News Release, 18 November 1999, pg. 2 (Exhibit Bra-18).

⁸⁴ Panel Report, para. 9.224.

⁸⁵ Panel Report, para. 9.222.

⁸⁶ Canadian Statement to the DSB, pg. 2 (Exhibit Bra-2). *See also* Canadian Letter to the DSB (Exhibit Bra-1).

⁸⁷ *Id.* Should the Panel request this document from Canada, any refusal to provide it should lead to the inference and presumption that the document would reveal something short of Canadian compliance with the recommendations and rulings of the DSB regarding the Canada Account.

IV. CONCLUSION

49. Canada has not withdrawn the subsidies determined by the Panel and the Appellate Body to be prohibited export subsidies. The amendments proposed to TPC are inadequate to implement the recommendations and rulings of the DSB, and are not otherwise in compliance with Canada's obligations under the Subsidies Agreement. The cosmetic changes included in Canada's implementation strategy consist of little more than an effort to strike the word "export" from TPC documents. This is not sufficient to cure a programme rendered *de facto* export contingent, since *de facto* export contingency "must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy . . ."⁸⁸ Under the "facts constituting and surrounding" TPC subsidies, implementation of the DSB's recommendations and rulings and compliance with the Subsidies Agreement requires nothing short of complete and total withdrawal of TPC, as it relates to the regional aircraft industry.

50. With regard to the Canada Account, Canada's cryptic statement that debt financing under the programme will in future conform to the terms of the OECD Arrangement is not sufficient to discharge its burden of proving what amounts to an appeal to an affirmative defence.

51. Accordingly, Brazil requests that the Panel determine that Canada has not implemented the recommendations and rulings of the DSB or otherwise complied with its obligations under the Subsidies Agreement.

⁸⁸ Appellate Body Report, para. 167 (emphasis in original).

LIST OF EXHIBITS

Canadian Letter to DSB, 19 November 1999	Exhibit Bra-1
Canadian Statement to DSB, 19 November 1999	Exhibit Bra-2
Brazilian Letter to DSB, 23 November 1999	Exhibit Bra-3
Superseded TPC Charter (<i>in</i> TPC Interim Reference Binder, March 1998)	Exhibit Bra-4
TPC Special Operating Agency Framework Document	Exhibit Bra-5
TPC Annual Report, 1998-1999	Exhibit Bra-6
Updated Expert Report	Exhibit Bra-7
TPC Annual Report, 1996-1997	Exhibit Bra-8
Industry Canada News Release, 10 January 1997	Exhibit Bra-9
Industry Canada News Release, 17 December 1996	Exhibit Bra-10
“Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment,” October 1999	Exhibit Bra-11
Industry Canada, “Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry,” 29 November 1999	Exhibit Bra-12
“Canadian Aerospace Suppliers Base Strategy for Change,” 25 June 1999	Exhibit Bra-13
Aerospace Industries Association of Canada Annual Report, 1999	Exhibit Bra-14
TPC Terms and Conditions	Exhibit Bra-15
TPC Investment Application Guide	Exhibit Bra-16
TPC Current Statistics, 6 December 1999	Exhibit Bra-17
Industry Canada News Release, 18 November 1999	Exhibit Bra-18
TPC website, “Aerospace and Defence”	Exhibit Bra-19

TPC website, "Project Identification and Description," 21 January 1998	Exhibit Bra-20
TPC Business Plan, 1996-1997	Exhibit Bra-21
Superseded TPC Terms and Conditions (<i>in</i> TPC Interim Reference Binder, March 1998)	Exhibit Bra-22
Industry Canada, CIBS Overview, "Executive Summary"	Exhibit Bra-23
Industry Canada, CIBS Strategic Overview, "International Business Development Priorities"	Exhibit Bra-24
Industry Canada, CIBS Geographic Overview	Exhibit Bra-25
Industry Canada, CIBS Aerospace and Defence	Exhibit Bra-26
Conference Board of Canada, <i>Performance and Potential 1999</i> , "Working Smarter, Not Harder"	Exhibit Bra-27
Submission of Appellant Canada, 13 May 1999, paras. 45-46	Exhibit Bra-28
Export Development Corporation, <i>Chairman and President's Message</i>	Exhibit Bra-29

ANNEX 1-2

REBUTTAL SUBMISSION OF BRAZIL

(17 January 2000)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	62
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	62
A. TPC CONTRIBUTIONS STILL CONSTITUTE SUBSIDIES UNDER ARTICLE 1 OF THE SUBSIDIES AGREEMENT.....	62
B. DETERMINING WHETHER CANADA HAS IMPLEMENTED THE RECOMMENDATIONS AND RULINGS OF THE DSB DOES NOT REQUIRE EVIDENCE OF TPC CONTRIBUTIONS SUBSEQUENT TO 18 NOVEMBER 1999.....	62
1. Canada Mischaracterizes the Appellate Body's Test for <i>De Facto</i> Export Contingency	63
2. Canada's Argument Reduces Article 21.5 to 'Inutility'	63
C. COSMETIC CHANGES DO NOT CURE TPC OF <i>DE FACTO</i> EXPORT CONTINGENCY...64	
1. TPC Remains Focused on the Aerospace Industry and the Regional Aircraft Industry, the Export Orientation of Which Has Been Singled out by the Canadian Government As Significant	66
2. Removing the 'Near to Market' Terminology from TPC Documents is Irrelevant.....	69
3. To Qualify for TPC Funds, Applicants Must Demonstrate a Contribution to Goals and Objectives Requiring a Commitment to Export Performance.....	69
(a) Export Contingency Need Not Be the Sole Condition for Receipt of a Subsidy	71
(b) Brazil Has Relied on Valid Evidence	71
4. References to the Term 'Export' Have Not Been Removed from All TPC Documents	73
III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS.....	75
A. DETERMINING WHETHER CANADA HAS IMPLEMENTED THE RECOMMENDATIONS AND RULINGS OF THE DSB DOES NOT REQUIRE EVIDENCE OF CANADA ACCOUNT FINANCING SUBSEQUENT TO 18 NOVEMBER 1999	75
B. CANADA'S CLAIM THAT THE RECOMMENDATIONS AND RULINGS OF THE DSB REQUIRED NO IMPLEMENTATION BY CANADA IS IN ERROR	76
IV. CANADA'S PROPOSAL REGARDING THE ESTABLISHMENT OF 'VERIFICATION PROCEDURES'	78

V. CONCLUSION.....	78
LIST OF EXHIBITS	80

I. INTRODUCTION

1. In its first submission¹ Canada claims to have adopted measures implementing the recommendations and rulings of the Dispute Settlement Body (“DSB”) regarding the withdrawal of subsidies provided by the Canadian government to the regional aircraft industry *via* two programmes – Technology Partnerships Canada (“TPC”) and Canada Account. In *Canada – Measures Affecting the Export of Civilian Aircraft*² these subsidies were determined to constitute prohibited export subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (“Subsidies Agreement”), and were accordingly ordered withdrawn, pursuant to Article 4.7 of that Agreement.

2. Brazil reiterates its claim that the Canadian measures do not adequately implement the DSB’s recommendations and rulings, and that the impugned programmes remain inconsistent with the Subsidies Agreement. In this submission, Brazil addresses arguments levied by Canada in its first submission, and demonstrates that Canada’s implementation measures are insufficient to comply with the recommendations and rulings of the DSB that it “withdraw ” TPC and Canada Account subsidies to the regional aircraft industry.

II. CANADA’S AMENDMENTS TO THE TPC PROGRAMME DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB’S RECOMMENDATIONS AND RULINGS

A. TPC CONTRIBUTIONS STILL CONSTITUTE SUBSIDIES UNDER ARTICLE 1 OF THE SUBSIDIES AGREEMENT

3. Without repeating the arguments included in paragraphs 8-11 of its first submission, Brazil simply reiterates that the legal status of TPC contributions as “subsidies” under Article 1 of the Subsidies Agreement remains unchanged under the “new” TPC.

4. Canada argues that the question whether TPC contributions will continue to constitute subsidies is “not the issue in this case.”³ With this statement, Canada effectively concedes that should the Panel determine that contributions under the “new” TPC will continue to be contingent in fact on export performance under Article 3 of the Subsidies Agreement, it should also presume that those contributions will continue to constitute “subsidies” under Article 1 of the Agreement.

B. DETERMINING WHETHER CANADA HAS IMPLEMENTED THE RECOMMENDATIONS AND RULINGS OF THE DSB DOES NOT REQUIRE EVIDENCE OF TPC CONTRIBUTIONS SUBSEQUENT TO 18 NOVEMBER 1999

5. In its first submission, Canada contends that in the absence of new “financial contributions” to the regional aircraft industry made subsequent to 18 November 1999 under the “restructured” TPC, this Panel cannot judge whether Canada has effectively implemented the recommendations and rulings of the DSB. Specifically, Canada claims that “in the absence of any such financial contribution and a full consideration of those facts, there can be no grounds to support Brazil’s allegations of *de facto* export contingency under the restructured TPC programme.”⁴

¹ First Article 21.5 Submission of Canada, dated 10 January 2000 [“Canadian First Submission”].

² WT/DS70/R (14 April 1999) (Adopted as modified by the Appellate Body, 20 August 1999) [“Panel Report”]; WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999) [“Appellate Body Report”].

³ Canadian First Submission, para. 39.

⁴ *Id.* at para. 45.

6. Canada appears to draw this conclusion from the first element of the Appellate Body's test for *de facto* export contingency, which Canada characterizes as an inquiry into whether "there is granting of assistance by Canada."⁵ Since no new assistance has been granted under the "new" TPC, Canada asserts that the Panel cannot conclude that Canada has failed to implement the recommendations and rulings of the DSB. Canada's assertion is in error, for two reasons.

1. Canada Mischaracterizes the Appellate Body's Test for *De Facto* Export Contingency

7. First, Canada mischaracterizes and takes wholly out of context the first element of the Appellate Body's test. What the Appellate Body actually said is that

the initial inquiry must be on whether the *granting authority* imposed a condition based on export performance in providing the subsidy. In the words of Article 3.2 and footnote 4, the prohibition is on the "*granting* of a subsidy", and not on receiving it. The treaty obligation is imposed on the *granting* Member, and not on the recipient. Consequently, we do not agree with Canada that an analysis of "contingent . . . in fact . . . upon export performance" should focus on the reasonable knowledge of the recipient.⁶

Brazil has retained the original italicized emphasis employed by the Appellate Body to demonstrate that the Appellate Body's point with this first element was to show the error of Canada's assertion that an interpreter should look to a subsidy *recipient's* knowledge to determine whether the recipient, rather than the grantor, understood the subsidy to be conditioned in fact on export performance.

8. To interpret this first element of the Appellate Body's test otherwise, as Canada suggests the Panel should, would be to render redundant Article 1.1 of the Subsidies Agreement – which already requires demonstration of a "financial contribution by a government." In *Brazil – Export Financing Programme for Aircraft*, the Appellate Body held that the Panel erred in importing the notion of a "benefit," from Article 1.1(b) of the Subsidies Agreement, into the definition of a "financial contribution" in Article 1.1(a); it termed these two sub-parts of the same Article "two separate legal elements."⁷ Since there was no textual basis to read one provision (regarding "benefit") into another provision (regarding "financial contribution"), the Appellate Body concluded that it was not permissible to do so.

9. Similarly, there is no textual basis to import the notion of a "financial contribution by a government," from Article 1 of the Subsidies Agreement, into the legal test of "contingen[cy] . . . in fact . . . upon export performance," from Article 3 of the Agreement. Nor, when read in context, does the Appellate Body's exposition of the first element of demonstrating *de facto* export contingency create such a requirement.

2. Canada's Argument Reduces Article 21.5 to 'Inutility'

10. Second, Canada's claim confuses a *de novo* challenge to a financial contribution *not yet judged* to be a prohibited export subsidy, with a challenge to those measures allegedly remedying something *already judged* to be a prohibited export subsidy. If accepted, Canada's claim would make measures allegedly constituting effective implementation impervious to effective challenge under Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes

⁵ *Id.* at para. 38.

⁶ Appellate Body Report, para. 170 (emphasis in original).

⁷ WT/DS46/AB/R (2 August 1999) (Adopted 20 August 1999) para. 157.

(“DSU”). This is because a Member determined by a Panel to have adopted measures constituting subsidies contingent in fact on export could, under Canada’s theory, escape effective Article 21.5 scrutiny by merely refraining from *applying* any remedial measures until the 20-day time period to seek compensation has passed.⁸

11. The opportunity to manipulate the system in this way did not escape Canada; according to TPC’s website, Canada waited until 10 January 2000 to award its first contribution under the “new” TPC.⁹ Nor should it escape other Members. The effect, of course, would be to reduce Article 21.5 to “inutility,” a result considered unacceptable by the Appellate Body.¹⁰ Members that have successfully challenged a subsidy contingent in fact on export would be left, effectively, with little more than a Pyrrhic victory. When it comes to enforcement of the most egregious of export subsidies – those subsidies determined by a Panel or the Appellate Body to be levied in a manner designed to *circumvent* the prohibition of *de jure* export contingency – Members would be left without an effective remedy.¹¹

12. Finally, beyond undermining Article 21.5, accepting Canada’s theory would also undermine any incentive a Member would have to implement the DSB’s recommendations and rulings at all. If implementation measures remedying a finding of a subsidy programme’s *de facto* export contingency are impervious to effective challenge, what incentive would a Member have to undertake those implementation measures? More specifically, if all Canada considers it needed to do to insulate TPC from challenge was to refrain from making a contribution under the “new” TPC, why did it bother to undertake any implementation measures at all?

13. It would not have had to do so, under its own logic, since it could have defended Brazil’s challenge under Article 21.5 strictly on the basis that no new subsidies to the regional aircraft industry had been granted. Obviously, Canada undertook the implementation measures detailed in its first submission because it considered itself compelled to do more than simply not issue TPC subsidies to the regional aircraft industry for the time being.¹² The fact that Canada felt compelled to do so demonstrates that it does not consider the absence of subsequent subsidies to immunize it from Brazil’s Article 21.5 challenge. For this and the other reasons expressed above, Canada’s argument must be rejected.

C. COSMETIC CHANGES DO NOT CURE TPC OF *DE FACTO* EXPORT CONTINGENCY

14. “TPC assistance to the Canadian regional aircraft industry” was determined by the Panel and the Appellate Body to be contingent in fact on export performance.¹³ Canada’s response, however, as demonstrated by its implementation strategy and detailed in its first submission, has been to treat TPC

⁸ See DSU Article 22.2.

⁹ Moreover, this contribution does not involve the regional aircraft industry. TPC News Release, 10 January 2000 (Exhibit Bra-30). According to TPC’s website, no other TPC awards had been made since 17 November 1999, one day before expiration of the “reasonable period of time” for implementation. TPC News Release, 17 November 1999 (Exhibit Bra-31).

¹⁰ *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, pg. 23 (29 April 1996) (Adopted 20 May 1996) (An interpreter “is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.”).

¹¹ The Panel will recall that the European Communities proposed the express prohibition of subsidies contingent in fact on export because the *de jure* provision is “open to circumvention.” *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989).

¹² In paragraph 2 of its first submission, Canada confirmed this fact, characterizing its TPC implementation measures as “new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement.”

¹³ Panel Report, paras. 10.1(f), 10.3; Appellate Body Report, paras. 220(b), 221.

as though it had been judged *de jure*, rather than *de facto*, export contingent. Canada considers that by demonstrating that it made some changes to TPC, such as the removal of the term “export” from some (although not all) TPC documents, or the inclusion of self-serving statements regarding its undertaking not to consider export information, the task of implementing the DSB’s recommendations and rulings is complete.

15. This is not effective implementation of a determination of *de facto* export contingency. According to the Appellate Body, while *de jure* export contingency is indeed demonstrated (or remedied) “on the basis of the words of the relevant legislation, regulation or other legal instrument,” *de facto* export contingency is to be “inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy . . .”¹⁴ Brazil demonstrated in its first submission, at paragraphs 18-38, that the facts surrounding the “new” or the “restructured” TPC still support an inference of *de facto* export contingency. Under the “new” TPC,

- contributions remain targeted to specific industries – in particular, the aerospace industry, which is to continue, as before, receiving two-thirds of TPC fund¹⁵ – that are overwhelmingly export-oriented and recognized by the Government of Canada as such (discussed at section 1 below);
- the same types of projects continue to be eligible for “new” TPC funds as were eligible under the “old” TPC (discussed at section 2 below);
- applicants must demonstrate that they will contribute to goals and objectives the achievement of which requires a commitment to export performance, according to the Government of Canada itself (discussed at section 3 below);
- Canada has failed to amend or to provide documents that the Panel previously considered supported an inference of *de facto* export contingency (discussed at section 4 below).

16. Apart from removing references to the word “export” from some TPC documents, the only thing that the DSB’s recommendations and rulings have prompted Canada to do is to increase, *by 396 per cent*, what TPC itself projects to be “Total funds available for new contributions in future years.”¹⁶ Additionally, over the period 1998-2003, TPC’s “Available contribution funding” is slated to increase from \$203 million to \$367 million.¹⁷

17. Thus, under the “new” TPC, the same recipient industries will receive even more government subsidies to undertake the same types of projects. This is not effective implementation.

18. The facts surrounding TPC, described in paragraphs 18-38 of Brazil’s first submission, lead to the conclusion that funds granted to the regional aircraft industry under the “new” TPC will continue, unavoidably, to be contingent in fact on export performance. It is for this reason that Brazil argued, in its first submission, that “withdrawing the subsidy” in the case of TPC – the very design, structure,

¹⁴ Appellate Body Report, para. 167 (emphasis in original).

¹⁵ Canadian First Submission, para. 32. Canada notes at paragraph 32 that “it cannot be assumed that regional aircraft industry-related projects will receive the majority of the funds.” This may be so, but is utterly irrelevant. If the regional aircraft industry is able to receive \$1 of funds contingent in fact on export performance, Canada has not implemented the recommendations and rulings of the DSB.

¹⁶ TPC Annual Report, 1998-1999, pg. 28 (row titled “Total funds available for new contributions in future years,” comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6). Canada complains in Annex A to its first submission that “[t]his is a distortion of the actual programme funding situation.” Brazil reiterates that these figures are taken directly from the TPC Annual Report.

¹⁷ TPC Annual Report, 1998-1999, pg. 28 (row titled “Available contribution funding”).

and economic reality of which betrays its *de facto* export contingency – cannot be achieved without withdrawal of the programme altogether, with regard to the regional aircraft industry.¹⁸

19. At a *minimum*, Canada's implementation measures must *ensure* that prohibited export subsidies *cannot* be granted to the regional aircraft industry under the facts surrounding the operation of TPC, and not merely that they *might not* be granted. Since TPC, as it applies to the regional aircraft industry, was judged *de facto* export contingent, maintaining funding under the "new" TPC requires that Canada *ensure* that the programme will operate in full compliance with the Subsidies Agreement. It is not sufficient for Canada to simply provide a framework which, in consideration of the "total configuration of the facts constituting and surrounding the granting of the subsidy"¹⁹, could permit it to maintain operation of TPC as a *de facto* export contingent programme. To constitute effective implementation, any amendments made by Canada to TPC should not focus on making the programme merely *de jure* compliant (which it may already have been), but instead on making it *de facto* compliant, on a consideration of the "total configuration of the facts."²⁰

20. A review of the "total configuration of the facts" reveals that Canada has not met this obligation. Brazil recalls that under the "new" TPC, the same industry recipients are getting even more TPC subsidies to undertake the same types of projects. This does not suggest effective implementation of a finding of *de facto* export contingency.

1. TPC Remains Focused on the Aerospace Industry and the Regional Aircraft Industry, the Export Orientation of Which Has Been Singled out by the Canadian Government As Significant

21. As discussed in Brazil's first submission, the same three industries eligible for funding under the "old" TPC are targeted for continued funding under the "new" TPC.²¹ Moreover, Canada has confirmed that the aerospace industry will continue, as it did under the "old" TPC, to receive two-thirds of all "new" TPC funds.²² Although the Panel determined that the regional aircraft industry had in its period of review received approximately 68 per cent of TPC funds allotted to the aerospace industry.²³ Canada contends that under the "new" TPC, "it cannot be assumed that regional aircraft-industry related projects will receive the majority of the funds."²⁴ Whether regional aircraft-industry related projects are to receive the *majority* of the "new" TPC's funds or *51* of those funds, if TPC subsidies remain *de facto* export contingent, Canada has not implemented the recommendations and rulings of the DSB.

¹⁸ As discussed in paragraph 7 of its first submission, Brazil reiterates that this result is also supported by Canada itself. In its submissions to the Appellate Body, Canada argued that the word "subsidy" is used interchangeably with the term "subsidy programme" in the Subsidies Agreement, and that TPC is just such a "subsidy programme." See Submission of Appellant Canada, 13 May 1999, paras. 45-46 (Exhibit Bra-28). The requirement that Canada "withdraw the subsidy," therefore, must by force of Canada's own logic mean that it is required to withdraw TPC in its entirety.

¹⁹ Appellate Body Report, para. 167 (emphasis in original).

²⁰ *Id.*

²¹ For a list of the three industries eligible for funds under the "new" TPC, see, e.g., TPC Terms and Conditions, pg. 1, Section 3.1 ("Eligible Areas") (Exhibit Bra-15). For a list of the identical three industries eligible for funds under the "old" TPC, see, e.g., Panel Report, paras. 6.173, 9.283.

²² Canadian First Submission, para. 32.

²³ Panel Report, para. 9.307.

²⁴ Canadian First Submission, para. 32. Canada also states that "no new regional aircraft-related projects have been approved or contracted since 14 November 1997." This is simply not true. In March 1998, TPC announced a \$9.9 million subsidy to Sextant Avionique Canada Inc. for the development of both the avionics system for the Dash 8-400 and the flight control system for the CRJ-700. Panel Report, para. 6.193.

22. Furthermore, Canada did not, with its amendments to TPC, change the nature of the Canadian aerospace industry generally or the regional aircraft segment specifically. Brazil has demonstrated that the Canadian aerospace industry in general and the regional aircraft segment in particular continue to be overwhelmingly export-oriented. More importantly, the Canadian government itself recognizes the exceptional export performance of the industry, and has cited that performance as its motivation for funding the industry.²⁵

23. Canada complains that certain of the Canadian government documents cited to establish this point, in paragraph 19 of Brazil's first submission, may not be relied upon to challenge Canada's implementation and to demonstrate a continued inference of *de facto* export contingency. According to Canada, this evidence "relates not to the restructured TPC, but to TPC as it was previously constituted."²⁶

24. Canada cites two decisions for support. At paragraph 41 of its first submission, Canada cites to what it claims to be a principle "duly recognised by the Panel in *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*." According to Canada, the Panel stated that "WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, thereby bringing themselves into compliance with their multilateral obligations under the SCM Agreement."²⁷

25. Brazil encourages the Panel to review paragraph 9.64 of the decision in *Australia – Leather*, for two reasons. First, the sentence extracted by Canada merely records *an argument made by Australia*, rather than *a conclusion made by the Panel*. The Panel only offers its views on the issue in the final sentence of paragraph 9.64, commencing with its statement that "We agree that . . ."

26. Even if the sentence extracted by Canada represents a conclusion of the Panel, however, that conclusion represents only half of the story. In the first instance, Canada has not "replaced" TPC contributions to the aerospace industry and the regional aircraft segment with anything else; TPC is still available to this same industry for the same types of projects even after implementation.

27. Moreover, after the sentence from *Australia – Leather* quoted by Canada, the Panel stated that even if measures previously constituting prohibited export subsidies are no longer in place, and have instead been "replaced" with purportedly non-prohibited "other measures" providing funds to the same recipient, statements made by a Member in conjunction with the earlier but now superseded measures are relevant to an analysis of the subsequent, purportedly compliant measures.²⁸

28. Therefore, since the "new" TPC has retained its focus on the same recipient industries funded under the "old" TPC, comments made by the Canadian government regarding its rationale for funding those recipients are relevant to the Panel's analysis of the "new" TPC. For example, the Leader of the Government in the House of Commons noted that a key "output" of the TPC-funded Dash 8-400 project was "the building of exports," which was, with job creation, "just what the government had in mind when we established" TPC.²⁹ Canada cannot seriously expect to maintain funding to the same industry under the "new" TPC, and yet at the same time escape the implications of its earlier statements regarding why it chose that industry in the first place. *Australia – Leather* provides support for the Panel, in its analysis of any "inferences" of *de facto* export contingency flowing from

²⁵ See Brazilian First Submission (and sources cited therein), para. 19. Regarding the role of the regional aircraft industry's export-orientation in TPC's funding decisions, *see, e.g.*, the comments by the Leader of the Government in the House of Commons, included in Brazil's first submission, para. 19.

²⁶ Canadian First Submission, para. 43.

²⁷ WT/DS126/R (25 May 1999) (Adopted 16 June 1999), para. 9.64.

²⁸ *Id.* at para. 9.65.

²⁹ Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

the surrounding facts, to consider statements by the Canadian government regarding its support for particular recipient industries of “old” TPC funding, where Canada has maintained its focus on those same recipients in the “new” TPC.

29. Canada also cites the Appellate Body in *Chile – Taxes on Alcoholic Beverages* for the principle that “previous . . . measures” cannot be relied upon to assume continued non-compliance with a Member’s obligations.³⁰ Since certain of the documents relied upon by Brazil pre-date 18 November 1999 – the date on which the “new” TPC took effect – Canada contends that any reliance upon them to infer *de facto* export contingency would fall afoul of the Appellate Body’s ruling in *Chile – Alcohol*.

30. While Brazil does not quarrel with Canada’s statement of the rule in *Chile – Alcohol*, that rule is simply inapplicable in the circumstances of this case. *Chile – Alcohol* did not, in the first instance, involve subsidies *de facto* contingent on export performance. Furthermore, Canada’s objection, and its citation to the rule in *Chile – Alcohol*, would only have been appropriate and relevant had Brazil not relied upon the “measures” constituting the “new” TPC, and instead relied upon the “measures” constituting the “old” TPC.

31. But this is not the situation at hand. The facts enumerated in paragraph 19 of Brazil’s first submission are not, to begin, Canadian “measures.” They are instead facts that remain unaltered by anything Canada claims to have accomplished with its amendments to TPC. Canada has retained its commitment to offer two-thirds of “new” TPC funds to an industry that it has previously recognized as “highly export oriented”³¹, “globally competitive with exports exceeding 70 per cent of output,”³² and “crucial . . . for Canada’s economy, with exports growing at 10 per cent per year.”³³ Even after 18 November 1999, Canada continues to recognize this industry as a source of ever increasing export revenue.³⁴ As far as Brazil is aware, nothing that Canada has proposed in restructuring TPC alters the truth of these statements.

32. These statements lead to the inference that in choosing which industry would receive the lion’s share of “old” and “new” TPC funds, Canada was not casually indifferent to the trading patterns of that industry. Instead, Canada chose, as TPC’s showcase, an industry that exports significantly more than others, *because* it exports significantly more than others.

33. The “new” TPC retains a focus on contributions to the aerospace industry. Canada simply cannot expect to retain a focus on this industry, and yet at the same time escape the inference created by all of its previous statements about the esteem in which it holds that industry *as a result of its export performance*. Such an expectation is neither credible, nor demanded by the rule in *Chile – Alcohol*. Some elements, essential to the Panel’s and Appellate Body’s consideration, were not, and cannot be, erased by the cosmetic amendments to TPC.

³⁰ Canadian First Submission, para. 44, *quoting* WT/DS87/AB/R, WT/DS110/AB/R (13 December 1999) (Adopted 12 January 1999) para. 74.

³¹ TPC Annual Report, 1996-1997, pg. 5 (Exhibit Bra-8); “Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment,” October 1999, pg. 33 (Exhibit Bra-11).

³² “Think Canada, Think Bottom Line, Think Aerospace Industry, Think Investment,” October 1999, pg. 3 (Exhibit Bra-11).

³³ Industry Canada News Release, 10 January 1997 (Exhibit Bra-9).

³⁴ Industry Canada, “Results of the 1998/99 Survey of the Canadian Aerospace and Defence Industry,” 29 November 1999 (Exhibit Bra-12).

2. Removing the ‘Near to Market’ Terminology from TPC Documents is Irrelevant

34. Canada claims that TPC now focuses on funding projects aimed at “improving the technological capability of the firm or sector, rather than on the commercial viability and export potential of supported products.”³⁵ In its first submission, Brazil noted, first, the Appellate Body’s statement that “[i]t is . . . no ‘less possible’ that the acts, taken together, may demonstrate that a pre-production subsidy for research and development is ‘contingent . . . in fact . . . upon . . . export performance.’”³⁶ Simply including “Industrial Research” as a category of funding under the “new” TPC does not make it any less possible to *infer* from the facts that TPC constitutes a prohibited export subsidy.

35. Second, Brazil demonstrated that the available descriptions of eligible activities under the “new” TPC, to the extent they are different at all from eligible activities under the “old” TPC³⁷ betray an interest in “near market” projects with high commercialization potential. The “new” TPC Terms and Conditions, along with the “new” TPC Investment Application Guide, describe as eligible those projects “aimed at the discovery of knowledge, with the objective that such knowledge may be useful in *developing new products*,” and those projects leading to “translation of industrial research findings into a plan, blueprint or *design for new, modified or improved products* . . .”³⁸

36. Finally, Canada has withheld from the Panel documents that could shed some light on these categories of eligible activities, and whether they contribute to an inference of *de facto* export contingency – for example, the “new” TPC’s “Framework Investment Proposals.” Exhibit Cdn-9 states that Canada has not yet provided, and is still developing, this document, which presumably could contain a description of the three eligible categories of TPC projects.³⁹ Canada cannot claim, as it has in paragraphs 33-34 of its first submission, that it has implemented the recommendations and rulings of the DSB by making TPC “less near-market,” without providing the documents demonstrating this fact.

3. To Qualify for TPC Funds, Applicants Must Demonstrate a Contribution to Goals and Objectives Requiring a Commitment to Export Performance

37. Brazil demonstrated in its first submission that to qualify for TPC funds, an applicant must demonstrate that it meets TPC’s “selection criteria” and “assessment criteria,” and that it provides the “strategic benefits” sought by the programme. Brazil also demonstrated that among those selection or assessment criteria and strategic benefits is the requirement that applicants establish that TPC funds would be used to create Canadian jobs, to increase Canadian economic growth, or to increase Canadian wealth. To wit:

- The “new” TPC’s Investment Application Guide states that applicants’ proposals “are assessed in the context of their relevance to the objectives of TPC, namely the extent to which they demonstrate,” among other things, “that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada (increasing economic growth, creating jobs and wealth, and supporting sustainable development).”⁴⁰

³⁵ Canadian First Submission, para. 33.

³⁶ Appellate Body Report, para. 174.

³⁷ Brazilian First Submission, paras. 29-30.

³⁸ TPC Terms and Conditions, pg. 2 (emphasis added) (Exhibit Bra-15); TPC Investment Application Guide, pg. 4 (emphasis added) (Exhibit Bra-16).

³⁹ Exhibit Cdn-9 (Serial 16). Although Canada claims that this document is not available, it is able at paragraph 34 of its first submission to describe in some detail what is included in one of the categories, “Industrial Research.”

⁴⁰ TPC Investment Application Guide, pg. 6 (Exhibit Bra-16).

- The Investment Application Guide also states that a proposal must include information regarding the “strategic benefit” offered by the project, including “[p]otential economic benefit to Canada (for example, jobs created or maintained, economic growth, wealth creation . . .).⁴¹
- The “new” TPC’s Terms and Conditions state that applicants’ proposals “will be assessed in terms of the extent to which they demonstrate,” among other things, “that the project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada⁴², the latter of which are defined in the Investment Application Guide as “increasing economic growth, creating jobs and wealth, and supporting sustainable development.⁴³
- The “new” TPC’s Investment Decision Document, to be completed by TPC officials evaluating an applicant’s proposal, requires that those officials identify “strategic considerations” of the project that would constitute “benefits to Canada,” including “the link between the proposed R&D initiative and achieving Canada’s objectives of increasing economic growth, creating jobs and wealth and sustainable development.⁴⁴

38. In paragraph 33 of its first submission, Brazil then demonstrated, quoting numerous Industry Canada publications and the Canadian Minister of Industry, along with economic experts like the Conference Board of Canada, that creating Canadian jobs, increasing Canadian wealth and spurring Canadian economic growth requires, first and foremost, exports. These objectives are driven by, and cannot be achieved without, massive Canadian exports.

39. For a regional aircraft applicant for TPC funds to demonstrate a proposed project’s contribution to “increasing economic growth, creating jobs and wealth,” therefore, it must – even if implicitly – commit to export performance. The “new” TPC has, in other words, imposed mandatory selection and assessment criteria that can only be met if an applicant can demonstrate export performance. Such a requirement is the very essence of *de facto* “export contingency” – concealing export contingency in a requirement that does not actually employ the word “export.”

40. The Panel is not here faced, however, with a situation in which it is required to determine that all subsidies contingent on “increasing economic growth, creating jobs and wealth,” in all cases, are prohibited export subsidies, as Canada claims at paragraph 42 of its first submission. Brazil has discussed elsewhere in this and its first submission the “total configuration of the facts constituting and surrounding” TPC subsidies to the regional aircraft industry which lead to an “inference” of *de facto* export contingency.⁴⁵

41. For example, with the “new” TPC, Canada has retained as its target the aerospace industry, which will continue to receive two-thirds of all TPC funds.⁴⁶ The Panel found, and the Appellate Body confirmed, that this same funding under the “old” TPC was intended by Canada to circumvent its obligations under the Subsidies Agreement – it was provided contingent in fact on export performance.⁴⁷ The Canadian government has frequently extolled the overwhelming export-

⁴¹ *Id.* at pg. 8.

⁴² TPC Terms and Conditions, pg. 2 (Exhibit Bra-15).

⁴³ TPC Investment Application Guide, pg. 6 (Exhibit Bra-16).

⁴⁴ TPC Investment Decision Document, pg. 2 (Exhibit Cdn-7).

⁴⁵ Appellate Body Report, para. 167.

⁴⁶ Canadian First Submission, para. 32.

⁴⁷ *Elements of the Negotiating Framework*, Submission of the European Communities, MTN.GNG/NG10/W/31 (27 November 1989) (The prohibition of subsidies contingent in fact on export was proposed because the *de jure* provision is “open to circumvention”).

orientation of that industry generally, and the regional aircraft industry specifically⁴⁸ including in its decisions to award TPC funds.⁴⁹ It has, as such, shown something considerably more than casual indifference regarding the trading patterns of that industry retained in the “new” TPC as the main target for funding.

42. In these circumstances, the requirement that successful applicants demonstrate the ability to fulfill particular assessment and selection criteria that are inextricably linked to export becomes all the more significant, and adds to the inference that the “new” TPC retains its *de facto* export contingency. TPC knows, before it even sees an application, that regional aircraft industry applicants will be able to fulfill these criteria by virtue of their extreme export orientation. The deck, as the saying goes, is stacked. In these circumstances, TPC does not have to express the export contingency of its contributions; it knows that requiring applicants to demonstrate a proposal’s ability to contribute to “increasing economic growth, creating jobs and wealth” is nothing more than a euphemism for export contingency, as that requirement applies to regional aircraft industry applicants.

43. In its decision in *Australia – Leather*, the Panel was faced with similar circumstances, and made a similar inference of *de facto* export contingency. Where Australia was aware that an applicant, to meet an objective or requirement for a subsidy, must, “of necessity, have to continue and probably increase exports,” Australia’s imposition of the objective or requirement was considered a condition on the grant of the subsidy.⁵⁰ The Panel reached this conclusion, in the circumstances of that case, even though there was no express mention of exports or an export requirement. In the specific circumstances of the case before this Panel, Brazil contends the Panel should do the same.

(a) Export Contingency Need Not Be the Sole Condition for Receipt of a Subsidy

44. Canada attempts to counter Brazil’s claim with two arguments. First, Canada attempts, at paragraphs 22-25 of its first submission, to de-emphasize the requirement that a TPC applicant demonstrate how its proposal will “increase economic growth, jobs and wealth,” by listing that requirement as one among many. Canada’s attempt must fail, however. Article 3.1(a) of the Subsidies Agreement requires only that export performance be “one of several other conditions,” and not the sole condition for receipt of a subsidy. It is, quite simply, irrelevant that the “new” TPC requires that an applicant demonstrate “strategic benefits” or meet selection and assessment criteria that do not constitute evidence of *de facto* export contingency, as long as it must comply with one requirement that does constitute evidence of *de facto* export contingency.

(b) Brazil Has Relied on Valid Evidence

45. Second, Canada objects on two grounds to the evidence used by Brazil in paragraph 33 of its first submission to demonstrate that for the regional aircraft industry to increase economic growth, jobs and wealth in Canada requires export performance. In Annex A to its first submission, Canada argues, in the first instance, that Brazil’s sources are “from the period prior to the restructuring of TPC.”⁵¹

46. Canada’s argument is in error. Brazil did not rely on evidence relating to TPC “as it was previously constituted,” thus objecting to “previous [Canadian] measures,” in the words of the

⁴⁸ See sources cited in Brazilian First Submission, para. 19.

⁴⁹ See, e.g., Industry Canada News Release, 17 December 1996 (The then-Government House Leader stated that “[t]hese two outputs of the Dash 8-400 project – the creation of jobs and the building of exports – are just what the government had in mind when we established Technology Partnerships Canada . . .”) (Exhibit Bra-10).

⁵⁰ Australian Leather, para. 9.67.

⁵¹ Canadian First Submission, Annex A, para. 5.

Appellate Body in *Chile – Alcohol*.⁵² To demonstrate that applicants for TPC funds are required to show that their proposals provide “strategic benefits” or meet “selection” and “assessment criteria” related to the creation of Canadian jobs, economic wealth and growth, Brazil relied on the “*new*” TPC’s Investment Application Guide, Terms and Conditions, and (in this submission) Investment Decision Document.⁵³ These citations are repeated above, at the outset of this section of Brazil’s submission.

47. Brazil then went on, in paragraph 33 of its first submission, to demonstrate that according to the Canadian government and the Conference Board of Canada, increasing and creating Canadian jobs, economic wealth and growth requires exports. It is utterly irrelevant whether the statements supporting this conclusion, contained in paragraph 33 of Brazil’s first submission, were made before or after 18 November 1999. As far as Brazil is aware, Canada did not, with its amendments to the TPC programme, change or even attempt to change these aspects of the Canadian economy. Unless Canada can show that something about the Canadian economy and the Canadian regional aircraft industry changed on 18 November 1999 as a result of its implementation measures, such that increasing and creating Canadian jobs, economic wealth and growth no longer depends, as a matter of necessity, on export, the documents and statements compiled by Brazil at paragraph 33 of its first submission retain both their validity and persuasive force, and contribute to an inference that TPC retains its *de facto* export contingency.

48. Canada also states that the evidence cited by Brazil in paragraph 33 of its first submission is either “of a general nature,” providing “general sectoral information unrelated to TPC,” or “from non-governmental sources.”⁵⁴ Brazil notes, in the first instance, that six of the seven documents quoted in paragraph 33, to establish the link between exports and the increase and creation of Canadian jobs, economic wealth and growth, were in fact published by Industry Canada, a government source. TPC is an agency of Industry Canada and reports to the Minister of Industry.⁵⁵

49. Brazil also notes that the source of this generic information regarding the Canadian economy is utterly irrelevant, as long as the source is reliable. As discussed above, Brazil first relied on the “*new*” TPC Investment Application Guide, Terms and Conditions, and (in this submission) Investment Decision Document⁵⁶ to demonstrate that applicants for TPC funds are required to show that their proposals provide “strategic benefits” or meet “selection criteria” and “assessment criteria” related to the creation of Canadian jobs, economic wealth and growth. To establish the link, in the Canadian economy, between exports and the increase of jobs, wealth and growth, Brazil then turned to documents published by Industry Canada.

50. To establish this link, why must Brazil rely, as Canada insists it must, solely on documents or statements made by TPC itself? TPC is not the only authority on the Canadian economy. TPC has itself elsewhere acknowledged its own reliance on other government authorities for what it dubs, in its first submission, “general sectoral information.”⁵⁷ In the Memorandum of Understanding between TPC and the Industry Sector of Industry Canada, for example, TPC has committed to rely on Industry Canada’s Industry Sector Branches as the “first source for technological and sectoral analysis and

⁵² *Id.* at paras. 43-44, quoting *Chile – Alcohol*, para. 74.

⁵³ Brazilian First Submission, paras. 31, 34. Brazil notes that the Investment Decision Document was not available until Canada filed its first submission on 10 January 2000.

⁵⁴ Canadian First Submission, Annex A, para. 5 (introductory paragraph and discussion of the Industry Canada CIBS documents cited by Brazil at footnotes 60, 61 and 62 to paragraph 33 of its first submission).

⁵⁵ TPC Special Operating Agency Framework Document, cover page, pg. 8 (Exhibit Bra-5).

⁵⁶ Brazilian First Submission, paras. 31, 34.

⁵⁷ Canadian First Submission, Annex A, para. 5.

advice.⁵⁸ Sectoral advice emanating from Industry Canada is therefore considered reliable and persuasive by TPC. Brazil's citation to Industry Canada documents to establish a fundamental fact about the Canadian economy – the link between exports and the increase and creation of Canadian jobs, economic wealth and growth – is equally reliable and persuasive.

4. References to the Term 'Export' Have Not Been Removed from All TPC Documents

51. Canada has acknowledged that not all TPC documents have in fact been cleansed of references to the term "export." In Exhibit Cdn-9, Canada lists 40 TPC documents⁵⁹ only 13 (or 32 per cent) of which have been reformulated and provided to the Panel.⁶⁰ On the one hand, Canada claims that it has effectively implemented the recommendations and rulings of the DSB, thus ridding TPC of *de facto* export contingency, by removing references to the term "export" from TPC documents. On the other hand, Canada has failed to provide 68 per cent of those documents.

52. Canada has, therefore, failed to implement the recommendations and rulings of the DSB, *by Canada's own measure of what constitutes effective implementation*. Alternatively, Canada's failure to provide certain "new" TPC documents supports a presumption that as-yet-unreplaced TPC documents supporting the Panel's original inference of *de facto* export contingency still apply. In either case, Brazil requests that the Panel determine that Canada has failed effectively to implement the recommendations and rulings of the DSB.

53. Experience demonstrates that many of the documents not provided by Canada could potentially aid the Panel's determination whether Canada has effectively implemented the DSB's recommendations and rulings, since they served as some of the sources of facts from which the Panel inferred *de facto* export contingency. For example, a "new" TPC Aerospace and Defence Sector Generic Model Agreement has not been provided.⁶¹ The Panel determined that this Model Agreement served as one source of facts from which the *de facto* export contingency of TPC could be inferred, citing to the requirement that applicants "distinguish between domestic sales and exports when reporting forecast and actual sales."⁶²

54. Similarly, TPC's Business Plan was found by the Panel to include facts leading to an inference of *de facto* export contingency, with the statement that TPC's approach in the aerospace

⁵⁸ Exhibit Cdn-10, pg. 1, para. 6 (emphasis added). Brazil notes that Industry Canada's Industry Sector focuses on "develop[ing] initiatives to maximize Canada's share of global trade and investment" and on "working with industry to get more Canadian firms involved in trade, in more sectors and in more markets." The result of Industry Sector's activities will be to "help Canada, the most open of G7 countries, become a nation of traders. Currently, Canada's top five exporters account for 21 per cent of Canadian exports and less than 10 per cent of Canadian SMEs export at all." *About the Industry Sector of Industry Canada*, Industry Canada website, published 27 May 1999 (Exhibit Bra-32).

⁵⁹ Although the list is numbered 1-36, Serial 16 actually lists five separate documents.

⁶⁰ In fact, only 12 of the 40 documents were provided to the Panel. Canada states, however, that there is no equivalent under the "new" TPC for the document listed as Serial 15.

⁶¹ It is unclear whether this document is mentioned in the list included as Exhibit Cdn-9. It may be Serials 8 or 9. In any case, the document has not been provided.

⁶² Panel Report, para. 9.340 (bullet point 10) (emphasis in original). Brazil notes that even if the Model Agreement were to request only undifferentiated sales data and forecasts, without a distinction between domestic sales and exports, it would still lead to an inference of *de facto* export contingency in the instance of contributions to the Canadian regional aircraft industry. The Panel in *Australia – Leather* determined that requesting undifferentiated sales performance targets led to an inference of *de facto* export contingency because the Australian government knew that in order to reach those targets, the recipient would have to export. *Australia – Leather*, para. 9.67. The same logic applies in the case of the Canadian regional aircraft industry; the Canadian government knows that the industry exports virtually all it produces, and thus to reach sales forecasts, it must export.

sector is to support projects with “high export potential”⁶³ Canada has not provided a Business Plan for the “new” TPC.

55. It is simply inaccurate to claim, as Canada has at paragraph 51 of its first submission, that the documents not yet completed and produced “will not exist until such time as the restructured programme approves and contracts new investments.” Many of these documents are simply generic forms or templates, and were produced in the original proceedings without connection to any particular TPC investment. The Panel’s conclusion that *de facto* export contingency could be inferred from those documents came not from information regarding any particular investments. Brazil refers, for example, to the TPC Aerospace and Defence Sector Generic Model Agreement⁶⁴ and the TPC Business Plan⁶⁵

56. The same must be said of the “new” TPC documents cited by Canada as “under development” in Exhibit Cdn-9. It is by no means clear why many of these documents will not be created “until such time as the restructured programme approves and contracts new investments.”⁶⁶ Brazil cites to some, but not all, of the examples of the “new” TPC documents listed in Exhibit Cdn-9 that are apparently “under development”: the “TPC Repayment Policy” (Serial 2), “Assessment Guidelines for Due Diligence” (Serial 3), the various “Framework Investment Proposals” (Serial 16), the “TPC Business Plan” (Serial 18), “TPC Review Procedures” (Serial 20), “Special Purpose Equipment List” (Serial 21), “TPC Policies and Procedures on Incrementality, Irreversibility and Retroactivity” (Serial 25), etc. The nature of these documents does not suggest that they are in any way associated with individual contributions, such that they would not be created until contributions were made.

57. Even those documents that would, once completed, be associated with individual projects and contributions, start out as blank, generic forms or templates. These forms would certainly be developed well in advance of the grant of actual contributions under the “new” TPC. Brazil notes several examples from Exhibit Cdn-9, although this list is by no means exhaustive: “Standard Contribution Agreement” (Serial 8), “Performance Measures – Project Data Sheet” (Serial 23), “TPC Project File Structure” (Serial 24), “Evaluation Framework” (Serial 25), “Claims Package for Clients” (Serial 28), “PBS Integrity Review Checklist” (Serial 29), “Claims Verification Checklist” (Serial 32), “Contribution Verification Checklist” (Serial 36), etc. These “Standard Agreements,” “Packages,” “Sheets,” “Frameworks,” “Checklists” and the like should exist in the abstract, even without data regarding particular contributions written on them.

58. In any event, investments have already been approved under the “new” TPC. On 10 January 1999 – the very day on which Canada filed its first submission with this Panel and claimed that these documents were as yet unavailable because no contributions had yet been approved – TPC announced the award of a contribution to an Ontario company for the development of a robotics system. The news release recording this announcement is included as Exhibit Bra-30. Therefore, even if the TPC documents withheld from the Panel were in fact not produced until actual investments under the “new” TPC were approved, such approvals have in fact occurred. The documents should, therefore, exist.

59. If the Panel permits Canada to hold back these documents until after the close of these proceedings, and the documents, when eventually produced, betray evidence of continued *de facto* export contingency, Brazil may, of course, be able to bring a new case against TPC support. At the same time, however, the remedy provided Brazil under Article 21.5 of the DSU would be utterly and completely undermined. Telling Brazil to “wait and see” would reduce Article 21.5 to a nullity, a

⁶³ Panel Report, para. 9.340 (bullet point 2) (emphasis in original).

⁶⁴ *Id.* (bullet point 10).

⁶⁵ *Id.* (bullet point 2).

⁶⁶ Canadian First Submission, para. 51.

result that, according to the Appellate Body in *United States – Standards for Reformulated and Conventional Gasoline*, cannot attach.⁶⁷

60. In sum, Canada cannot claim compliance with the DSB's recommendations and rulings *on the basis of amendments made to TPC documents*, without actually demonstrating that those amendments were made.⁶⁸ In fact, if documents that originally contributed to the Panel's inference of *de facto* export contingency do not yet exist for the "new" TPC, Canada has offered this Panel further evidence of its failure to implement the recommendations and rulings of the DSB by 18 November 1999. The Panel should conclude that Canada's failure to produce these documents constitutes a failure to implement the recommendations and rulings of the DSB, or, in the very least, should presume that the original documents, and the inferences of *de facto* export contingency drawn therefrom, continue to apply.

III. CANADA'S AMENDMENTS TO THE CANADA ACCOUNT DO NOT MAKE IT CONSISTENT WITH THE SUBSIDIES AGREEMENT, AND DO NOT CONSTITUTE EFFECTIVE IMPLEMENTATION OF THE DSB'S RECOMMENDATIONS AND RULINGS

61. Canada's implementation of the recommendation that it withdraw "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft"⁶⁹ consists of a one-sentence "Policy Guideline" not to approve transactions that do not comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits.⁷⁰ In its first submission, Canada now asserts that the intent of this "Policy Guideline" is, specifically, to appeal to the second paragraph of Item (k) of the Illustrative List of Export Subsidies, and the OECD Arrangement's "interest rates provisions" cited therein.

62. This is, quite simply, insufficient. Canada's "Policy Guideline" merely suggests that prohibited export subsidies *via* Canada Account *might not* be granted; as noted above, to be sufficient, an implementation measure must instead *ensure* that prohibited export subsidies *cannot* be granted.

A. DETERMINING WHETHER CANADA HAS IMPLEMENTED THE RECOMMENDATIONS AND RULINGS OF THE DSB DOES NOT REQUIRE EVIDENCE OF CANADA ACCOUNT FINANCING SUBSEQUENT TO 18 NOVEMBER 1999

63. In its first submission, Brazil argued that Canada has a burden to demonstrate its entitlement to a defence included in Item (k), since it chooses to appeal to such a defence.⁷¹ According to Canada, however, it has no obligation and bears no burden to demonstrate what compliance with Item (k) means unless, at some time "in the future, there is a financing transaction under Canada Account in relation to which Canada claims the exception in Item (k) and the exception is challenged."⁷² According to Canada, because the Panel "expressly did not find that the Canada Account programme *per se* was a prohibited export subsidy," and instead found that the Canada Account programme constituted a prohibited export subsidy as it was applied in the context of two specific transactions for the export of regional aircraft, Canada had no duty to do anything whatsoever

⁶⁷ WT/DS2/AB/R, pg. 23 (An interpreter "is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.").

⁶⁸ Of course, TPC also must not be *de facto* export contingent, based on the "total configuration of the facts constituting and surrounding" its operation. Appellate Body Report, para. 167.

⁶⁹ Panel Report, para. 10.1(b).

⁷⁰ Canadian First Submission, para. 57. *See also* Exhibit Cdn-13.

⁷¹ Brazilian First Submission, para. 46.

⁷² Canadian First Submission, paras. 67-68.

in order to implement the Panel's ruling, other than to ensure that those two transactions were completed by 18 November 1999.⁷³

64. As it has for TPC, Canada therefore effectively claims that its implementation measures with regard to Canada Account are impervious to challenge under Article 21.5 of the DSU, since it has not yet extended Canada Account financing for regional aircraft subsequent to the adoption of those measures.

65. This position must be rejected. The consequence of Canada's position would be to reduce Article 21.5 of the DSU to "inutility" in any and all instances of successful "as applied" challenges to the violation by a Member of *any* of its WTO obligations (not just those contained in the Subsidies Agreement). A Member determined by a Panel to have maintained measures inconsistent with its WTO obligations could escape effective Article 21.5 scrutiny by merely refraining from applying those measures until the 20-day time period to seek compensation had passed.⁷⁴ Rendering Article 21.5 useless for the entire category of "as applied" challenges is not a result envisaged by the DSU, nor one accepted by the Appellate Body⁷⁵ and should therefore be rejected.

B. CANADA'S CLAIM THAT THE RECOMMENDATIONS AND RULINGS OF THE DSB REQUIRED NO IMPLEMENTATION BY CANADA IS IN ERROR

66. Canada's argument that the Panel's findings did not require it to take any action at all, apart from ensuring that the two Canada Account transactions identified in paragraph 54 of its first submission were completed by 18 November 1999, does not accord with the Panel's definition of the subsidy to be withdrawn. The Panel did not hold that only the two transactions identified in paragraph 54 of Canada's first submission were prohibited export subsidies. This is too narrow an interpretation of the Panel's determination regarding Canada Account financing "as applied." The Panel's conclusion was, rather, "that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement."⁷⁶ From 1 January 1995 onward, Canada Account debt financing for Canadian regional aircraft exports will be considered to constitute a prohibited export subsidy, unless Canada implements sufficient changes.

67. Thus, to achieve effective implementation, Canada was *required* to do more than simply ensure the completion of the two Canada Account transactions identified in paragraph 54 of its first submission. What it did is simply not enough, and is fully susceptible to challenge under Article 21.5 of the DSU.

68. The "Policy Guideline" included as Exhibit Cdn-13 states simply that the Minister for International Trade will, as a policy matter, not approve transactions that are not in compliance with the OECD Arrangement on Guidelines for Officially Supported Export Credits. Canada asserts that this "Policy Guideline" states an intention to "meet the criteria to qualify for an exception under the second paragraph of Item (k)" of the Illustrative List of Export Subsidies included in Annex 1 to the Subsidies Agreement.⁷⁷

69. The "Policy Guideline" does no such thing. It does not refer to conformity with the second paragraph of Item (k), or the "interest rates provisions" of the OECD Arrangement referred to therein.

⁷³ *Id.* at para. 56.

⁷⁴ See DSU Article 22.2.

⁷⁵ *United States – Gasoline*, pg. 23 (An interpreter "is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.").

⁷⁶ Panel Report, para. 10.1(b).

⁷⁷ Canadian First Submission, para. 68.

It merely states a hortatory intention to comply with the OECD Arrangement generally, without any indication of the specific provisions with which it intends to comply. Under the “Policy Guideline,” it is by no means evident that Canadian practices would qualify it for the specific “safe haven” included in the second paragraph of Item (k).

70. Even Canada’s assertion that the “Policy Guideline” refers to Item (k) and thus the “interest rates provisions” of the OECD Arrangement begs an obvious question – what does Canada consider to be the “interest rates provisions” of the Arrangement with which it will comply? Even if the Panel accepts Canada’s bald, unsupported assertion that the reference in the “Policy Guideline” to compliance with the OECD Arrangement means, specifically, compliance with the second paragraph of Item (k) and the application of the Arrangement’s “interest rates provisions,” Canada has not identified which articles of the Arrangement constitute the “interest rates provisions” mentioned in Item (k).

71. In the DSB’s recommendations and rulings regarding the Canada Account, Canada was determined to have maintained measures constituting or providing prohibited export subsidies. The Panel is not here conducting *de novo* review of Canada Account debt financing for regional aircraft. In these circumstances, implementing the DSB’s recommendations and rulings regarding the Canada Account should at a minimum ensure that prohibited export subsidies *via* the Canada Account cannot be granted, and not merely that they might not be granted.

72. To determine whether the “Policy Guideline” so ensures, Canada should be held to a duty of disclosure similar to that contained in the notification provisions of Article 25 to the Subsidies Agreement, thus enabling Members to inform themselves of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will “comply with the OECD Arrangement” in future. Without the provision of this type of information, the lack of transparency regarding what Canada considers “comply with the OECD Arrangement” to mean, or with which “interest rates provisions” Canada intends to comply, will enable it to continue to operate the Canada Account as a prohibited export subsidy, undetected and undetectable. There will be no assurance that prohibited export subsidies will not continue. At the implementation stage of dispute settlement proceedings, when a Member has already been found to be in violation of its WTO obligations, more is required; unelaborated policy guidelines offering vague hortatory statements regarding the Member’s intentions do not constitute effective implementation.

73. If this is permitted, Canada will have accomplished a very clever trick – it will have successfully passed off as an implementation measure something that, in the original Panel proceedings, it repeatedly contended it was already doing.

74. In the original Panel proceedings, Canada submitted “that Canada Account activity is not inconsistent with Article 3 as it benefits from the exception contained in Item (k) of Annex I of the SCM Agreement.”⁷⁸ More specifically, on three separate occasions, Canada represented to the Panel, without elaboration, that Canada Account financing and loan guarantees for exports “have been consistent with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I.”⁷⁹

⁷⁸ Panel Report, para. 6.64.

⁷⁹ First Written Submission of Canada, 16 November 1998, para. 173 (Exhibit Bra-33). *See also* First Oral Submission of Canada, 26 November 1998, para. 101 (“Canada Account financing and loan guarantees for exports committed since the entry into force of the SCM Agreement have complied with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I.”) (Exhibit Bra-34); Second Written Submission of Canada, 4 December 1998, para. 77 (“Canada Account transactions are consistent with the interest rates provisions of the OECD Consensus.”) (Exhibit Bra-35).

75. Canada subsequently decided not to invoke “the second paragraph of item (k) as a positive defence.”⁸⁰ The relevant point, however, is that Canada expects to pass off the “Policy Guideline” contained in Exhibit Cdn-13 as a *new measure* sufficient to constitute valid implementation of the DSB’s recommendations and rulings, when it was, according to its previous submissions to this Panel, already applying this measure well in advance of the Panel’s determination that the Canada Account provides prohibited export subsidies to the Canadian regional aircraft industry.

76. To claim satisfactory implementation of the DSB’s rulings and recommendations, Canada must bear the burden to do more than this. The minimum burden accorded Canada must be to explain with some precision what “comply with the OECD Arrangement” will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in future. Canada has failed to discharge this minimum burden. Accordingly, Brazil requests that this Panel determine that Canada has failed to implement the recommendations and rulings of the DSB with regard to the Canada Account.

IV. CANADA’S PROPOSAL REGARDING THE ESTABLISHMENT OF VERIFICATION PROCEDURES’

77. Canada proposes that the Panel suggest to the parties, pursuant to Article 19.1 of the DSU, that they establish a reciprocal arrangement for verifying their mutual compliance with their obligations under the Subsidies Agreement.⁸¹ Brazil notes that the parties have been engaged for some time in negotiations concerning these disputes and have discussed, *inter alia*, the question of verification. Brazil also notes, however, that the issue of transparency thus far has had to do with Canada’s programmes, not Brazil’s.⁸²

78. While Brazil does not, in principle, oppose such an agreement, it considers that resolution of the matter in the context of dispute settlement is not clearly compatible with the spirit, if not the letter, of Article 19 of the DSU. Brazil also believes that such an arrangement is better agreed to by the parties in the course of bilateral discussions. It is, in particular, fundamentally necessary for Brazil that any such arrangement involves balanced and truly reciprocal offers of transparency, not only by Brazil, but also by Canada. Discussions between the parties in this regard are on-going, but no agreement has been reached either on the specific Canadian and Brazilian programmes to be included and subjected to verification, or on the institutional framework for a potential monitoring mechanism.

V. CONCLUSION

79. For the reasons expressed in this and Brazil’s first submission, Canada has not withdrawn the subsidies determined by the Panel and the Appellate Body to be prohibited export subsidies. The implementation measures Canada has adopted, in the case of both TPC and Canada Account, merely suggest to Members that Canada *might not* continue to grant subsidies contingent in fact on export performance, rather than provide an *assurance* that it *cannot* do so.

80. Moreover, Canada’s defence – that its implementation measures are protected from challenge until such time as they are actually applied – is untenable. Such a solution reduces Article 21.5 of the

⁸⁰ Panel Report, para. 6.161. *See also Id.*, para. 9.225 (footnote 576).

⁸¹ Canadian First Submission, paras. 59-61.

⁸² Both the Panel and the Appellate Body noted Canada’s failure to produce documents requested by the Panel in the original proceedings. Appellate Body Report, para. 199 (“Canada refused to provide the information requested by the Panel.”). *See also* Panel Report, paras. 6.80, 6.171, 6.203, 6.258, 6.259, 6.260, 6.279, 6.303, 6.304, 6.326, 6.327, 9.176, 9.188, 9.218, 9.244, 9.253, 9.272, 9.293, 9.294, 9.299, 9.303, 9.313, 9.314 (footnote 621), 9.327, 9.345, 9.347 (footnote 633).

DSU to inutility, and would render hollow a finding that a Member had maintained measures inconsistent with its WTO obligations.

81. Accordingly, Brazil requests that the Panel reject Canada's defence, and determine that Canada has not implemented the recommendations and rulings of the DSB with regard to TPC and Canada Account.

LIST OF EXHIBITS

TPC News Release, 10 January 2000	Exhibit Bra-30
TPC News Release, 17 November 1999	Exhibit Bra-31
<i>About the Industry Sector of Industry Canada</i> , Industry Canada website, published 27 May 1999	Exhibit Bra-32
First Written Submission of Canada, 16 November 1998, para. 173	Exhibit Bra-33
First Oral Submission of Canada, 26 November 1998, para. 101	Exhibit Bra-34
Second Written Submission of Canada, 4 December 1998, para. 77	Exhibit Bra-35

ANNEX 1-3

FIRST ORAL STATEMENT OF BRAZIL

(6 February 2000)

Mr. Chairman and Members of the Panel,

1. Brazil thanks the Panel for this opportunity to present its views regarding Canada's implementation of the Report in *Canada – Measures Affecting the Export of Civilian Aircraft*. As the Panel is aware, Brazil considers that the implementation measures adopted by Canada to withdraw subsidies provided by the Canadian government to the regional aircraft industry *via* two programmes – Technology Partnerships Canada, or “TPC,” and Canada Account – are inadequate. The measures remain inconsistent with the Subsidies Agreement and the rulings and recommendations of the Dispute Settlement Body.

Significance of 18 November

2. Let me begin by addressing Canada's argument that the Panel may not consider anything that happened before 18 November 1999, the date on which Canada purports to have implemented the DSB's recommendations and rulings.

3. First, Canada argues that Brazil may not, in these proceedings, rely on any documents dated prior to 18 November, even though the facts addressed in those documents remain unchanged after 18 November. In its Rebuttal Submission, Brazil addressed this argument in considerable detail. I would simply note here that where facts remain unchanged by Canada's implementation measures, the publication date of documents supporting those facts is utterly irrelevant.

4. Second, Canada argues that its implementation measures are impervious to challenge under Article 21.5 of the DSU, since no TPC or Canada Account subsidies have been provided to the regional aircraft industry after 18 November. As noted in Brazil's Rebuttal Submission, I ask the Panel to consider the impact that Canada's argument, if accepted, would have on the broad question of implementation not just in this case, but in all cases. Canada's argument would reduce Article 21.5 to inutility.

5. As the Panel is aware, Brazil argues that the structure of TPC, as it applies to the regional aircraft industry, is tainted by *de facto* export contingency. The facts underlying that structure must be changed for Canada to claim that it has implemented the recommendations and rulings of the DSB. The changes made to TPC are merely cosmetic. In Brazil's view, in fact, the only way for Canada to rid TPC of the inference of *de facto* export contingency, as it applies to the regional aircraft industry, is to exclude that industry from TPC funding opportunities, or alternatively, to change radically the programme's eligibility and allocation requirements.

6. Canada argues, however, that Brazil cannot here challenge the amendments made to TPC, since no subsidy has actually been granted to the Canadian regional aircraft industry since 18 November 1999. The obvious implication of Canada's argument is that Brazil must wait until yet another prohibited TPC subsidy is granted to the regional aircraft industry, presumably after the Article 21.5 review has ended, and then begin dispute settlement proceedings anew. In the meantime, Canada demands that Brazil – and this Panel – simply take Canada's word that it will not do wrong again.

7. This is not acceptable. Were the Panel to accept Canada's argument, the inescapable result would be to lock Brazil into a futile spiral of endless challenges to a continual string of TPC subsidies, identical to ones already judged by this Panel and the Appellate Body to be prohibited. There would be, in that case, no way for Brazil to vindicate its rights and force Canada to observe its obligations. This is not an effective remedy, and cannot be considered acceptable.

8. Canada's position presents this Panel with the same problem faced by the Panel in *Australia – Leather*. That Panel found that the approach urged by Australia, as recorded in paragraph 6.35 of the Report, was unacceptable. In paragraph 6.38 of its Report, the Panel stated that this approach "would grant full absolution to Members who grant export subsidies that are fully disbursed to the recipient before a recommendation to withdraw the subsidy is issued in dispute settlement, and for which the export contingency is entirely in the past." According to the Panel, the drafters of Article 3.1(a) of the Subsidies Agreement would not have included "the strict prohibition against subsidies contingent on export performance, including one-time subsidies contingent in fact on export performance, only to undermine that prohibition by providing a remedy which is ineffective in the case of such subsidies." To ensure an effective remedy, the Panel then required retroactive repayment of the subsidies granted.

9. This is precisely the situation with which this Panel is faced. Canada's proposal is to "withdraw the subsidy" prospectively only, but at the same time to make the measures constituting that withdrawal impervious to challenge.

10. Mr. Chairman, Brazil believes that the decision in *Australia – Leather* to require retroactive repayment was wrong, and that such a result is not required by the language of the Subsidies Agreement. However, Canada leaves the Panel in this case with no choice. If, under Canada's theory, Brazil is not permitted to challenge Canada's amendments to the TPC, the only remaining remedy is the retroactive repayment of TPC subsidies provided to the regional aircraft industry. Leaving Brazil without any effective remedy would negate completely the "strict prohibition against subsidies contingent on export performance" included in Article 3.1(a).

11. Brazil therefore requests, first and foremost, that the Panel reject Canada's argument that its implementation measures, in the form of amendments to the TPC, are impervious to challenge under Article 21.5. In the alternative – and although Brazil does not in general agree with the requirement of retroactive repayment of prohibited export subsidies – Brazil requests that should the Panel accept Canada's argument, it then recommend the retroactive repayment of TPC subsidies to the regional aircraft industry. Later in this statement, I will have more to say about the similarities between the facts of *Australia – Leather* and the facts of this case, should it be necessary for the Panel to reach the question of retroactive repayment of TPC subsidies to the regional aircraft industry.

TPC

12. I now turn to the substance of Canada's implementation measures regarding TPC. Brazil has demonstrated in detail that those measures make nothing more than cosmetic changes to the documents underlying TPC. Canada's actions fail to meet its obligations to achieve effective implementation.

13. TPC subsidies to the Canadian regional aircraft industry were not held to be *de jure* export contingent. Rather, those subsidies were determined by this Panel and the Appellate Body to be contingent in fact upon export performance. In other words, this Panel, affirmed by the Appellate Body, determined that in providing subsidies to the regional aircraft industry *via* TPC, Canada *circumvented* the Subsidies Agreement. As the Appellate Body noted at paragraph 167 of its report in this case, "the Uruguay Round negotiators have, through the prohibition against export subsidies that

are contingent *in fact* upon export performance, sought to prevent circumvention of the prohibition against subsidies contingent *in law* upon export performance.”

14. Canada contends that merely removing the term “export” from TPC documents constitutes effective implementation. As I will discuss shortly, that would normally be true for subsidies that are contingent *in law* on export, but it is not true for subsidies that are contingent *in fact* on export. However, even if we accept, for the sake of argument, that Canada is correct, Brazil has shown in its submissions that Canada has failed to meet even its own measure of what constitutes effective implementation. Canada has failed to provide most of the documents associated with the “new” TPC to the Panel. As Canada itself admitted, in its Exhibit 9, it has failed to provide 68 percent of those documents. Canada cannot maintain that it has effectively implemented the DSB’s recommendations and rulings by virtue of changes to TPC’s documentation, without providing that documentation. Moreover, Brazil has demonstrated that those few documents Canada has provided still reveal a number of the factors considered by the Panel to support a finding of *de facto* export contingency.

15. But Canada’s discussion of TPC *documents* is beside the point. As I have already noted, removing the term “export” from those documents might have been sufficient implementation had TPC been judged contingent *in law* on export performance. It is not, however, sufficient to remedy something determined to have *circumvented* the Subsidies Agreement; that is, something determined to be contingent *in fact* on export performance.

16. Remedying *de facto* export contingency requires more than merely going through a checklist of what Canada terms, at paragraph 21 of its First Submission, “the factual elements considered relevant by the Panel and Appellate Body in determining that contributions to the Canadian regional aircraft industry” were *de facto* export contingent. As stated in paragraph 6.21, footnote 24 of *Australia – Leather*, “the specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance . . . and therefore prohibited do not, in our view, determine what is required in order to ‘withdraw the subsidy’ . . .”

17. In other words, the task of remedying *de facto* export contingency is not a mere matter of formula. For implementation to be effective, more than “the specific details of the factual evidence underlying the conclusion that” TPC subsidies were *de facto* export contingent must change. However, the facts leading to the inevitable “*inference*” of TPC’s *de facto* export contingency have not or cannot be changed. For this reason, Brazil has argued that TPC, as it applies to the regional aircraft industry, must be withdrawn in its entirety.

18. At a minimum, since Canada was judged to have circumvented the prohibitions of the Subsidies Agreement by providing TPC subsidies contingent in fact on export, its implementation measures must *ensure* that prohibited export subsidies *cannot* be granted to the regional aircraft industry in future, and not merely that they *might not* be granted.

19. Short of the retroactive repayment of subsidies already granted, requiring positive action by a Member to ensure that such subsidies will not be provided is the only means available to provide an effective remedy. Without such positive action, or in its place, without retroactive repayment, Members lodging successful “as applied” challenges to *de facto* export subsidies would be locked in an unending loop of litigation concerning something that had been already been found to violate the Subsidies Agreement.

20. The problem is that the facts of the “new” TPC do not ensure that prohibited export subsidies *cannot* be granted to the regional aircraft industry in future. Brazil describes those facts in detail in its submissions, and I will not repeat them here. The salient point, however, is that under the “new” TPC, the same, specifically-selected industries will receive even more TPC money than before for the

same types of projects. I ask the Panel to note that on page 3 of the Industry Canada news release included as Brazil's Exhibit 18, Canada reports that it has even encouraged those companies whose TPC applications were closed on 18 November 1999 simply "to submit new proposals" under the TPC as amended.

21. In paragraph 22 of its First Submission, Canada claims that its sole motivation with the "new" TPC is "to promote technological innovation and enhance the technological capability of Canadian industry." But "Canadian industry" is not the beneficiary of the "new" TPC. Rather, specifically-selected sectors of Canadian industry are the beneficiaries. And, it is the overwhelmingly export-oriented aerospace industry that will continue to receive two-thirds of all TPC funds, as Canada itself states at paragraph 32 of its first submission.

22. The regional aircraft sector is, moreover, totally export-oriented. As you know, even Bombardier sales to Air Canada were structured as export sales to obtain export financing and to launch an export product. The Canadian government has consistently expressed something considerably short of casual indifference to the trading patterns of this industry, and has in fact explicitly said that it selected this industry to receive TPC funds *because* of its export orientation. Statements like this cannot now be "unsaid." They reveal the intent of the Canadian government in extending TPC funds to this industry. And according to Section 5.15.1.3 of Canada's Special Import Measures Handbook, cited by the United States at paragraph 5 of its submission, Canada considers the grantor's intent to be an important indication of export contingency where a government, rather than revealing a "direct linkage to export performance," instead circumvents the prohibition of export subsidies by establishing *de facto* export contingency.

23. Brazil has also demonstrated that, given the regional aircraft industry's virtually total export-orientation, any consideration of production or sales targets for applicants will, necessarily, be a reference to export performance. Additionally, the "strategic benefits," "selection criteria" and "assessment criteria" that must be demonstrated by regional aircraft industry applicants to receive TPC funds are, when applied to that industry, nothing more than euphemisms for export contingency. Furthermore, Brazil has demonstrated that the "new" TPC retains its "near market" focus, and will continue to fund the same types of projects as it did before. Finally, Brazil has noted that Canada has not granted the Panel access to the majority of documents associated with the "new" TPC – documents that, under the "old" TPC, demonstrated facts from which the inference of *de facto* export contingency was drawn.

24. Under all of these circumstances – in the words of the Appellate Body at paragraph 167 of its Report, "the total configuration of the facts constituting and surrounding" TPC – the "inference" of *de facto* export contingency still exists. Canada's measures do not, therefore, constitute effective implementation. Brazil asks that the Panel so conclude.

Repayment of TPC Subsidies

25. Canada states that it has terminated \$16.4 million in TPC subsidies to the regional aircraft industry as part of what it calls "full and faithful implementation" of the DSB's recommendations and rulings. This \$16.4 million figure apparently represents the amount of outstanding disbursements not yet paid under the five TPC subsidies to the Canadian regional aircraft industry discussed in the original Panel proceedings. Those five large non-recurring grants, discussed in paragraph 9.285 of the Panel Report, totaled \$266.6 million.

26. Whether Canada's prospective termination of \$16.4 million in as-yet-unpaid TPC subsidies is sufficient to achieve effective implementation quite obviously raises the question of the applicability of the Article 21.5 decision in *Australia – Leather*. I have introduced that decision earlier, but allow

me to expand somewhat upon it. In that case, the Panel determined that to “withdraw the subsidy” under Article 4.7 of the Subsidies Agreement means more than simply withholding any prospective, not-yet-paid portion of a subsidy. Rather, at paragraph 6.39 of its Report, the Panel determined that to “withdraw the subsidy” means to repay the subsidy.

27. As I have already stated, Brazil believes that the Panel in *Australia – Leather* reached a result that is not required by the language of the Subsidies Agreement. As long as an effective remedy is available apart from retroactive repayment, Brazil does not believe that repayment should, in general and as a matter of law, be recommended.

28. However, Brazil faces two unknowns. First, this Panel may consider itself, like the Panel in *Australia – Leather*, not to be bound by the arguments of the Parties or the Third Parties regarding the issue of retroactive repayment. In that case, it may decide to follow the reasoning in *Australia – Leather*.

29. Second, the Panel may accept Canada’s argument that its amendments to the TPC are impervious to challenge under Article 21.5, leaving Brazil without any effective remedy. In that case, as I have already stated, the only way to achieve an effective remedy and uphold the “strict prohibition against subsidies contingent on export performance” is to follow the reasoning of the Panel in *Australia – Leather*.

30. Brazil hopes that neither of these situations comes to pass. But if they do, the Panel will find that the circumstances of *Australia – Leather* are similar to the facts surrounding the grant of TPC subsidies to the regional aircraft industry. Applying the reasoning in *Australia – Leather* to the facts of this case leads to the conclusion that the TPC subsidies to the regional aircraft industry should be repaid in full and their impact eliminated.

31. First, the form in which TPC subsidies were provided is similar to the form in which the subsidies in *Australia – Leather* were provided. Both cases involve large “investment” grants enjoyed by recipients, and therefore allocable, over a period of time. Second, like the subsidies provided in *Australia – Leather*, TPC subsidies, which were first granted in 1996, were not notified by Canada, under Article 25.2 of the Subsidies Agreement, until 30 April 1999, after the Panel rendered its decision in this case.

32. Third, and again like Australia, Canada was held to have circumvented the Subsidies Agreement *via* the provision of subsidies contingent in fact on export performance. And like Australia, when faced with a determination that it had provided prohibited subsidies, Canada worked a second circumvention; in *Australia – Leather*, as described at paragraphs 6.13 and 6.50 of the Report, Australia simply replaced one *de facto* export contingent subsidy with another. Similarly, under the “new” TPC, the same, specifically-selected recipient industry is to receive even more TPC money to conduct the same types of projects funded by the “old” TPC. As I stated earlier, Canada has even encouraged companies whose TPC applications were closed on 18 November 1999 simply “to submit new proposals” under the “new” TPC.

33. Under these circumstances, the Panel in *Australia – Leather* determined, at paragraph 6.45 of its Report, that nothing less than “full repayment would suffice to satisfy the requirement to ‘withdraw the subsidy’ . . .” Under that line of reasoning, Canada has not secured “full repayment” of the TPC subsidies provided to the regional aircraft industry, and has not therefore withdrawn the subsidy.

34. Once again, I reiterate that Brazil does not believe that this or any other Panel should follow *Australia – Leather*. However, if this Panel accepts the interpretation of Article 4.7 offered by the

Panel in *Australia – Leather*, or if it accepts Canada’s argument that its amendments to the TPC are not subject to challenge under Article 21.5, it should determine that Canada’s failure to secure repayment means that it has not implemented the DSB’s recommendations and rulings, and that the subsidies must be repaid.

Canada Account

35. In paragraph 2 of its First Submission, Canada states that its implementation of the DSB’s recommendations and rulings regarding the Canada Account involves two steps: first, the completion of Canada Account transactions involving the regional aircraft industry; and second, the adoption of a policy to conform Canada Account financing to the terms of the OECD Arrangement.

36. Brazil has explained why these actions do not constitute effective implementation. The Canadian “policy statement” included as Canadian Exhibit 13 does not, as Canada claims at paragraph 10 of its Rebuttal Submission, state that Canada Account financing “must” comply with the OECD Arrangement. Nor does it state what “comply with the OECD Arrangement” means. Canada now asserts that it means that Canada Account financing will adhere to Item (k) of the Illustrative List of Export Subsidies and the “interest rates provisions” of the OECD Arrangement. The policy statement does *not* say this, but even if it did, neither the statement itself nor anything else issued by Canada defines what are the “interest rates provisions” with which it intends to comply, or how it will apply those provisions.

37. Brazil has also noted that Canada already stated – on at least three occasions during the original Panel proceedings – that Canada Account financing already complied with the terms of the OECD Arrangement and, specifically, with the terms of Item (k). Extracts from the submissions in which Canada made this statement were included as Brazilian Exhibits 33-35. Contrary to Canada’s claim, measures that were already in place at the time of the Panel’s and the Appellate Body’s ruling cannot credibly be touted as evidence of “full and faithful implementation.”

38. Canada Account financing to the regional aircraft industry was determined by this Panel to constitute a prohibited export subsidy. Measures adopted by Canada to implement the Panel’s ruling must ensure that the same thing will not happen again. In the absence of information regarding what “comply with the OECD Arrangement” means, or with which “interest rates provisions” Canada intends to comply, Canada will be able to continue to operate Canada Account as a prohibited export subsidy, undetected and undetectable. This is not effective implementation.

39. Several questions arise. For example, does “comply with the OECD Arrangement” mean that Canada Account financing will in every instance be issued at or above the OECD Arrangement’s Commercial Interest Reference Rate, with an appropriate add-on for the risk factors associated with the particular transaction and the particular parties involved? Does it mean that all Canada Account financing will in every instance adhere to the 10-year maximum repayment term set by the OECD Arrangement? The Canadian “policy statement” fails to address these questions.

40. In the companion case against Brazil’s PROEX, Brazil provided details regarding its implementation measures, and not just vague suggestions styled as government “policy.” It offered specifics about how it had amended PROEX to comply with the DSB’s recommendations and rulings. In light of Canada’s implementation strategy with respect to the Canada Account, maybe Brazil should instead have issued a “policy statement” stating its intention to “comply with the OECD Arrangement.” I hesitate to speak for Canada, but my guess is that it would not have found such a statement sufficient to implement effectively the recommendations and rulings of the DSB. I also presume that the Panel in the PROEX case would not have found such a change acceptable. Nor should this Panel, in consideration of Canada’s “policy statement” regarding the Canada Account.

41. Brazil is not a Participant in the OECD Arrangement. Our understanding, however, is that it is unenforceable, not subject to dispute settlement, and subject, in its application, to often widely-varying interpretations by its various Participants. Under these circumstances, there is no way of knowing what Canada means when it says it will “comply with the OECD Arrangement” or the “interest rates provisions” included in the Arrangement.

42. Based on the information provided, Canada cannot possibly claim that it has put in place what it purports at paragraph 2 of its First Submission to be “new measures to ensure full and faithful implementation of the DSB rulings and recommendations.” Canada has not offered anything “new” at all with regard to Canada Account, and has fallen well short of providing assurances that Canada Account cannot continue to provide prohibited export subsidies to the regional aircraft industry. The Panel should conclude that this is not effective implementation.

Conclusion

43. In conclusion, Brazil requests that the Panel determine that Canada has not implemented the recommendations and rulings of the DSB, with regard to both TPC and the Canada Account. Once again, Brazil thanks the Panel for this opportunity to present its views, and welcomes any questions the Panel might have.

ANNEX 1-4

CONCLUDING STATEMENT OF BRAZIL

(6 February 2000)

Mr. Chairman and members of the Panel:

1. We heard a large number of arguments from the parties and the third parties today, some referring to technical details of the case, some to political considerations, some to procedural aspects of the case. I felt that, in the midst of all these arguments, we may lose the focus of what is really at stake before the Panel, and of what the essence of this case is. That is why I choose to make this brief summary of Brazil's views.

2. I guess the best way to start is to picture a scenario. I would ask the Members of the Panel to imagine a situation where a given country has a highly export-oriented industry. Some segments of this industry reach 100% export orientation. That country decides to support the export sales of that industry and builds a subsidy programme around it. The programme is *very carefully* designed to avoid a possible finding of *de jure* export contingency. At first 90% of all funds in the programme are directed to that industry, and in subsequent years, never less than 2/3 of the funds are allocated to that same highly export-oriented industry.

3. A Member who is directly affected by the exports of the beneficiary industry questions that programme in the WTO. A Panel constituted to examine the dispute understands that it is not facing a case where an industry that happens to be highly export oriented incidentally receives subsidies. That Panel finds that it is before a case where a highly export-oriented industry is specifically targeted to receive massive subsidies *because* it exports.

4. After the DSB recommends that the subsidizing country *withdraw* the prohibited subsidy – and not merely bring it into conformity with the WTO disciplines – that country completely ignores those recommendations and simply makes cosmetic alterations to the regulations of the original subsidizing programme. For example, they delete the word exports from all flyers and administrative documents.

5. The subsidizing country announces that it now has a "new" programme and that it has faithfully implemented the recommendations of the DSB. The fact, however, is that under this "new" programme the same companies will continue to receive subsidies to use in the same type of projects approved under the "old" programme. Actually, they will now receive even more money, since the results of the original programme have proven to be quite successful.

6. Such "implementation" is obviously challenged by the complaining country, which brings about Article 21.5 procedures. Under these procedures, the complainant shows unequivocally that the programme remains essentially the same and requests that the Panel make a finding of non-implementation. The subsidizing country nonetheless alleges that it has put in place a new programme, which cannot be deemed to be a *de facto* export subsidy. After all, it implemented the recommendations of the DSB in good faith and it could not possibly prove, after just a few weeks of implementation, that the *de facto* export contingency has disappeared. The complainant, it submits, is proposing a burden of proof that is **impossible** to be met. It further argues that, quite on the contrary, it is the complainant who bears the burden of proof. It is the complainant that has to prove that the "new" programme is also *de facto* contingent on export subsidies. Furthermore, such proof would

have to be based on "new" factual evidence, which could positively infer that the payments under the new subsidy programme are still *de facto* contingent on exports.

7. Mr. Chairman and members of the Panel, Brazil agrees that the complainant has the initial burden of proof, but since no payments were made under the new programme, it would be impossible for the complaining country to meet the standards suggested by this subsidizing country. The subsidizing country figures, therefore, that if it takes no actions during 60 or 90 days – or whatever the duration of the Article 21.5 Review Panel is – it will get away with its carefully planned circumvention of the Subsidies Agreement. The "impossible" burden of proof is now on the complainant.

8. Turning to the specific case of TPC payments, let me recall that the Appellate Body put before us a three-part test. First, one has to establish the "granting of a subsidy" – and Canada does not dispute that this occurs. The second part of the test concerns the expression "tied to". Finally, one should determine that exports are "anticipated" or "expected". Canada does not dispute that the regional aircraft industry in Canada is highly export-oriented, and even pointed out that this is a fact that will not change. Canada anticipates and expects export sales from that industry and this is not disputed either. What Canada does argue, is that Brazil failed to meet the second part of the test, the one concerning the "tied to" provision.

9. Mr. Chairman, Brazil has provided conclusive evidence that the targeted industries of the "old" TPC are the same recipients under the "new" TPC. Canada itself confirmed that when answering a follow-up question posed by you this morning. When it first examined this case, this Panel found that the way TPC was conceived and operated provided ample evidence that the subsidies granted to the targeted industries were "tied to" anticipated and expected export earnings. The Appellate Body unconditionally confirmed this finding. Under the "new" TPC the same three industries are targeted and Canada knows that whatever sales are made by those industries will be almost entirely directed to foreign markets. Nothing has changed, the granting of the subsidy is still firmly "tied to" anticipated and expected export earnings of the same industry.

10. Brazil showed that we still have the same answers to the three parts of the test the Appellate Body put before us. By doing this, Brazil has given the Panel ample evidence that Canada did not implement the recommendations of the DSB and has, therefore, met its burden of proof. On the other hand, Canada has given us nothing that would resemble a credible effort to implement those recommendations. It claims, nonetheless, that it must be deemed to be in compliance, since it has adopted the implementing measures in good faith and that Brazil is proposing a standard of proof that is impossible to meet. I will soon show that this is definitely not the case.

11. Mr. Chairman, Brazil admits that the task to implement recommendations to withdraw a *de facto* export subsidy is more complex than when we are dealing with a *de jure* export subsidy; but it is by no means impossible, as Canada claims.

12. One possible way to implement the findings on TPC could be, for example, the simple withdrawal of the 100 per cent export-oriented regional aircraft industry from the list of eligible recipients of the programme.

13. Nevertheless, if Canada still wanted to avoid such action, its changes to the regulations of the programme would have to ensure that the *de facto* contingency would not exist anymore. Let me recall that payments under the "old" TPC were not found to be *de jure* contingent on exports. However, Mr. Chairman, the regulatory changes made to TPC not only would allow the programme to be operated as before, it virtually ensures that it will. The representative from the EC said in the third party session that Canada must be given the "benefit of the doubt". There is no doubt here

Mr. Chairman. TPC will operate as before, will benefit exactly the same companies – but, I forgot, now there will be even more money to be dispensed.

14. Canada claims that it could not possibly make changes to TPC that would ensure that the de facto contingency would disappear. This is an impossible task they say. Let me assure you Mr. Chairman that this is not true. It would not be particularly difficult to devise changes to the programme that would ensure the withdrawal of the export contingency. I could think of hundreds of alternatives.

The Chairman of the Panel asks if Mr. Azevêdo could provide examples of these alternatives.

15. Mr. Chairman, certainly the Canadian officials are aware of the concept of general availability of a subsidy. Canada could make TPC subsidies available to all industries. It did not do so. It maintained the programme resources limited to the same highly export oriented industries targeted by the "old" TPC. Canada could also make eligibility automatic and reduce the subjectivity of the criteria and conditions governing the approval of grants. Canada did not do so. Instead, Canada maintained highly subjective criteria and conditions, linking disbursements to vague goals such as "increasing economic growth, creating jobs, and supporting sustainable development", or to "strategic" concerns. I could go on providing examples of how Canada could reduce or eliminate the specificity of the programme, therefore eliminating the contingency on export earnings. But I do not wish to offer Canada an implementation roadmap. I wonder if later they would not simply characterize these examples as a sufficiency test proposed by Brazil.

16. The point is that Canada could have introduced changes that would ensure that, operating with a broader range of automatically eligible recipients (export oriented and otherwise), the granting authority had little or no room to arbitrarily make funds available based on the export propensity of the beneficiary. Canada chose not to do so. In fact Canada scrupulously tried to make sure that the programme would function just as it did before. The standard proposed by Brazil is by no means impossible to meet. It falls well within the boundaries of what is reasonable.

17. With regard to the Canada Account I believe that there's not a whole lot to be said. Before this Panel, during the original procedures of this case, Canada affirmed, in good faith I am sure, that Canada Account complied with the terms of the OECD Arrangement. Brazil pointed this out in its submissions in the current proceedings. Regardless of that good faith interpretation of the OECD Arrangement, this Panel found Canada Account to violate the SCM Agreement – a finding confirmed by the Appellate Body. Canada has now issued a "policy guideline" which, in effect, merely reproduces in writing what Canada had already said it was doing before the programme was found to grant prohibited subsidies.

18. If this is to be considered as effective implementation Mr. Chairman, the implications for the Multilateral Trading System would be grave indeed. Members could from then on feel obliged to merely state in writing, as a policy guideline or as part of a regulation, that the programmes found not to be in conformity with the WTO Agreement will henceforth operate in full compliance with the recommendations of the DSB; in compliance with the WTO Agreements; or any similar variation. In good faith, Mr. Chairman, they will then interpret the DSB recommendations, or the WTO Agreements, and implement the "new" programmes as they see fit. In the case of the Canada Account, the WTO Members not participants in the OECD Arrangement, as Canada itself asserts, would not even be able to verify such implementation.

19. I would further note that, regarding Canada Account, Canada itself acknowledges the issue of interpretation of the OECD Arrangement. Let me read a sentence found in the introductory paragraph of the document where Canada lists what it considers to be the relevant interest rate provisions of the OECD Arrangement: "within limits, variations of certain of these provisions are permitted under the

terms of the Arrangement." Mr. Chairman, the DSB found that Canada Account subsidies were to be withdrawn, and Canada asks Brazil and the other WTO Members to believe that, from now on, they will interpret the OECD Arrangement, in good faith as before, but now in ways that would not be found to be in violation of the SCM Agreement.

20. Mr. Chairman, nothing has changed with regard to Canada Account. If Canada's policy guideline is found to be effective implementation, the multilateral trading system will have suffered a serious setback.

ANNEX 1-5

RESPONSES BY BRAZIL
TO QUESTIONS FROM THE PANEL

(14 February 2000)

Canada Account

Q1. Could Brazil please elaborate regarding the basis on which it considers the Policy Guideline “purely hortatory” (Brazil’s second submission at para. 69)? In Brazil’s view, what changes would be necessary for it to become mandatory?

Response

The Policy Guideline adopted for Canada Account is hortatory because, according to Brazil’s information, Policy Guidelines are not binding in Canadian law and cannot fetter Ministerial discretion. They provide guidance on how decision makers will exercise their discretion, but they are not binding and do not require a specific outcome. In *Maple Lodge Farms v. Canada* [1982] 2SCR 2 at 7, the Supreme Court of Canada held that Ministerial discretion cannot be fettered through the issuance of a Policy Guideline.

The Federal Court of Canada has also held that Policy Guidelines may be issued, but should not be drawn so narrowly that they “crystallize into binding and conclusive rules.” See *Dawkins v. Canada* [1992] 1 FC 639 at 649. Similarly, decision-makers that issue Policy Guidelines may not construe those Policy Guidelines as binding obligations which restrict their ability to exercise discretion. *Saunders Farms v. B.C.* [1985] 32 Admin. L.R. (2d) 145 (BCCA).

Therefore, the Policy Guideline adopted by Canada for use with Canada Account cannot bind the Minister because that would fetter Ministerial discretion and violate Canadian law. Consequently, as the Policy Guideline is not binding but merely provides direction, it is merely hortatory.

In fact, Canada’s actions demonstrate that its Policy Guideline does not remove Canada Account financing from the category of prohibited export subsidies; the policy was already in existence before the Panel determined that Canada provided prohibited export subsidies *via* the Canada Account. Despite the fact that Canada stated to the Panel in the original proceedings, on at least three different occasions, that Canada Account financing and loan guarantees for exports “have been consistent with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I,” the Panel determined that Canada Account support constituted prohibited export subsidies.¹ If this policy did not provide a disincentive for Canada to maintain prohibited export subsidies *via* the Canada Account *before* the Panel’s determination, why would it do so *after* the Panel’s determination?

¹ First Written Submission of Canada, 16 November 1998, para. 173 (Exhibit Bra-33). See also First Oral Submission of Canada, 26 November 1998, para. 101 (“Canada Account financing and loan guarantees for exports committed since the entry into force of the SCM Agreement have complied with the interest rate provisions of the OECD Consensus, as required by Item (k) of Annex I.”) (Exhibit Bra-34); Second Written Submission of Canada, 4 December 1998, para. 77 (“Canada Account transactions are consistent with the interest rates provisions of the OECD Consensus.”) (Exhibit Bra-35).

As to what changes would be necessary for the guideline to become mandatory under Canadian law, Brazil would note that it is not expert on Canadian law. However, it would seem that a minimum mandatory language should be used, and provision should be made for consequences in the event of non-compliance.

Q2. Does Brazil agree with Canada's identification of the "interest rate provisions" of the OECD Arrangement as set forth at paragraphs 69-80 of its oral statement and in the document provided by Canada entitled "Item (k): Interest Rates Provisions of the OECD Arrangement"? Are there other provisions of the OECD Arrangement that Canada has not mentioned but that in Brazil's view form part of the "interest rate provisions" of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies? Are there any provisions identified by Canada that in Brazil's view do not form part of the "interest rate provisions" of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies? Please explain in detail.

Response

Brazil, like most Members of the WTO, is not a Participant in the OECD Arrangement, and for that reason has limited knowledge of the Arrangement and its workings. Therefore, rather than questioning the specific list of "interest rates provisions" listed by Canada, Brazil has asked Canada a series of questions regarding the significance of the provisions it cites.

It should fall to Canada, as one of a minority of WTO Members that is a Participant in the Arrangement, to explain what those provisions are and how, precisely, it will apply them. As stated in its Statement to the Panel, Brazil's understanding is that in their *application* – and not merely in their *identification* – the provisions of the OECD Arrangement are subject to widely-varying interpretations by the various Participants. There is no dispute settlement mechanism in the Arrangement to regulate or constrain those different interpretations. There are no publicly-available documents recording the agreement of the Participants to abide by particular interpretations of particular provisions.

Brazil understands, however, that in applying the Arrangement, some Participants have adopted rather controversial interpretations of various provisions that affect the scope of financing subject to the disciplines of the Arrangement. Brazil's questions to Canada are posed in an attempt to discover whether Canada itself, as a Participant in the Arrangement, has adopted some of these interpretations in its provision of export financing.

We begin, for example, with Article 2 of the Arrangement, which states that it applies to "official support for exports." The Arrangement contains no definition of the term "official support," and Brazil has confirmed with the OECD that the Participants have not reached agreement on a definition.² As a result, Brazil understands, some Participants take the position that "official support" consists only of the provision of support at rates below a government's cost of funds. According to those Participants, support extended at rates equal to or above the government's cost of funds constitutes so-called "market window" support. These Participants consider that, so long as support is granted through this "market window," it may be provided at rates below the minimum Commercial Interest Reference Rates ("CIRR") applicable to "official support" for exports. This interpretation of the "market window" exception may be perfectly acceptable, but it demonstrates why Brazil considers Canada's statement that it will "comply with the OECD Arrangement" ambiguous.

² OECD Arrangement, Article 88. *See also* Correspondence with OECD Secretariat (Exhibit Bra-37).

Further, there is an apparent discrepancy in the particular “interest rates provisions” identified by Canada, even under Canada’s own standard. According to Canada, the “interest rates provisions” of the OECD Arrangement, incorporated into Item (k), include those provisions that “affect what the interest rate and the amount of interest payable will be in a given transaction.”³ Brazil understands that the so-called “Knaepen Package,” which took effect on 1 April 1999, requires Participants to adhere to certain sovereign and country risk premiums. These requirements may have been incorporated into the Arrangement, and may be incorporated *via* Canada’s listing of Article 21(a). As a non-Participant, Brazil does not know whether this is the case. However, those requirements, which in Canada’s words “affect what the interest rate and the amount of interest payable will be in a given transaction,” should be included as “interest rates provisions” of the Arrangement, or Canada should explain why they are not. Thus far, Canada has been silent on this point.

Finally, Brazil has not knowingly asserted in this proceeding that Canada will not comply with the “non-derogation commitment,” as Canada argues at paragraph 71 of its Oral Statement. Indeed, Brazil is not certain what that commitment is, and Canada has not specified which provisions compose the “non-derogation commitment set forth in the Arrangement.” If Canada is referring to Article 27, however, titled “No Derogation for Export Credits,” Brazil notes that Canada has not included this provision on its list.

Q3. Could Brazil describe in detail what it considers is required for full compliance with the interest rate provisions of the OECD Arrangement in the sense of the second paragraph of item (k) of the Illustrative List of Export Subsidies. That is, what precisely would Canada have to do for Canada Account transactions in the regional aircraft sector to qualify for the safe haven of the second paragraph of item (k)? How if at all does this differ from what Canada has said would be necessary? If Canada Account transactions in the regional aircraft sector complied to the letter with all of the provisions of the OECD Arrangement that Canada identified in paragraphs 69-80 of its oral statement and in the Canadian document entitled “Item (k): Interest Rates Provisions of the OECD Arrangement”, does Brazil believe that such transactions would qualify for the safe haven in the second paragraph of item (k)? Please explain in detail.

As discussed in its response to Question 2, Brazil considers that Canada has not fulfilled its implementation commitments by merely listing what it considers the “interest rates provisions” of the OECD Arrangement to be. Canada should state how it intends to apply those provisions, and what it means when it says it will “comply” with them.

Brazil has described above the ambiguities surrounding the application of the Arrangement regarding, for example, the definition of “official support” and the concept of “market windows.” Without information from Canada regarding how it intends to *apply* each of the provisions included on its list, a non-Participant like Brazil will have no way of knowing what to “comply with” those provisions actually means. Only with this information could the Panel, or any WTO Member who is a non-Participant in the Arrangement, reasonably determine whether the Canada Account, as the Panel’s question states, “complies to the letter with all of the provisions of the OECD Arrangement” included on Canada’s list.

The Arrangement would appear to make the obtaining of information difficult for non-Participants. For example, it appears to Brazil that Article 52 of the Arrangement requires a Participant intending to match alleged non-conforming terms and conditions by another Participant to inform that Participant. However, Article 53 appears to permit a Participant to match the alleged non-conforming terms and conditions of a non-Participant by simply notifying other Participants of

³ Canadian document provided to the Panel on 6 February 2000, “Item (k): Interest Rates Provisions of the OECD Arrangement,” pg. 1.

that fact, with no notice to the non-Participant. Thus, if the matching provisions of the OECD Arrangement were considered to be part of its “interest rates provisions,” it would appear that a Participant would have to notify another WTO Member that is a Participant but not one that, like Brazil, is not a Participant. It is also unclear to Brazil what a non-Participant’s obligations would be under these provisions. The point is, however, that it is up to Canada as the Member invoking the second paragraph of Item (k) to explain whether it intends to comply with these, and the other provisions, and if so, how it intends to do so. This is not a question of proof; it is a question of explanation.

Q4. Concerning Canada’s proposal that the Panel endorse the verification mechanism suggested by Canada, Brazil states that it considers that resolution of the matter in the context of dispute settlement “is not clearly compatible with the spirit, if not the letter, of Article 19 of the DSU” (Brazil’s second submission at para. 78). Could Brazil please elaborate on this point. In particular, in what specific sense might Canada’s proposal be considered out of keeping with the spirit and with the letter of Article 19? Are there any other provisions of the DSU or the SCM Agreement that would be relevant to Canada’s proposal?

Response

Under Article 19.1 of the DSU, a Panel may make recommendations that a Member violating its commitments bring its measure into conformity with a particular agreement. Within the context of prohibited export subsidies, however, Panels are, more specifically, required by Article 4.7 of the Subsidies Agreement to recommend that a Member providing such a subsidy “withdraw the subsidy.” Put simply, while a bilateral transparency and verification mechanism may be desirable, it is not a replacement for the requirement that Canada withdraw the prohibited export subsidies identified in the recommendations and rulings of the DSB. Canada is proposing that the Panel recommend verification, not implementation. Brazil would also note that Article 3.2 of the Dispute Settlement Understanding provides that recommendations and rulings of the Dispute Settlement Body cannot add to the obligations of the Members. A verification requirement would add to the obligations of the parties.

Bilateral discussions between Brazil and Canada regarding transparency and verification of programmes maintained for the support of their regional aircraft manufacturers are on-going. Whether those discussions succeed or fail will depend in part on Canada’s willingness to submit a broader range of programmes than merely the Canada Account and TPC to the terms of any transparency and verification arrangement. Any such arrangement must be truly reciprocal to be acceptable to Brazil.

Further, the proposed bilateral agreement envisions the disclosure of extensive amounts of highly confidential commercial information. Confidentiality requirements, therefore, are vital in any bilateral arrangement. As the Panel is aware, confidentiality has been, and continues to be, an issue in these cases.

The Panel will recall that in Brazil – Export Financing Programme for Aircraft, WT/DS46, the interim report of the original Panel, containing its findings and conclusions, was prematurely released to the Parties, despite the understanding – otherwise adhered to in these proceedings – that all reports would be issued simultaneously. Late in the afternoon of the premature release, Northwest Airlines announced that it was awarding a contract for a large number of aircraft to the Canadian producer, Bombardier, rather than to Embraer of Brazil. Northwest had previously informed both manufacturers that it would await the results of the WTO proceedings before making its decision. Brazil is confident that it did not provide the interim report in DS46 to Northwest.

Likewise, in this Article 21.5 proceeding, the Panel will recall that Brazil's confidential Second Submission to this Panel somehow was obtained by the European Communities, despite the fact that it had not been provided to the EC by Brazil. While it has not been established exactly how the unauthorized disclosure to the EC occurred, the Panel will appreciate that incidents of this nature do not contribute to building confidence that unauthorized disclosure of highly sensitive commercial information under a transparency agreement will not occur.

Technology Partnerships Canada

Q1. At paras. 18 and 19 of its second submission, Brazil claims that “[a]t a minimum, Canada’s implementation measures must ensure that prohibited export subsidies cannot be granted to the regional aircraft industry under the facts surrounding the operation of the TPC programme . . .” (emphasis in original). Out of preference, Brazil would have Canada implement the Panel’s findings on TPC assistance by eliminating the TPC programme altogether with respect to the regional aircraft sector.

- (a) *Please comment on Canada’s assertion (para. 32 of oral submission of Canada) that, with regard to TPC assistance to the regional aircraft industry, Brazil has set Canada an “impossible burden of proof”. Is it possible, in practice, for a panel to verify that a sovereign state has eliminated all discretionary authority to grant de facto export subsidies to a specific sector of its domestic industry? Is the elimination of all such discretionary authority required by Article 3.1(a) of the SCM Agreement?*

Response

Brazil does not agree that it suggested that a sovereign state must eliminate all of its discretionary authority. Obviously, a sovereign state cannot do that and remain a sovereign state. Nor does Brazil agree that it has set Canada “an impossible burden of proof.” Brazil recognizes that it bears the burden of showing that Canada has failed to implement, and Brazil has done so. Brazil has shown that all the essential elements of the programme remain unchanged, and that many of these elements will never change. It then becomes Canada’s burden to explain how Brazil was wrong and how Canada’s purported changes actually constitute effective implementation. This Canada has not done. This is especially true here, where Canada has admitted that it has not in fact yet even completed its revisions of the programme.

The Panel will not, of course, be able to verify in these Article 21.5 proceedings that Canada never again will grant a subsidy *de facto* contingent on export to the regional aircraft industry. For the recommendations and rulings of the DSB in this case to have any meaning, however, withdrawal of the prohibited subsidy should consist of measures that make it clear to the Panel that Canada is not simply going to continue the same programme as before once these proceedings are completed. Otherwise, to obtain an effective remedy, Brazil would be required to engage in endless challenges to future generations of TPC subsidies issued under circumstances virtually identical to ones already judged to be prohibited by this Panel.

Brazil does not consider that the elimination of all discretionary authority is required by Article 3.1(a) of the Subsidies Agreement. For example, in Brazil’s view, Article 3.1(a) does not prohibit the exercise of discretion in evaluating the financial or technical feasibility of a proposal. Rather, the specific question in this proceeding is whether Canada has “withdrawn the subsidy,” under Article 4.7 of the Agreement. Under the “new” TPC, Canada has not withdrawn the subsidy; instead, the same, specifically-selected industries will receive even more TPC money than before for the same types of projects. By any reasonable standard, this is not sufficient to achieve the effective remedy required by Article 4.7.

- (b) *Would elimination of the TPC programme have the effect desired by Brazil (i.e., elimination of discretionary authority to grant prohibited export subsidies to the Canadian regional aircraft industry) if Canada were subsequently able to introduce a new programme that could, in principle, lead to the grant of de facto export subsidies to the Canadian regional aircraft industry?*

Response

Brazil agrees that it is not possible to prevent all eventualities. However, the fact that a remedy could be subject to manipulation, does not mean that no remedy should be provided. Regardless of what new programmes are created in the future, the issue now before the Panel is whether Canada has fully implemented the DSB's recommendations and rulings.

Q2. Does Brazil consider that the provision of specific subsidies to export-oriented industries – in the absence of other factual considerations demonstrating de facto export contingency – necessarily violates Article 3.1(a) of the SCM Agreement? Please explain.

Response

When an industry is specifically targeted for a subsidy *because* of its undisputed export orientation, a violation of Article 3.1(a) of the SCM Agreement occurs. As the United States said, at paragraph 7 of its Third Party Submission, “there is a fundamental difference between a government granting a subsidy to an enterprise which happens to export and a government granting a subsidy to an enterprise *because* it exports.”⁴

Moreover, Brazil has demonstrated that the export-orientation of the industry has not changed since the original Panel proceedings, and Canada has acknowledged that it maintains the same focus in the “new” TPC as it did in the “old” TPC – two-thirds of all funds will continue to go to the aerospace industry. Canada cannot maintain the identical focus on this industry, originally *selected because* of its exports, in the “new” TPC, with the export-orientation of the industry as evident as ever, and expect that the motivations underlying this focus in the “old” TPC are no longer relevant.

The Panel will recall that the Appellate Body concluded that a *de facto* export subsidy exists when it is “tied to” actual or anticipated exportation or export earnings. Brazil has shown that TPC subsidies were and, under the “new” TPC, will continue to be, provided to the aircraft sector *because* of its high export performance. As Canada has decided to provide subsidies to this industry *because* it exports, TPC subsidies clearly are “tied to” actual or anticipated exportation or export earnings.

Q3. At footnote 62 of its second submission, Brazil states that, “to reach sales forecasts”, the Canadian regional aircraft industry must export. Is the grant of TPC assistance to the regional aircraft sector contingent on fulfillment of sales forecasts?

Response

Brazil noted in its submissions to the Panel that Canada has not yet provided 68 per cent of the documents associated with the “new” TPC. Therefore, Canada has made it impossible to determine whether this or other factors considered by the Panel in the original proceedings to constitute evidence demonstrating *de facto* export contingency are maintained in the “new” TPC. Canada has also admitted to the Panel that it has not yet completed the revision of many of these

⁴ Emphasis in original.

documents. For these reasons alone, the Panel may properly find that Canada has failed to implement the recommendations and rulings of the DSB.

Under the TPC Aerospace and Defence Sector Generic Model Agreement, applicants are required to report forecast and actual sales.⁵ Since Canada did not provide a new version of this document by the deadline for implementation of the recommendations and rulings of the DSB, the Panel should presume that the prior version still applies. Given its status as a generic form agreement, there is no reason why a new version of this document will not be created “until such time as the restructured programme approves and contracts new investments,” as Canada suggests.

Brazil also notes that even after 18 November 1999, TPC’s website states that TPC contributions, 65 per cent of which are allocated to the aerospace industry, “are forecasted to generate sales of more than \$89.6 billion . . .”⁶ TPC therefore records and tracks sales forecasts.

Finally, Brazil notes that under the “new” TPC, one form of repayment of TPC contributions will be based upon “royalties on total company or division sales.”⁷ To prepare a repayment schedule based upon royalties from sales, TPC must obtain information on and evaluate forecasted sales.

Q4. If, hypothetically (and as Brazil claims), the current measures taken by Canada to comply with the DSB recommendation are not a sufficient change in the factual situation which led to the initial conclusion that TPC assistance to the regional aircraft industry is de facto contingent on export, what alternative action(s) does Brazil consider Canada could take to implement the DSB recommendation other than withdrawal of the TPC programme in respect of the Canadian regional aircraft industry?

Response

Alternatives available to Canada would include making TPC funds available to Canadian industry generally, and changing TPC so that its contributions do not confer benefits, and therefore do not constitute subsidies, within the meaning of Article 1.1 of the SCM Agreement.

Q5. At para. 37 of its first submission, Canada claims that “[t]he restructuring of TPC has removed all elements that had formed the basis for the Panel and Appellate Body finding of de facto export contingency, with the exception of one, namely that the Canadian regional aircraft industry has a high propensity to export its final products”. Does Brazil agree that all other elements that had formed the basis of the Panel and Appellate Body rulings on export contingency – with the exception of the export orientation of the Canadian regional aircraft industry – were removed by Canada? If not, why not? If yes, and if the export orientation is the only element remaining, does it not then logically follow that the subsidies granted are no longer export contingent, especially in the light of the Appellate Body’s statement in para. 173 of its report that the “export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding”?

Response

Brazil does not agree with Canada’s claim that it has removed all elements forming the basis, in the original proceedings, for the determination that TPC contributions to the regional aircraft industry were *de facto* export contingent. In paragraph 15 of its Second Submission, Brazil describes

⁵ Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/R (14 April 1999) (Adopted as Modified by the Appellate Body, 20 August 1999) para. 9.340 (bullet point 10) (“Panel Report”).

⁶ TPC Current Statistics, 6 December 1999 (Exhibit Bra-17).

⁷ Industry Canada News Release, 18 November 1999, pg. 4 (Exhibit Bra-18).

the factors that in its view support a continued inference of *de facto* export contingency and a determination that Canada has not “withdrawn the subsidy”:

- **First**, Brazil points to the export-orientation of the industry, along with the specificity of TPC, which maintains two-thirds of its contributions for the aerospace industry. That factor is discussed in the section beginning at paragraph 21 of Brazil’s Second Submission (as well as in the section beginning at paragraph 18 of Brazil’s First Submission).
- **Second**, Brazil notes that essentially the same projects continue to be eligible for contributions under the “new” TPC as were eligible under the “old” TPC. A discussion of this factor begins at paragraph 34 of Brazil’s Second Submission (and is also included in Brazil’s First Submission in the section commencing with paragraph 24).
- **Third**, Brazil shows that applicants for funds under the “new” TPC must demonstrate that their proposed project fulfills selection and assessment criteria, and programme goals and objectives, the achievement of which requires a commitment to export performance. Brazil also demonstrates that the link between these criteria and export is particularly evident for aerospace and regional aircraft industry applicants, which are awarded two-thirds of TPC funds. This discussion begins at paragraph 37 of Brazil’s Second Submission (as well as in Brazil’s First Submission in the section beginning with paragraph 31).
- **Fourth**, Brazil demonstrates that Canada has not amended or provided documents that the Panel considered resulted in an inference of *de facto* export contingency. Brazil’s discussion of this factor begins at paragraph 51 of its Second Submission (and is also included with the section beginning at paragraph 35 of Brazil’s First Submission).

In this regard, we would recall the language of the Panel in *Australia – Leather*, at paragraph 6.21, note 24: “The specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement and therefore prohibited do not, in our view, determine what is required in order to ‘withdraw the subsidy’ within the meaning of Article 4.7 of the SCM Agreement.

Q6. At para. 11 of its oral statement, Brazil “requests that should the Panel accept Canada’s argument, it then recommend the retroactive payment of TPC subsidies to the regional aircraft industry”. Was this request contained in Brazil’s first two written submissions to the Panel? If not, why not? Is Brazil seeking repayment of TPC subsidies to the Canadian regional aircraft industry? If so, what would be the basis for the Panel to recommend repayment?

Response

Brazil’s First and Second Submissions did not contain a request for this retroactive repayment, which, as expressly stated in paragraph 11 of its Statement for the Meeting of the Panel, is an alternative, though not a preferred, remedy. Brazil’s presentation of arguments regarding the retroactive repayment of TPC subsidies was in response to the circulation of the Article 21.5 decision in *Australia – Leather*, which was not circulated to the Members until 21 January 2000, four days after Brazil’s Second Submission was filed on 17 January 2000.

Brazil submits that retroactive repayment may be appropriate only in the event that either or both of two scenarios materializes. First, if the Panel considers itself required to follow the reasoning of the Panel in *Australia – Leather*, Brazil has argued that the factual similarity between *Australia – Leather* and the case at hand make the reasoning of *Australia – Leather* applicable here. Second, if

the Panel accepts Canada's argument that "in the absence of any such financial contribution and a full consideration of [the] facts, there can be no grounds to support Brazil's allegations of *de facto* export contingency under the restructured TPC programme,"⁸ Brazil will be left without recourse to Article 21.5 review of Canada's implementation measures. In that event, Brazil will be left with no effective remedy apart from the retroactive repayment of TPC subsidies granted to the Canadian regional aircraft industry.

Question to both parties

Please comment on the EC argument (para. 7 of the EC's oral statement) that, in light of the Panel's terms of reference set forth in document WT/DS70/9, "[t]he Panel may not . . . in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two programmes at issue have not implemented the Report".

Response

This argument was raised by the European Communities and the parties before the Panel in *Australia – Leather* and was not accepted by that Panel. As Brazil stated in its oral presentation, Brazil believes the EC and the parties were correct in their positions in *Australia – Leather*, and that the case was wrongly decided. However, the fact remains that this Panel, like the Panel in *Australia – Leather*, might not find itself constrained by the positions of the parties. In its statement, Brazil attempted to allow for this fact and to point out the implications of *Australia – Leather* for this case, should the Panel decide to accept the reasoning of that case.

⁸ Canadian First Submission, para. 45.

ANNEX 1-6

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

(16 February 2000)

In Canada's answers to questions 1 and 2 posed by the Panel regarding TPC, Canada acknowledges (paras. 53-58) that it has actually completed very few changes to the TPC programme. Canada lists 24 documents pertaining to the TPC programme, but states that it has thus far in fact amended only three of these documents. There are drafts available for 13 documents. However, not even drafts are available for the remaining eight documents, including such potentially important materials as the "Statement of Work" and "Evaluation Framework". Canada's attempts to reform TPC are incomplete, leaving the Panel no basis on which to decide that TPC no longer retains its export contingency. For this simple reason alone, the Panel cannot conclude that Canada has implemented the rulings and recommendations of the DSB.

ANNEX 2-1

FIRST SUBMISSION OF CANADA

(10 January 2000)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	104
II. TECHNOLOGY PARTNERSHIPS CANADA.....	105
A. FINDINGS OF THE PANEL AND THE APPELLATE BODY	105
B. MEASURES TAKEN BY CANADA	106
1. Termination of Activities under TPC	106
(a) Canada has Cancelled Funding	106
(b) Canada has Withdrawn Approvals-in-Principle	107
(c) Canada has Closed all TPC Files in the Regional Aircraft Sector	107
2. Canada has Restructured the TPC Programme	107
(a) TPC statements of it's overall objectives: The restructured TPC's objectives focus on innovation and not export promotion.....	108
(b) The types of information called for in applications for TPC funding: Information on exports is not called for or accepted under the restructured TPC.....	109
(c) The considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance: Eligibility criteria under the restructured TPC do not encompass export considerations.....	109
(d) The Factors to be identified by TPC officials in making recommendations about applications for funding: Under the restructured TPC administrators will not consider exports when making funding recommendations	110
(e) The restructured TPC's record of funding in the export field generally, and in the aerospace and defence sector in particular	110
(f) The nearness-to-the-export-market of projects funded: The restructured TPC is considerably less near-market.....	110
(g) Significance of projected export sales to funding decisions under the restructured TPC: There will be no recording of projected Export Sales.	111
C. AS CANADA HAS COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB, BRAZIL'S ALLEGATIONS ARE UNFOUNDED	111
III. CANADA ACCOUNT	114
A. FINDINGS OF THE PANEL AND THE APPELLATE BODY	114
B. MEASURES TAKEN BY CANADA	114
1. No Outstanding Contracts	114
2. Canada has Taken Measures in Respect of Future Export Financing Transactions	115
(a) The Minister has Adopted a Guideline	115
(b) Canada Proposes the Establishment of Verification Procedures	115

C.	AS CANADA HAS COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB, BRAZIL'S ALLEGATIONS ARE UNFOUNDED	116
IV.	REQUESTED FINDING.....	117
	Annex A.....	118
	LIST OF EXHIBITS	121

I. INTRODUCTION

1. In *Canada – Measures Affecting the Export of Civilian Aircraft (Canada – Aircraft)*¹ the Panel and the Appellate Body found that contributions under Technology Partnerships Canada (TPC) to the Canadian regional aircraft industry were *de facto* contingent on export performance and thus such contributions were prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Duties (SCM Agreement)*.² The Panel also concluded that Canada Account debt financing as applied to certain regional aircraft exports constituted subsidies, which were *de jure* contingent on exports, and thus inconsistent with Articles 3.1(a) and 3.2. Canada did not appeal this finding. On 20 August 1999, the Dispute Settlement Body (DSB) adopted the Reports of the Panel and the Appellate Body. It recommended that Canada bring assistance to the regional aircraft industry under TPC and Canada Account into conformity with its obligations under the SCM Agreement within 90 days, that is by 18 November 1999.

2. In response, Canada has put in place new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement. In summary:

- with regard to TPC, Canada terminated all obligations for the disbursement of funds to the Canadian regional aircraft sector, and undertook a complete restructuring of the TPC programme to ensure that actual or anticipated exports will play no role whatsoever in eligibility or decision-making regarding future TPC assistance; and
- with respect to the Canada Account programme, transactions financed under this programme were all completed as of 18 November 1999. Further, to prevent prohibited export subsidies under this programme in the future, Canada adopted a policy requiring that any future Canada Account transactions comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits, thus bringing them within the exception of the second paragraph of Item (k) of the Illustrative List of Export Subsidies (Annex I to the SCM Agreement).

3. described in detail below, these measures fully satisfy the requirement to withdraw the TPC and Canada Account assistance to the Canadian regional aircraft industry that was found to constitute prohibited export subsidies. In addition, these measures ensure – through programmatic changes – that any future assistance under either of these programmes with respect to regional aircraft will be consistent with the SCM Agreement. Canada has, therefore, fully implemented the DSB recommendations.

4. Brazil nonetheless challenges Canada's implementation measures pursuant to Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). It argues that Canada's measures are insufficient to constitute effective implementation of the recommendations and rulings of the DSB.

5. Brazil's contentions have no merit.

6. With regard to TPC, Brazil ignores the termination of ongoing assistance and the restructuring of TPC. It asks the Panel to find export contingency, not based on the three part test established by the Appellate Body, but rather on a combination of past statements made about the programme before restructuring and an argument that TPC objectives of economic growth and jobs should be regarded as legal surrogates for export contingency. Brazil's contentions amount to a

¹ WT/DS70/R and WT/DS70/AB/R, Reports of the Panel and the Appellate Body adopted on 2 August 1999.

² Unless otherwise stated, all Articles refer to the SCM Agreement.

request that the Panel find that TPC must cease all contributions under any conditions to the regional aircraft industry because of the export orientation of the sector. That request has no foundation in the SCM Agreement or the recommendations and rulings of the DSB.

7. With regard to the Canada Account programme, Brazil's contentions are equally unfounded. Transactions financed under this programme were all completed as of 18 November 1999. In addition, Canada has adopted measures to ensure that financing under the Canada Account for transactions after 18 November 1999 will have to conform with the exception in Item (k) of the Illustrative List of Export Subsidies.

8. Canada therefore respectfully requests that the Panel reject Brazil's allegations and arguments, and find that Canada's measures implement fully and faithfully the rulings and recommendations of the DSB.

II. TECHNOLOGY PARTNERSHIPS CANADA

A. FINDINGS OF THE PANEL AND THE APPELLATE BODY

9. In *Canada Aircraft*, the Panel found that that TPC contributions to the regional aircraft sector were subsidies "contingent . . . in fact . . . upon export performance" within the meaning of Article 3.1(a). Brazil did not allege, and the Panel and Appellate Body did not find, that the TPC programme *per se* constituted an export subsidy under Articles 3.1(a) and 3.2. Rather Brazil challenged, in the words of the Panel "the actual application of the TPC . . . programme . . . in the Canadian regional aircraft sector"³

10. The Appellate Body upheld the Panel's findings, while further elaborating on the interpretation of "contingent . . . in fact . . . upon export performance" and modifying the analysis of the legal weight to be accorded to the nearness-to-the-market of a financed project.⁴ *De facto* export contingency, according to the Appellate Body, requires proof of three different substantive elements:

- (1) "the granting of a subsidy";
- (2) that "is tied to";
- (3) "actual or anticipated exportation or export earnings."⁵

11. In agreeing with the Panel that contributions to the regional aircraft industry under the TPC programme as then constituted were *de facto* contingent on export performance, the Appellate Body noted that the Panel considered sixteen factual elements covering a variety of matters, which the Appellate Body grouped into the following eight categories⁶:

- (a) TPC's statements of its overall objectives;
- (b) the types of information called for in applications for TPC funding;
- (c) the considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance;
- (d) the factors to be identified by TPC officials in making recommendations about applications for funding;

³ Panel Report at para. 9.282

⁴ Appellate Body Report at paras. 162-180; *see* Panel Report at para. 9.339.

⁵ Appellate Body Report at para. 169.

⁶ Appellate Body Report at para. 175

- (e) TPC's record of funding in the export field generally and in the aerospace and defence sector in particular;
- (f) the nearness-to-export-market of the projects funded;
- (g) the importance of the projected export sales by applicants to TPC's funding decisions; and
- (h) the export orientation of the firms or the industry supported.

12. The Panel and Appellate Body found that those factual elements *taken together* warranted a finding of a *prima facie* case of *de facto* export contingency. However, the Panel and the Appellate Body both affirmed that the export propensity of a recipient could not, by itself, form the basis for a finding of export contingency.⁷ Further, as the Appellate Body emphasised, "the facts must 'demonstrate' that the granting of a subsidy is *tied to* or *contingent upon* actual or anticipated exports. It does *not* suffice to demonstrate solely that a government granting a subsidy *anticipated* that exports would result."⁸

B. MEASURES TAKEN BY CANADA

13. Canada implemented the recommendations and rulings of the DSB by taking two sets of measures. First, Canada terminated all obligations for the disbursement of funds relating to the Canadian regional aircraft industry under TPC as it was previously constituted. Second, in order to ensure that any future transaction involving the Canadian regional aircraft industry would be compliant with the SCM Agreement, Canada comprehensively amended the structure and administration of TPC.

1. Termination of Activities under TPC

(a) Canada has Cancelled Funding

14. As of 18 November 1999, the Government of Canada terminated all obligations for the disbursement of funds pursuant to the five Canadian regional aircraft industry Contributions Agreement cited in *Canada- Aircraft*.

15. As shown in the amendments to the Contribution Agreements contained in Canada's Exhibit 1, the Government of Canada and the private party to each of the Contribution Agreements entered into irrevocable amendments providing that:

"Notwithstanding any other provisions of this Agreement, the Minister shall not, on or after 18 November 1999, disburse any part of the contribution provided for in the Contribution Agreement, whether or not the Claim on which such disbursement would otherwise be made, was submitted before or after 18 November 1999."

16. As a result of these cancellations, more than \$16.4 million of funding has been cancelled.

⁷ Panel Report at paras. 9.336-9.337; Appellate Body Report at para. 173 (stating that "[t]he second sentence of footnote 4 precludes a panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is 'granted to enterprises which export'. In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports.")

⁸ Appellate Body Report at para. 171 (emphasis in original; footnote omitted).

(b) Canada has Withdrawn Approvals-in-Principle

17. In 1998 TPC had approved-in-principle two projects in the regional aircraft sector, for which no Contribution Agreements had yet been concluded. As documented by letters in Canada Exhibit 2, on 5 November 1999, Industry Canada informed the applicants that it would not proceed with contracts for the projects in question, and the applicants acknowledged that the Minister of Industry has no obligations *vis-à-vis* the applicants pursuant to the prior approvals-in-principle. Consequently, as of 18 November 1999, TPC had no obligation whatsoever to disburse funds to the Canadian regional aircraft industry.

(c) Canada has Closed all TPC Files in the Regional Aircraft Sector

18. As described below, the Government of Canada undertook a thorough restructuring of the TPC programme. The restructuring applied not only to the regional aircraft sector, but to the programme as a whole. To bring all TPC activities under the restructured programme, all files relating to outstanding applications for financial assistance submitted prior to the restructuring were closed as of 18 November 1999. Letters so advising the applicants are contained in Canada Exhibit 3. In order to pursue funding under TPC, applicants must now submit applications under the new programme in accordance with the new Terms and Condition⁹ and the new Investment Application Guide.¹⁰

2. Canada has Restructured the TPC Programme

19. Following the Panel and Appellate Body rulings, Industry Canada undertook fundamental amendments to the structure and administration of TPC to ensure that TPC assistance is not contingent in law or in fact upon export performance. Indeed, export performance is not even a consideration in TPC activities.

20. The new restructured TPC came into effect on 18 November 1999. The specific elements of the TPC restructuring are set forth in a series of documents that are described below and appended as Exhibits. The most important of these are the TPC Terms and Condition¹¹, the Special Operating Agency Framework Document (SOA Framework)¹² the Investment Application Guide¹³ and the Investment Decision Document (IDD).¹⁴ These documents set out and reflect the key aspects of the programme, including its mandate, objectives and guiding principles, as well as eligibility and application and requirements and the required format for bringing recommendations forward for approval.

21. Canada has taken all the steps it can to address the factual elements considered relevant by the Panel and Appellate Body in determining that contributions to the Canadian regional aircraft industry under the previous version of the TPC programme were *de facto* export contingent. The following analysis uses the categories employed by the Appellate Body.

⁹ Exhibit Can - 4.

¹⁰ Exhibit Can - 5.

¹¹ *Supra*, note 9.

¹² Exhibit Can - 6.

¹³ *Supra* note 10.

¹⁴ Exhibit Can - 7.

- (a) TPC statements of its overall objectives: The restructured TPC's objectives focus on innovation and not export promotion

22. The restructured TPC's objectives, put simply, are to promote technological innovation and enhance the technological capability of Canadian industry. The mandate and overall programme objective of the restructured TPC are set out in the Terms and Conditions and the SOA Framework as follows:

“In a context in which innovation is essential in an increasingly knowledge-based economy, TPC is a technology investment fund established to contribute to the achievement of Canada's objectives of increasing economic growth, creating jobs and wealth, and supporting sustainable development. TPC will advance and support government initiatives by investing strategically in research, development and innovation in order to encourage private sector investment, and so maintain and grow the technology base and technological capabilities of Canadian industry. TPC will also encourage the development of SMEs in all regions of Canada.¹⁵

23. As set out in the SOA Framework, specific programme objectives indicate that contributions under TPC will be administered in a way that will contribute to:

- “increasing economic growth, jobs and wealth;
- supporting sustainable development;
- maintaining and building the industrial technology and skill base essential to a knowledge-based economy;
- encouraging the development of SMEs in all regions of Canada;
- encouraging private sector investment;
- managing the contributions so that all repayments are recycled into TPC, allowing potential for future growth;
- managing the sharing ratios on TPC contributions, with a target of an average TPC sharing ratio of no more than 33 per cent (with typical project sharing ratios between 25 per cent and 30 per cent); and
- taking an investment approach through sharing in rewards as well as risks.¹⁶

24. Consistent with these objectives, the Terms and Conditions stipulate that Aerospace and Defence component:

“...encourages and supports the development and application of those technologies essential for the development of these sectors. It involves projects that sustain and expand the technological capacity and capability of these sectors. Support is also available for defence conversion projects aimed at reducing the dependency of enterprises on military contracts.¹⁷

¹⁵ *Supra* note 12 at section 2.1 and *Supra* note 9 at section 2.

¹⁶ *Supra* note 12 at para. 2.2.

¹⁷ *Supra* note 9 at section 3.1.

25. In short, the restructured TPC's mandate and objectives clearly do not encompass the enhancement of exports or Canada's export base.

(b) The types of information called for in applications for TPC funding: Information on exports is not called for or accepted under the restructured TPC

26. The restructured TPC's application procedure has been reformed consistent with the new objectives of the programme. As such applicants must provide information on the proposed research and development initiative and its strategic benefit to Canada.¹⁸ The Investment Application Guide does not require the applicant to submit information regarding actual or anticipated exportation and explicitly states that: "*TPC will not accept or consider information concerning the extent to which your company does or may export*".¹⁹

(c) The considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance: Eligibility criteria under the restructured TPC do not encompass export considerations

27. All investment proposals submitted for consideration will be evaluated against the revised assessment criteria as set out in the restructured programme's Terms and Conditions. Project assessment concentrates on the contribution that a project makes to improving the technological capability of a firm, rather than on the commercial viability and export potential of a specific product.

28. Applications for contributions are assessed in the context of the relevance of the project to the objectives of TPC and whether they fall within one of the eligible activities set out in section 3.3 of the Terms and Conditions. Specifically, proposals are assessed in terms of the extent to which they demonstrate:

- "a. that the that project contributes to the strategic objectives of the government, including technological and net economic benefits to Canada;
- b. that the project is technologically feasible, and the applicant possesses, or can reasonably be expected to secure, the requisite technological and managerial capabilities, and financial resources, to achieve the stated objectives of the project;
- c. that a contribution under TPC is necessary to ensure that the project (either individually or as part of a portfolio of related activities of the applicant) proceeds with the desired scope, timing or location; and
- d. that the contribution can be repaid.²⁰

29. In granting assistance in the aerospace and defence sector under TPC, *as previously constituted*, consideration was given to whether a project maintained and built "upon the

¹⁸ *Supra*, note 10 at section 7. Applicants to the programme have been advised that the Minister of Industry reserves the right to release commercially confidential information, provided in the course of applying for assistance, for the purposes of the conduct of an international or internal trade dispute, in which Canada is a party or a third party intervenor (Investment Application Guide at page 7). Clauses similar to those used in the five contribution agreement amendments (See Exhibit Can – 1) will also now form part of all future contribution agreements. This permits Canada to release commercially confidential information contained in these agreements.

¹⁹ *Ibid.*

²⁰ *Supra* note 9 at section 4.

technological capabilities and production, employment and export base.²¹ . The focus under TPC is now squarely on the “development and application of technology” and the expansion of “technology capacity and capability”. Indeed, under the restructured TPC, export performance is explicitly *not* a consideration. Section 6.1 of the Terms and Conditions mandate that:

“TPC will be administered in accordance with Canada’s international agreements, and in particular, the granting of contributions will not be contingent, either in law or in fact, upon actual or anticipated export performance.”

30. TPC has also taken a number of steps to enhance its transparency and will publicly announce all TPC investments identifying who the recipient is, the amount of funding provided, and the government’s rationale for granting the assistance.

(d) The Factors to be identified by TPC officials in making recommendations about applications for funding: Under the restructured TPC administrators will not consider exports when making funding recommendations

31. When making a funding recommendation under the restructured TPC, officials will base their decision on the information compiled in the course of the due diligence process and summarised in the Investment Decisions Document (IDD). This document, which is included as Canada Exhibit 7, draws out all of the information on a project that is relevant for the purposes of assessing it in relation to the mandate and objectives of TPC. The IDD is submitted to TPC Management Board, the Programmes and Services Board, the Deputy Minister of Industry Canada and the Minister of Industry Canada, as required for approval. The IDD contains all the necessary information to authorise TPC to enter into Contribution Agreements (i.e. the contribution amount, sharing ratio, and any special conditions). Decision-makers are explicitly directed that “TPC will not accept or consider information concerning the extent to which a company does or may export.”²²

(e) The restructured TPC’s record of funding in the export field generally, and in the aerospace and defence sector in particular

32. While the aerospace and defence component of TPC will continue to receive two-thirds of the programme funds, it cannot be assumed that regional aircraft industry-related projects will receive the majority of the funds. In fact, no new regional aircraft-related projects have been approved or contracted since 14 November 1997.

(f) The nearness-to-the-export-market of projects funded: The restructured TPC is considerably less near-market

33. TPC has been restructured to enable it to be less near-market. The programme's objectives themselves now focus on the contribution a project makes to improving the technological capability of the firm or sector, rather than on the commercial viability and export potential of supported products.

34. The programme now includes Industrial Research as an eligible category; this permits the restructured TPC to support earlier stage research and development that is further removed from the production and sale of specific products. The pre-competitive development category of eligible activity enables TPC to support the development of horizontal technologies that cut across the operations of recipient firms (e.g. measures to improve product quality, improve engineering

²¹ See Exhibit Can 8 at para. 3.2.3.

²² See Exhibit Can 7 at part 4.

efficiency, develop generic technologies with multiple applications, etc.) rather than the development of specific products.

- (g) Significance of projected export sales to funding decisions under the restructured TPC: There will be no recording of projected Export Sales.

35. As noted above, TPC will no longer accept or gather, much less consider, any information whatsoever related to actual or anticipated exports or export sales. Accordingly, TPC Contribution Agreements will not record projections of export sales by recipients as was previously the case.

C. AS CANADA HAS COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB, BRAZIL'S ALLEGATIONS ARE UNFOUNDED

36. Canada has terminated all obligations for the disbursement of funds relating to Canadian regional aircraft industry under TPC as of 18 November 1999. It has, in addition, restructured the programme and its administration to de-link funding under TPC from any consideration of actual or anticipated exports or export earnings. Canada has, therefore, complied fully with the recommendations and rulings of the DSB.

37. The restructuring of TPC has removed all elements that had formed the basis for the Panel and Appellate Body finding of *de facto* export contingency, with the exception of one, namely that the Canadian regional aircraft industry has a high propensity to export its final products.²³ This element is clearly beyond the purview of the TPC. A company's or an industry's export orientation, or lack thereof, is not within the control of the Government of Canada. Moreover, as the Appellate Body has found, the SCM Agreement does not prohibit the granting of subsidies to firms or industries that are export oriented, including in circumstances where the government is aware of this export orientation:

*"The second sentence of footnote 4 precludes a panel from making a finding of de facto export contingency for the sole reason that the subsidy is 'granted to enterprises which export'. In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports...We agree with the Panel that...the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and it is not the only fact supporting the finding. [emphasis added]"*²⁴

38. Despite the measures taken by Canada with respect to TPC, Brazil argues that nonetheless these measures fail to comply with the rulings and recommendations of the DSB. Brazil does not attempt to demonstrate, as it must, that contributions under the restructured TPC will be *de facto* export contingent by applying the three-part test established by the Appellate Body: that (1) there is granting of assistance by Canada under the restructured TPC that is (2) tied to (3) actual or anticipated exports. Rather, it makes the following three main arguments, none of which satisfies the standard for establishing *de facto* export contingency established by the Appellate Body.

39. First, Brazil makes the point that Canada's measures do not alter the status of TPC contributions as subsidies under Article 1 of the SCM Agreement. Canada's future assistance under TPC may or may not constitute subsidies. However, that is not the issue in this case. The issue of relevance to this proceeding is whether such assistance is contingent in fact upon export performance.

²³ The "export propensity" of the aerospace sector is a fact of the market. The world aircraft industry is one of the most globalized industries with few countries producing all the necessary technology domestically and relying on economics of scale for profitability. The Canadian aerospace sector is no different.

²⁴ Appellate Body Report at para. 173.

Canada notes, in any event, that it has not made any contributions to the regional aircraft industry since 18 November 1999.

40. Second, Brazil asserts that *de facto* export contingency is still “inferred from the total configuration of facts constituting and surrounding any TPC contributions to the Canadian regional aircraft industry”.²⁵ Brazil argues, therefore, that the withdrawal of the *de facto* export subsidy by Canada cannot be adequately achieved without a “complete and total abolition”²⁶ of the TPC programme as it relates to the Canadian regional aircraft industry.

41. Canada has undertaken a complete restructuring of the TPC programme in order to meet the concerns identified by the Panel and the Appellate Body and to comply with the recommendations and rulings of the DSB. Canada is not under any obligation to abolish the TPC programme. As was duly recognised by the Panel in *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*:

“WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, there by bringing themselves into compliance with their multilateral obligations under the SCM Agreement.”²⁷

42. Third, Brazil tries to infer export contingency from a combination of past statements by Canadian government officials and industry groups endorsing exports; continued eligibility of aerospace and defence companies for TPC assistance; and allegations that objectives such as economic growth and jobs should be regarded as legal surrogates for export performance. This proposition is, however, untenable. By such logic, all subsidies are export subsidies and would be prohibited.

43. As set out in Annex A to this submission, Brazil’s factual evidence suffers from a number of errors and distortions. Leaving these aside, however, virtually all of the evidence cited by Brazil relates not to the restructured TPC, but to TPC as it was previously constituted.²⁸ Indeed, in many cases Brazil uses the same quotations that it relied on in challenging TPC as it was previously structured and administered without acknowledging that such information is dated and superseded by the changes introduced by Canada.

44. The Appellate Body ruled that “Footnote 4 makes it clear that *de facto* export contingency must be *demonstrated* by the facts.”²⁹ [emphasis original] Absent such a demonstration it cannot be assumed that assistance to the Canadian regional aircraft industry is *de facto* export contingent under the restructured TPC programme. In *Chile – Taxes on Alcoholic Beverages*³⁰ the Appellate Body held that where there has been a finding of non-compliance with WTO rules and a Member has adopted a replacement measure, that Member cannot be assumed to have continued the previous prohibited practice. The Appellate Body found:

“The final factor that the Panel relied upon in reaching the conclusion under the issue of ‘so as to afford protection’ was ‘the way this new measure fits in a logical connection with existing and previous systems of *de jure* discrimination against imports.’ In our view, the Panel has relied on the fact that previous Chilean measures, which are no longer applicable, involved some protection of domestic alcoholic beverages to show that the *new* tax system will also be applied ‘so as to

²⁵ First Written Submission by Brazil, Article 21.5 Panel at para. 5 - footnotes omitted

²⁶ *Ibid*, at para. 6.

²⁷ WT/DS126/R at para. 9.64.

²⁸ See Annex A, paras. 4 and 5.

²⁹ Appellate Body report, para. 169.

³⁰ WT/DS/87/AB/R, WT/DS/110/AB/R, Report of the Appellate Body adopted on 13 December 1999.

afford protection'. The Panel's reliance on this factor is wrong. *Members of the WTO should not be assumed, in any way, to have continued previous protection or discrimination through the adoption of a new measure. This would come close to an assumption of bad faith.*³¹ [emphasis added, footnotes omitted]

45. The object of Canada's restructuring of TPC is to ensure that future TPC transactions with the Canadian regional aircraft industry will not be *de facto* contingent upon export performance. Establishing *de facto* export contingency requires a consideration of all the facts surrounding the granting of assistance. In the absence of any such financial contribution and a full consideration of those facts, there can be no grounds to support Brazil's allegations of *de facto* export contingency under the restructured TPC programme.

46. Finally, Brazil notes that Canada has not provided revised versions of the documents previously produced before the Panel in the original proceedings and certain other documents referenced in the SOA Framework, and argues that the Panel should draw a negative inference from this fact.

47. The restructuring of TPC involves a complete re-engineering of all of TPC's policies and procedures and related documents. While the Terms and Conditions have been modified, not all supporting documents have been finalised. Attached as Exhibit Can-9 is a list of TPC administrative documents currently being revised with an indication of the status of the revision. For the convenience of the Panel and Brazil, the table provides a mapping from old documents to new documents. Canada notes, once again, that no new contributions to the Canadian regional aircraft industry will be approved until the programme has been fully restructured.

48. Canada has provided the key restructuring documents, namely the new Terms and Conditions, the SOA Framework and the Investment Application Guide and the IDD. Copies of the documents identified in the above-referenced list that have been finalised are included in Exhibit Can-9. Moreover, Canada is prepared to provide additional documents, as they become available.

49. Attached, as Exhibit Can-10 is the Industry Sector – TPC Memorandum of Understanding, as requested by Brazil. This document sets out the respective roles and responsibilities of TPC and Industry Sector Branches.

50. Attached, as Exhibit Can-11 is the Treasury Board Policy on Repayable Contributions, as requested by Brazil. This document is not specific to TPC, but rather sets out the Government of Canada's policy in this area with which TPC must abide as indicated in its Terms and Conditions.³²

51. Moreover, Canada is unable to provide many of the documents requested by Brazil because they will not exist until such time as the restructured programme approves and contracts new investments. Specifically these documents include: completed Case Assessment or Project Summary Forms (now IDDs), completed Sector Branch Technical Assessments, Programme Forecasts and Progress Reports (as specified in the Contribution Agreement and which allow TPC to monitor progress). Moreover, the TPC Advisory Board, the Interdepartmental Advisory Committee, and the TPC Management Board have not met since 18 November 1999. As such there are no minutes, reports or records of decision available. While the Programmes and Services Board did meet on 8 December 1999, no minutes have yet been prepared. Canada also notes that the Board did not consider any project-specific items pertinent to the restructured programme at that meeting.

³¹ *Ibid* at para. 74.

³² Exhibit Can – 4 at section 5.

52. In summary, Canada has terminated all obligations for the disbursement of funds to the regional aircraft sector under TPC, as it was previously constituted. This included cancelling funding under existing Contribution Agreements, withdrawing the approvals-in-principle that had been granted for specific projects and closing all TPC files resulting to applications for financial assistance. Canada has also made fundamental and pervasive changes to the nature and administration of TPC that ensure that funding under the programme, if and when it occurs with respect to the regional aircraft industry, will in no way be tied to or contingent upon any consideration of actual or anticipated exports or export earnings. Canada therefore has withdrawn the subsidies found to be *de facto* export contingent by the Panel and Appellate Body, and has complied with its obligations under the SCM Agreement and with the recommendations and rulings of the DSU.

III. CANADA ACCOUNT

A. FINDINGS OF THE PANEL AND THE APPELLATE BODY

53. In *Canada – Aircraft* the Panel rejected Brazil’s claim the Canada Account programme as such is inconsistent with the SCM Agreement. The Panel also rejected Brazil’s argument that the Canada Account programme mandates prohibited export subsidies. It found that:

“Brazil has failed to demonstrate that the Canada Account programme as such mandates subsidies that are contingent upon export performance. Rather, the Canada Account programme constitutes discretionary legislation. In light of the distinction that GATT/WTO panels have consistently drawn between discretionary legislation and mandatory legislation, *we find that we may not make any findings on the Canada Account programme per se. We therefore confine our analysis to Brazil’s claims concerning the actual application of the Canada Account programme.*” [emphasis added].³³

54. The Panel found, however, that the application of the Canada Account debt financing in the two export transactions involving regional aircraft between 1 January 1995 and 30 June 1998 – covering deliveries to South African Express and LIAT – constituted subsidies that were contingent in law upon export performance within the meaning of Article 3.1(a). The Panel ruled that Brazil made a *prima facie* case that such debt financing was a subsidy contingent on export performance, and that Canada had not rebutted that case “nor sought to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies....”³⁴ The Panel concluded, as a result, that the debt financing in question constituted subsidies that were contingent in law upon export performance.

B. MEASURES TAKEN BY CANADA

1. No Outstanding Contracts

55. The Canada Account debt financing transactions with respect to South African Express and LIAT that were examined by the Panel in *Canada Aircraft* were completed in 1995 and 1998. Since 18 November 1999, there have been no new financing transactions in the regional aircraft sector under the Canada Account programme.

³³ Panel Report at para. 9.213.

³⁴ Panel Report at para. 9.225.

2. Canada has Taken Measures in Respect of Future Export Financing Transactions

56. While the Panel expressly did not find that the Canada Account programme *per se* was a prohibited export subsidy, Canada has taken further action to assure that the discretionary authority of the Export Development Corporation (EDC) in relation to financing under Canada Account will, in the future, be applied in a way consistent with the SCM Agreement. First, Canada has amended the guidance under which the Canada Account operates to require conformity with the OECD Arrangement on Guidelines for Officially Supported Export Credits (the OECD Arrangement). The second paragraph of item (k) of the Illustrative List of export subsidies permits export credit financing that abides by the interest rate provisions of the OECD Arrangement. Second, recognising the importance of verification of compliance, Canada is prepared to agree to procedures, discussed below, that will enable the disputing parties to verify that each is complying with the SCM Agreement in the way it administers export-finance related governmental programmes.

(a) The Minister has Adopted a Guideline

57. Under subsection 23(1) of the *Export Development Act*³⁵ Canada's Minister for International Trade, with the concurrence of the Minister of Finance, may authorise EDC to enter into any transaction or class of transactions which in the opinion of the Minister for International Trade is in the national interest, including Canada Account financing transactions. The Minister for International Trade adopted the policy that, with respect to financing under Canada Account, *only* those transactions that comply with the OECD Arrangement will be considered to be in the national interest.

“Policy Guideline - Canada Account

For the purposes of an authorisation under subsection 23(1) of the Export Development Act of a financing transaction or class of transactions, it is the policy of the Minister for International Trade to consider that any such transactions or class of transactions which does not comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits would not be in the national interest.”

58. This policy, which is included as Exhibit Can – 13, was adopted by the Minister on 15 November 1999 and communicated officially to the President and Chief Executive Officer of EDC on 29 December 1999. By this policy, the Minister informs EDC and the world that he will not authorise any financing transaction under the Canada Account programme unless it complies with the OECD Arrangement. Under Canadian law, no Canada Account transaction may proceed without Ministerial authorisation and the Minister may not approve transactions that he does not find to be in the national interest. It should be noted that, while only regional aircraft financing was at issue in the dispute, the Minister has chosen to require that *all* financing transactions under the Canada Account, not only those in the regional aircraft sector, will be in conformity with the OECD Arrangement

(b) Canada Proposes the Establishment of Verification Procedures

59. To facilitate a definitive resolution of this dispute, Canada is prepared to agree to the establishment of verification procedures in respect of Canada's future arrangements to bring any subsidies in respect of Canada Account financing transactions for regional aircraft into compliance with the SCM Agreement, provided that such arrangements are also applicable to Brazil with respect to its implementation of the rulings and recommendations in *Brazil- Export Financing Programme for Aircraft* (PROEX).³⁶

³⁵ R.S.,c.E-20 Exhibit Can-12.

³⁶ WT/DS46/R and WT/DS46/AB/R adopted on 20 August 1999

60. Endorsement of this proposal for bilateral verification procedures would be consistent with the objectives of the DSU, and could be suggested by the Panel pursuant to Article 19.1 of the DSU. Canada also notes that in consultations with Brazil on 16 and 19 November 1999 concerning implementation of the Panels' recommendations and rulings in the two cases, Canada proposed that the Parties establish procedures that would enable each government to verify the compliance of the other with respect to specific future transactions under the pertinent measures to bring that Party into consistency with the SCM.

C. AS CANADA HAS COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB, BRAZIL'S ALLEGATIONS ARE UNFOUNDED

62. The financing transactions found by the Panel to be subsidies contingent in law upon export performance have been completed, i.e. all disbursements under the relevant loan agreements have been made. No new financing transactions in the regional aircraft sector have been entered into since 18 November 1999. To ensure complete implementation of the rulings and recommendations of the DSB and full compliance with the SCM Agreement, the Minister for International Trade has made a commitment not to authorise any financing transaction under Canada Account unless it complies with the OECD Arrangement. Canada is also prepared to enter into an agreement with Brazil to enable each to monitor compliance with the SCM Agreement in regard to financing of regional aircraft.

63. Article 3.1(a) prohibits subsidies contingent in law or in fact upon export performance. Footnote 5 to that Article provides, in turn that "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provisions of this Agreement."

64. One such exception can be found in the second paragraph of Item (k) of Annex I. According to the Appellate Body in PROEX:

"The second paragraph applies when a Member is 'a party to an international undertaking on official export credits' which satisfies the conditions of the proviso, or when a Member 'applies the interest rate provisions of the relevant undertaking'. In such circumstances, an 'export credit practice' which is in conformity with the provisions of 'an international undertaking on official export credits' shall not be considered an export subsidy prohibited by the *SCM Agreement*. The OECD Arrangement is an 'international undertaking on official export credits' that satisfies the requirements of the proviso in the second paragraph in item (k).³⁷

65. An export credit practice that is in conformity with the interest rate provisions of the OECD Arrangement on Guidelines for Officially Supported Export Credits (OECD Arrangement) is not a prohibited export subsidy under the SCM Agreement.

66. Pursuant to the Ministerial Guideline discussed above, all future Canada Account financing transactions will abide by the OECD Arrangement. Therefore, to the extent that future financing transactions under the Canada Account programme are subsidies within the meaning of Article 1.1 and export subsidies within the meaning of Article 3.1, these transactions will benefit from the exception in Item (k).

67. In its submission Brazil has suggested that Canada must establish its entitlement to use Item (k) as an affirmative defence³⁸. Canada agrees that it is the Member claiming an exception that must demonstrate its entitlement to that exception. If, in the future, there is a financing transaction

³⁷ Appellate Body Report at para. 180.

³⁸ *Supra* note 25 at para. 46.

under Canada Account in relation to which Canada claims the exception in Item (k) and the claim to that exception is challenged, Canada will accordingly bear the burden of demonstrating compliance of the transaction with the exception in Item (k), to the extent Canada relies thereon.

68. Brazil has also asserted that Canada has not indicated which of the provisions of the OECD Arrangement it considers pertinent and in what way Canada intends to comply with them in respect to any future Canada Account activities. While that is true, Canada does not see why it would be obligated to provide such a delineation as to its future course, other than indicating, as Canada has, that it will meet the criteria to qualify for an exception under the second paragraph of Item (k). It is also far from clear what the legal consequence would be of attempting in this proceeding to delineate in the abstract, and before-the-fact, the various ways that Canada considers WTO members can act within the exception in the second paragraph of Item (k). As noted above, should Canada invoke the exception, in any possible future challenge it would have the burden of demonstrating compliance with second paragraph of Item (k) at that time. Canada also notes that the Canada-Brazil verification procedure that it has proposed would facilitate monitoring of compliance on a reciprocal basis.

69. In summary, the Canada Account financing transactions that were found to be prohibited export subsidies were completed prior to 18 November 1999. Canada has therefore withdrawn the subsidies found to be export contingent by the Panel and complied with the recommendations and rulings of the DSB. Canada has also taken steps to ensure that all future Canada Account financing transactions will comply with the OECD Arrangement and benefit from the exception in Item (k). Finally, and perhaps most importantly, Canada suggests the development of a verification procedure under which Canada and Brazil would exchange relevant information regarding specific financing transactions in the regional aircraft sector so as to enable verification of their respective compliance with the SCM Agreement.

IV. REQUESTED FINDING

70. Canada requests that the Panel reject Brazil's claim.

Factual Errors and Misrepresentations

Contained within the Submission by Brazil

1. On three occasions, Brazil asserts that funding for Technology Partnerships Canada (TPC) is rapidly increasing (e.g. 396 per cent). (Para. 13, 21, 23, citation: footnote 14 - TPC Annual Report, 1998-99, pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure)(Exhibit Bra-6).

This is a distortion of the actual programme funding situation. This schedule actually shows that TPC funding has been increased by 20 per cent. This increase in total programme funding (from \$250 million to \$300 million) was announced as part of the Government of Canada's February 1999 Budget Speech and as such pre-dates the *Canada- Measures* Report.

2. Brazil asserts (Para 20) that the Government of Canada admits that the export orientation of the regional aircraft industry "... drives the government's commitment to fund that industry...".

Brazil adduces no evidence to support this allegation. This is not the policy of the Government of Canada.

3. Brazil asserts (Para 21) that TPC is "captive" to the regional aircraft sector. In its use of statistics Brazil is not comparing like figures, but rather mixes apples and oranges.

As of 30 November 1999, TPC had approved \$972 million of contributions of which 65 per cent of total funding was for the Aerospace & Defence component of the programme. However, only 27 per cent or \$265 million of these contributions were provided in support of regional aircraft industry projects. Furthermore, no new regional aircraft projects have been approved or contracted since 14 November 1997.

During the 1998/99 fiscal year, 76 per cent of disbursements (i.e. \$152 million of a total of \$202 million) were from the Aerospace & Defence component of the programme while \$88.9 million (or 44 per cent of total disbursements) were paid to the sponsors of regional aircraft industry-related projects.

4. The Brazilian submission relies on extensive reference to documents and material from the period prior to the restructuring of TPC, many of which were previously submitted in the *Canada - Measures* case. These documents do not provide an accurate representation of the restructured programme.

<u>Footnote(s)</u>	<u>Citation</u>
21	TPC Annual Report, 1996-97, pg.5 (Exhibit Bra-8).
22 and 63	Industry Canada News Release, 10 January 1997 (Exhibit Bra-9).
23	Industry Canada News Release, 17 December 1996 (Exhibit Bra-10).

5. The Brazilian submission also introduces other evidence, not previously submitted in the *Canada - Measures* case. Again this information is from the period prior to the restructuring of TPC. Moreover, much of this information is either of a general nature or from non-governmental sources. As noted above, these documents do not provide an accurate representation of the restructured programme.

<u>Footnote(s)</u>	<u>Citation/Comments</u>
12	TPC Annual Report, 1998-99, pg.20 (Exhibit Bra-6).
13	<i>Id.</i> at pg. 21.
14	TPC Annual Report, 1998-99, pg.28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure) (Exhibit Bra-6).
34	TPC Annual Report, 1998-99, pg.27 (Exhibit Bra-6).
35	<i>Id.</i> at pg. 28 (row titled "Total funds available for new contributions in future years," comparing 1999-2000 figure with 2002-2003 figure).
24	AThink Canada, Think Bottom Line, Think Aerospace Industry, Think Investment," October 1999, pgs. 3,33 (Exhibit Bra-11).
25	<i>Id.</i> at pg.20 This general overview of the Canadian aerospace industry was published in October 1999, however most of the data used is from 1997.
26	Industry Canada, AResults of the 1998/99 Survey of the Canadian Aerospace and Defence Industry," 29 November 1999 (Exhibit Bra-12). This survey was published on 29 November, 1999, using 1998/99 survey data.
27	A Canadian Aerospace Suppliers Base Strategy for Change," 25 June 1999, pgs. 1, 16-17 (relevant excerpt included at Exhibit Bra-13).
28	<i>Id.</i> at pg.17. This was an independent assessment done by Price Waterhouse Coopers and commissioned by the Aerospace Industries Association of Canada, published on 25 June 1999, and does not represent the views of the Government of Canada. (Only 1 of 12 members of the study's Steering Committee was from Industry Canada. TPC representatives were not interviewed.)
29	Aerospace Industries Association of Canada, Annual Report, 1999, pg.4 Exhibit Bra-14).
30	<i>Id.</i> at pg.13.
31	<i>Id.</i> at pg.12. This report was published 20 September 1999 and is not a government publication.
33, 43	TPC Current Statistics, 6 December 1999 (Exhibit Bra-17). Although published after the 18 November 1999 implementation deadline, all data relates to projects undertaken prior to the restructuring of TPC.

58 Industry Canada, CIBS Overview, "Executive Summary," pg.2 (Exhibit Bra-23).

59 Id. at pg.1.

60 Industry Canada, CIBS Strategic Overview, "International Business Development Priorities," pg. 1 (Exhibit Bra-24).

These documents published 7 March 1997, provide general sectoral information unrelated to TPC.

61 Industry Canada, CIBS Geographic Overview, pg.1 (Exhibit Bra-25).

This document, published 30 March, 1997, provides general sectoral information unrelated to TPC.

62 Industry Canada, CIBS - Aerospace and Defence, pg. 1 (Exhibit Bra-26).

This document published 10 March 1999, provides general sectoral information unrelated to TPC.

64 Conference Board of Canada, Performance and Potential 1999, "Working Smarter, Not Harder," pg. 107. (Exhibit Bra-27).

This report, published in October 1999, provides an independent assessment of Canada's economy. It is not a government publication and does not represent the views of the Government of Canada.

LIST OF EXHIBITS

Exhibit Can-1	Amendments to TPC Contribution Agreements terminating disbursement of funds
Exhibit Can-2	Letters withdrawing approvals-in-principle under TPC
Exhibit Can-3	Letters closing all files relating to outstanding applications under TPC
Exhibit Can-4	Revised TPC terms and conditions
Exhibit Can-5	TPC investment application guide
Exhibit Can-6	TPC special operating agency framework document
Exhibit Can-7	Investment decisions document
Exhibit Can-8	Original TPC terms and conditions
Exhibit Can-9	List of TPC administrative documents being revised as at 7 January 2000
Exhibit Can-10	Industry Sector-TPC memorandum of understanding
Exhibit Can-11	Treasury Board policy on repayable contributions
Exhibit Can-12	Export Development Act – R.S., c. E-20
Exhibit Can-13	Policy Guideline – Canada Account

ANNEX 2-2

REBUTTAL SUBMISSION OF CANADA

(17 January 2000)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	123
II. CANADA HAS FULLY COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB	123
A. TECHNOLOGY PARTNERSHIPS CANADA	123
B. CANADA ACCOUNT	124
III. BRAZIL'S ALLEGATIONS ARE UNFOUNDED	124
A. TECHNOLOGY PARTNERSHIPS CANADA	124
B. CANADA ACCOUNT	125
IV. REQUESTED FINDING	126

I. INTRODUCTION

1. In *Canada – Measures Affecting the Export of Civilian Aircraft (Canada – Aircraft)*¹ the Panel and the Appellate Body found that contributions under Technology Partnerships Canada (TPC) to the Canadian regional aircraft industry were *de facto* contingent on export performance and thus such contributions were prohibited export subsidies within the meaning of Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Duties* (SCM Agreement). The Panel also concluded that Canada Account debt financing as applied to certain regional aircraft exports constituted subsidies, which were *de jure* contingent on exports, and thus inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement. Canada did not appeal this finding.

2. On 20 August 1999, the Dispute Settlement Body (DSB) adopted the Reports of the Panel and the Appellate Body. It recommended that Canada bring assistance to the regional aircraft industry under TPC and Canada Account into conformity with its obligations under the SCM Agreement within 90 days, that is by 18 November 1999.

3. In response, Canada has put in place new measures to ensure full and faithful implementation of the DSB rulings and recommendations and compliance with the SCM Agreement. Brazil nonetheless challenges Canada's implementation measures pursuant to Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and argues that Canada's measures are insufficient to constitute effective implementation of the recommendations and rulings of the DSB.

4. In Canada's first written submission in these 21.5 proceeding², Canada established that it has fully implemented the DSB recommendations and rulings and that thus Brazil's allegations are unfounded. The purpose of this second submission is not to put forward any additional information or arguments but to provide a summarised version of Canada's position.

II. CANADA HAS FULLY COMPLIED WITH THE RECOMMENDATIONS AND RULINGS OF THE DSB

A. TECHNOLOGY PARTNERSHIPS CANADA

5. As of 18 November 1999, Canada has terminated all obligations for the disbursements of funds pursuant to the five Canadian regional aircraft Contribution Agreements cited in *Canada-Aircraft*, and has withdrawn the approvals-in-principle that were issued under TPC for two other regional aircraft projects.³

6. In addition, taking full account of the factual elements which led the Panel and the Appellate Body to reach the finding of *de facto* export contingency, Canada has restructured the TPC programme and its administration to ensure that actual or anticipated exports or export earnings play no role in the goals, the application process, or decision-making under TPC. The key aspects of the restructured TPC are set out in the TPC Terms and Condition⁴, the Special Operating Agency Framework Document⁵ the Investment Application Guide⁶ and the Investment Decision Document⁷ Various secondary administrative documents are currently being finalised.⁸

¹ WT/DS70/R and WT/DS70/AB/R, Reports of the Panel and the Appellate Body adopted on 2 August 1999.

² Submitted on 10 January 2000.

³ Exhibits Can - 1 and Can - 2.

⁴ Exhibit Can - 4.

⁵ Exhibit Can - 6.

⁶ Exhibit Can - 5.

7. Files relating to outstanding applications for financial assistance submitted prior to the restructuring were closed as of 18 November 1999. In order to pursue funding under TPC, applicants must submit applications in accordance with the new Terms and Conditions and Investment Application Guide. No transactions in relation to the Canadian regional aircraft industry will be approved until such time as the restructuring of the programme (including the finalisation of all secondary documentation) has been fully completed.

8. These measures fully and faithfully implement the DSB rulings and recommendations in *Canada-Aircraft* and are in compliance with the provisions of the SCM Agreement.

B. CANADA ACCOUNT

9. The Canada Account debt financing transactions that were examined by the Panel in *Canada-Aircraft* were completed in 1995 and 1998 and there have been no new financing transactions in the regional aircraft sector under the Canada Account programme since 18 November 1999.

10. Canada has taken further action to ensure that financing under the Canada Account will, in the future, be consistent with the SCM Agreement. First, Canada has confirmed in a Ministerial Guideline that all Canada Account financing transactions must comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits (the OECD Arrangement). Second, recognising the importance of verification of compliance, Canada is prepared to agree to procedures that will enable the disputing parties to verify that each is complying with the SCM Agreement in the way it administers export-finance related governmental programmes.

11. These measures fully and faithfully implement the DSB rulings and recommendations in *Canada-Aircraft* and are in compliance with the provisions of the SCM Agreement.

III. BRAZIL'S ALLEGATIONS ARE UNFOUNDED

A. TECHNOLOGY PARTNERSHIPS CANADA

12. Despite the measures taken by Canada with respect to TPC, Brazil argues that these measures fail to comply with the rulings and recommendations of the DSB.

13. Brazil does not attempt to demonstrate, as it must, that contributions under the restructured TPC will be *de facto* export contingent by applying the three-part test established by the Appellate Body. This test requires the proof of three substantive elements:

- (1) the granting of a subsidy by Canada under the restructured TPC;
- (2) that is tied to;
- (3) actual or anticipated exports.⁹

14. Rather than applying the three-part test set out by the Appellate Body, Brazil attempts to infer export contingency from evidence that suffers from a number of errors and distortions and

⁷ Exhibit Can - 7.

⁸ See Exhibit Can - 9 for a list of all the administrative documents currently being revised, with an indication of the status of the revision. Where not provided under another Exhibit to Canada's first 21.5 submission, copies of finalised documents are included in Exhibit Can - 9.

⁹ Appellate Body Report at para. 169.

relates, almost entirely, to TPC as previously constituted.¹⁰ The Appellate Body has clearly ruled that *de facto* export contingency must be *demonstrated* by the facts.¹¹ Brazil has failed to demonstrate, on the facts, that TPC as currently constituted will result in transactions that are *de facto* export contingent.

15. As fully set out in Canada's first submission in these 21.5 proceedings, and as noted above, Canada has terminated all obligations for the disbursement of funds to the regional aircraft sector under TPC, as it was previously constituted. No new transactions have been approved under the restructured TPC and therefore no new financial contributions have occurred. Canada has also made fundamental and pervasive changes to the nature and administration of TPC that ensure that funding under the programme, if and when it occurs with respect to the regional aircraft industry, will in no way be tied to or contingent upon any consideration of actual or anticipated exports or export earnings

16. By these actions, Canada has withdrawn the subsidies found by the Panel and Appellate Body to be *de facto* export contingent and thus has complied with the recommendations and rulings of the DSB and with its obligations under the SCM Agreement. Brazil's allegations are therefore unfounded.

B. CANADA ACCOUNT

17. Despite the measures taken by Canada with respect to Canada Account, Brazil argues that these measures fail to comply with the rulings and recommendations of the DSB.

18. The financing transactions found by the Panel to be subsidies contingent in law upon export performance have been completed, i.e. all disbursements under the relevant loan agreements have been made. Furthermore, no new financing transactions in the regional aircraft sector have been entered into since 18 November 1999.

19. To ensure complete implementation of the rulings and recommendations of the DSB and full compliance with the SCM Agreement, the Minister for International Trade has made a commitment not to authorise any financing transaction under Canada Account unless it complies with the OECD Arrangement. Pursuant to the second paragraph in Item (k) of Annex I to the SCM Agreement, an export credit practice that is in conformity with the interest rate provisions of the OECD Arrangement is not a prohibited export subsidy under the SCM Agreement. Therefore, to the extent that future financing transactions under the Canada Account programme are subsidies within the meaning of Article 1.1 and export subsidies within the meaning of Article 3.1, these transactions will benefit from the exception in Item (k).

20. Brazil has suggested that Canada must establish its entitlement to use Item (k) as an affirmative defence. Canada agrees that should Canada claim the exception under Item (k) in relation to any future financing transaction under Canada Account, and if the claim to that exception is challenged, Canada will accordingly bear the burden of demonstrating compliance with Item (k) at that time.

21. Recognising that it is in the interest of both Canada and Brazil to avoid such future challenges and in an attempt to reach a definitive solution to this dispute, Canada suggests that the Parties develop a verification procedure. Under this procedure the two governments would exchange

¹⁰ Annex A to Canada's first Article 21.5 submission sets out these errors and distortions and the dated nature of the Brazilian evidence.

¹¹ *Supra*, note 8.

relevant information regarding specific financing transactions in the regional aircraft sector so as to enable verification of their respective compliance with the SCM Agreement. Canada has withdrawn the subsidies found by the Panel to be *de jure* contingent on exports and has thus complied with the recommendations and rulings of the DSB and with its obligations under the SCM Agreement. Brazil's allegations are therefore unfounded.

IV. REQUESTED FINDING

23. Canada requests that the Panel reject Brazil's claim and find that Canada's measures fully implement the rulings and recommendations of the DSB.

ANNEX 2-3

ORAL STATEMENT OF CANADA

(6 February 2000)

I. INTRODUCTION

Thank you, Mr. Chairman,

Mr. Chairman, distinguished members of the Panel, distinguished members of the delegation of Brazil, on behalf of Canada, let me first express our sincere appreciation to the Panel for agreeing to serve once more in this dispute, which we know has already been demanding of your time and attention. We will try to cooperate in every way possible to facilitate your task.

1. Mr. Chairman, in this proceeding under Article 21.5 of the DSU, Brazil has claimed that Canada has not complied with the rulings and recommendations of the DSB regarding Canada's TPC and EDC programmes. As the Panel knows well, it found that TPC contributions to the Canadian regional aircraft industry were subsidies contingent in fact upon export performance under the then applicable criteria and circumstances, and that two EDC Canada Account transactions were subsidies contingent in law upon export performance. The DSB recommended that Canada withdraw the subsidies within 90 days.
2. Canada has done so. Specifically, in response to those findings and recommendations, as of 18 November 1999, the date fixed for compliance, Canada has taken two types of actions.
3. First, Canada has terminated all subsidies and all obligations to provide subsidies to the Canadian regional aircraft industry that were outstanding under TPC as of the compliance date. The two Canada Account debt financing transactions addressed by the Panel have been completed and there have been no new Canadian regional aircraft financing transactions under Canada Account. Brazil does not dispute this.
4. Second, in response to the rulings and recommendations of the DSB, Canada has modified the rules and ministerial guidance under which these programmes operate so that any future assistance that Canada may provide to the regional aircraft industry under the TPC and the EDC Canada Account programmes will not conflict with the requirements of Article 3.1 (a) of the SCM Agreement.
5. In the case of TPC, Canada terminated all obligations to disperse funds related to the Canadian regional aircraft industry under the previous programme. Canada then completely restructured TPC to remove any consideration of export performance in the granting of assistance.
6. In the case of the EDC Canada Account Programme, Canada has taken a policy decision that future Canada Account financing of regional aircraft will be carried out in accordance with the OECD Arrangement. Thus, to the extent that future financing transactions under Canada Account may be prohibited export subsidies, they will benefit from the exception in the second paragraph of item (k) of the Illustrative List of Export Subsidies.
7. Thus, Canada has not only withdrawn the subsidies that were found to be prohibited, but has revised its programmes to be fully consistent with Canada's obligations under the SCM Agreement.

8. Furthermore, in response to the criticism directed at Canada by this Panel and the Appellate Body for failing to produce certain commercially confidential information in the earlier proceedings, Canada is revising the form of the confidentiality provisions contained in TPC contribution agreements and in EDC transactions, so as to facilitate, if requested, the disclosure of such information in the context of WTO dispute settlement proceedings. Finally, to facilitate a definitive resolution of this dispute Canada has proposed to Brazil the development of a bilateral compliance verification procedure.

9. In the face of Canada's actions, Brazil has not been able to base its claims in this proceeding on any currently pertinent evidence that even remotely suggests non-compliance— for there is none. Instead, Brazil bases its claims on (i) innuendo, (ii) a presumption of bad faith and (iii) a wholly unfounded legal theory that Canada, rather than Brazil, has the burden of proof in this case.

10. Ensuring compliance with the export subsidy rules is the goal of Canada's actions, and it is the effect that would be expected on the basis of the changes Canada has made. According to Brazil, Canada's burden is to prove that the restructured programmes could never possibly be applied so as to grant export contingent subsidies. But there is no basis in the DSU or the SCM Agreement, or international law for imputing to Canada an obligation to prove that discretionary laws could not possibly be used to grant export subsidies. Brazil presumably advances this novel theory because only by imposing that essentially impossible burden on the defending party could Brazil prevail in a complaint where neither the law nor the facts support Brazil's claim.

11. The remainder of Canada's opening statement is divided into two parts: My colleague, Ms. Kirsten Hillman, will first address the TPC programme, and I will then address the Canada Account. In each case, Mr. Chairman, we will briefly summarise the compliance measures that Canada has taken both to withdraw the subsidies found to be illegal and to prevent future illegal export subsidies. We will also respond to the various claims made by Brazil. With your permission, Sirs, I will now ask Ms. Hillman to address the Panel.

II. TPC COMPLIANCE

12. Thank you Mr. Chairman. It is an honour to have the opportunity to appear before this Panel to discuss Canada's implementation with respect to TPC. As you know, this Panel did not find that TPC was *per se* an export subsidy. Rather the Panel found that TPC assistance as applied to the Canadian regional aircraft industry was contingent in fact on export performance.

13. Canada has implemented the rulings and recommendations of the DSB as follows:

14. First, effective 18 November 1999 Canada terminated all obligations for the disbursement of funds to the Canadian regional aircraft industry under TPC. As a result more than \$16.4 million in funding to the sector has been cancelled.

15. Second, the Government of Canada withdrew two approvals in principle that had been issued under the old TPC programme to projects relating to the Canadian regional aircraft industry.

16. Third, the Government of Canada closed all application files under TPC as it was previously constituted. These three actions together mean that Canada has no obligations to disburse funds to the Canadian regional aircraft industry under the former TPC. In addition, under the restructured TPC no new investments have been approved and none will be approved until such time as all the necessary administrative documentation related to the restructured TPC has been finalized.

17. And the fourth implementation measure that the Government has taken to amend the very structure and administration of TPC in so as to address the factual elements that led the Panel and

Appellate Body to find that contributions to the Canadian regional aircraft industry were *de facto* contingent upon export.

Restructuring of the TPC Programme

18. As of 18 November 1999, TPC, as it was previously constituted, no longer exists. The former TPC has been abolished and a new programme has been created with a new mandate from Cabinet. Under this new mandate exports or export performance will have absolutely no relevance to assistance to the Canadian regional aircraft industry – or to any other industry.

19. In undertaking the task of restructuring TPC, Canada was guided by the analysis and findings of the Panel and the Appellate Body. The Appellate Body concluded that there are three elements to a subsidy that is contingent in fact upon export performance. There must be (1) the granting of a subsidy (2) that is tied to (3) actual or anticipated exports. In reforming TPC, Canada focused on the second element of this three part test, and sought to eliminate those aspects of the TPC programme that led the Panel to conclude (and the Appellate Body to confirm) that the subsidies were “tied to” anticipated exports.

20. As to the first element – whether there is a subsidy – as Canada has noted, no new transactions have been approved under the restructured TPC. Future TPC assistance may or may not constitute subsidies under Article 1 of the SCM Agreement.

21. The third element of the Appellate Body test is “anticipated exports”. Here we would note, Mr. Chairman, that the Canadian regional aircraft industry, like virtually every aircraft industry in the world, can be “anticipated” to export. Brazil suggests that the Government of Canada should take steps to alter the export orientation of the Canadian regional aircraft industry¹ and should even attempt to change the nature of the Canadian economy as a whole. Clearly an industry’s export orientation, or lack thereof, is not within the control of the Government. In fact, the Brazilian, American and European regional aircraft industries, even though they exist in much larger domestic markets than that of Canada, are all also substantially export dependent. Furthermore, the SCM Agreement is very clear that subsidies to industries that export are not forbidden as such. The mere awareness or even anticipation of such exports does not preclude subsidization to such an industry. As the Appellate Body has clearly stated, and I quote “It does not suffice to demonstrate solely that a government granting a subsidy anticipated that exports would result”.

22. According to the Appellate Body, a subsidy to an export oriented industry only becomes a prohibited subsidy when, the facts demonstrate that the granting of a subsidy is tied to or conditional on actual or anticipated exports. This is the second element of the Appellate Body’s test, to which I will now turn.

23. In this case, the facts surrounding the administration of TPC led the Panel and the Appellate Body to conclude that TPC assistance was tied to or conditional upon anticipated exports. In response to this finding, Canada addressed the elements that the Panel and the Appellate Body determined were indicative of export contingency. We have reformed TPC so export performance is not even a *consideration* when funding is granted under TPC - let alone a *condition* for the granting of assistance.

24. The modifications made to the TPC programme in order to implement the rulings and recommendations of the DSB are fully set out in Canada’s first submission and I will not reiterate them in detail here today. I would simply like briefly mention a few of the major changes, these include:

¹ See para. 47 of Brazil’s second Submission.

- First, the objectives of the restructured TPC focus on the promoting innovation and on improving the technological capability of Canadian industry;
- Second, information on exports will not be accepted from applicants under the restructured TPC; and
- Third, administrators will not in any way consider exports when making funding recommendations.

25. In addition, confidentiality clauses will be included in all future contribution agreements so as to permit the Government to release the pertinent information contained in these agreements in the context of WTO dispute settlement proceedings.

26. In summary, Mr. Chairman, the “total configuration of the facts” demonstrates that funding under the restructured TPC is not contingent in any sense on export performance. The European Communities are clearly of the same view and have stated in their third party submission that, and I quote: “The EC considers that Canada’s actions with regard to TPC do *prima facie* amount to implementation of the Appellate Body’s findings...there does not seem to be any basis on which continued *de facto* export contingency or some other violation of the SCM Agreement can be established.”

27. Let me now turn to the arguments raised by Brazil.

Brazil's Arguments

28. As I have just set out, Canada has terminated all obligations to disburse funds to the Canadian regional aircraft industry under the former TPC programme. As Mr. Hankey noted, Brazil does not dispute this, and certainly does not offer any evidence to the contrary.

29. In addition, in order to achieve compliance, Canada has restructured TPC so that assistance to the regional aircraft industry under this programme will not run afoul of Article 3 of the SCM Agreement in the future. In its second submission, and again here this morning, Brazil presents a lengthy and rather inflamed critique of a position that Canada manifestly did not take; namely that until such time as there is a transaction under the restructured TPC, a Panel constituted under Article 21.5 of the DSU cannot determine whether Canada has complied with the DSB’s rulings and recommendations. That was not and is not Canada’s view.

30. Lest we all be distracted by a jurisdictional argument not made, let me be very clear. Canada certainly believes that this Panel can – and indeed should – assess whether the restructured TPC programme implements the DSB’s rulings and recommendations regarding *de facto* export contingency. In that regard, as we have demonstrated and as the restructured TPC’s Terms and Conditions and Framework Document make explicit, export performance is in no way a consideration in the granting of assistance under the new TPC. Consequently, there is no evidence to support Brazil’s claim that the restructured programme is *de facto* export contingent.

31. Beyond that, Canada’s point was simply the obvious one that since there have been no transactions under the restructured TPC, it is naturally impossible at present, to look at facts relating to specific applications of the new programme. Canada is confident that when such transactions arise, they will be fully consistent with the SCM Agreement. At the same time, Canada recognises that, in the future, Brazil may want to examine the facts surrounding specific transactions to satisfy itself that the restructured TPC as applied in practice is not *de facto* export contingent.

32. Brazil, for its part, does not adduce evidence that the granting of funds under the restructured TPC programme would be de facto export contingent. Nor does Brazil attempt to apply the three part test set out by the Appellate Body for determining export contingency, namely that there must be (1) a subsidy that (2) is tied to (3) anticipated exports. Rather Brazil fabricates its own test based on an impossible burden of proof and a presumption of bad faith. In its second submission, Brazil states, and I quote, that:

“The implementation measures Canada has adopted, in the case of both TPC and Canada Account, merely suggest to Members that Canada might not continue to grant subsidies contingent in fact on export performance, rather than provide an assurance that it cannot do so.”²

33. Brazil’s proposed test imposes the burden of proof in this case on Canada, rather than Brazil. However, as we all know, it is the complaining party that bears the burden of proof.³ Brazil is arguing that Canada must prove that Canadian law prevents it from granting subsidies that are de facto contingent on exports. There is no basis in the findings of the Panel or the Appellate Body, the SCM Agreement, or international law for imputing to Canada an obligation to prove that discretionary laws could not possibly be used to grant export subsidies. Of course, the proper test in this case is the three part test set out by the Appellate Body that requires Brazil to demonstrate on the facts assistance under the restructured TPC is tied to, or contingent upon export performance. It is precisely because Brazil cannot meet the test of the Appellate Body that it tries to invent and impose its own test.

34. According to Brazil’s test, Canada’s restructured TPC programme must always be tainted by the finding that some aspects of the former programme operated to create de facto export subsidies in some circumstances. At the heart of this test is the presumption that Members intend to circumvent their WTO obligations – hence the purported necessity for Canada to establish that its replacement programmes cannot grant de facto export contingent subsidies.

35. In effect, Brazil argues that TPC can never be restructured to comply with Canada’s WTO obligations. This directly contradicts by the Appellate Body’s rule in Chile – Alcohol, which is, and I quote, “[m]embers of the WTO should not be assumed, in any way, to have continued previous protection or discrimination through the adoption of a new measure.” The Appellate Body has found that, and here again I quote, “This would come close to an assumption of bad faith.”

36. Brazil argues that the rule in Chile – Alcohol does not apply in the case of de facto violations. However, Brazil offers no rationale to explain why de facto violations should be subject to a different legal standard than de jure violations. This is clearly unsupported by the text of the SCM Agreement, WTO rulings or indeed common sense. Indeed, Brazil’s argument is contradicted by the Appellate Body in this very case where it held that the prohibition of de jure and de facto export subsidies are subject to the same legal standard, but are established through different evidence.

37. Brazil also argues that, in any event, its allegations of non-implementation are based solely on the new TPC programme⁴ and that therefore the rule in Chile - Alcohol does not apply. This is clearly at odds with the text of Brazil’s submissions. While Brazil’s submissions do make some reference to the restructured TPC programme, the evidence it puts forward as representing the “total configuration of the facts” from which de facto export contingency must be inferred consists almost exclusively of evidence relating to the old programme. This evidence is largely recycled from Brazil’s submission to the Panel in the original proceedings. Here I refer you to Annex I of Canada’s

² See para. 79 of Brazil’s second Submission.

³ While this principle is articulated in many decisions under the WTO, the one most often cited in support of this proposition is the Appellate Body’s ruling in *Wool Shirts*.

⁴ See para. 30 of Brazil’s second Submission.

first submission where Canada reviews Brazil's evidence and reveals that it is dated and riddled with errors and misrepresentations.

38. In its second submission Brazil does acknowledge that its arguments rely heavily on dated evidence but argues that such evidence should be presumed to be equally applicable to the new TPC programme.⁵ This reasoning is directly at odds with the statement of the Appellate Body in *Chile – Alcohol* and amounts to an unsubstantiated allegation of bad faith.

39. Indeed, the only evidence that Brazil adduces regarding the restructured TPC relates to the objectives of the programme and its subsidiary documentation.

40. Brazil underlines that one of the objectives of TPC is the promotion of economic growth, and the creation of wealth and jobs, and notes that potential projects are assessed in relation to the extent to which they achieve these objectives. Brazil contends that the consideration of economic benefits of a project is equivalent to making export performance a condition to granting funding. Brazil's reasoning goes something like this:

- In assessing a potential project, TPC considers the economic benefits of the project to Canada.
- Examples of economic benefits include economic growth, creating jobs and wealth.
- Economic growth and wealth are achieved in Canada, in part, through trade, which includes, of course, exports.
- Therefore, and here is where Brazil makes an untenable leap of logic, the consideration of the economic benefits of a project is equivalent to making export performance a condition of the granting of funding.

41. Brazil's assertion that economic objectives such as creating jobs, increasing Canadian wealth and spurring economic growth are surrogates for export conditionality is untenable. If this argument were to be accepted, and positive economic objectives were equated with exports, the scope of prohibited export subsidies would be radically expanded from that envisioned by the drafters of the SCM Agreement. Clearly, when governments give subsidies to industry, the intent is to make a positive contribution to the economy in one form or another. However, Brazil's reasoning would effectively prohibit all subsidies to any industry that exports, unless that subsidy has no benefit whatsoever to the economy. This is clearly not acceptable as it would preclude WTO Members from providing any subsidies to industries that export – a result directly contrary to the text of footnote 4 of the SCM Agreement.

42. Despite Brazil's spurious argument, Mr. Chairman, the fact remains that under the restructured TPC, the eligibility criteria reflect the overall objectives of the revised programme and do not include any consideration whatsoever of exportation or export earnings.

43. Finally, Mr. Chairman, Brazil has made much of the fact that Canada has not produced certain documents related to the restructured programme. However, the key documents that provide the restructured TPC with Cabinet authority to operate have been provided by Canada. These are the Terms and Conditions and the Special Operating Agency (SOA) Framework Document.⁶

44. The remaining documents are subsidiary documents that must respect the authority provided in the Terms and Conditions and the SOA Framework Document. This authority explicitly requires

⁵ See para. 28 of Brazil's second Submission.

⁶ See Exhibits Can-4 and Can-6.

that TPC be administered in accordance with Canada's international obligations. Therefore all subsidiary documents must respect Canada's WTO obligations.

45. Canada would like to underline, once again, that the restructuring of TPC involves a complete re-engineering of all TPC's administrative documents. Consequently, no documents relating to TPC, as it was previously constituted, are valid under the new programme. To put it another way, those documents no longer exist for the purposes of TPC as it is now constituted.

46. Despite Canada's assurances – which I now reaffirm – that it will provide these documents as soon as they are finalized, Brazil has accused Canada of bad faith and alleged that Canada is “holding back” relevant documents.⁷ Canada takes exception to this baseless allegation.

47. Furthermore, Canada wishes once again to reiterate and make absolutely clear that no investments have been approved under the restructured TPC, and none will be approved until such time as all the supporting documents have been finalized. Despite Canada's assurance to this effect, Brazil, in its second submission, accuses Canada of having approved an investment under the revised TPC. Brazil refers to a press release made on 10 January 2000 regarding a TPC contribution to an Ontario company for the development of a robotics system. I have here a copy of the title and signature pages of the Contribution Agreement in question that I would like to submit to the Panel as Canada's Exhibit 14. As you will see this project was approved prior to November 18, 1999, under the former TPC.

48. To summarise, Mr. Chairman, the thrust of Brazil's submission is that it should be presumed that the restructured TPC programme will in practice violate the SCM Agreement, even though Brazil can point to nothing to substantiate its claim beyond evidence and innuendo regarding the predecessor programme and the regional aircraft industry's propensity to export.

49. Canada, for its part, has carefully noted the findings of the Panel and the Appellate Body and has made substantial and meaningful changes to the TPC programme so as to bring it into compliance with Canada's obligations under the SCM Agreement.

50. Accordingly, Mr. Chairman, Canada requests that the Panel find that Canada has fully and faithfully implemented the rulings and recommendations of the DSB by:

- Withdrawing assistance to the Canadian regional aircraft industry under TPC as previously constituted; and
- Amending the structure and administration of TPC so that assistance granted to the Canadian regional aircraft industry under this programme is not contingent in fact upon export performance.

51. Thank you for your attention. Mr. Hankey, will now address the measures taken by Canada in respect of the EDC Canada Account.

III. EXPORT DEVELOPMENT CORPORATION – CANADA ACCOUNT

52. Mr. Chairman, Members of the Panel, I would like to turn now to the measures that Canada has taken to bring the Canada Account programme into compliance with the recommendations and rulings of the DSB. Before doing so, however, I shall briefly review the findings of this Panel with respect to the Canada Account.

⁷ See para. 59 of Brazil's second Submission.

Appellate Body and Panel findings

53. In the original proceeding Brazil claimed that the Canada Account programme was inconsistent with the SCM Agreement and that it mandated export subsidies. The Panel rejected these claims. It found that the programme constituted discretionary legislation and did not mandate subsidies that are contingent on export performance. The Panel did not, as a result, make any findings on the Canada Account per se.

54. The Panel did find, however, that Canada Account debt financing in two transactions -- one involving South African Express and the other LIAT -- constituted export subsidies prohibited by Article 3.1(a). The Panel ruled that Brazil made a prima facie case that such debt financings were subsidies contingent on export performance, and that Canada had not rebutted that case, nor had Canada -- and I quote -- "sought to rely on the safe haven provided for in item (k) of the Illustrative List of Export Subsidies".⁸

55. These findings of the Panel -- that the debt financing in the South African Express and LIAT transactions was contingent in law on export performance and that the Canada Account programme constituted discretionary legislation -- were not appealed to the Appellate Body. The Panel's findings were limited, therefore, to Canada Account debt financing in two transactions.

EDC Compliance

56. Let me recall that the two Canada Account debt financing transactions that the Panel addressed were completed in 1995 and 1998. Since 18 November 1999, there have been no financing transactions in the regional aircraft sector. Canada has also taken action to ensure that, in the future, the discretionary authority under the Canada Account programme will be exercised in a way that is consistent with the SCM Agreement. Under Canadian law, no Canada Account transaction may proceed without the approval of the Minister for International Trade and no transaction may be approved unless the Minister determines that it is in the "national interest".

57. Canada adopted a Policy Guideline on 15 November 1999 that informs EDC and the world that the Minister for International Trade, from that date forward, will consider any Canada Account financing transaction that does not comply with the OECD Arrangement for Officially Supported Export Credits not to be "in the national interest".

58. The Minister is thereby saying that all future Canada Account financing transactions must comply with the OECD Arrangement if they are to receive the required Ministerial authorization. This is perfectly clear and unambiguous. A copy of the Guideline can be found at Tab 13 of Canada's Exhibits and is also publicly available and has been posted on the web site of the Department of Foreign Affairs. I have here a printout from the web site that I would like to present as Canada's Exhibit 15.

59. As the Appellate Body noted in the Brazil-Aircraft (PROEX) case, the OECD Arrangement is an international undertaking on official export credits that satisfies the requirements of the proviso in the second paragraph of item (k). Pursuant to this paragraph of item (k), an export credit practice that is in conformity with the interest rates provisions of the Arrangement is not a prohibited subsidy under the SCM Agreement. Therefore, by conforming to the OECD Arrangement, future Canada Account financing transactions will conform with the requirements of the exception provided by the second paragraph of item (k).

⁸ Panel Report at para. 9.225.

60. Finally, Canada has indicated that it is prepared to agree to the establishment of verification procedures whereby Canada and Brazil would exchange relevant information regarding specific future financing transactions in the regional aircraft sector so as to allow both Canada and Brazil to verify compliance of such transactions with the SCM Agreement. Canada has proposed this procedure in the interest of avoiding future dispute settlement proceedings, believing that such a procedure would provide sufficient transparency to allow both Parties to satisfy themselves that the other is in compliance with its WTO obligations. Canada would like to make clear that it asks only that the Panel endorse the establishment of such an arrangement, and is not proposing an ongoing role for the Panel should a verification process be established. We also note, Mr. Chairman, that in the light of the rulings and recommendations of the Panel and Appellate Body concerning the provision of confidential information, EDC is revising the form of its confidentiality agreements entered into with its customers, to facilitate, if required, disclosure of such information in the context of the WTO dispute settlement proceedings.

61. In summary, the South African Express and LIAT transactions were completed before 18 November 1999. The implementation of the Policy Guideline will ensure that all future Canada Account financing transactions will comply with the OECD Arrangement, and thereby with the proviso in the second paragraph of item (k). Canada has, therefore, fully complied with the recommendations and rulings of the DSB.

Brazil's arguments

62. Mr. Chairman, Members of the Panel, Brazil has produced no evidence to call into question Canada's compliance in this case, because there is none.

63. Instead Brazil resorts to the same arguments it has advanced in the case of TPC. It argues that completion of the two transactions found to be *de jure* export contingent by this Panel is "simply not enough" and suggests that Canada must "do more" to bring itself into compliance with the DSB's recommendations and rulings. Canada has, of course, done "more" by adopting the Ministerial Policy Guideline. Brazil, however, dismisses this action on the basis that the Ministerial Guideline "does not ensure that prohibited export subsidies cannot be granted". This legal standard for compliance has no foundation in the WTO or international law.

64. Brazil's novel legal standard seeks not only to reverse the burden of proof onto Canada, but to create an extraordinary degree of burden: that Canada must prove that the Canada Account programme **cannot** be used to grant export subsidies. Brazil states this position in paragraph 71 of its second submission as follows: "...implementing the DSB's recommendations and rulings regarding the Canada Account should at a minimum ensure that prohibited export subsidies via the Canada Account **cannot** be granted, but **not merely that they might not** be granted".

65. Ms. Hillman has already noted that this standard finds no support whatsoever in the DSU, the SCM Agreement or international law. The Appellate Body has said that the complaining party bears the burden of proving a violation and there is nothing in Article 21.5 that suggests a different burden of proof in a proceeding under that Article.

66. In addition to seeking to reverse the burden of proof and to set it at an unreasonably high level, Brazil complains about Canada's compliance on two grounds. First, Brazil complains that the Guideline refers to the OECD Arrangement, and does not explicitly state that Canada will thereby meet the criteria to qualify for an exception under the second paragraph of Item (k). Second, it complains that Canada has not identified which of the articles in the Arrangement it believes constitute the "interest rates provisions" referred to in item (k).

67. With respect to Brazil's first point, Canada has already explained in its submissions why the Guideline does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the Arrangement and therefore the provisions referred to in the second paragraph of item (k). In requiring compliance with the OECD Arrangement, Canada requires compliance with the totality of the Arrangement, including all of its interest rates provisions. Canada has thereby required that all future Canada Account financing transactions will conform to the requirements of the exception provided in the second paragraph of item (k).

68. Regarding Brazil's second argument, Canada has already noted the reasons why Canada does not think it is necessary to set out all the provisions of the Arrangement with which Canada must comply. First, the Guideline ensures that Canada will comply with all provisions of the OECD Arrangement, which include the Arrangement's interest rates provisions. Second, it is far from clear what the legal consequence would be of attempting in this proceeding to delineate in the abstract, and before-the-fact, the various ways that Canada considers WTO members can act within the exception in the second paragraph of Item (k). Canada accepts that should it invoke the exception in the future, Canada would have the burden of demonstrating compliance with the second paragraph of Item (k) and is prepared to do so, should a transaction be challenged.

69. That said, Canada is willing to set forth its view as to which provisions of the current text of the OECD Arrangement would constitute interest rates provisions within the meaning of item (k) for the purposes of this dispute and in the context of regional aircraft transactions.

70. Canada considers that the most logical interpretation of the term "interest rates provisions" would include all provisions in the OECD Arrangement that affect what the interest rate and the amount of interest payable will be in a given regional aircraft transaction.

71. For the purposes of this dispute, the relevant "interest rates provisions" are generally contained in Chapter II of the Arrangement, which deals with the general rules governing the provision of officially supported export credits, and in Annex III, which contains the sector specific rules on Export Credits for Civil Aircraft. Canada notes that there may be other provisions of the Arrangement that are relevant to other sectors. Also, contrary to what Brazil has asserted, by complying with the OECD Arrangement, Canada will also respect the non-derogation commitment set forth in the Arrangement.

72. For ease of understanding, we would group the most relevant provisions into two categories:

73. First, there are provisions that set the minimum interest rates for official financing support and that establish how these minimum rates are constructed and applied, and the terms by which they are offered. These include all the articles that cover the definition, construction and application of the minimum interest rates called the Commercial Interest Reference Rates, or CIRRs, such as Articles 15, 16 and 17 of Chapter II and Article 22 of Annex III.

74. In the second group of provisions are those that either directly or indirectly affect the amount of the interest charged and the timing of when it is paid, in a given transaction. These include provisions such as Article 7, which deals with cash payments, because the amount of the cash payment will affect the amount of interest charged; Article 10, which deals with the maximum repayment term, because the length of the term will determine the applicable minimum interest rates, as well as the overall amount of interest payable throughout the life of the loan; Article 14, which deals with payment of interest, because the payment profile will determine when an interest rate materializes in the form of an actual cash outlay; and Article 29, which deals with matching another government's terms and conditions that are outside of the Arrangement rules, because the terms and conditions that are being matched in such a case include interest rates. The requirements for a risk-

based premium referred to in Article 21(a) and providing for higher effective interest rates for higher credit risks for direct lenders should also be included.

75. In Canada's view, this identification of interest rates provisions flows from the plain meaning of the words. The text of paragraph 2 of Item (k) refers to "interest rates provisions" and not simply to "interest rate". Thus, it must refer to more than the CIRR.

76. As this Panel and the Appellate Body have noted, pursuant to the second paragraph of Item (k), an export credit practice that is in conformity with the "interest rates provisions" of the Arrangement is not a prohibited subsidy under the SCM Agreement. If the term were applied only to the CIRR, the benefit of the exception would be extended to financing transactions that apply the CIRR, but do not abide by any of the other Arrangement rules, such as those relating to maximum terms and minimum risk premiums.

77. A financing transaction that applied a naked interest rate alone – one that is divorced from the other terms and conditions that affect the interest rate, and are generally part of any financing transaction – could very easily confer a benefit to the recipient that would be considered a subsidy under Article 1 of the Agreement and, if contingent on export, a prohibited export subsidy under Article 3.

78. Finally, one should bear in mind that the Illustrative List of the SCM Agreement was carried over from the Tokyo Round Subsidies Code. After more than ten years of negotiations, the OECD Arrangement was adopted in 1978. In 1979, the Tokyo Round Subsidies Code was agreed together with other Tokyo Round Agreements. It is inconceivable that the signatories of the GATT Subsidies Code, who were at the same time participants in the OECD Arrangement, would have agreed to an item (k) that incorporated only a single, isolated provision of the Arrangement thus undermining the rest of the Arrangement less than one year after its adoption.

79. To assist the Panel, Canada has prepared a list of provisions that Canada considers to be "interest rates provisions" for the purposes of Item (k) in the context of this dispute. We are pleased to provide a copy of this list to the Panel, and to Brazil.

80. We would be happy to further discuss our rationale for this categorization of "interest rates provisions", if the Panel so wishes.

81. I will now briefly address the findings of the 21.5 Panel in *Australia – Leather*. In *Australia – Leather*, the factual circumstances of the "circumvention" are fundamentally different from the facts of this case. Brazil argued that the Panel decision was not correctly decided. But even if the Panel considers that the reasoning was not correct, the findings of the Panel in *Australia – Leather* are not in any way appropriate to this case. Let me explain.

82. In *Australia – Leather*, the Panel was faced with two, one-time financial contributions. The first of these financial contributions was found by the Panel to have been a subsidy contingent upon export performance. Australia purported to implement the Panel's findings, which had not been appealed, by placing the specific export subsidy found to have been prohibited, with another specific export subsidy. It was this second subsidy that was required to be removed. This, very clearly, is not the case here.

83. As you well know, it was the operation of TPC in the regional aircraft sector that was at issue. And it is the operation of TPC, as newly constituted, that is at issue in this proceeding. There is no evidence, and, indeed, no suggestion, that new subsidies have been granted to "circumvent" a Panel ruling. The claim here is that the restructuring of TPC has not gone far enough. In these

circumstances, naturally, repayment of subsidies, even if such a remedy were available under the SCM Agreement, is not warranted.

84. Mr. Chairman, Brazil has made a valiant effort to bring the findings of the 21.5 panel in *Australia - Leather* into the discussion of this case. But, despite such effort, Brazil has failed to demonstrate the relevance of that decision in the context of the matter that is now before the Panel.

85. First, Brazil has not explained why the Panel should *now* entertain Brazil's argument for a retrospective application of Canada's obligation to withdraw, under Article 4.7 of the SCM Agreement, to subsidies that had already been granted before the recommendations of the DSB. Second, Brazil has not demonstrated how the specific findings of the panel report in *Australia - Leather* would be applicable to the facts of this case. I will address each issue in turn.

86. First, Mr. Chairman, Brazil is now in effect seeking to modify its original claim for a remedy. In fact, Brazil now asks the Panel to issue new recommendations as to what constitute Canada's obligation to withdraw subsidies found to have been contingent upon export performance. Brazil asks the Panel to use those new recommendations to assess Canada's compliance with those same recommendations.

87. Brazil does so, however, in the context of a procedure that is solely concerned with determining whether Canada has implemented the *original* rulings and recommendations of the DSB. Brazil is trying to get not only what it never got but, more importantly, what it never sought. This can only be characterized as "trial by ambush", to borrow Lord Denning's famous phrase.

88. Brazil has known Canada's position on the interpretation and application of Article 4.7, in particular insofar as it applies to subsidies already granted. Canada's position on this issue was set out in Canada's second written Submission (para. 142 ss.) in the PROEX dispute running parallel to this case, where, of course, Canada is the complainant. In that submission, Canada indicated very clearly that its interpretation of the obligation to withdraw export subsidies under Article 4.7 of the Agreement does not allow for a retroactive withdrawal of subsidies that have already been granted. In that case, Brazil heartily supports Canada's view. In fact, in that case, Brazil has severely criticized the decision in *Australia - Leather* as bad policy and bad law.

89. In any event, Brazil could not have been unaware of Canada's interpretation of the scope and application of the obligation to "withdraw".

90. Nevertheless, during the various stages of the Panel process or even before the Appellate Body, Brazil has never taken exception with Canada's interpretation. It raises serious question of fairness and equity now for Brazil to ask the Panel to make a finding of non-compliance because Canada did not withdraw subsidies that had been granted before the recommendations of the DSB. Brazil never made that claim; in the course of implementing the rulings and recommendations of the DSB, Canada was not aware and could not have been aware of the nature of the obligation that Brazil now seeks to impose on Canada.

91. The role of the Panel under Article 21.5 of the DSU is to determine whether Canada's implementation measures are in conformity with the rulings and recommendations of the DSB. The ultimate role of the Panel is to settle the dispute between the parties. That dispute was framed by the parties in the course of their various submissions. The dispute, and therefore the rulings and recommendations of the DSB, do not include the withdrawal of subsidies that were granted before the recommendations of the DSB.

92. In conclusion on this point Mr. Chairman, Canada respectfully submits that in the light of the above considerations, it would not be an appropriate use of the Panel's jurisdiction under Article 21.5 to now grant Brazil a remedy that it never sought.

ATTACHMENT

Item (k): Interest Rates Provisions of the OECD Arrangement

This document sets out Canada's view of which provisions pertinent to regional aircraft financing in the current text of the OECD Arrangement would, for purposes of this dispute constitute "interest rates provisions" within the meaning of item (k) of Annex I of the SCM Agreement. The provisions described below affect what the interest rate and the amount of interest payable will be in a given transaction. Within limits, variations of certain of these provisions are permitted under the terms of the Arrangement. Canada notes that provisions in the Arrangement that are pertinent to sectors other than regional aircraft have not been listed. This list is thus without prejudice to Canada's position as far as other sectors are concerned. While Canada has not listed definitional provisions of the Arrangement, those provisions apply to the provisions listed below.

Article 2: Scope of Application

This article restricts the scope of the Arrangement to officially supported export credits with repayment terms of two years or more, and to official support in the form of tied aid.⁹

Article 3: Special Sectoral Applications and Exclusions

This article sets out the applicability of special guidelines to certain specific sectors. The guidelines applicable to the aircraft sector provide that in cases where provisions in the Sector Understanding on Export Credits for Civil Aircraft (Annex III) correspond with provisions in the Arrangement, the provisions of the Sector Understanding prevail.

The relevant provisions in the Sector Understanding are Articles 21, 22, 23, 24 and 25 of Annex III, Part 2, which covers new aircraft, and Articles 28, 29, 30 and 31 of Annex III, Part 3, which covers used aircraft, spare engines, spare parts, maintenance and service contracts.

Article 7: Cash Payments

This article requires providers of official support to require purchasers of goods and services to make cash payments of a minimum of 15 per cent of the export contract value of the goods or services, at or before the starting-point of a credit (defined in Article 9 of the Arrangement).

Article 9: Starting-point of Credit

This article requires that the repayment term begin by the actual date of delivery. However, depending on the complexity of the underlying export contract, other dates may be applicable.

Article 10: Maximum Repayment Term

This article sets out the maximum term for repayment of the export credit, which can be either five years (with a possible extension to eight and a half), or ten years, depending on whether the recipient country is classified as a Category I or Category II country. (The category of country is determined by world Bank data based on GNP per capita).

⁹ Tied aid support is not permitted for civilian aircraft, except for humanitarian purposes (Annex III, Article 24).

Article 13: Repayment of Principal

This article requires that the principal sum of the export credit is normally to be repaid in equal, and at least semi-annual instalments. It also permits equal, blended payments of principal and interest in the case of leases. Within limits, variations are allowed.

Article 14: Payment of Interest

This article requires payments of interest to be made in at least semi-annual instalments during the repayment term. Within limits, variations are allowed.

Article 15: Minimum Interest Rates

This article requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs), and sets out the principles by which CIRRs are established. These include the principle that CIRRs should closely correspond to the rate for first-class domestic borrowers and to the rate available to first-class foreign borrowers.

Article 16: Construction of CIRRs

This article requires CIRRs to be set at a fixed margin of 100 basis points above their respective base rates. For most OECD Participants, the base rates are the yields of government bonds with terms that roughly correspond to the average life of the loan.

Article 17: Application of CIRRs

This article provides that CIRRs can be held for 120 days at an additional cost of 20 basis points. When official financing support is provided for floating rate loans (rather than on a CIRR basis), the Participants must not grant the borrower the option of choosing the lower of CIRR or the short-term market rate throughout the life of the loan.

Article 19: Official Support for Cosmetic Interest Rates

This article forbids the offering of artificially reduced interest rates, which give the borrower the illusion of obtaining more favourable financing terms than are envisaged under the Arrangement.

Article 21(a): "Premium shall be risk-based."

Paragraph (a) of Article 21 requires that premiums be risk-based. This is understood to mean that premiums must "not [be] inadequate to cover long-term operating costs and losses" (as provided in Article 22(a)).

Article 26: Validity Period for Export Credits

This article imposes a limit of six months on the length of time offers can remain outstanding for acceptance by the buyer/borrower.

Article 29: Matching

This article permits the offering of terms and conditions that are outside of the Arrangement's rules, but only if such terms and conditions are matching another government's offer with terms and conditions that are outside of the Arrangement's rules.

ANNEX 2-4

ANSWERS TO QUESTIONS POSED TO CANADA
BY THE PANEL AND BY BRAZIL

(14 February 2000)

Questions Posed by the Panel Concerning Canada Account

Q1. The Panel notes that the Policy Guidelines is worded in the negative, i.e., that a Canada Account financing transaction or class of financing transactions that does not comply with the OECD Arrangement would not be considered to be in the national interest. This wording suggests that there may be transactions or classes of transactions that are outside the scope of, and therefore not subject to, the Arrangement. As a matter of logic, any such transactions could not “not comply with” the Arrangement, and therefore would neither be subject to, nor contrary to, the Guideline. Could Canada please explain why the Guideline was not worded in the affirmative, i.e., that only transactions that do comply with the Arrangement would be considered to be in the national interest? Could Canada please indicate whether all Canada Account transactions in the regional aircraft sector will be subject to the Arrangement and will comply therewith. Question 1:

Response

1. Under subsection 23(1) of Canada’s Export Development Act, a prerequisite to authorization of a financing transaction under the Canada Account is a determination by the Minister for International Trade that the transaction is in the national interest. In making this determination, the Minister may reject a financing transaction for any number of reasons. The wording of the Policy Guideline in the negative is designed to preserve the Minister’s ability to conclude that a proposed Canada Account financing transaction is not in the national interest based on other factors *even though* it complies with the OECD Arrangement. That is, if the Guideline were worded in the affirmative, as suggested in the Panel’s query, it could be read to provide in effect that compliance with the OECD Arrangement means that a transaction, without more, would be in the national interest. This would leave no scope for other “national interest” considerations to be factored in by the responsible Minister.
2. As written, the Ministerial Guideline means that a transaction that does comply with the Arrangement may be in the “national interest”, but that a transaction that does not comply with the OECD Arrangement will be considered, *ipso facto*, and without more, incapable of being in the “national interest”. Compliance with the OECD Arrangement is therefore the one essential condition that must always be met in order for the transaction to be found to be in the national interest and authorized under the Canada Account.
3. All Canada Account transactions in the regional aircraft sector will be subject to and will comply with the OECD Arrangement.

Q2. Concerning Canada’s apparent pledge, through the Policy Guideline, that “any future Canada Account financing transactions will be in conformity with the OECD Arrangement” (Canada’s Oral Statement at para. 67.), the Panel notes, as acknowledged by Canada, that the “safe haven” in the second paragraph of item (k) of the Illustrative List makes specific reference to the “interest rate provisions” of the understanding in question, i.e., the OECD Arrangement. Canada

has provided a paper (“Item (k): Interest Rates Provisions of the OECD Arrangement”) and an oral statement concerning what it considers to be the interest rate provisions of the OECD Arrangement.

- (a) *Is it Canada’s view that, in general, all of the substantive interest rate provisions that it has identified (i.e., all of the provisions other than matching) must both apply and be complied with for an export credit practice to be in conformity with the interest rate provisions of the OECD Arrangement? Please explain. If yes, does Canada consider that where this is not the case because of matching with non-complying terms and conditions, (i.e., where the transaction in question is matching the terms and conditions of a non-complying transaction), the transaction is question nevertheless is in conformity with the interest rate provisions of the Arrangement? Please explain.*

Response

1. All of the substantive interest rates provisions must be complied with to the extent that they are applicable. Not all substantive interest rates provisions are always applicable. For instance, for export credits in some sectors other than regional aircraft, Article 25 (“Local Costs”) would, in Canada’s view, represent a substantive interest rates provision; however, we did not retain Article 25 on our list because we decided to limit the list to those provisions that are relevant for the purpose of this case because they are generally applicable to regional aircraft. The local cost issue does not arise in the regional aircraft sector.
 2. Also, some of the substantive interest rates provisions that are relevant for regional aircraft might not apply depending on the circumstances of the underlying export credit transaction. For example, Article 10 (“Maximum Repayment Term”) has substantive rules that are significantly amended by the specific provisions stipulated in Annex III. We still found it important to list Article 10 because the concept of a maximum repayment term as set out in the main Arrangement text is directly related to the levels of the CIRR (see Article 16), and CIRR are applicable to regional aircraft.
 3. The right to match is an intrinsic part of the disciplines of the Arrangement. It operates as a right to match financing by those countries which might provide financing pursuant to terms and conditions other than the standard terms and conditions. It works as a rather effective deterrent to those countries that might be tempted to not comply. Recent experience has shown that the total number of matching notifications has declined to less than 10 per year (all Participants combined). Because matching effectively amends some or all of the other interest rates provisions in their applicability to a particular transaction, matching is itself a substantive interest rates provision. Therefore, a matching transaction undertaken in conformity with the Arrangement is also in conformity with the interest rates provisions of the Arrangement.
- (b) *If in answering (a) Canada indicates that it does not believe that all of the substantive provisions that it has identified must apply and be complied with for a transaction to be in conformity with the interest rate provisions of the Arrangement, does Canada consider that a transaction which complies with any one of these provisions or some subgroup of them is in conformity with the interest rate provisions of the Arrangement? Please explain, and identify the provision of provisions in questions. In particular, does Canada consider that export credits that are not CIRR-based (e.g., floating-rate financing), or export credit practices that do not involve an interest rate as such (e.g., export credit guarantees), can qualify for the safe haven of the second paragraph of Item(k)? Please provide a detailed explanation.*

Response

1. All the substantive interest rates provisions that are applicable and therefore can be complied with under the circumstances of the underlying export credit transaction, must be complied with for the transaction to be in conformity with the interest rates provisions of the Arrangement. Canada does not hold the view that any country should be allowed to not comply with an interest rates provision that is applicable to a transaction and still claim conformity with the interest rates provisions of the Arrangement.
2. Floating rates are a good example for illustrating this point. Clearly, floating rate financing is envisaged by the Arrangement, and the face value of the floating interest rate can be below the face rate of the CIRR; otherwise, the restriction imposed in Article 17.b) on choosing between the "lower of either the CIRR (...) or the short-term market rate" would be pointless. A floating rate transaction like the one described in Article 17.b) is in full conformity with the interest rates provisions of the Arrangement (indeed, Article 17 is itself an interest rates provision); CIRR is constructed on a fixed rate basis (Article 16) and therefore not applicable in a pure floating rate scenario. It is also clear from the plain wording of the Article 17.b) that the minimum floating interest rate is "the short-term market rate"; this is generally understood to refer to international market benchmarks such as LIBOR.
3. Canada wishes to clarify that export credit guarantees do involve an interest rate in respect of the underlying loans that are being guaranteed. A financial institution which receives an insurance policy or an unconditional guarantee (in either case, with or without interest rate support by government) from an export credit agency in respect of the financing of an export transaction may only provide a loan that respects the relevant interest rates provisions of the Arrangement.
4. While Article 17.b) confirms that official support can be provided on a floating rate basis at short-term market rates below CIRR, a narrow interpretation of the provision limits its application to cases of "pure cover" as described above, i.e. loans insured or guaranteed by an export credit agency and extended at short-term market rates without interest rate support from the government. Canada holds the view that official support in the form of direct loans extended by export credit agencies at short-term market rates is equally legitimate under the Arrangement. Indeed, Canada believes that precluding direct lenders from undertaking floating rate transactions would give an undue advantage to those OECD Participants that operate insurance/guarantee systems. Moreover, short-term market rates such as LIBOR can be presumed to satisfy the principles for minimum interest rates set out in Article 15, insofar as they can be applied.
5. OECD Participants are fully aware of Canada's practice to offer floating rate financing under official support. While discussions on floating rate practices continue at the OECD, no Participant has alleged that Canada's floating rate practice represents a derogation from the Arrangement. Based on all of the above, Canada is of the firm view that official support provided in the form of direct loans at short-term market rates is fully compliant with the Arrangement and its interest rates provisions.
6. Notwithstanding that Canada believes that floating rates are encompassed within the OECD Arrangement, and should be included as "interest rates provisions" and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is

clarified either under the OECD Arrangement or in the context of WTO proceedings that addresses this issue.

Q3. Would Canada please elaborate on how it intends to comply with the interest rate provisions of the Arrangement, as it has identified them, in respect of Canada Account transactions in the regional aircraft sector?

(a) Please describe the form of forms that all Canada Account transactions in the regional aircraft sector will take. Please indicate, in particular, whether all such Canada Account transactions will take the form of official support for export credits with repayment terms of two years or more. If not please explain, and indicate how such transactions would be considered to be in conformity with the interest provisions of the Arrangement.

Response

1. Any regional aircraft transaction entered into under the Canada Account will likely take the form of direct lending. While official support could be given by way of other means, for example guarantees, it is Canada's practice to provide support via direct lending. Because of the nature of the product, we do not expect any borrower to request repayment terms of less than two years. Accordingly, Canada would expect that all future Canada Account transactions in the regional aircraft sector will take the form of official support for export credits with repayment terms of two years or more. Whether in the form of a direct loan or a guarantee, the interest rates provisions of the OECD Arrangement will be followed.

(b) Will all Canada Account transactions in the regional aircraft sector fall within, and comply with the terms of Articles 7, 9, 10, 13, 14, 17, and 26 of the Arrangement in respect of cash payments, starting point of credit, maximum repayment term, repayment of principal, payment of interest, application of CIRRs, and validity period for export credits, respectively? If not, how would any such transactions be considered to be in conformity with the interest rate provisions of the Arrangement?

Response

1. Except in cases of matching or in cases of humanitarian aid, all Canada Account transactions in the regional aircraft sector will comply with Article 7 ("Cash Payments"), Article 9 ("Starting Point of Credit"), Article 13 ("Repayment of Principal"), Article 14 ("Payment of Interest"), Article 17 ("Application of CIRR"), and Article 26 ("Validity Period of Export Credits"). As for the maximum repayment term, Article 21 of Annex III effectively replaces Article 10 as the relevant interest rates provision for the purpose of compliance with regards to new regional aircraft

2. Canada Account transactions in the regional aircraft sector that are undertaken in full compliance with the matching provisions of the OECD Arrangement, will also be in compliance with the Arrangement and its interest rates provisions. This is because matching itself is an interest rates provision of the Arrangement as it specifically allows the offering of terms and conditions that are more favourable than otherwise allowed under the interest rates provisions of the Arrangement, provided they do not render the offer more favourable than the competing offer which is supported by another government and includes non-compliant terms and conditions for the same transaction (i.e., provided the terms do not "overmatch").

(c) Why does Canada not include Article 8 "repayment terms" in its list of relevant provisions?

Response

1. Canada chose not to include definitional provisions in its list. Article 8 does not specify a rule; rather it provides a definition that is required for the purpose of setting rules in the subsequent articles. While the list of interest rates provisions provided to the Panel did not list definitional provisions of the Arrangement, as Canada noted in that document, those provisions apply.
 - (d) *With all Canada Account transactions in the regional aircraft sector take the form of fixed rate financing at interest rates at or above the CIRR? If not, please explain in what sense any floating-rate financing and any below-CIRR fixed rate financing would be in conformity with the interest rate provisions of the Arrangement, given the requirement in Article 22 of the Sector Understanding that the CIRR shall be applied.*

Response

1. As indicated in our answer to question 2 b: Notwithstanding that Canada believes that floating rates are encompassed within the OECD Arrangement, and should be included as “interest rate provisions” and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is clarified either under the OECD Arrangement or in the context of WTO proceedings that directly address this issue. Accordingly, except in cases of matching or humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed-rate financing at interest rates at or above the CIRR.
2. Also, if support were to be provided by way of “pure cover”, i.e. a guarantee issued to a lending bank, the interest rates provision in Article 17.b) would be applicable. It is conceivable that the financing bank could price the loan on a floating rate basis and at a face rate below CIRR. The transaction would still be in full compliance with the interest rates provisions of the Arrangement. (Indeed, Article 17 is itself an interest rates provision.) Article 22 of the Sector Understanding simply reconfirms the applicability of the CIRR regime to regional aircraft; this is required because Article 6 of the Sector Understanding creates a different system of minimum interest rates for large aircraft. It is not the purpose of Article 22 of the Sector Understanding to invalidate Article 17.b) of the Arrangement.
 - (e) *Will any so-called “market window” financing or other transactions be undertaken under the Canada Account in the regional aircraft sector? If so, please explain in detail the nature of any such transactions and the sense in which Canada considers the they would be in conformity with the interest rate provisions of the Arrangement.*

Response

1. Canada understands this question to ask whether Canada Account financing in the regional aircraft sector will be provided outside of the standard terms and conditions of the OECD Arrangement, notwithstanding whether such financing is consistent with the market. The answer is no. All Canada Account financing in the regional aircraft sector will be within the OECD Arrangement, whether or not the terms of a particular financing transaction are in fact market terms.

- (f) *Will any Canada Account transactions in the regional aircraft sector be provided in the form of export credit guarantees? If so, in what sense does Canada consider that such transaction would be in conformity with the interest rate provisions of the Arrangement.*

Response

1. Canada Account transactions in the regional aircraft sector will typically take the form of direct loans, although, for example, guarantees could also be envisaged. Guarantee transactions would also have to be in compliance with the relevant interest rates provisions of the Arrangement.
2. The package of disciplines reflected in the interest rates provisions is as important in a guarantee context as it is in the context of direct financing. See also Canada's response to question 2(b).
3. All future Canada Account transactions, whether undertaken on a direct lending basis or on a guarantee basis, will comply with the relevant interest rates provisions of the OECD Arrangement.

- (g) *How is it envisioned that the provision of official support for cosmetic interest rates with respect to the regional aircraft sector will be prevented (Article 19)?*

Response

1. Canada will simply not offer any cosmetic interest rates as defined in Article 18 when entering into regional aircraft transactions on Canada Account.
2. As a matter of clarification, interest rates below CIRR offered under the matching provisions of the Arrangement are not cosmetic interest rates because they do not involve compensatory measures (i.e. hidden measures) in the form of contractual adjustments. Matching is "open", not "cosmetic".

- (h) *Could Canada please describe how it will be ensured that appropriate risk-based premiums will be charged on Canada Account transactions in the regional aircraft sector. Why are the premium-related provisions of the Arrangement other than Article 22.a not, in Canada's view, part of the "interest rate provisions" of the Arrangement?*

Response

1. Canada selected only Article 21.a) because it articulates the principle of risk-based premiums and is the only premium-related provision that is available to WTO members that are not also OECD Participants. Clearly, the obligation to comply with the OECD Arrangement in its entirety imposes disciplines on Canada Account transactions in the regional aircraft sector that go beyond the obligation to adhere to the mere principle of Article 21.a). There are provisions in the Arrangement that add greater precision as to the nature of these premium-related disciplines.
2. Basically, OECD Participants have agreed on a common system for classifying countries into risk categories and setting minimum premiums in relation to the risk levels associated with each category that are expected to cover the Participants' long-term operating costs and losses. The actual country classifications and premium levels applicable to countries remain confidential because OECD Participants would like to avoid political interference with the country classification process. For an extensive description of the OECD premium system, we attach the OECD communications piece on premiums as a Canada's Exhibit 17.

3. Canada recognises that it would be unreasonable to expect a non-OECD WTO Member to charge a minimum premium level which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the Arrangement. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second paragraph of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants.

(i) *Please explain in detail how the matching provision will be applied with respect to Canada Account transactions in the regional aircraft sector. What, if any, are the limits on matching under the Arrangement? Does Canada consider that any Canada Account transaction in the regional aircraft sector that "matches", in the sense of the Arrangement, a non-complying transaction would be in conformity with the interest rate provisions of the Arrangement? Please explain.*

Response

1. Canada confirms that it considers any Canada Account transaction in the regional aircraft sector that is undertaken in full compliance with the matching provisions of the OECD Arrangement, to be in conformity with the Arrangement and its interest rates provisions.
 2. This is because matching itself is an interest rates provision of the Arrangement as it specifically allows the offering of terms and conditions that are more favourable than otherwise allowed under the Arrangement, provided they do not render the offer more favourable than the competing offer that is officially supported by another government and includes non-compliant terms and conditions for the same transaction.
 3. Clearly, "overmatching", i.e. offering more favourable terms and conditions than the competing, non-compliant offer, is not compliant with the Arrangement. Any case of matching by an OECD participant such as Canada must be notified to the other OECD Participants prior to the issuance of the commitment and will be scrutinised by them, particularly in cases of "non-identical matching" which are subject to a discussion procedure. "Non-identical matching" is still compliant provided it is not "overmatching". For instance, Canada would not have an issue with another Participant notifying a "non-identical matching" at CIRR over 12 years to match a non-compliant offer at CIRR minus 5 per cent over 10 years as there is no reason why a matching Participant should be obliged to provide a cash subsidy if another tool is available to reduce the distortion created by the non-compliant offer to be matched.
 4. For more details on the matching procedures of the Arrangement, we refer the Panel to Articles 50 through 53. We draw the Panel's attention to the high level of due diligence and disclosure required in the case of matching of a non-Participant. These cases are rare.
 5. In Canada's view, the right to match is also available to WTO members that are not OECD Participants. If the matching transaction of a non-Participant were challenged at the WTO and found to provide a prohibited export subsidy, the "safe haven" of Item (k) would be available to that non-Participant, provided that the matching was undertaken in good faith and on the basis of reasonable due diligence.
- (j) *Please describe in detail, including the nature of the differences, any particular provisions of the Sector Understanding on Export Credits for Civil Aircraft (Annex III of the Arrangement) that prevail over corresponding provisions of the Arrangement. To the extent that provisions of the Sector Understanding apply, will all Canada Account transactions in the regional aircraft sector fall within their scope and be in full compliance with them? Please explain in detail.*

Response

1. Annex III prohibits tied aid, except for humanitarian purposes (Article 24 of Annex III). This is an additional restriction applicable to the regional aircraft sector that Canada will obviously respect when entering into regional aircraft transactions on Canada Account.
2. Annex III also sets different maximum repayment terms. Rather than linking the repayment term to the wealth of the recipient country, the Sector Understanding ties it to the type (and effectively, the size) of the aircraft being exported. This rule can be more generous in one case (e.g. a Category A aircraft going into a Country I country) and more restrictive in another case (e.g. a Category B aircraft going into a Category II country).
3. As envisaged in Article 3, the sector-specific rule (i.e. Article 21 of Annex III) prevails over and effectively replaces the general Arrangement rule (i.e. Article 10).
4. Article 21 and Article 24 of Annex III are the interest rates provisions of the Sector Understanding that govern the repayment term and tied aid support. They are applicable to all Canada Account transactions in the regional aircraft sector, and all Canada Account transactions in the regional aircraft sector will comply with these two articles, except in cases of matching..

(k) In the context of the responses to the above questions, would Canada please provide full details on all "variations" "allowed" under the relevant provisions of the Arrangement, referred to inter alia in the introductory paragraph of the Canada's paper ("Within limits, variations of certain of these provisions are permitted under the terms of the Arrangement"). Will Canada Account transactions in the regional aircraft sector in all cases respect the applicable limits on any variations? Please explain in detail.

Response

1. Canada Account transactions in the regional aircraft sector will respect the applicable limits on allowed variations.
2. Allowed variations are called Permitted Exceptions under the Arrangement, and a comprehensive list can be found in Articles 48 and 49. The only Permitted Exception that is relevant for the purpose of regional aircraft transactions is the variation listed under Article 49 a) 2), which relates to irregular payment practices with respect to principal and interest.
3. One formal limitation on irregular payment practices is the no derogations engagement in relation to the repayment date of the first instalment of principal (Article 27). Generally speaking, and acknowledging that not all of the OECD Participants' conventions can be found written in the Arrangement text, the basic principle is that Permitted Exceptions are not supposed to make the offer more favourable than the most favourable terms and conditions that are allowed under the Arrangement. For instance, Canada would not have an issue with another Participant notifying a modest balloon payment after 7 years if the average life of the loan remained shorter than in the case of a standard repayment profile of 20 equal, semi-annual instalments.
4. The number of notifications of Permitted Exceptions generally exceeds 100 per year. Participants clearly consider Permitted Exceptions to be "permitted", i.e. in conformity with the Arrangement.

(l) Will Canada please elaborate on its apparent pledge, at para. 71 of its oral statement, that Canada "will also respect the non-derogation commitment set forth in the Arrangement".

Response

1. Article 27.a) of the Arrangement states that "(t)he Participants shall not derogate from maximum repayment terms, minimum interest rates, minimum premium benchmarks (...), the six-month limitation on the validity period for export credit terms and conditions, or extend the repayment term by extending the repayment date of the first instalment of principal (...)."
2. A derogating Participant is not in compliance with the Arrangement, nor in compliance with its interest rates provisions. As Canada Account transactions must comply with the Arrangement, Canada will not derogate from the Arrangement.
3. Canada notes that derogations are different from Permitted Exceptions and are also different from matching. Permitted Exceptions and matching are compliant; derogations are not.

Q4. Does Canada agree with the EC that Canada has "undertaken" to respect all of the provisions of the OECD Arrangement? If so, does Canada consider that this "undertaking" is legally binding on Canada Account transactions in the regional aircraft sector, and would Canada please elaborate on the specifics of this undertaking, making reference both to the interest rate provisions of the Arrangement as identified by Canada and to Canada's responses to questions 1-3, above.

Response

1. Canada has undertaken to respect all of the provisions of the OECD Arrangement with respect to financing transactions under the Canada Account. Through the Ministerial Policy Guideline the Minister for International Trade has undertaken not to authorise any financing transaction under Canada Account that does not comply with the OECD Arrangement. While the Ministerial Guideline is an administrative instrument and not a legislative one, for all practical purposes the effect is almost the same. This is because the exercise of discretion under the Canada Account programme is in the hands of the Minister and it is the Minister who has given the undertaking. In addition, officials administering the programme and/or referring financing transactions to the Minister for authorization will act in accordance with the Guideline. With respect to the difference between administrative guidelines and legislative instruments we refer the Panel to the comments made by the Panel in *United States – Sections 301–310 of the Trade Act of 1974 (Sections 301-310)* where it stated:

“We recognize of course that an undertaking given by one Administration can be repealed by that Administration or by another Administration. But this is no different from the possibility that statutory language under examination by a panel be amended subsequently by the same or another Legislator.”

2. The critical question, according to the Panel is whether the instrument in question is “lawful and effective.” In this case, the Ministerial Guideline is effective in requiring that all Canada Account financing transactions in the regional aircraft sector comply with the OECD Arrangement and thereby comply with the interest rates provisions of the Arrangement.
3. Canada’s view of which interest rates provisions are pertinent to this dispute is fully set out in Canada’s exhibit -- and a detailed explanation of how these would apply in practice can be found in Canada’s responses to questions 1 and 2 from the Panel.

Q5. Would Canada please indicate the extent of and basis for its compliance obligations with respect to Canada Account. In this regard, we note that Brazil (at paragraph 66 of its second submission) characterizes Canada's position as being that the Panel's findings did not require Canada to take any action other than to ensure that the two Canada Account transactions identified

in paragraph 54 of Canada's first submission were completed by 18 November 1999. Canada appears to disagree, as it stated at the meeting with the Panel that it does consider that the Panel's ruling imposes a legal obligation on Canada to take remedial action with respect to future Canada Account transactions in the regional aircraft. Does Canada confirm the Panel's understanding of Canada's position? Could Canada please discuss the implications, if any, of Australia-Leather for Canada's arguments as to its obligations concerning Canada Accounts.

Response

1. Yes, Canada confirms the Panel's understanding of Canada's position.
2. In the original proceeding, the Panel found that the Canada Account was a discretionary programme that did not mandate subsidies contingent on export performance; the Panel therefore made no findings on the Canada Account programme per se. The Panel concluded, however, that Brazil had established a prima facie case, unrebutted by Canada, that applications of the Canada Account programme in the form of two debt financings involving regional aircraft were subsidies within the meaning of Article 1. (Because these financings were expressly for exports, the Panel also found them to be contingent in law upon export performance within the meaning of Article 3.1(a).) The Panel therefore concluded that "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement."
3. Although the Panel's conclusion concerned the programme as applied, it did not appear to be limited by its terms to the two transactions that had been before the Panel. Consequently, Canada understood the Panel ruling to mean that it was essential to take steps to ensure that any future financing transactions involving regional aircraft would be consistent with Canada's obligations under the SCM Agreement. Canada did so, by issuance of the Ministerial Policy Guideline making clear that any financing transaction not in compliance with the OECD Arrangement (necessarily including the interest rates provisions thereof) will not be approved for Canada Account financing.
4. Canada does not believe that the panel decision in Australia – Leather, which addressed whether the withdrawal of an individual subsidy might, in some factual circumstances, encompass the repayment of the subsidy, has any implications at all for the steps Canada it has taken to ensure that any future Canada Account financings involving regional aircraft are consistent with the SCM Agreement. Because the discretionary Canada Account programme was not per se found to mandate prohibited export subsidies, there can be no issue of withdrawing the Canada Account programme itself. Even Brazil has not argued for that result.
5. Nor does Canada believe that Australia – Leather has relevance for the Canada Account financings that formed the basis for this Panel's conclusion on the Canada Account as applied. Even assuming that Australia – Leather's controversial conclusion that repayment may be a required form of "withdrawal" in some circumstances were to be accepted, it could not, in Canada's view, apply here. The Australia – Leather case involved a one-time subsidy to a producer and its replacement measure which were contingent on a still ongoing stream of exports, which that Panel viewed as remediable only through repayment. In this dispute, by contrast, the two transactions before the Panel in the original proceeding were completed, including the export of all aircraft that were "subsidized", in 1995 and 1998, long before the date for compliance.

Q6. Could Canada please elaborate on the legal basis for its argument that DSU Article 19.1 would allow the Panel to endorse, as part of its findings under DSU Article 21.5, the verification mechanism that it has proposed. Are there any other provisions of the DSU or the SCM Agreement that are relevant to this issue?

Response

1. Canada believes that reciprocal verification provisions would make both Brazil and Canada more confident of their respective compliance in the future. The second sentence of Article 19.1 authorizes a panel to "suggest" ways to implement a recommendation. Canada believes that endorsing the concept of reciprocal verification arrangements would be a useful suggestion, consistent with the spirit of Article 19.1.

Questions posed to Canada by the Panel regarding TPC

Q1. Please provide an up-dated version of Exhibit Cdn-9, and provide copies of all finalized "new" documents not already submitted to the Panel. Please provide the latest draft version of any "new" document still "under development". If no draft versions are available, please describe in detail the nature of the planned changes to the "new" document still under development".

Response

1. Exhibit Cdn-9 contains 35 serials of which 11 have already been provided to the Panel. Appended below are copies of all recently finalized "new" documents, as well as the latest draft versions of "new" documents still under development. Moreover, summary sheets describing in detail the nature of the planned changes to documents for which draft versions are not presently available are also included. Finally, a new serial, the Contribution Verification Checklist, is provided in draft form.
2. The draft documents submitted with this response are still under active consideration by TPC management and, therefore, are subject to change. Similarly, the planning assumptions underlying the summary sheets on documents not available in draft form could also change as the documents are developed. However, as all of these document must respect TPC's Terms and Conditions, in their final form they will not be permitted to request or consider information concerning the extent to which applicant enterprises do or may export.
3. All of the documents identified in Exhibit Cdn-9 that remain to be finalized will be rolled out as they are completed and approved. It is reiterated that TPC will not approve contributions to the Canadian regional aircraft industry until the programme has been fully restructured. Therefore, TPC has a vested interest in completing this important task in a timely manner. But while time may be important, it is far more critical that TPC's policy and procedural documents be revised through a detailed review process that ensures that Canada is honouring its international obligations.
4. The current status of TPC documents are identified below under the three categories solicited by the Panel, namely:
 - finalized "new" documents not already submitted to the Panel;
 - "new" documents still "under development"; and
 - documents for which draft versions are not available at this time.

Exhibit Cdn-9 Serial No.	Document
Finalised “new” documents not already submitted to the Panel (copies provided)	
5	Financial Data Outline (retitled)
6	Contribution Agreement Repayment Terms (retitled)
30	Environmental Assessment and Review Process
“New” documents still “under development”(latest draft versions provided)	
2	TPC Repayment Policy
3	Assessment Guidelines for Due Diligence
20	TPC Review Procedures (including Standard Letters)
21	Special Purpose Equipment List
24	TPC Project File Structure
25	TPC Policies and Procedures on Incrementally, Irreversibility and Retroactivity
28	Claims Package for Clients
29	PSB Integrity Review Checklist
31	Procedures for Project Amendments (retitled)
32	Claims Verification Checklist
33	Policy on Eligible Overhead Costs
34	Policy Guideline for Treatment of Eligible Equipment costs and Project Assets (retitled)
New	Contribution Verification Checklist
Documents for which draft versions are not available at this time (summary sheets provided)	
7	Statement of Work
8 & 9	TPC Standard Contribution Agreement (merged)
16	Framework Investment Proposals: Industrial Research Pre-competitive Development Studies
18	TPC Business Plan (2000/2001-2001/2002)
22	Schedules of Estimated and Actual Project Benefits (retitled)
23	Performance Measures – Project Data Sheet
26	Evaluation Framework
35	Quality Assurance Checklist

Q2. Does Canada agree with Brazil's argument (para. 5 of its oral submission) that the only way for Canada to remove de facto export contingency is to "exclude [the regional aircraft industry] from TPC funding opportunities, or alternatively, to change radically the programme's eligibility and allocation requirements", and that (para. 17 of Brazil's oral submission)"TPC, as it applies to the regional aircraft industry, must be withdrawn in its entirety"? If not, what other ways of implementing the DSB recommendation would be possible in Canada's view if, hypothetically (and as Brazil claims), the current measures taken by Canada to comply with the DSB recommendation are not considered a sufficient change in the factual situation which led to the initial conclusion that TPC assistance to the regional aircraft industry is de facto contingent on export?

Response

1. Canada rejects Brazil's argument and considers that it is not required to cease all TPC assistance to the Canadian regional aircraft industry. As noted previously, based on guidance provided by the Panel and the Appellate Body and in accordance with the test for *de facto* export contingency developed therein, Canada has taken the steps within Canada's control to ensure that any assistance that TPC may provide in the future to the Canadian regional aircraft industry will not be contingent on export performance in law or in fact. To go further and require Canada to "exclude [the regional aircraft industry] from TPC funding" would go beyond the rulings and recommendations of the DSB and be contrary to footnote 4 of the SCM Agreement.
2. Given the substantial steps already taken, we are aware of no other steps that Canada could take or needs to take, other than ensuring that future subsidiary documents and implementing measures as they are adopted conform with the changes already implemented.

Question to both Parties

Please comment on the EC argument (para. 7 of the EC's oral statement) that, in light of the Panel's terms of reference set forth in document WT/DS70/9, "[t]he Panel may not... in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two programmes at issue have not implemented the Report."

Response

1. We believe that the EC is correct. Brazil did not request the Panel to examine the sufficiency of Canada's withdrawal of previous subsidies, but has only questioned whether the changes to the two programmes are sufficient to conform with the SCM Agreement. This is in stark contrast to the situation in the *Australia – Leather 21.5* hearing where the Panel found repayment of the subsidy in question to be required. In that case, the issue of repayment was already before the Panel as the United States was seeking repayment of a portion of the monies already paid out. In deciding how much repayment was necessary, the Panel may have gone further than any Party desired, but the issue of repayment had been placed before the Panel.
2. Canada notes that Canada has fully complied with its WTO obligations in terminating, by the required date, all assistance found to have been export subsidies.

Questions by Brazil to Canada in the Canada Case Re Canada Account

Q1. Please identify any publicly-available sources from which information regarding particular Canada Account transactions could be obtained.

Response

1. As Canada noted at the hearing, information on specific Canada Account transactions is not made publicly available due to commercial confidentiality. It is for this reason that Canada proposed a reciprocal verification procedure so that Brazil could have access to that information.
2. Information on the Canada Account *in general* can be found from the following publicly available sources:
 - EDC's Annual Report
 - The Summary Report of the Canada Account Report to the Treasury Board. (This summary report can be found on EDC's website.)
 - The Government Expenditure Plan and Main Estimates

Q2. Is there any information available to WTO Members that are not Participants in the OECD Arrangement of that have not negotiated bilateral transparency or verification arrangements with Canada that would allow those Members to determine whether particular Canada Account transactions constitute prohibited export subsidies?

Response

1. Canada is not aware of any sources of information that would allow WTO members that are not OECD members and that are not party to bilateral verification procedures to determine whether particular Canada Account transactions constitute prohibited export subsidies.

Q3. In a document provided to the Panel during its meeting of 6 February, Canada states that Article 15 of the OECD Arrangement, which "requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs)," is amongst the "interest rates provisions" referred in the second paragraph of Item (k) to Annex 1 to the Subsidies Agreement¹⁰ Brazil poses the following questions:

(a) Please define the term "official financing support."

Response

1. "Official financing support" is referred to in the fourth paragraph of the Introduction to the OECD Arrangement: "Direct credits/financing, refinancing and interest rate support are referred to as official financing support."
 - (b) Is Canada's term "official financing support" the same as the term "official support," form the OECD Arrangement? If not, what is the difference between the two terms?*

¹⁰ "Item (k): Interest Rates Provisions of the OECD Arrangement," Canadian document provided to the Panel on 6 February 2000, pg. 2

Response

1. All "official financing support" is "official support", but not all "official support" is "official financing support". The fourth paragraph of the Introduction is clear in that regard. Aid financing (credits and grants) as well as export credit insurance and guarantees (without interest rate support, i.e. "pure cover") are listed as possible forms of "official support", but they do not represent "official financing support".

(c) *As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft constitute "official financing support"? If so, why? If not, why not?*

Response

1. All Canada Account financing transactions involving regional aircraft will comply with the Arrangement. If Canada Account were used to provide loan guarantees, the transactions would, as a matter of definition, not constitute "official financing support"; however, they would still comply with the Arrangement rules on "official support". In the more typical cases of direct financing offered under Canada Account, the transactions will, of course, comply with the Arrangement rules on "official financing support". Whether a transaction is undertaken in the form of a direct loan or a guarantee, it will be structured in a way to be in full compliance with the relevant interest rates provisions of the Arrangement.

Q4. As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft always be extended at interest rates equal to or above the OECD Arrangement's CIRR?

Response

1. Notwithstanding that Canada believes that floating rates are encompassed within the OECD, and should be included as "interest rate provisions" and thus fall under the exception in Item k, the issue of floating rates is still under discussion in the OECD. In the interest of contributing to a speedy resolution of this dispute, Canada wants to avoid making this an issue in this case and has consequently decided not to implement any floating rate transactions under Canada Account in the regional aircraft sector unless and until this issue is clarified either under the OECD Arrangement or in the context of WTO proceedings that directly address this issue. Accordingly, except in the cases of matching and humanitarian tied aid, all Canada Account financing transactions in the regional aircraft sector will take the form of fixed rate financing at interest rates at or above the CIRR.

(a) *If Canada responds in the negative, under what circumstances would such financing not be extended at interest rates equal to or above the OECD Arrangement's CIRR?*

Response

1. If official support were provided by way of "pure cover", i.e. a guarantee issued to a lending bank, the interest rates provision in Article 17.b) would be applicable. It is conceivable that the financing bank could price the loan on a floating rate basis and at a face rate below CIRR. The transaction would still be in full compliance with the interest rates provisions of the Arrangement. (Indeed, Article 17 is itself an interest rates provision.)

(b) *If Canada responds in the affirmative, please reconcile this response with the following: first, Canada's statement, reported at paragraph of the Panel Report, that Canada Account financing is used where support under EDC's Corporate Account cannot be extended, i.e., where a particular transaction involves risk factors or*

requires financing terms in excess of those which EDC's Corporate Account would normally undertake; and second, Canada's statement, in the 3-4 February Panel meeting in the companion Article 21.5 case against PROEX, that EDC's Corporate Account does sometimes lend at rates below the CIRR.

Response

1. Support under Canada Account will continue to be offered in circumstances where for risk, size or capacity reasons, EDC cannot provide support under the Corporate Account. In such cases, the risks will be assessed and the borrower offered terms and conditions commensurate with the risk, but in accordance with the interest rates provisions of the Arrangement. A risk premium would be applied to compensate Canada for the risk incurred. Canada's statement, in the 3-4 February Panel meeting in the companion Article 21.5 case against PROEX, that EDC's Corporate Account has sometimes lent at rates below the CIRR, is correct. In such a case the terms and conditions are not only commensurate with the risk, but are also consistent with the terms and conditions that would be available to the borrower from commercial banks/lenders.

Q5. As Canada Account now exists, subsequent to the adoption of Canada's implementation measures, would support from it for transactions involving Canadian regional aircraft always comply with the 10-year maximum repayment term applicable to regional aircraft transactions under the OECD Arrangement?¹¹

- (a) *If Canada responds in the negative, under what circumstances would such financing not comply with the 10-year maximum repayment term?*

Response

1. Canada confirms that Canada Account transactions in the regional aircraft sector will always comply with the maximum repayment terms of Article 21 of Annex III of the Arrangement, except in those cases where Canada might exercise its right to match non-compliant terms and conditions in accordance with Article 29 of the Arrangement, as confirmed by Article 25 of Annex III.
 - (b) *If Canada responds in the affirmative, please reconcile this response with the following: first, Canada's statement, at paragraphs 6.159-6.160 of the Panel Report, that Canada Account financing is used where support under EDC's Corporate Account cannot be extended, i.e., where a particular transaction involves risk factors or requires financing terms in excess of those which EDC's Corporate Account would normally undertake; and second, the fact that EDC's Corporate Account provides repayment terms (specifically, 16.5 -year terms)¹² beyond the maximum 10-year term identified for regional aircraft transactions in the OECD Arrangement*

Response

1. The circumstances that would give rise to 16.5 year terms under Corporate Account would not be such that Canada Account support would be required. Canada Account continues to be used in circumstances where Corporate Account can not be extended, for reason of risk, size of transaction, or country concentration reasons. In other words, such a term would be granted because it would be consistent with the terms and conditions available to that

¹¹ OECD Arrangement, Annex III, Part 2, Chapter V, Article 21(a).

¹² *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999) para. 65.

particular borrower from commercial banks/lenders. Canada could not, under Canada Account, support terms in excess of the ten-year repayment term identified for regional aircraft transactions in the OECD Arrangement, unless it was doing so in order to match another country's financing offer on other than the standard terms and conditions of the OECD Arrangement.

Q6. In a document provided to the Panel during its meeting on 6 February, Canada states that Article 29 of the OECD Arrangement, which "permits the offering of terms and condition that are outside of the Arrangement's rules, but only if such terms and conditions are matching another government's offer with terms and conditions that are outside of the Arrangement's rules" is amongst the "interest rates provisions" referred to in the second paragraph of Item (k) to Annex 1 to the Subsidies Agreement.¹³

(a) When Canada states that in the circumstances detailed in Article 29, it may provide "terms and conditions that are outside of the Arrangement's rules" would the provision of those "terms and conditions" still constitute "official financing support", as that term is defined by Canada?

Response

1. Whether or not a transaction is undertaken on a matching basis, if it falls under the Arrangement's definition of "official financing support" (i.e., official support offered by way of direct credits/financing, refinancing and/or interest rate support), it remains "official financing support". Canada notes that the definition is the OECD Arrangement definition, not a definition devised by Canada.

(b) Does Canada consider it to be consistent with the interest rates provisions OECD Arrangement to offer terms that are "outside of the Arrangement's rules" where it is "matching another government's offer with terms and conditions that are outside of the Arrangement's rules"?

Response

1. Yes. Article 29 grants a positive right. As a result, matching (unlike unilateral derogations) is compliant with the Arrangement. It is an interest rates provision because it allows Participants to offer terms and conditions affecting the interest rate and the amount of interest payable that are more favourable than the terms and conditions envisaged in the other interest rates provisions of the Arrangement.

(c) Does Canada consider it to be consistent with the Subsidies Agreement to offer terms that are "outside to the Arrangement's rules", where it is "matching another government's offer with terms and conditions that are outside of the Arrangement's rules"? If Canada's response is in the affirmative, please identify which provision of the Subsidies Agreement permits "matching" in these circumstances.

Response

1. Matching involves the provision of an export subsidy. An export subsidy is, as a rule, prohibited under the SCM Agreement. Matching is, however, permitted under the second paragraph of Item (k) as an export credit practice that complies with the interest rates provisions of the OECD Arrangement.

¹³ "Item (k): Interest Rates Provisions of the OECD Arrangement," Canadian document provided to the Panel on 6 February 2000, pg. 3

Q7. In paragraph 71 of its Statement for the Meeting of the Panel, dated 6 February 2000, Canada stated that the "interest rates provisions" of the OECD Arrangement relevant to this dispute are "generally" contained in Chapter 11 and Annex III to the Arrangement. Please identify any exceptions.

Response

1. In its list of "interest rates provisions", Canada also identified Article 2 ("Scope of Application") and Article 3 ("Special Sectoral Applications and Exclusions"). These two articles can be found in Chapter I of the Arrangement.
2. Canada listed Article 2 because the scope of the Arrangement naturally determines the scope of the interest rates provisions of the Arrangement. Article 3 is of particular relevance in the context of export credits for regional aircraft because it effectively establishes how the interest rates provisions of the Annexes are related to the interest rates provisions of the Arrangement.

Canada wishes to note that it limited its list to those interest rates provisions that are relevant for regional aircraft transactions. Other interest rates provisions might be relevant in other sectors. For illustrative purposes only, Article 25 ("Local Cost") would, in Canada's view, be among the interest rates provisions that are relevant for export credits in support of power projects.

ANNEX 2-5

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

(17 February 2000)

CANADA ACCOUNT

Question 1

1. Canada confirms the statements made in its written submissions and in its response to question 4 from the Panel regarding the serious and effective nature of the Ministerial Policy Guideline. The Guideline is not at all hortatory.

Question 4

2. Canada would like to re-confirm that Canada is committed to complying with the rulings and recommendations of the Panel and Appellate Body on an on-going basis. Accordingly, and in response to the criticism directed at Canada by the Panel and the Appellate Body for failing to produce certain commercially confidential information in the earlier proceedings, Canada is revising the form of the confidentiality provisions to be contained in future TPC contribution agreements and in future EDC transactions, so as to facilitate, if requested, the disclosure of such information in the context of WTO dispute settlement proceedings.

TECHNOLOGY PARTNERSHIPS CANADA

Question 2

3. The Panel has asked Brazil whether the provision of specific subsidies to export-oriented industries, for that reason alone, necessarily violates Article 3.1(a) of the SCM Agreement. While it is not stated directly, Brazil's answer, and in particular Brazil's quotation of the United States third party submission, implies that in Brazil's opinion, granting a subsidy to an industry that exports is not, in and of itself a violation of Article 3.1(a).

4. Canada has two comments regarding Brazil's response.

5. First, Brazil's assertion that "two-thirds of all funds [under TPC] will go to the aerospace industry", and its implication that "aerospace" and "regional aircraft" mean the same thing, are incorrect. Regional aircraft is but one part of the aerospace industry, which is one component of the A&D sector. The sector includes 800 establishments and encompasses everything from satellites to combat boots. This sector is, in turn, only one of the areas designated for funding under TPC. Indeed, it is in an effort to focus on Enabling and Environmental technology projects, and recognizing that projects in the A&D sector are significantly more costly than those in other eligible areas, that TPC has placed a limit on the share of funds that can be allocated to A&D.

6. In any event, as Brazil rightly notes in its Second Submission, the issue is not whether Canadian regional aircraft related projects receive the majority of TPC funds (which they clearly do not) or \$1 of those funds, but whether TPC funding is export contingent. The facts demonstrate that it is not.

7. Second, TPC provides funding for R&D in the A&D sector because it is a sector with significant potential for important industrial research and development.

8. The OECD Economic Survey of Canada noted the widely held view that Canadian industry suffers from an innovation gap compared with other developed countries, ranking 9th out of 10 countries in industrial research. This innovation gap has contributed to weak productivity performance over the past two decades, resulting in sub-optimal employment growth and contributing to high government deficits.

9. In exploring ways of increasing industrial R&D, it is natural for the Government to look for sectors or technologies that are already or potentially positioned to conduct R&D on a large scale and at the leading edge of the technology spectrum.

10. Canada's A&D sector is one such sector. It is one of the country's largest investors in R&D and a source of high-paying jobs employing some 800,000 Canadians. R&D expenditures in the A&D sector total more than \$1 billion annually. The R&D intensity (R&D/sales) of the A&D sector was 7.28 per cent in 1998, well in excess of the average of 1.2 per cent for all Canadian manufacturing enterprises.

Question 3

11. Brazil did not answer the Panel's question; namely, whether the granting of TPC assistance to the regional aircraft sector is contingent on the fulfilment of sales forecasts. The answer is no, and Canada notes that Brazil has offered no evidence to the contrary.

Question 4

12. Brazil proposes two alternatives for reforming TPC: (1) "making funds available to Canadian industry generally", and (2) "changing TPC so that its contributions do not confer benefits, and therefore do not constitute subsidies within the meaning of Article 1.1 of the SCM Agreement".

13. The first proposal – making TPC generally available – would be legally irrelevant to remedying a practice found to be an export subsidy, since export subsidies are deemed to be specific under Article 2, regardless of general availability. Brazil is also wrong on the facts, since TPC contributions are available to Canadian industry generally. Funds are available to two technologies (enabling and environmental) that cut across all industrial, agricultural and service sectors, and a group of industrial sectors broadly termed aerospace and defence that encompass a vast area of the Canadian economy.

14. Regarding Brazil's second alternative – eliminating any benefit from TPC contributions, Canada notes that Canada is not required to refrain from subsidizing the regional aircraft industry, provided Canada has taken steps so that any such subsidization will not be contingent on export performance. Canada has done so.

ANNEX 3-1

SUBMISSION OF THE EUROPEAN COMMUNITIES

(17 January 2000)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	163
II. BUSINESS CONFIDENTIAL INFORMATION.....	163
III. TECHNOLOGY PARTNERSHIPS CANADA.....	163
1. Introduction.....	163
2. Assessment by the EC.....	164
IV. THE CANADA ACCOUNT SUBSIDIES	165
1. Introduction.....	165
2. Assessment by the EC.....	166
V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL.....	166
VI. CONCLUSION.....	167

I. INTRODUCTION

1. The European Communities (hereafter "the EC") makes this third party submission because of its systemic interest in the correct interpretation of the *SCM Agreement* and the of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").

2. It will comment on the facts and arguments of the parties as they appear from the Reports and the first written submissions of the parties. The arguments presently before the Panel are not however as yet fully developed and the EC anticipates that it will have more to say at the third party session of the meeting with the Panel. The EC does not consider that it is appropriate for it at this stage to discuss arguments that have not yet been developed by the parties.

3. Section III will discuss the Technology Partnerships Canada programme ("TPC") and Section IV the Canada Account subsidies.

II. BUSINESS CONFIDENTIAL INFORMATION

4. The EC must first recall its position on the special procedures for the protection of "Business Confidential Information."

5. The EC recognises that certain information used in panel proceedings may be of such a nature that particular care is called for to protect it. The EC cannot accept however that protective procedures are adopted which it is impossible for the EC to follow. As the EC explained before the Appellate Body, EC officials are not allowed to enter into personal commitments to third country governments concerning the conduct of dispute settlement proceedings. Such obligations may only be undertaken by the EC, which is bound vis-à-vis other WTO Members by Article 18.2 DSU to ensure that confidential information is protected. In the case of the EC, the effectiveness of this obligation is ensured by the fact that EC officials are all bound by the EC Treaty and their terms of employment not to disclose confidential information, including business confidential information.

III. TECHNOLOGY PARTNERSHIPS CANADA

1. Introduction

5. The Panel has found and the Appellate Body has affirmed that the TPC programme as applied to the regional aircraft industry constituted a *de facto* export subsidy, and was therefore inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*. The Panel recommended that Canada bring these subsidies into conformity of the *SCM Agreement* within 90 days.

7. Canada claims to have implemented the Appellate Body's findings in the following way :

(a) Canada has terminated all obligations to regional aircraft projects under the TPC programme, with effect from 18 November 1999. It has cancelled all outstanding funding for regional aircraft projects. It has also withdrawn approvals-in-principle and has closed all files relating to outstanding applications. Canada claims that it now has no further obligation to disburse funds or consider applications with regard to regional aircraft under the TPC programme as previously constituted.

(b) Canada has also restructured the TPC programme, with a view to eliminating the inconsistencies identified by the Panel and the Appellate Body. In particular, in the framework of the new TPC, it has restructured the TPC's objectives to remove the

references to export promotion, it has removed export considerations from the eligibility and approval criteria and it has opened up the programme to activities which a further from the market (e.g. industrial research), although certain elements of the documentation have not yet been finalised. Significantly, Canada states that under the new TPC information on export sales will no longer be gathered or recorded.

8. Canada claims that these actions amount to implementation of the Panel's and Appellate Body's findings.

2. Assessment by the EC

9. The Panel found TPC to be *de facto* export contingent. Establishing whether *de facto* export contingency has ceased (and not been re-introduced in some way) obviously involves difficult questions of fact.

10. The EC considers that Canada's actions with regard to the TPC do *prima facie* amount to implementation of the Appellate Body's findings. In addition since no disbursements have been made since 18 November and no new applications for assistance have been approved since that date, there does not seem to be any basis on which continued *de facto* export contingency or some other violation of the *SCM Agreement* can be established.

11. The TPC was found to constitute an export subsidy in fact, not in law. Therefore Canada is not required to change the law in order to bring the TPC into conformity with the *SCM Agreement*, but it must satisfactorily address the elements which have been found by the Appellate Body to justify a conclusion of *de facto* export contingency. The Panel and the Appellate Body held that a number of facts relating to the TPC, when considered together, demonstrated that the granting of TPC subsidies was tied to actual or anticipated export¹ and that export contingency could be "... *inferred* from the total configuration of the facts."²

12. It should be noted that Canada is required to remove the export *contingency*, it is not required to stop subsidising the aircraft industry. In order to meet the 'but for' test established by the Panel in paragraph 9.332 of its Report, Canada must satisfy the Panel that TPC assistance will in future be granted without reference to actual or anticipated export earnings, in order to avoid a finding of *de facto* export contingency as defined by Article 3.1(a) and footnote 4 of the *SCM Agreement*. Put another way, Canada must ensure that the freedom of choice of applicants to decide between selling on the domestic or export markets is not limited in any way by the conditions attached to the receipt of the subsidy.

13. The EC notes that the amendments to the TPC programme introduced by Canada are designed to address each of the groups of facts found to warrant the conclusion of *de facto* export contingency. In the restructured TPC programme export performance is no longer referred to as an objective, export considerations have been removed as a criterion for eligibility or approval, and the scope of eligible activities under TPC have been expanded to include industrial research, thus shifting the focus of support further away from the market. The systematic gathering of information on export performance has also been stopped. Therefore it seems that export contingency can no longer be inferred from the total configuration of the facts, the balance of which has clearly been changed by the amendments to the TPC, and in this way Canada has *prima facie* removed the basis for a finding of *de facto* export contingency.

¹ Paragraphs 9.316 to 9.348 of the Panel Report. Sixteen factual elements were identified.

² Paragraph 167 of Appellate Body Report

14. Brazil claims in its First Written Submission that Canada's amendments to the TPC are "cosmetic" and do not change the fact that the programme is export contingent. In particular, it argues that the sectoral coverage of the TPC has not changed, that the aerospace sector (including regional aircraft) will continue to receive the largest share of funds and that the regional aircraft industry remains export-oriented.

15. The EC considers that Canada is not prevented by the *SCM Agreement* from limiting eligibility for a subsidy to certain sectors or from concentrating funding on certain industries. As for the export-oriented nature of the regional aircraft industry, while the Appellate Body found that it was legitimate for the Panel to consider it as a relevant fact in its assessment of export contingency, it cannot by itself justify such a finding, in view of the provisions of footnote 4 of the *SCM Agreement*. However, Brazil has not produced any other relevant arguments to support its contention that the restructured TPC is still export-contingent; most of its other argument³ seem to relate the operation of the previous TPC programme.

16. In the view of the EC, the requirements imposed on a WTO Member to remove *de facto* export contingency cannot be so onerous as to effectively prevent a Member from exercising its basic right to grant subsidies which are not prohibited. In this regard, the fact that a Member continues to subsidise the same firms or sectors under a modified scheme is not by itself sufficient to conclude that the status of the scheme has not changed.

17. It is of course possible that in the future the restructured TPC programme may, in the light of evidence on its actual operation, be found to provide export subsidies to regional aircraft. For instance, if the stated eligibility criteria were not adhered to and/or funding was found to be disproportionately granted to export projects, such a situation may arise. In such a case, the amendments to the restructured TPC prove not to have been sufficient to prevent a finding of export contingency. However, at the moment, there are no facts before the Panel, with regard to the restructured TPC, to indicate that this is likely happen. The Panel can only take its decision on the basis of the information currently available; the implementing party must be assumed to be acting in good faith unless there are good reasons to believe the contrary.

IV. THE CANADA ACCOUNT SUBSIDIES

1. Introduction

18. In the original proceeding, the Panel found that the Canada Account programme provided debt financing (export credits on projects which are deemed to be in the national interest, but which the EDC cannot support for reasons of size or risk) which constituted *de jure* export subsidies prohibited by Article 3.1(a) of the *SCM Agreement*. Canada did not seek to rebut the *prima facie* evidence of an export subsidy provided under this programme, nor did it appeal the Panel's finding to the Appellate Body.

19. The Panel also held that since Canada Account financing was *discretionary*, it could only rule on the particular cases of support.⁴ This finding was not challenged on appeal. As a result, the Panel merely found a number of *transactions* to have been *de jure* export contingent.

20. Canada has however accepted that the Canada Account programme was inconsistent with the *SCM Agreement*, and has taken steps to rectify this inconsistency and make the programme compatible with the Agreement.

³ Section D.3 of Brazil's submission.

⁴ Paragraph 9.213 of the Panel Report.

21. First Canada points out that the cases of Canada Account debt financing transactions on which the Panel ruled had been *completed* in 1995 and 1998⁵ and that there had been no transactions financed under Canada Account since 18 November 1999. Secondly, it has, for future transactions, adopted a policy that the Minister of Finance will not consider Canada Account financing which does not conform to the OECD Arrangement on Export Credits to be in the national interest.

2. Assessment by the EC

22. Since, according to Canada, the Minister is required to approve all such transactions and may not approve financing transactions which are not in the national interest, it would seem that all Canada Account transactions (not only those concerning regional aircraft) will in future comply with the OECD Arrangement. Under the second paragraph of item (k) of Annex 1 of the *SCM Agreement*, in conjunction with footnote 5, any Member which respects the provisions of the OECD Arrangement (Canada is a party to it) is not considered to be granting a prohibited export subsidy. Therefore, since Canada has undertaken to respect all the provisions of the OECD Arrangement (including presumably the interest rate provisions), it appears to the EC that Canada has *prima facie* correctly implemented the Panel's findings by amending the Canada Account programme to eliminate those elements which the Panel found to be inconsistent with the *SCM Agreement*.

23. Brazil has not produced any evidence to call into question Canada's implementation. It merely suggests that Canada could have opted to assert the affirmative defence under the second paragraph of item (k) before the original panel, and argues that Canada still bears the burden of proving this affirmative defence in the implementation Panel.

24. This is clearly correct (and would also be correct if Canada had invoked the defence and it had been rejected). The EC presumes that Canada did not invoke item (k) in the original panel proceeding because the Canada Account financing did not meet the requirements of the OECD Arrangement at that time.

25. Now that the programme has been amended by Canada's undertaking to comply with the OECD Arrangement, it must, in accordance with the presumption of good faith to which WTO Members are entitled, be considered to no longer constitute a prohibited export subsidy.

26. Unless Brazil can show reasons which lead to Panel to conclude that the programme will not be applied according to the rules, the Panel must conclude that the implementation is sufficient.

V. TRANSPARENCY AGREEMENT BETWEEN CANADA AND BRAZIL

27. Canada proposes to enter into a transparency agreement with Brazil to ensure financing complies with the *SCM Agreement* and asks the Panel to suggest this in its recommendations.

28. Canada and Brazil are of course free to settle their dispute in whatever way they wish so long as the settlement complies with the WTO Agreement.

29. The EC does not however consider that it would be appropriate for the Panel to suggest a transparency agreement. Canada and Brazil already have an obligation to notify all their subsidies, including the ones found by the Panel in this case. They do not seem to have fully complied with this obligation.. It would appear more appropriate for the Panel to insist that Canada and Brazil fulfil their WTO commitments than to make the suggestion requested by Canada.

⁵ It appears from the Panel Report (paragraph 6.171) that *deliveries* were also completed by 1998.

VI. CONCLUSION

30. The EC is conscious that the case before the Panel today poses a number of important issues concerning the interpretation of the *SCM Agreement*.

31. The state of the arguments presented by the parties and the information and time for reflection available to the EC has not allowed it to make as full a contribution to the reflections of the Panel as it might have liked. It will therefore supplement its arguments at the Third Party Session in the light of the other submissions to be presented to the Panel before that meeting.

ANNEX 3-2

SUBMISSION OF THE UNITED STATES

(17 January 2000)

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	169
II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME AND THE CANADA ACCOUNT.....	169
A. THE DETERMINATION OF WHETHER A SUBSIDY IS CONTINGENT IN FACT UPON EXPORT REQUIRES A PANEL TO EXAMINE ALL OF THE FACTS SURROUNDING THE GRANTING OF THE SUBSIDY.....	169
B. THE UNITED STATES DISAGREES WITH BRAZIL'S AND CANADA'S CHARACTERIZATIONS OF ITEM (K) OF THE ILLUSTRATIVE LIST	171
III. CANADA'S PROPOSAL FOR "VERIFICATION PROCEDURES"	172
IV. CONCLUSION.....	173

I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the Article 21.5 proceeding that Brazil has requested to review Canada's implementation of the recommendations and rulings of the Dispute Settlement Body ("DSB") in *Canada -- Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, 14 April 1999 ("Panel Report"); WT/DS70/AB/R, 2 August 1999 ("Appellate Body Report"). As was the case before the Panel and the Appellate Body, the United States does not intend to comment upon the specific factual matters at issue in this dispute. Rather, the United States intends to limit its comments to certain fundamental interpretive issues relating to the proper legal interpretation of what constitutes a subsidy that is "contingent in fact" upon export performance and the proper approach for addressing claims involving item (k) of the Illustrative List. The United States will also comment briefly on Canada's proposal to establish "verification procedures" that it claims will "facilitate a definitive resolution of this dispute."¹ The United States does not comment at this time upon the other issues raised in this proceeding.

II. CANADA'S AMENDMENTS TO THE TPC PROGRAMME AND THE CANADA ACCOUNT

2. Brazil claims that Canada's amendments to the TPC programme and the Canada Account do not make the programmes consistent with the WTO Agreement on Subsidies and Countervailing Measures ("the SCM Agreement"), and do not constitute effective implementation of the DSB's recommendations and rulings. The United States takes no position on these issues. The United States does, however, wish to make certain brief observations that it hopes will assist the Panel in reaching its own determinations.

A. THE DETERMINATION OF WHETHER A SUBSIDY IS CONTINGENT IN FACT UPON EXPORT REQUIRES A PANEL TO EXAMINE ALL OF THE FACTS SURROUNDING THE GRANTING OF THE SUBSIDY

3. Brazil properly notes in its submission that the Panel and the Appellate Body each concluded that TPC assistance to the Canadian regional aircraft industry was contingent "in fact" (or "*de facto*") upon export performance.² As the Appellate Body explained, the purpose of the prohibition on export subsidies that are contingent in fact upon export performance is to prevent circumvention of the prohibition against export subsidies contingent in law upon export performance.³ Moreover, although the legal standard for demonstrating such contingency is the same for the two types of export subsidy, the types of evidence that may be employed to meet the legal standard may differ. The Appellate Body explained that proving *de facto* export contingency is much more difficult than proving *de jure* export contingency because:

There is no single legal document which will demonstrate, on its face, that a subsidy is "contingent . . . in fact . . . upon export performance". Instead, the existence of this relationship of contingency, between the subsidy and export performance, must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.⁴

4. Thus, it is not enough merely to examine the legal criteria controlling an alleged *de facto* export subsidy. Nor is it enough simply to examine the formal, non-legal criteria that a Government considers in determining whether to grant the subsidy. Rather, a Panel must look at all of the facts

¹ Canada Submission, paras. 59-61.

² See Panel Report, para. 9.347; Appellate Body Report, para. 180.

³ Appellate Body Report, para. 167.

⁴ Appellate Body Report, para. 167.

surrounding the granting of the subsidy to determine whether – despite the absence of any formal requirements – the granting of the subsidy was in fact tied to actual or anticipated exportation.

5. In this sense, the United States noted before the Appellate Body that Canada's own approach for identifying *de facto* export subsidies under its domestic countervailing duty law views the intent of the subsidizing government as a primary consideration. Section 5.15.1.3 of the "Special Import Measures Act ("SIMA") Handbook"⁵ contains the following discussion on "Guidelines on What Constitutes an Export Subsidy":

Sometimes . . . a subsidy may not be explicitly contingent on export performance but may have the same effect. For example, where a grant or concessional loan is provided to aid the establishment of an industry which will produce largely for export markets, the subsidy may be a "de-facto" export subsidy.

If the subsidy cannot be readily identified as an export subsidy, on the basis of a direct linkage to export performance, then it may be useful to examine other factors to determine whether there is an export linkage. These factors could include the granting authority's intention in establishing the programme gleaned from government statements or publications which announced or publicized the programme. The enabling legislation should also be reviewed to determine whether it indicates a linkage to export performance. However, if increased external trade and balance-of-payments considerations are incidental to national industrial or regional objectives, then the subsidy may not be intended as an export subsidy. Accordingly, the intention may be difficult to distinguish in practice. . . .

Trade impact is another factor in making the distinction. Domestic subsidies are introduced to relieve distortions in the domestic economic scene, whereas export subsidies are intended to have a major trade impact. Of course, any domestic subsidy will often have some indirect trade impact, however minor, and subsidies which lower the costs of industries producing tradeable goods are properly a matter for concern. Also, subsidies are rarely provided with one purpose in mind. Objectives such as sectoral, structural, scientific, or regional policies are also bound up in subsidy decisions.⁶

Thus, the SIMA Handbook recognizes the intent and objectives of the subsidizing government as relevant factors for determining whether a particular subsidy is a *de facto* export subsidy.

6. Moreover, the EC argued before the Appellate Body that "[o]ne circumstance in which an indication of *de facto* export contingency might arise is where the recipient is required to achieve certain minimum production and sales targets which in the light of the facts of the case can only be achieved through increased export effort and not from sales on the domestic market." The United States agrees wholeheartedly with the EC's statement. If there is something about the product itself, or the nature of the market for that product, which indicates that a recipient will have to export to fulfill the conditions of the subsidy, that would be persuasive evidence of *de facto* export contingency. This is not to say, however, that such a circumstance is the *only* circumstance that would indicate the existence of a *de facto* export subsidy.

7. Finally, Canada quotes the Appellate Body's statement that:

⁵ The Special Import Measures Act ("SIMA") is the Canadian antidumping and countervailing duty law. The SIMA Handbook is the working manual of the Revenue Canada Anti-Dumping and Countervailing Directorate. It can be accessed online at <http://www.rc.gc.ca/sima>.

⁶ SIMA Handbook, para. 5.15.1.3 (Nov. 27, 1998) (emphasis added).

The second sentence of footnote 4 precludes a panel from making a finding of de facto export contingency for the sole reason that the subsidy “is granted to enterprises which export”. In our view, merely knowing that a recipient’s sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports. . . . We agree with the Panel that, under the second sentence of footnote 4, the export orientation of a recipient may be taken into account as *a* relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding.⁷

Canada views the Appellate Body’s statement as support for the proposition that the SCM Agreement does not prohibit the granting of subsidies to firms or industries that are export oriented, “including in circumstances where the government is aware of this export orientation.”⁸ In the view of the United States, this statement is not quite accurate. As the above excerpt demonstrates, the Appellate Body in fact stated that the export orientation of a firm is not enough *standing alone* to support a finding of *de facto* export contingency. In the view of the United States, there is a fundamental difference between a government granting a subsidy to an enterprise which happens to export and a government granting a subsidy to an enterprise *because* it exports.

8. As noted at the beginning of this discussion, the United States takes no position on the issue of whether the amendments that Canada has made to the TPC programme comply with the rulings and recommendations of the DSB. The United States hopes, nonetheless, that its comments on the need to examine all of the facts surrounding the decision to grant the subsidy will prove useful to the Panel as it evaluates the complex issue at hand.

B. THE UNITED STATES DISAGREES WITH BRAZIL’S AND CANADA’S CHARACTERIZATIONS OF ITEM (K) OF THE ILLUSTRATIVE LIST

9. The second type of financing at issue in this proceeding is the “Canada Account.” In challenging Canada’s amendments to the Canada Account, Brazil notes Canada’s statement that future transactions under the Account will be authorized only if they comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits.⁹ The relevance of the OECD Arrangement to this issue is that the second paragraph of item (k) of the SCM Agreement’s Illustrative List states that:

if a Member is a party to an international understanding on official export credits . . . or if in practice a Member applies the interest rates of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.¹⁰

Brazil characterizes this language as an “affirmative defense” and argues that it is “not sufficient” for Canada merely to assert the defense in this proceeding.¹¹ While disputing whether it has an obligation to “do more” at the present time, Canada does not dispute Brazil’s description of the cited language as an affirmative defense and, in fact, “agrees that it is the Member claiming an exception that must demonstrate its entitlement to that exception.”¹²

10. The United States disagrees with Brazil’s and Canada’s characterization of the second paragraph of item (k) as an “affirmative defense” or an “exception” to the SCM Agreement. In the

⁷ Canada Submission, para. 37, *citing* Appellate Body Report, para. 173.

⁸ Canada Submission, para. 37.

⁹ Brazil Submission, para. 45.

¹⁰ SCM Agreement, Annex I (Illustrative List), item (k).

¹¹ Brazil Submission, para. 46.

¹² Canada Submission, para. 67.

view of the United States, a complainant that challenges a practice contained in the Illustrative List has the burden of establishing that the practice constitutes an export subsidy. If the complainant establishes a *prima facie* case, the burden then shifts to the defendant to rebut the *prima facie* case. In the view of the United States, the items contained in the Illustrative List are not “exceptions” to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices.

11. The United States has no further comments to make on the issue of Canada’s amendments to the Canada Account.

III. CANADA’S PROPOSAL FOR “VERIFICATION PROCEDURES”

12. Finally, the United States wishes to comment briefly on Canada’s proposal to establish “verification procedures,” which it asserts will “facilitate a definitive resolution of this dispute.”¹³ Canada’s willingness to accept these procedures is conditioned on Brazil’s willingness to accept similar procedures with respect to the rulings and recommendations in *Brazil – Export Financing Programme for Aircraft (PROEX)*.¹⁴ Canada claims that the “[e]ndorsement of this proposal for bilateral verification procedures would be consistent with the objectives of the DSU, and could be suggested by the Panel pursuant to Article 19.1 of the DSU.”

13. In the view of the United States, if they so desire, Canada and Brazil certainly may agree to establish procedures that would enable each party to monitor the other’s compliance with the rulings and recommendations applicable to the programmes at issue. However, the United States disagrees that Article 19.1 of the DSU would permit the Panel to suggest such procedures. By its plain terms, Article 19.1 permits a panel to suggest ways to implement the recommendations that it makes after concluding that a measure is inconsistent with a covered agreement. It does not permit – or even contemplate – that a panel may take further steps and play some role in monitoring the implementation process itself. As the Appellate Body stated in *India – Patent Protection for Pharmaceutical and Agricultural Products*:

[a]lthough panels enjoy some discretion in establishing their own working procedures, this discretion does not extend to modifying the substantive provisions of the DSU. . . . Nothing in the DSU gives a panel the authority to disregard or to modify other explicit provisions of the DSU.¹⁵

14. Furthermore, the United States observes that nothing would prevent Canada and Brazil from agreeing on “transparency” procedures under Article 25 of the DSU, which permits parties by mutual agreement to resort to arbitration as an alternative to dispute settlement. Article 25.2 of the DSU explicitly permits parties to agree on the procedures to be followed in that context.¹⁶

¹³ Canada Submission, paras. 59-61.

¹⁴ WT/DS46/R and WT/DS46/AB/R adopted on 20 August 1999.

¹⁵ *India – Patent Protection for Pharmaceutical and Agricultural Products*, WT/DS50/AB/R, 19 December 1997, para. 92.

¹⁶ DSU, art. 25.2.

15. Lacking additional details, the United States is not in a position to comment upon the actual structure that the verification procedures would take. Once again, this presumably would be an issue for the parties to decide among themselves.

IV. CONCLUSION

16. In conclusion, the United States thanks the Panel for providing an opportunity to comment on the important issues at stake in this proceeding, and hopes that its comments will be useful.

ANNEX 3-3

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(6 February 2000)

1. Introduction

1. The European Communities makes this third party submission because of its systemic interest in the correct interpretation of the *SCM Agreement* and the correct application of the DSU.

2. The EC is in particular most concerned by the fact that the recent Article 21.5 panel on *Australia – Automotive Leather*¹ has considered itself entitled to interpret the WTO Agreement as allowing retroactive remedies. Since similar issues may be involved in this case and the present Panel may have to confront the question, the EC feels it must devote some time today to explaining why the approach of the Article 21.5 panel on *Australia – Automotive Leather* is a serious error.

2. Panels may not decide *ultra petitem*

3. The Panel in this case ought not to reach the issue of retroactivity of remedies which proved so problematic in the Article 21.5 report by the *Australia – Automotive Leather* since the terms of reference of this Panel are carefully circumscribed² as covering only the measures that Canada has taken (or not taken) to amend the two *programmes* at issue – the Canada Account export credit financing and the operation of the TPC programme.

4. WTO dispute settlement is a *member-driven* process that can only be initiated by members and is continuously under the control of the parties who are free to choose the panellists they desire and to terminate the process when they wish. The DSU expressly states that the purpose of dispute settlement is to *preserve* the rights and obligations of Members, that it cannot add to or diminish those rights and that it should encourage amicable settlements and aim at a satisfactory resolution of disputes.

5. The Appellate Body made clear in *India – Patent Protection*³ that a claim that has not been made in the request for the establishment of the panel cannot be the subject of a finding by a panel and explained this *inter alia* on the grounds of procedural fairness.⁴

6. Although there is in principle no bar to the parties or the panel developing new *arguments* during the process, the EC considers that this does not allow new arguments to be developed by a panel which declare or assume the existence of rights that the parties have not claimed. Such action raises the same systemic and procedural fairness concerns as arise when a panel makes findings on a new claim.

7. The Panel may not therefore find in this case consider whether Canada has failed to implement the report retroactively since Brazil has only asked for a finding that the changes to the two *programmes* at issue have not implemented the Report.

¹ Report under Article 21.5 DSU by the Panel on *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, 21 January 2000.

² WT/DS70/9 of 23 November 1999.

³ Report by the Panel on *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products – Complaint by the European Communities and their Member States*, WT/DS79/R, 24 August 1998, at paragraphs 85 - 90.

⁴ See esp. paragraph 88.

3. The requirement to withdraw subsidies can only be prospective

8. However, since it cannot be excluded that arguments about retroactive remedies under the *SCM Agreement* may arise in this case and in view of the unacceptability of retroactive remedies for the EC, and we are sure for other Members, the EC will now set out its view and comment on the *Australia – Automotive Leather* report.

9. The EC agrees with the parties to this dispute and the other third party that the remedy under Article 4 *SCM Agreement*, like all other remedies under the WTO dispute settlement system, can only be, and were only intended by the Members to be, *prospective* in nature. They are not intended to and indeed cannot remove the effects of a trade distortion or restriction situated in the past.

3.1 The text and context of the relevant provisions

10. The terms “withdraw the measure” or “withdraw the subsidy” in Article 4.7 *SCM Agreement* do not require retroactive implementation any more than the term “bring the measure into conformity” in Article 19.1 DSU.

11. The term “withdraw” is a general term which may cover many different concepts including revocation, repeal, repayment of money, liquidation of an interest or a neutralisation of an effect. The definitions in the New Shorter Oxford Dictionary include⁵:

Take back or away (something bestowed or enjoyed). Cause to decrease or disappear.
Remove (money) from a place of deposit.

12. The term “withdraw” is used in Article 4.7 precisely because there may be many ways of implementing a panel report concerning export subsidies – as the EC will discuss in more detail below.

13. “Withdraw” does not imply a *retroactive* remedy but rather in the context a *prospective* remedy. If an investment is withdrawn the investor may receive more or much less than he put in. A right, or even an obligation, to withdraw does not imply recovering exactly the sum originally invested. Indeed Articles 3.7 and 26.1(b) DSU also use the term “withdrawal of the measure” when referring to implementation in the sense of Article 19.1 DSU and this has been held to mean only prospective implementation in the report of the Article 21.5 panel in *European Communities – Bananas – Recourse by Ecuador*,⁶ where the panel held that:

In framing this issue for consideration, we do not imply that the European Communities is under an obligation to remedy past discrimination. Article 3.7 of the DSU provides that “... the first objective of the dispute settlement is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.” This principle requires compliance *ex nunc* as of the expiry of the reasonable period of time for compliance with the recommendations and rulings adopted by the DSB. If we were to rule that the licence allocation to service suppliers of third-country origin were to be “corrected” for the years 1994 to 1996, we would create a retroactive effect of remedies *ex tunc*. However, in our view, what the EC is required to ensure is to

⁵ New Shorter English Oxford Dictionary - CD - January 1997.

⁶ Report by the Panel on *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*, WT/DS27/RW/ECU, 12 April 1999, at paragraph 6.105.

terminate discriminatory patterns of licence allocation with *prospective* effect as of the beginning of the year 1999.

14. In the same way, the Article 22.6 Report on the recourse to Article 22 DSU by the US in *EC – Bananas*,⁷ considered that the level of nullification and impairment had to be assessed as it existed at the end of the reasonable period of time (which may, for a number of reasons, be different from that which existed before). This supports the view that the obligation to implement only relates to the future, not the past.

15. An additional element of context supporting the non-retroactivity of remedies in the WTO is the fact that both Articles 19.1 DSU and 4.7 *SCM Agreement* allow Members a period of time in which to implement panel reports. Since these provisions do not require *immediate* implementation, why should they be interpreted to require *retroactive* implementation?

3.2 The object and purpose of the WTO Agreement

16. The above interpretation is fully supported by a consideration of the object and purpose of the WTO Agreement.

17. The fundamental reason why WTO remedies are not retroactive is that the objective of the WTO Agreement is the removal of restrictions on trade, not compensation for past restrictions or the creation of rights to restrict trade in the future. This objective can only be achieved by ensuring that trade-restricting or trade distorting-measures are removed for the future. Past trade restrictions or distortions *cannot* be remedied. In particular, creating new restrictions and distortions in the future cannot eliminate the fact that trade was distorted or restricted in the past but in fact only frustrate the object and purpose of the WTO Agreement. The situation is very different from legal procedures that seek to provide monetary compensation.

18. Specifically, in the case of subsidies, a benefit and a corresponding trade advantage that has been enjoyed in the past cannot be removed. All that can be removed is the benefit that is yet to be enjoyed. A requirement to remove more than the prospective benefit in an effort to “punish” or “deter” or “compensate” would logically mean that the company concerned suffers a *disadvantage* for the future. This would not remove the earlier benefit and the resulting restrictions or distortions of trade but merely create new ones contrary to the fundamental objectives of the WTO Agreement.

19. Indeed, the *Australia – Automotive Leather* panel did itself recognise that there was no intent in the *SCM Agreement* that the remedy attempt to restore the *status quo ante* or to provide reparation or compensation when it ruled that there was no basis on which to add interest to the amount to be repaid.

20. An additional purpose of the WTO Agreement and in particular its dispute settlement system is to provide “security and predictability to the multilateral trading system” (Article 3.2 DSU). This purpose is also frustrated by retroactive remedies.

21. It is clear that the operation of the WTO Agreement can *affect* the rights and obligations of private operators even though, as international law, it cannot *create* rights and obligations for private operators except where this expressly provided for. The EC is firmly of the view that the WTO Agreement and the *SCM Agreement* in particular do not have direct effect in municipal legal systems

⁷ *European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU WT/DS27/ARB of 9 April 1999, paragraph 4.8.*

– that is they are not “self-executing”.⁸ This fact has consequences for the degree of interference in private rights that the WTO Agreement was intended to give rise.

22. The EC would observe more generally that under the SCM Agreement there is a distinction to be drawn between the interest of private parties in the continuation of a law or other general measure and the individual rights arising out of a particular act of a government, such as the grant of a subsidy. The former can be withdrawn, the latter cannot be simply be revoked under the constitutional systems of most WTO Members.

23. Consequently, the EC considers that the obligation to “withdraw” the prohibited export subsidy in Article 4.7 SCM Agreement can only be to withdraw the general measure or programme to the extent that it is contrary to the *SCM Agreement* and, as regard individual or “one-off” subsidies to withdraw that portion of it that corresponds to the future effects, that is the prospective benefit, and not that which corresponds to effects which have occurred in the past.

24. The panel in *Australia – Automotive Leather* relied in fact heavily on a different “object and purpose” argument to support its interpretation. This was that a retroactive remedy was necessary in order to allow an effective remedy.⁹

25. The *Australia – Automotive Leather* panel expressly states in paragraph 6.37: “we decline to read ‘withdraw the subsidy’ in a manner that does not give it effective meaning.” Its motivation is explained in paragraph 6.35 as follows:

In our view, terminating a programme found to be a prohibited export subsidy, or not providing, in the future, a prohibited subsidy, may constitute withdrawal in some cases. However such actions have no impact and consequently no enforcement effect, in the case of prohibited subsidies granted in the past.¹⁰

26. The *Australia – Automotive Leather* panel seems to be saying that its rigorous interpretation of the terms of the *SCM Agreement* would lead to a different conclusion to that it arrives at in that case where the defending party would have to take some other unpalatable action. It seems therefore that the basis for the Panel’s finding is that the need for a *deterrent effect* in the *SCM Agreement*.

27. The EC would observe that this approach based on requiring an effective remedy or a deterrent effect might mean that a subsidy which is paid in regular instalments over, say, 10 years would be treated differently to a subsidy of equivalent value paid immediately in one lump sum. In the former case, if the *Australia – Automotive Leather* panel had been confronted with the former subsidy it might have considered that that cessation of future payments was sufficient withdrawal (on the basis that there would have been an “effective remedy”). In the latter case, it would have required repayment of the whole amount. This would treat equivalent subsidies differently for no good reason and elevate form over substance. The approach advocated by the EC and the parties in that case would allow the two cases to be treated consistently.

28. The EC contests that the *SCM Agreement* or any other part of the WTO Agreement is intended to have any deterrent effect. This is not only apparent from the object and purpose of the WTO Agreement, described above, but also from the fact that in the event of non-compliance,

⁸ This view is confirmed by the Report by the Panel on *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, 22 December 1999, at paragraph 7.72. The absence of direct effect of WTO provisions in the EC has recently been confirmed by the court of Justice in case-149/96, *Portugal v. Council*. Judgment of the Full Court of 23 November 1999. See also annotation by Rosas in *Common Market Law Review* [2000].

⁹ Paragraphs 6.35 to 6.38 of the report.

¹⁰ Paragraph 6.34.

suspension of concessions under Article 22 DSU must be “equivalent” to the level of the nullification and impairment caused by the measure found to be WTO-incompatible and countermeasures under Article 4.10 *SCM Agreement* must be appropriate and not disproportionate. As the Arbitrators in *EC – Bananas* explained:

... the purpose of countermeasures to *induce compliance*. But this purpose does not mean that the DSB should grant authorisation to suspend concessions beyond what is *equivalent* to the level of nullification or impairment. In our view, there is nothing in Article 22.1 of the DSU, let alone in paragraphs 4 and 7 of Article 22, that could be read as a justification for counter-measures of a *punitive* nature.

29. If countermeasures are not to have a punitive or deterrent element, then nor should the voluntary compliance. Otherwise, voluntary compliance would be discouraged.

30. In any event, the “need for an effective remedy” argument of the *Australia – Automotive Leather* panel is misguided since the correct approach of withdrawing the prospective portion of the benefit of the financial contribution does provide an effective remedy. The *Australia – Automotive Leather* panel’s reason for rejecting this approach was, apart from its wrong interpretation of the word “withdraw”, simply that “the valuation of the benefit of a subsidy, its allocation over time, and the calculation of the “prospective portion” thereof, are complicated questions, for which there are no guidelines in the SCM Agreement.”¹¹

31. This is not acceptable. WTO dispute settlement generally, and subsidy proceedings in particular, will often involve complex issues of fact but this is no reason for a panel to abandon its mission and require, for example, the repayment of the whole of the financial contribution rather than just a part. This is just as unacceptable as saying that since it is difficult to calculate a precise amount, no amount need be repaid.

3.3 Past practice

32. The absence of a remedy for past and consummated violations has always been a well-known feature of the GATT/WTO system. It is established and accepted that it can lead in some cases to there being no remedy at all for the complaining party. The EC considers that this established practice confirms the conclusions it reaches above.

33. A useful discussion of the practice of the GATT Contracting Parties is contained in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*.¹² In the WTO, panels have also always operated on the basis that remedies cannot be retroactive and the EC has already referred the Panel to the reports in the banana litigation.

3.4 Application to subsidies and the present case

34. There may be several ways of withdrawing a prohibited export subsidy in a particular case. The application of the above principles to the case of prohibited export subsidies must bear in mind that such subsidies are made up of three elements. First there must be a financial contribution. Second, for there to be a subsidy, the financial contribution must give rise to a benefit to the recipient. Third the subsidy is only prohibited if it is contingent upon export performance. Each of these elements may have components that are past and components that only arise in the future.

¹¹ Paragraph 6.44 of the *Australia – Automotive Leather* Report.

¹² See e.g. the discussion in the panel report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*. GPR/DS.2/R, adopted on 13 May 1992, paras. 4.21, 4.24 and 4.26.

35. Withdrawing the measure or prohibited export subsidy may be achieved by effectively withdrawing any of these elements.

36. In some cases the choice may be constrained by the practical impossibility of withdrawing one or other of these elements. Thus the *Australia – Automotive Leather* panel noted that removal of the export contingency was not possible in that case since the contingency was found to exist at the date of grant which was in the past. But equally, withdrawal of effects that have already been manifested, including a benefit which has been enjoyed in the past, is also not possible. The only effects that can be prevented, that is the only benefit that can be withdrawn, is the benefit that is yet to be enjoyed in the future. Attempting to withdraw a benefit enjoyed in the past by ordering the repayment of the whole of the financial contribution paid simply imposes a penalty on the company (even though the panel attempts to deny this) for the future which may even create a new and additional distortion of trade contrary to the object and purpose of the WTO Agreement.

4. Is the TPC now in conformity with the WTO Agreements?

37. The question of whether the TPC has now been brought into conformity with the *SCM Agreement* depends evidently on the facts which the Panel will verify but on which the EC is ill-equipped to comment – especially since it has not been provided with all the facts. The EC can agree with US that it is not sufficient to establish that there is *a de facto* export subsidy to show that subsidies are provided to companies *which export*. It must at a minimum be established that they have been provided to companies *because they export*. Establishing the legal rule does not however help to resolve the case since there does not appear to be any basis on which to decide that subsidies are still being provided to companies “because they export”.

38. In fact, it would appear logically impossible to establish that companies are in fact receiving subsidies “because they export” where there are no exports. Brazil is complaining that the TPC *programme* is still *de facto* export contingent. The EC makes the following comments on the legal constructions that are used by Brazil in its second written submission in an attempt to establish *de facto* export contingency of a programme – the new TPC – of which the details are not known and under which no subsidies have been paid.

39. The original panel report in conjunction with Article 4.7 *SCM Agreement* obliges Canada to take positive action to remove the inconsistency found. But it does not create any *additional obligation* to that which applies generally with respect to export subsidies. For the EC this follows from general principles and is confirmed by Article 3.2 DSU which states that:

Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

40. Thus the Panel Recommendation cannot diminish a Member’s rights or increase its obligations under the *SCM Agreement*. As the EC has already submitted, Canada is not required to abolish the TPC, nor is it prevented from subsidising the regional aircraft sector, provided that it does so in a manner consistent with the *SCM Agreement*.

41. Similarly, Canada is not prevented from increasing the TPC budget; this is not inconsistent with the *SCM Agreement*. It should be remembered that WTO Members still have adequate redress against the injurious use of subsidies under Part III of the *SCM Agreement*, even if they are not prohibited.

42. Thus Brazil is wrong to argue that Canada must now take measures to *ensure* that TPC cannot in the future give rise to export subsidies. As the Community has already submitted, Canada,

in restructuring the TPC, is simply required to do two things. Firstly, to remove those features of the regime that gave rise to the original finding, and secondly, not to introduce any new elements into the restructured programme which can already be demonstrated to give rise to export contingency. In this respect, the restructured TPC has to be judged on its merits and on the extent to which it has addressed the inconsistencies identified by the Appellate Body. To the extent that Canada has remedied such inconsistencies, it must be given the benefit of the doubt. It is not sufficient for Brazil to make assumptions about the new programme on the basis of statements made in relation to the old TPC.

43. On this point, the EC notes Brazil's allegation that the restructured TPC has "retained its focus" on the same recipient industries funded by the old TPC. The Appellate Body did not identify the apportioning of TPC funds by sector as a factor leading to *de facto* export contingency. Consequently, Canada is not required to change the distribution of funding by sector in order to remedy *de facto* contingency.

44. In view of the measures that have been taken and the fact that no new support has been granted, the EC maintains its view that the inconsistency must be considered to have been removed, or at least that the contrary cannot yet be proved. Brazil is right to point out that absence of any financial contribution is not by itself sufficient to ensure implementation,¹³ but in this case changes that have been made to the restructured TPC must create a presumption that any such contribution will not lead to the granting of an export subsidy. In this regard, implementation of a panel report does not require an absolute guarantee of future good behaviour, especially in the case of *de facto* export subsidies, where the Government may not even know that it is granting such a subsidy.

45. Brazil argues that the Article 21.5 DSU proceeding will be ineffective and therefore reduced to "inutility" (referring to the case law of the Appellate Body) if the measures taken by Canada are judged sufficient. The EC does not consider that this is a reason for the Panel to create new rights and obligations in violations of Article 3.2 DSU for three reasons:

- First the WTO Agreement, as international law, cannot be expected to guarantee "effective remedies" in all cases.
- Second, there is an available remedy in the possibility of bringing new panel proceedings.
- Third, the alleged "ineffectiveness" of a remedy does not mean that the corresponding provision of the Agreement is reduced to inutility. As the panel in *US – Foreign Sales Corporations* held, inutility in the sense used by the Appellate Body means "without meaning" or "redundant" and refers to the "principle of effective treaty interpretation" which requires that a treaty be interpreted so as to give meaning to all its terms. This does not mean that there must be a satisfactory sanction for the violation of every provision.¹⁴

46. The EC also takes issue with Brazil's statement¹⁵ that "When it comes to enforcement of the most egregious of export subsidies – those subsidies determined by a Panel or the Appellate Body to be levied in a manner designed to circumvent the prohibition of *de jure* export contingency – Members would be left without an effective remedy."

47. The EC does not consider it appropriate for WTO remedies to depend on the presumed intent or "design" of Members, a matter that is notoriously difficult to establish.

¹³ Paragraphs 6 and 13 of Brazil's second submission

¹⁴ See Report by the Panel on *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, 8 October 1999, at paragraph 7.9.

¹⁵ Paragraphs 13 (and 53) of Brazil's second submission.

48. While it is true that the Uruguay Round negotiators sought to prevent circumvention of the *de jure* prohibition¹⁶, it does not follow that all *de facto* export subsidies are motivated by circumvention. *De facto* export subsidies can be determined to exist in many other circumstances, depending on the panel's appreciation of the totality of the facts in question, which do not involve any notion of circumvention. Indeed, there is arguably no need to demonstrate that a Government originally *intended* to grant an export subsidy at all; Footnote 4 of the SCM Agreement merely requires that the subsidy "...is in fact tied to actual or anticipated exportation....". The Appellate Body did not conclude that Canada intended to circumvent any provisions of the SCM Agreement. There is no basis for Brazil's claim that *de facto* export subsidies are the "most egregious form of export subsidies", since all export subsidies are subject to the same remedy under Part II of the SCM Agreement.

5. Item (k) of the Illustrative List

49. The EC now comes to the issue of item (k) of the Illustrative List. Canada has declared that it will not in future approve Canada Account financing "which does not comply with the OECD Arrangement."¹⁷ If it respects this commitment (and in the view of the EC Canada is entitled to a presumption of good faith), there can be no prohibited export subsidy because of footnote 5 to the *SCM Agreement* and the second paragraph of item (k). Much has already been written on this matter and the EC will confine its remarks to the argument made by the US that item (k) is part of the definition of a subsidy rather than being in the nature of an "affirmative defence," which is the position of all the parties and of the EC.

50. The US position is that:

... the items contained in the Illustrative List are not "exceptions" to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices.¹⁸

51. This cannot be right and the US does seek to justify its self-serving¹⁹ contention. But the EC will briefly examine the relevant provisions. The Illustrative List is incorporated into Article 3.1(a) in two ways. First the prohibition in Article 3.1(a) is stated to *include* the subsidies *illustrated* in Annex I. Second, footnote 5 states that that:

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

52. Let us consider these two sources of incorporation in turn:

53. It seems absolutely clear that the word "including" means that in principle the Annex to does diminish the generality of the prohibition in Article 3.1(a). The word "illustrated" does not do so either. This is particularly clear from the explanation given by the 1960 GATT Working Party Report that originally proposed the list:²⁰

¹⁶ Paragraph 167 of Appellate Body Report

¹⁷ Paragraph 57 of Canada's First Written Submission.

¹⁸ Paragraph 10 of the US Third Party Statement.

¹⁹ Its position is motivated by its desire to defend its own export subsidy programme.

²⁰ See the EC submissions reported at 4.940 and 4.941 of the Report.

“The Working Party agreed that this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI.”²¹

54. It is the fact that the Illustrative List in Annex I is incorporated into Article 3.1(a) without restricting the generality of the prohibition that renders footnote 5 necessary. The drafters realised that Annex I contained certain exceptions and they wanted to preserve these in the *SCM Agreement*. However what they clearly did not intend was that the Illustrative List should be exhaustive of the disciplines applying to the measures it described. If it were, there would be no need for Article 3.1(a) but simply a reference to the Annex and a statement prohibiting “any other subsidies contingent upon export performance”. The fact that the drafters did otherwise must have some meaning.

55. That the US position is erroneous is also clear from the consequences that it would entail:

- The first consequence of the US position would seem to be that Brazil has to prove that the new Canada Account export credits are inconsistent with the second paragraph of item (k). If that were true, the Panel could never have found a violation in the original proceeding where Brazil left it to Canada to raise this defence and Canada declined to do so. Accordingly, if there was no established violation, there can be no obligation to implement and, also, Brazil would have to prove that the existing practice does not comply with the Arrangement.
- Second, the US approach of making the Illustrative List exhaustive for those matters addressed by it, would mean that stricter disciplines only exist for those rare measures *not included* in the Illustrative List. This also cannot have been the intention. The intent of the parties in incorporating Annex I was not to ensure that everything that was previously not prohibited would now be exempted (which would mean *no progress*). It was to ensure that what was previously prohibited would remain prohibited (which means *no backtracking*). If the Illustrative List exempted measures that are simply not identified as export subsidies, the general words of Article 3.1(a) would fail in their basic task of introducing stricter disciplines.
- Finally, the US approach by making the Illustrative List relevant to the definition of subsidy in Article 1, would make the Illustrative List a rich source of exceptions to all the disciplines of the *SCM Agreement*. Where the drafters wanted the Illustrative List to be relevant for the purpose of the definition of subsidy, they said so. Footnote 1 to the *SCM Agreement* is a clear example.

6. Conclusion

56. The EC is conscious that the case before the Panel today is complex and poses a number of important issues concerning the interpretation of the *SCM Agreement*. The EC has sought to provide arguments that it thinks may assist the Panel in coming to the correct conclusion on a number of these issues. The EC has not however commented on all the issues which the Panel may potentially decide are relevant to a resolution of this case. It would be happy to respond to any questions that the Panel may have on such issues, just as it is ready, if requested, to clarify and develop the comments that it has made today.

²¹ BISD 9S/187, immediately following the list.

ANNEX 3-4

ORAL STATEMENT OF THE UNITED STATES

(6 February 2000)

1. Mr. Chairman and Members of the Panel, it is my honour to appear before you today to present the views of the United States as a third party in this Article 21.5 proceeding. It is not my intent today simply to repeat the comments already stated in our written submission. Instead, I will first comment briefly on certain statements made by the EC in its written submission, and then make a few broader observations on the overall purpose of the SCM Agreement, which the United States believes should inform the Panel as it considers the difficult issues at hand. Finally, although I had not intended to do so, I will also make a few brief comments on the *Australia – Leather* decision in light of the EC’s comments this afternoon.

2. Turning first to the comments of the EC in its written submission, in paragraph 12 of its 17 January submission, the EC claims that Canada will be able to avoid a finding of *de facto* export contingency for the TPC programme if it is able to satisfy the Panel that future assistance is being granted without reference to actual or anticipated export earnings. To quote the EC’s submission, “Canada must ensure that the freedom of choice of applicants to decide between selling on the domestic or export markets is not limited in any way by the conditions attached to the receipt of the subsidy”.

3. The EC’s argument before the Panel is similar to the arguments that it raised without success before the Appellate Body. There, the EC argued that there are various tests that the Panel should have applied in determining the export contingency of the TPC programme. For example, the EC argued that the panel could have considered “whether the recipient’s freedom to direct his sales effort to the domestic or the export market is somehow restricted”.¹ This is essentially what the EC is arguing here.

4. The Appellate Body rejected this kind of rigid approach. To quote its opinion (at para. 169):

We agree with the Panel that what facts *should* be taken into account in a particular case will depend on the circumstances of that case. We also agree with the Panel that there *can be no general rule* as to what facts or what kinds of facts *must* be taken into account.²

The Appellate Body’s statement reflects the simple truth that the determination whether a subsidy is contingent in fact upon export is a complicated task. Again quoting the Appellate Body (this time at para. 167), proving *de facto* export contingency is “much more difficult” than proving *de jure* export contingency because the existence of the contingency must be “inferred” from *all* of the facts surrounding the granting of the subsidy.

5. Therefore, addressing the EC’s suggested test, it may well be that the recipients of a particular subsidy have complete freedom of choice to decide between selling in the domestic market and selling in the export market. The subsidy may still be a prohibited export subsidy. In the *Australian Leather* case, for example, the subsidy recipient was free as a legal matter to choose its own markets; it just happened that the nature of the market for its products meant that it had to export

¹ Report of the Appellate Body, *Canada -- Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, 2 August 1999, para. 104.

² *Id.*, para. 169 (partial emphasis added).

to meet the relevant sales targets. In this manner, the sales targets in essence became *de facto* export targets.³ The EC acknowledged the possibility of this type of scenario in its comments before the Appellate Body. The facts will vary from case to case.

6. Finally, in approaching this issue, it is important to keep in mind the Appellate Body's observation (at para. 167) that the Uruguay Round negotiators sought to prevent the circumvention of the prohibition on *de jure* export subsidies when they included the prohibition on *de facto* export subsidies. A clever government that wishes to provide export subsidies to its exporters may be able to do so in a way that leaves its reasons unclear. However, a subsidy that is neutral on its face may still be prohibited. The task for a panel is to determine whether, in spite of this facial neutrality, the surrounding facts lead to the inference that the grant of the subsidy was contingent upon export, that is, that it was tied to actual or anticipated exportation or export earnings. To quote this panel (at para. 9.332), "do the facts demonstrate" that the subsidy would not have been granted "but for" anticipated exportation or export earnings?

7. The United States would now like to comment briefly on certain broader points that we hope will influence the spirit in which the Panel evaluates this dispute.

8. This proceeding, as well as the companion proceeding brought by Canada against Brazil, is extremely important, for it revolves around the critical issue of compliance with DSB rulings and recommendations and the resultant effect on the SCM Agreement's ability to discipline injurious and prohibited subsidies.

9. As this Panel noted in its original opinion, subsidies by their very nature involve situations where governments insert themselves into the marketplace by providing benefits to favored companies, that is, financial contributions on better than market terms. While the SCM Agreement allows certain, non-injurious subsidies, it flatly prohibits export subsidies. These two cases are a good example of why this is so.

10. When a government chooses to provide an export subsidy, it effectively is deciding to interfere in the marketplace to provide its producers with an unjustified advantage over their foreign competitors *in their competitors' home markets and in third country markets*. Inevitably, this provokes a response from the affected countries and their producers. For example, in the companion case to this dispute, Brazil argued before the Appellate Body that PROEX subsidies were intended to match the subsidies provided by the Government of Canada to its producer. The result is a ruinous subsidy competition that distorts the world trading system, punishes taxpayers, and bleeds off resources that might better be used for other purposes. The governments concerned may well want to call off this competition; effective rules on export subsidies, effectively enforced, can make this possible.

11. Finally, I would like to comment briefly on the Panel's decision in the *Australian Leather* Article 21.5 proceeding. If the Panel would like detailed comments on this issue, I would prefer to provide them in writing. However, I am happy to provide some initial oral comments.

12. As an initial matter, the United States feels that the Panel's decision in the *Leather* case is not directly relevant to this dispute, because Brazil is not seeking the repayment of past TPC and Canada Account subsidies. For this reason, this Panel does not need to reach the issue addressed by the *Leather* panel.

³ Report of the Panel, *Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, 25 May 1999, para. 9.67.

13. If the Panel is nonetheless interested in our views, then I would simply observe that the *Leather* panel has spoken, so it is appropriate to conclude that its determination is definitive with regard to that case. The United States intends to support adoption of the report at the next meeting of the Dispute Settlement Body.

14. The United States notes that the *Leather* Panel itself acknowledged that the proper manner of withdrawing a prohibited export subsidy may differ from case to case.

15. While the Panel's conclusion in *Leather* went beyond the position that we took, we can't fault the logic of that conclusion.

16. As I noted at the beginning of my comments, the United States would be pleased to provide a more detailed response in writing if the Panel so desires.

17. As the United States noted in its written submission, we take no position on the issue of whether the amendments that Canada has made to the TPC programme and the Canada Account comply with the rulings and recommendations of the DSB. The United States hopes, nonetheless, that our comments today will prove useful to the Panel as it evaluates the complex issues at hand.

18. This concludes my comments. On behalf of the United States, I thank you again for providing us with this opportunity to present our views.

ANNEX 3-5

ANSWER OF THE UNITED STATES TO QUESTION POSED BY BRAZIL

(14 February 2000)

Q1. Please confirm the United States' statement, at the 6 February Meeting of the Panel, that it did not receive Brazil's Rebuttal Submission, dated 17 January 2000.

Response

The United States confirms the referenced statement.

ANNEX 3-6

ANSWERS OF THE UNITED STATES TO QUESTIONS POSED BY THE PANEL

(14 February 2000)

Questions to third parties

US

Q1. The US argues that the items contained in the Illustrative List are not, in Canada's words, 'exceptions' to the rest of the SCM Agreement, but rather are particular applications of the general standards in Article 1 to particular types of government practices. Would the US please elaborate on this statement. In particular, is the US suggesting that Canada's view is that the entire Illustrative List consists of exceptions to the rest of the SCM Agreement? Whatever the response to the preceding question, would the US disagree with a statement that the second paragraph of item (k) might at least in some circumstances be characterized as an "exception" to the first paragraph, in the sense that measures defined in the first paragraph of item (k) are prohibited export subsidies except if nevertheless they conform to the provisions of the second paragraph?

Response

1. With respect to the Panel's request that the United States elaborate on its statement, the question of the status of the items contained in the Illustrative List is connected to the so-called "*a contrario*" issue". Because the US position regarding the latter issue has been set out more fully in its written submissions in other dispute settlement proceedings, the United States will restate this position below for the benefit of this Panel, and hopes that this more detailed treatment of the issue will assist the Panel in its resolution of the matter before it. Following that discussion, the United States will address the other questions posed by the Panel in Question #1.

The "*A Contrario*" Issue

2. The basic question underlying the *a contrario* issue is this: In the case of a measure that is described by a particular item of the Illustrative List, is the measure's status as a prohibited or non-prohibited export subsidy governed by the standards contained in the item itself or by the general standards set forth in Article 1 and Article 3.1(a) of the SCM Agreement? For example, in the case of Canadian export financing under the Canada Account, if one assumes that the type of financing in question is of a type dealt with by item (k), is the prohibited/non-prohibited status of such financing controlled by item (k) or by Article 1 and Article 3.1(a)?

3. In the view of the United States, as a general matter of public international law, it is item (k) which is controlling. The principle of *generalia specialibus non derogant* holds that "a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of the general provision dealing with the category of subject to which that matter belongs, and which otherwise might govern it as part of that category."¹ While the Appellate Body has not necessarily invoked this principle by name, it repeatedly has emphasized the importance of analyzing a measure based on the provision of the WTO agreements that most specifically addresses the measure.² Of all

¹ Gerald Fitzmaurice, *The Law and Procedure of the Court of International Justice, 1951-4: Treaty Interpretation and Other Treaty Points*, 1957 British Y.B. Int'l L. 236; see also *Case Concerning Payment of Serbian Loans*, P.C.I.J. Ser. A, No. 20/21, page 30; and Grotius, *De Iure Belli Ac Pacis*, Lib. II, Cap. XVI, XXIX (Classics, 3, 1929).

² *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("Bananas"), WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997, paragraph 204

the provisions in the SCM Agreement, item (k) clearly is the provision that most specifically addresses export credit practices.

4. In addition to general principles of public international law, the items of the Illustrative List are controlling – where they apply – by virtue of footnote 5 of the SCM Agreement. Specifically, while Article 3.1(a) prohibits export subsidies, including those described in the Illustrative List, footnote 5 to Article 3.1(a) provides that “[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.” Footnote 5 makes clear that a practice identified by the Illustrative List as *not* constituting an export subsidy is not prohibited by Article 3.1(a) or any other provision of the SCM Agreement. Thus, if, for example, an export credit practice is permitted under item (k) – rather than prohibited – that is the end of the matter; no further analysis is needed. As such, footnote 5 constitutes an express incorporation into the SCM Agreement of the *generalia* principle.³

5. The disagreement as to whether an item of the Illustrative List is controlling appears to focus on the word “illustrative”. While all of the parties and third parties involved in this dispute agree that the Illustrative List is “illustrative”, they disagree on the manner in which it is illustrative. Canada and the EC appear to argue that if a particular type of financial contribution is described by a particular item in the Illustrative List, but cannot be considered as an export subsidy under the standard contained in the particular item, that financial contribution nonetheless can be found to be an export subsidy under some other standard.

6. In the view of the United States, this is not what the drafters intended when they used the term “illustrative” to refer to Annex I of the SCM Agreement. Instead, a more reasonable interpretation is that the drafters used the term “illustrative” simply to signify that not all types of financial contributions are covered by the Illustrative List.⁴ However, where an item of the Illustrative List does address a particular type of financial contribution – as is the case with respect to item (k) and export credits – that item sets forth the standard for determining whether the financial contribution is or is not an export subsidy.

7. Consider, for example, item (j) of the Illustrative List, which deals with export guarantee and insurance programmes. Looking just at the standard for premium rates, premium rates give rise to an export subsidy if they are “inadequate to cover the long-term operating costs and losses of the programmes.” Implicit in item (j), however, is the notion that premium rates do not give rise to an export subsidy if they are “adequate” to cover long-term operating costs and losses. Thus, on its face, item (j) provides Members with a predictable standard to use in establishing and administering export guarantee and insurance programmes.

(where the issues before a panel implicate two provisions, a panel should examine the more specific provision first); and *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, Report of the Appellate Body adopted 22 April 1998, para. 45 (“Because the language of Article II:1(b), first sentence, is more specific and germane to the case at hand, our interpretive analysis begins with, and focuses on, that provision.”).

³ Footnote 5 is not unique in this regard. Article 1.2 of the DSU, which provides that special or additional rules and procedures prevail over the general rules of the DSU, constitutes a very significant application of the *generalia* principle.

⁴ For example, with the exception of export credits, which are dealt with in item (k) and which relate to the sale of goods, the Illustrative List does not address export-contingent loans, such as government loans provided solely to exporters for purposes of capacity expansion. Indeed, debt financing provided under Canada’s TPC programme does not fall under item (k). Similarly, with the exception of export credit-related guarantees, which are dealt with in item (j), the List does not address loan guarantees to producers that are contingent on export performance. Likewise, the List does not address forgiveness of government-held debt which may be contingent upon export performance. Finally, the List does not address export-oriented equity infusions, a practice alleged in this very case. *Canada - Measures Affecting the Export of Civilian Aircraft (“Canada Aircraft”)*, WT/DS70/AB/R, Report of the Appellate Body adopted 20 August 1999, paras. 217-219.

8. Under the approach to the Illustrative List taken by Canada and the EC, however, any predictability is lost. For example, if item (j) was only “illustrative”, there would be numerous ways in which an export insurance or guarantee programme could be considered to be an export subsidy even though the premium rates conform to the standard in item (j). If premium rates were inadequate to cover *short-term* operating costs *or* losses, a programme could be considered to be an export subsidy. If premium rates were inadequate to cover short- or long-term *non-operating* costs, a programme could be considered to be an export subsidy. If premium rates were less than what an exporter might pay for comparable coverage in the marketplace, there could be an export subsidy under a “benefit to recipient” approach. This would be particularly true in a situation where a specific export transaction involves an unusually severe risk of nonpayment or currency fluctuation.⁵

9. It is extremely unlikely that the drafters of the SCM Agreement went to the trouble of crafting in the Illustrative List specific and detailed rules for particular types of financial contributions, such as the rules in item (j) and item (k), with the intent that those rules could be readily ignored in favor of more general standards found elsewhere in the SCM Agreement. Instead, a more plausible reading is that the drafters intended to use the Illustrative List as a vehicle for establishing detailed rules for certain types of financial contributions, rules that elaborate on the general principles contained in Article 1 but that cannot be ignored in favor of those more general principles.

10. The counter-arguments that have been made against this interpretation are not persuasive. For example, the EC has argued that in order for footnote 5 to exclude a measure from the prohibitions of the SCM Agreement, there has to be “a clear statement in Annex I that a measure *does not constitute* an export subsidy.”⁶ In its prior submissions to the Appellate Body on this issue, the EC stated that “footnote 5 requires an ‘affirmative statement’ in the Illustrative List to the effect that a measure does not constitute an export subsidy.”⁷ Under either standard, the EC has identified only the second paragraph of item (k) as falling within the purview of footnote 5.⁸

11. However, the text of footnote 5 does not require such a “clear” or “affirmative” statement, and there is a reason for this: the drafters had a different intent. Footnote 5 first appeared in the third draft agreement prepared by the Chairman of the Negotiating Group on Subsidies.⁹ In this draft, footnote 5 appeared for the first time – as footnote 4 to Article 3.1(a). Footnote 4 read as follows: “Measures *expressly* referred to in the Illustrative List as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.” (Emphasis added). Thus, the

⁵ Similarly, the approach taken by Canada and the EC would render irrelevant the “material advantage” clause in the first paragraph of item (k), a clause which the Appellate Body already has acknowledged must be given meaning. *Brazil - Export Financing Programme for Civil Aircraft* (“*Brazil Aircraft*”), WT/DS46/AB/R, Report of the Appellate Body adopted 20 August 1999, para. 179. Under the Canadian and EC interpretation, export credits that otherwise fall under the first paragraph could constitute prohibited export subsidies regardless of whether they “are used to secure a material advantage.”

⁶ *United States - Tax Treatment for “Foreign Sales Corporations”* (“*FSC*”), WT/DS108/R, Report of the Panel circulated 8 October 1999, para. 4.932 (emphasis in original).

⁷ *Brazil Aircraft*, para. 77.

⁸ *Id.*; and *FSC*, para. 4.932. If the drafters truly intended that footnote 5 apply only to the second paragraph of item (k), presumably they would have articulated this intent more directly by expressly referring to that paragraph.

⁹ MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990). In the prior two drafts, the prohibition against certain subsidies was contained in Article 1.1, which referred to three categories of subsidies: (a) subsidies contingent upon export performance; (b) subsidies listed in the Illustrative List; and (c) subsidies contingent upon the use of domestic over imported goods. MTN.GNG/NG10/W/38 (18 July 1990); and MTN.GNG/NG10/W/38/Rev. 1 (4 September 1990). In the third draft, Article 1.1 was redesignated as Article 3.1, and the first two categories were combined into a single subparagraph (a).

original version of footnote 5 had an additional word – “expressly” – which, had it been retained, might have supported the EC interpretation.

12. The word “expressly” was not retained, however. In the very next draft, the word was deleted from the footnote (still numbered as footnote 4).¹⁰ This change demonstrates that the drafters intended to expand, rather than restrict, the scope of footnote 5.¹¹ The change also demonstrates that the drafters did not intend the sort of narrow construction of footnote 5 advanced by the EC.

13. The second principal argument – advanced by both Canada and the EC – is that the US interpretation somehow would transform the Illustrative List into an exhaustive list that allegedly would allow “all sorts of measures” to escape the export subsidy prohibition.¹² Both Canada and the EC have offered as an example item (a) of the Illustrative List, which prohibits “direct subsidies,” claiming that under the US approach, *indirect* export subsidies would escape item (a) and, thus, prohibition under Article 3.1(a).¹³

14. However, this is a mischaracterization of the US position. First, as noted above, the US position is *not* that the Illustrative List is exhaustive. Instead, the US position is that the Illustrative List does not deal with all possible financial contributions, but for those that it does deal with, it establishes, by virtue of footnote 5, a dispositive legal standard insofar as prohibited subsidies are concerned. Second, in the case of the EC’s item (a) example, the US position is that item (a) simply does not address “indirect” subsidies. Thus, indirect subsidies do not “escape” any prohibition. Instead, the standard for a prohibited *indirect* subsidy must either be found elsewhere in the Illustrative List or, if the specific provisions of the Illustrative List are silent, in the general principles of Articles 1 and 3.1(a) of the SCM Agreement.

15. Finally, the opponents of the *a contrario* interpretation have never been able to explain how their approach to footnote 5 and the Illustrative List does not render various portions of the Illustrative List ineffective. For example, they have been unable to explain how their approach does not render the “material advantage” clause of item (k) superfluous. Because such an outcome is incorrect under public international law,¹⁴ a correct interpretation of footnote 5 and the Illustrative List is that the provisions of the Illustrative List are controlling with respect to the measures addressed therein.

¹⁰ MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

¹¹ *Cf.*, *Bananas*, para. 186, in which the Appellate Body found that where the negotiating history of the Lomé Waiver demonstrated that the word “foreseen” was replaced by “required”, the “change clearly suggests that the CONTRACTING PARTIES wanted to restrict the scope of the Lomé Waiver.” In the case of footnote 5, the change runs in the opposite direction; the drafters clearly wanted to expand the scope of footnote 5.

Likewise, one is “not entitled to assume that the disappearance [of “expressly”] was merely accidental or an inadvertent oversight on the part of either harassed negotiators or inattentive draftsmen.” *United States - Restrictions on Imports of Cotton and Man-Made Fibre Underwear*, WT/DS24/AB/R, Report of the Appellate Body adopted 25 February 1997, page 17. The negotiating record demonstrates that after the word “expressly” was deleted from the text, footnote 5 – then footnote 4 – continued to be the subject of discussion, including an unsuccessful attempt to delete the footnote altogether. *Negotiating Group on Subsidies and Countervailing Measures; Meeting of 6 November 1990: Note by the Secretariat*, MTN.GNG/NG10/24 (29 November 1990), page 2.

¹² *FSC*, para. 4.933.

¹³ *Brazil Aircraft*, WT/DS46/R, Report of the Panel, as modified by the Appellate Body, adopted 20 August 1999, para. 4.64; *FSC*, para. 4.933-4.934.

¹⁴ *See, e.g., Japan - Taxes on Alcoholic Beverages*, (“*Japan Alcoholic Beverages*”), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, Report of the Appellate Body adopted 1 November 1996, page 12.

Canada's View

16. Canada's view appears to be that footnote 5, as well as any item in the Illustrative List that – in Canada's view – is encompassed by footnote 5, is an exception to Article 3.¹⁵ In the view of the United States, neither footnote 5 nor the items in the Illustrative List constitute "exceptions". To the contrary, footnote 5 and the Illustrative List are part of Article 3, not exceptions to it.

The Second Paragraph of Item (k)

17. Whether one considers the second paragraph of item (k) to be an "exception to", a "qualification of", or a "refinement of" the first paragraph is, in the view of the United States, essentially a semantic exercise with no legal significance. The Appellate Body has stated that the assignment of the burden of proof is not affected by describing a particular provision as an "exception" to something else.¹⁶ Likewise, characterizing a provision as an "exception" does not affect the interpretation of the provision. As the Appellate Body has stated:

[M]erely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation.¹⁷

18. Thus, whether or not one characterizes the second paragraph of item (k) as an exception to the first paragraph, the complainant in a dispute – in this case, Brazil – has the burden of proving that the alleged offending practice fails to satisfy the terms of the second paragraph.

Q2. In any case, what are the practical implications, if any, for the issues before the Panel (and for the parties' arguments) of the US argument concerning the parties' characterizations of the Illustrative List (or at least of the second paragraph of item (k) thereof)? That is, the parties seem to agree that it would be for Canada eventually to choose whether to invoke that provision as a defense, and if it did so, to provide evidence to demonstrate its compliance therewith. Does the US agree or disagree with this? Please explain.

Response

1. The practical implications of the US argument depend upon whether the Panel considers itself bound by an agreement between the two parties as to how the SCM Agreement should be interpreted; *i.e.*, the parties' agreement that Canada bears the burden of proving that Canada Account financing now conforms to the second paragraph of item (k). If the Panel simply decides that it will accept the parties' interpretation because it happens to be something on which they agree, then the US argument is irrelevant.

2. However, in the view of the United States, a panel is not obliged to accept the interpretation of an agreement that happens to be shared by the two litigants present before it. Although it is true that WTO dispute settlement is a Member-driven process, that does not mean that a panel can ignore its mandate under Article 11 of the DSU to "make an objective assessment of the matter before it"

¹⁵ *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, Report of the Panel, as modified by the Appellate Body, adopted 20 August 1999, para. 5.81.

¹⁶ *EC - Measures Affecting Meat and Meat Products*, WT/DS26/AB/R, WT/DS48/AB/R, Report of the Appellate Body adopted 16 January 1998, para. 104.

¹⁷ *Id.*

3. Thus, the United States believes that the Panel must interpret the SCM Agreement objectively and independently of any agreement between the parties. When it does so, the United States believes that it should interpret the SCM Agreement – and, in particular, item (k) – in the manner described by the United States in its response to Question #1. Such an interpretation leads to the conclusion that the burden is on Brazil to demonstrate that the Canada Account does not conform to the second paragraph of item (k).

Q3. Concerning the verification mechanism proposed by Canada, the US argument seems to be that were the Panel to endorse any such mechanism, this would constitute a violation of Article 19.1 of the DSU, in that it would constitute a “modification” thereof which the Appellate Body has ruled is impermissible. Is this a correct understanding of the US argument. Please elaborate.

Response

1. The Panel’s understanding is correct. Under the DSU, panels may suggest methods of implementation, not methods of monitoring implementation. Surveillance of implementation is the subject of other provisions of the DSU, not Article 19.

ANNEX 3-7

RESPONSES BY THE EUROPEAN COMMUNITIES
TO THE QUESTIONS FROM THE PANEL AND
FROM BRAZIL

(14 February 2000)

Question 1 to the EC

The EC takes the view that because Canada has "undertaken" to respect all the provisions of the OECD Arrangement, Canada has prima facie correctly implemented the Panel's findings. Would the EC please elaborate on what it means by "undertaken". That is, is the EC's position dependent on the specific nature of characteristics of that undertaking, and if so, what are the elements that persuade the EC that the undertaking does constitute prima facie correct implementation? Under what circumstances, if any, would the EC consider that a statement issued by a government body, or made by a government employee acting in an official capacity, did not have the status of an undertaking constituting prima facie evidence of compliance with a ruling by the DSB ?

Response

1. The EC did not use the term "undertaken" to suggest that Canada had entered into a binding commitment. Canada has rather declared that it will not in future approve Canada Account financing "which does not comply with the OECD Arrangement."¹
2. In the original proceeding, the Panel took the view that since Canada Account financing was *discretionary*, it could only rule on particular cases of support.² This finding was not challenged on appeal. As a result, the Panel merely found a number of *transactions* to have been *de jure* export contingent.
3. There is not therefore any finding of an export subsidy programme to implement although Canada has taken some steps to ensure that the programme will not in future give rise to the same problems.
4. There is a change in Canada's practice on Canada Account financing since before the declaration it claimed that this financing was "consistent" with the OECD Arrangement, which can be taken simply to mean that Canada did not consider that Canada Account financing fell under the OECD Arrangement. Now, it positively declares that future Canada Account financing will *comply* with the Arrangement.
5. But this is not really the question before the Panel. If it was not possible in the original proceeding to declare the Canada Account financing incompatible with the *SCM Agreement* as a *programme*, that is in general, because it was discretionary, then it is still not possible now. The existence of the Panel Report cannot add to or diminish the rights and obligations of Members (Article 3.2 DSU).

Question 2 to the EC

Would the EC please elaborate on the specific reasons why it does not believe that it would be appropriate for the Panel to suggest a transparency agreement, as proposed by Canada. In

¹ Paragraph 57 of Canada's First Written Submission.

² Paragraph 9.213 of the Panel Report.

particular, does the EC consider that such a suggestion by the Panel would be impermissible under the DSU and/or the SCM Agreement, or simply inadvisable for other reason? Please explain.

Response

1. The EC finds itself in agreement with the statement of the US that Article 19.1 DSU, by its plain terms, allows a panel to suggest ways of implementing the recommendations that it makes after concluding that a measure is inconsistent with the covered agreement. A transparency agreement is not capable in itself to achieve the result of bringing Canada's subsidies into conformity. It is rather a means of verifying compliance, which is not a matter in which panels should become involved.
2. Accordingly, Article 19.1 DSU does not give to the Panel the necessary authority to make the suggestion and it is therefore impermissible.

QUESTION FROM BRAZIL

Brazil notes several references to its Rebuttal Submission, dated 17 January 2000, in the European Communities' Statement for the Meeting of the Panel on 6 February 2000. Please identify from whom the European Communities received this document.

Response

1. The European Communities received Brazil's second written submission by e-mail. No record of the origin of the transmission was kept. It expected to have received the text from Brazil.
 2. The European Communities is concerned that Brazil contests its right of have received the second submission and states that it did declined to send a copy to the EC as required by the Working Procedures of the Panel. How can the EC usefully contribute to the consideration of this matter by the Panel if it is not aware of all the arguments that have been presented to the Panel prior to the meeting?
 3. Article 10:3 of the Understanding on Rules and procedures governing the settlement of disputes (DSU) states that :
 4. Third parties shall receive the submissions of the Parties to the dispute to the first meeting of the Panel. (emphasis added).
 5. Furthermore, the DSU does not foresee any specificity in the application of this rule to panels reconvened pursuant to Article 21.5.
 6. As the meeting of 6 February 2000 was the **first** and **only** meeting of the Panel in this case, the EC was entitled to receive all submissions made to that meeting.
 7. A refusal by Brazil to allow the EC to have its second written submission would be a breach of the DSU and the Working Procedures an undermine the validity of the procedure.
 8. The European Communities can assure Brazil that there has been no breach of confidentiality since its second written submission has only been made available to Members participating in the proceeding and for that purpose, as required by the DSU.
-