The report of the Panel on Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada 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 26 July 2001 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.
I. PROCEDURAL BACKGROUND

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

1.2 The DSB recommended that Brazil bring its export subsidies for regional aircraft under the Programa de Financiamento às Exportações ("PROEX") interest rate equalization scheme into conformity with its obligations under Articles 3.1(a) and 3.2 of the Agreement on Subsidies and Countervailing Measures (hereafter "SCM Agreement"). The DSB further recommended that Brazil withdraw the export subsidies for regional aircraft within 90 days.

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

1.4 Canada disagreed that the Brazilian measure brought Brazil into conformity with its obligations under the SCM Agreement. As a result, on 23 November 1999, Canada requested the establishment of a panel under Article 21.5 of the DSU. On 9 December 1999, the DSB referred the matter to the original Panel pursuant to Article 21.5 of the DSU.

1.5 The report of the Article 21.5 Panel was circulated to Members on 9 May 2000. The Panel found that the measures taken by Brazil to comply with the Panel's recommendation either did not exist or were not consistent with the SCM Agreement. Accordingly, the Panel concluded that Brazil had failed to implement the 20 August 1999 recommendation of the DSB that it withdraw the export subsidies for regional aircraft within 90 days. The Appellate Body, in a report circulated to Members on 21 July 2000, upheld the Panel's conclusions. The DSB adopted the Appellate Body Report (WT/DS46/AB/RW) and the Panel Report (WT/DS46/RW), as modified by the Appellate Body Report, on 4 August 2000.

1.6 In the light of Brazil's failure to implement the 20 August 1999 recommendations of the DSB, on 12 December 2000 the DSB authorized Canada to take appropriate countermeasures in the amount of C$344.2 million annually. At the same meeting, Brazil advised the DSB of new measures it had taken, which, in its view, brought PROEX into compliance with Brazil's obligations under the SCM Agreement.

1.7 On 22 January 2001, Canada submitted a communication to the Chairman of the DSB (WT/DS46/26), seeking recourse to Article 21.5 of the DSU. In that communication, Canada indicated that there was disagreement between Canada and Brazil as to whether the measures taken by Brazil to comply with the 20 August 1999 and 4 August 2000 recommendations of the DSB brought Brazil into conformity with the provisions of the SCM Agreement and resulted in the withdrawal of the export subsidies to regional aircraft under PROEX. Canada, therefore, requested that the DSB refer the matter to the original panel, pursuant to Article 21.5 of the DSU. In its communication, Canada also noted that it had not yet implemented the countermeasures authorized by the DSB on 12 December 2000 and that its second recourse to Article 21.5 of the DSU was without prejudice to its legal position with respect to the implementation of those authorized countermeasures. Canada stated that it was invoking Article 21.5 in the interest of further legal clarity.

1.8 At its meeting on 16 February 2001, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Canada in document WT/DS46/26. At that DSB meeting, it was also agreed that the Panel should have standard terms of reference as follows:
1.9 To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS46/26, the matter referred to the DSB by Canada in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.10 The Panel was composed as follows:

    Chairperson: Dr. Dariusz Rosati

    Members: Prof. Akio Shimizu
              Mr. Kajit Sukhum

1.11 Australia, the European Communities, Korea and the United States reserved their rights to participate in the Panel proceedings as third parties.¹

1.12 The Panel met with the parties on 4-5 April 2001. It met with the third parties on 5 April 2001.


II. FACTUAL ASPECTS

2.1 As described in our original Panel Report², the Programa de Financiamento às Exportações (PROEX) was created by the Government of Brazil on 1 June 1991 by Law No. 8187 and is being maintained by provisional measures issued by the Brazilian government on a monthly basis. PROEX provides export credits to Brazilian exporters, inter alia through interest rate equalisation payments.³ Interest rate equalisation involves payments by Brazil's National Treasury to entities financing or refinancing export transactions involving goods and services.

2.2 In an effort to comply with the 20 August 1999 recommendations of the DSB, Brazil revised the interest rate equalisation system of PROEX through Central Bank of Brazil (BCB) Resolution 2667 of 19 November 1999 (hereafter "PROEX II"). That Resolution was the focus of the previous Article 21.5 proceedings initiated by Canada.

2.3 The subject of these second Article 21.5 proceedings commenced by Canada is another revision of the interest rate equalisation system of PROEX (hereafter "PROEX III"), effectuated by Brazil in view of the 4 August 2000 recommendations of the DSB. That revision is set out in Central Bank of Brazil (BCB) Resolution 2799 of 6 December 2000.⁴

2.4 Of particular relevance to the instant proceedings are the provisions of Article 1 and Article 8, paragraph 2 of BCB Resolution 2799. Article 1 stipulates in relevant part:

    Art 1. In export financing operations for goods and services, as well as for software, in compliance with Law No. 9,609, dated February 19, 1998, the National Treasury may provide to the financing or re-financing agency, as the case may be, equalization

¹ Australia did not make any written or oral submissions to the Panel.  
³ Law No. 8187 of 1 June 1991, replaced by Provisional Measure No. 1629 of 12 February 1998.  
⁴ Exhibit BRA-1.
enough to render financing costs compatible with those practiced in the international market.

Paragraph 1. When financing exports of regional aviation aircraft, interest rate equalisation shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation, complying with the Commercial Interest Reference Rate (CIRR) published monthly by the OECD corresponding to the currency and maturity of the operation.

2.5 Article 8, paragraph 2 of BCB Resolution 2799 states as follows:

Paragraph 2. In the process of analyzing received requests for eligibility [for PROEX III support], the [Export Credit Committee] shall have as reference the financing terms practiced in the international market.

2.6 The other main features of PROEX III remain essentially as they were during the previous Article 21.5 panel proceedings.

2.7 Thus, the maximum financing terms for which interest rate equalisation payments may be made are established by a Ministerial Directive. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to a maximum of 2.5 percentage points per annum, for a term of over nine years and up to ten years. The spread is fixed throughout the financing term.

2.8 PROEX III, like its predecessor versions, is administered by the Comitê de Crédito as Exportações (hereafter "Export Credit Committee"), a 13-agency group, with the Ministry of Finance serving as its executive. While day-to-day operations of PROEX III are conducted by the Central Bank of Brazil, all requests for PROEX III support in respect of exports of regional aviation aircraft must be approved by the Export Credit Committee.

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

2.10 PROEX III interest rate equalisation payments begin after the aircraft is exported and paid for by the purchaser. PROEX III payments are made to the lending financial institution in the form of non-interest-bearing National Treasury Bonds (Notas do Tesouro Nacional – Série I), referred to as NTN-I bonds. The bonds are issued by the Brazilian National Treasury to its agent bank, the Central Bank of Brazil, which then passes them on to the lending banks financing the transaction. The bonds are issued in the name of the lending bank which can decide to redeem them on a semi-annual basis for the duration of the financing or discount them for a lump sum in the market. PROEX III thus resembles a series of zero-coupon bonds which mature at six-month intervals over the course of the financing period. The bonds can only be redeemed in Brazil and only in Brazilian currency at the

exchange rate prevailing at the time of payment. If the lending bank is outside of Brazil, it may appoint a Brazilian bank as its agent to receive the semi-annual payments on its behalf.

III. PROCEDURAL ISSUE

3.1 Brazil asserts that, during the meeting of the Panel with the parties, while the representative of Brazil was presenting Brazil's oral statement, a member of the Canadian delegation left the room carrying a copy of the confidential written version of Brazil's oral statement. According to Brazil, a member of its delegation later left the room to investigate and found that several persons who were not members of Canada's delegation were sitting in the lounge outside the meeting room reading Brazil's confidential statement. Brazil does not contest that Members are entitled to decide for themselves the composition of their delegations, but considers that they have no right to decide for themselves which documents designated by the other parties as confidential should be treated as such.

3.2 Brazil objects strongly to the alleged disclosure of its confidential statements to the representatives of private parties who were not members of Canada's delegation. Brazil submits that the aforementioned alleged incident is a serious breach of Canada's obligations to respect the rules of confidentiality, including Article 14 of the DSU and paragraph 3 of the Panel's Working Procedures. According to Brazil, nothing in the Panel's Working Procedures or the DSU authorizes disclosure of confidential documents to persons who are not members of a delegation. Brazil requests that the Panel specifically note this alleged breach of the rules in its Report and that it take whatever other steps it deems appropriate.

3.3 Canada explains that it has not given access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings to any employees of Canadian regional aircraft manufacturers. Canada notes that it has shared these documents with members of a private law firm retained by a Canadian regional aircraft manufacturer. According to Canada, these individuals have served as advisors to the Government of Canada, form part of Canada's "litigation team", and are subject to a confidentiality agreement whereby they are not to disclose the documents such as those previously mentioned, including to their client. Canada also states that these individuals would not have received any business confidential information if Brazil had filed any in these proceedings.

3.4 In the view of Canada, paragraph 13 of the Panel's Working Procedures recognizes that parties may consult advisors who are not members of their delegations. Canada submits that the only reason why parties should have the responsibility for these advisors in regard to the confidentiality of the proceedings is because a party may share submissions and other documents with these advisors. Canada considers that statements by the Appellate Body in Canada – Measures Affecting the Export of Civilian Aircraft and Panel in Korea – Taxes on Alcoholic Beverages confirm its view that submissions may be shared with a party's advisors who are not on its "delegation". Canada also notes that, were it otherwise, parties would simply protect their ability to make a full response by greatly expanding their delegations, as is their right.

3.5 The Panel notes that, as a factual matter, Canada does not deny that a member of its delegation at the meeting of the Panel with the parties of 4 April 2001 provided a copy of Brazil's written version of its oral statement to people who were not members of its delegation, as notified to the Panel. In fact, Canada acknowledges that it has "shared [Brazil's submissions and statements]..."
with members of a private law firm retained by a Canadian aircraft manufacturer”. Accordingly, the issue facing us is whether it was permissible for Canada to share Brazil's oral statement and other documents submitted to the Panel with the private law firm in question. In considering this issue, we note that Article 18.2 of the DSU provides in relevant part that:

… Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential.  

3.6 In our view, it emerges from this provision that Canada must keep confidential all information submitted to this Panel by Brazil. However, as the Appellate Body has noted, "a Member's obligation to maintain the confidentiality of […] proceedings extends also to the individuals whom that Member selects to act as its representatives, counsel and consultants." Thus, the Appellate Body clearly assumed that Members may provide confidential information also to non-government advisors.

3.7 We see nothing in Article 18.2 of the DSU, or any other provision of the DSU, to suggest that Members may share such confidential information with non-government advisors only if those advisors are members of an official delegation at a panel meeting. Indeed, paragraph 13 of this Panel's Working Procedures expressly provides that:

The parties and third parties to this proceeding have the right to determine the composition of their own delegations. Delegations may include, as representatives of the government concerned, private counsel and advisers. The parties and third parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations, as well as any other advisors consulted by a party or third party, act in accordance with the rules of the DSU and the working procedures of this Panel, particularly in regard to confidentiality of the proceedings. Parties shall provide a list of the participants of their delegation before or at the beginning of the meeting with the Panel. (emphasis added)

3.8 It is apparent from the second and third sentences of paragraph 13 of the Working Procedures that the "other advisors" referred to are advisors who are not part of a Member's delegation at a panel meeting. It is equally clear to us that paragraph 13 is based on the premise that parties to panel proceedings may give their "other advisors" access to confidential information submitted by the other

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9 Canada's Response to Panel Question 31 (AnnexA-4).
10 Paragraph 3 of this Panel's Working Procedures also includes the quoted sentence.
11 This is subject, of course, to the provisions of the last sentence of Article 18.2 of the DSU, which allow a party to panel proceedings to disclose to the public non-confidential summaries of the information contained in the written submissions of the other party, if such summaries are requested.
12 Original Appellate Body Report on Canada – Aircraft, supra, para. 141 (emphasis added). The Appellate Body made the quoted statement in respect of appellate review proceedings. We do not see, however, why the same reasoning should not extend, by analogy, to panel proceedings.
13 Contrary to Brazil, we do not think that Article 14 of the DSU is relevant to the issue before us. Article 14 focuses on panels and their obligations in respect of confidentiality; it does not address itself to the obligations of the parties in respect of confidentiality.
14 The following statement by the Panel in Korea – Alcoholic Beverages supports this view:

We note that written submissions of the parties which contain confidential information may, in some cases, be provided to non-government advisors who are not members of an official delegation at a panel meeting. The duty of confidentiality extends to all governments that are parties to a dispute and to all such advisors regardless of whether they are designated as members of delegations and appear at a panel meeting. (Panel Report on Korea – Alcoholic Beverages, supra, para. 10.32, emphasis added)
party.\textsuperscript{15} Were it otherwise, there would be no point in requiring parties to safeguard the confidentiality of panel proceedings in respect of such "other advisors".\textsuperscript{16}

3.9 On the basis of the foregoing, we are unable to accept Brazil's argument that Canada acted inconsistently with the requirements of the \textit{DSU} or this Panel's Working Procedures by giving advisors not designated as members of its delegation access to information submitted to this Panel by Brazil.\textsuperscript{17}

3.10 In reaching this conclusion, we note, however, that, pursuant to paragraph 13 of the Working Procedures, Canada must ensure that any advisors who were not members of its official delegation respect the confidentiality of the present proceedings.

3.11 We note Canada's statement that the members of the law firm which have had access to Brazil's submissions have been part of its litigation team and have served as "advisors" to the Government of Canada. Since no members of a private law firm were part of Canada's delegation to the meeting of the Panel with the parties, the private lawyers Canada says were advising it fall within the "other advisors" category within the meaning of paragraph 13 of the Panel's Working Procedures. It was (and is), therefore, the responsibility of Canada to ensure that those private lawyers maintain the confidentiality of the documents submitted by Brazil.

3.12 Based on Canada's representations, we also understand that the law firm in question has an attorney-client relationship with a Canadian regional aircraft manufacturer. We think that the dual role performed by the law firm -- as advisor to the Government of Canada and attorney for a Canadian regional aircraft manufacturer -- places the law firm in a particularly delicate position as far as the protection of Brazil's submissions, statements and exhibits is concerned.\textsuperscript{18} In our view, it is crucial, in such circumstances, that Canada put in place appropriate safeguards to ensure non-disclosure of confidential information.

3.13 Importantly, Canada has represented that the members of the law firm who have had access to Brazil's submissions, statements and exhibits are subject to a confidentiality agreement with the Government of Canada which requires them not to disclose any such information, including to the Canadian regional aircraft manufacturer which is their client.

3.14 Brazil does not contest these facts. Moreover, Brazil has provided no evidence that those private lawyers have disclosed Brazil's confidential documents to the regional aircraft manufacturer which is their client.

3.15 We agree that maintaining confidentiality in accordance with the obligations of the \textit{DSU} is important. On the other hand, in applying the rules on confidentiality we must be careful not to stifle necessary communication between Member governments and their advisors, as long as appropriate safeguards are in place. In the absence of arguments and evidence to the contrary, we have no basis

\textsuperscript{15} Brazil is correct in pointing out that paragraph 13 does not \textit{expressly} authorize disclosure of confidential information to "other advisors", but, in our view, it does so by implication. We stress, however, that paragraph 13 talks about "advisors" and not other members of the public, such as private parties interested in the outcome of particular panel proceedings.

\textsuperscript{16} We note that there is nothing in the other paragraphs of this Panel's Working Procedures to suggest that confidential information may be disclosed to non-government advisors only if those advisors are members of an official delegation to a panel meeting.

\textsuperscript{17} It should be pointed out that Brazil did not, in these proceedings, submit any business confidential information.

\textsuperscript{18} We recall that Brazil's concern is with the confidentiality of its arguments and statements. Business confidential information, which might require other procedures and safeguards, is not, as already mentioned, involved in this situation.
for questioning Canada's representation that the relevant private lawyers are subject to a confidentiality agreement with the Government of Canada. 19

IV. INTERIM REVIEW 20

4.1 In letters dated 25 June 2001, Canada and Brazil requested an interim review by the Panel of certain aspects of the Interim Report issued to the parties on 20 June 2001. Neither party requested an interim review meeting. As agreed by the Panel, both parties were permitted to submit further comments on the other party's interim review requests. Brazil submitted such further comments on 28 June 2001.

A. COMMENTS BY CANADA

4.2 Canada requests that the Panel complement its description of the facts of this case by adding a reference to the "undisputed fact" that the Export Credit Committee has the authority to waive some of the published PROEX III guidelines. Brazil disagrees with Canada's characterization of its position and of the facts before the Panel. Brazil recalls its argument that, while PROEX III support will be considered on a case-by-case basis, Article 8, paragraph 2 of BCB Resolution 2799 imposes a specific affirmative requirement on the Export Credit Committee to ensure that PROEX III support, in addition to meeting the specific criteria enumerated elsewhere, is consistent with the terms practised in the international markets. The Panel notes that the issue of Brazil's discretion to waive some of the published PROEX III guidelines, and of the circumstances under which it may do so, is addressed in some detail at various points in our findings, including paras. 5.186–5.188 and 5.159-5.161. We therefore decline Canada's request to include further language on this issue in para. 2.8.

4.3 With respect to footnote 24, Canada believes to have established that PROEX III is now offered, at least by Embraer, in conjunction with, or as part of BNDES export financing packages. Canada supports its view by reference to exhibit CDA-19, which contains a sworn declaration by a Bombardier employee and an attached confidential report by that employee to his employer. Canada says the confidential report demonstrates that Embraer offered a particular regional airline company PROEX support through BNDES. Brazil does not accept that Canada has established that Embraer "offered PROEX support" through BNDES to that particular airline company. Brazil recalls, in this regard, that it has stated to the Panel that it has not received an application for interest rate support for putative Embraer sales to that airline company and that it has not approved any support for sales of regional aircraft to that company. In the Panel's view, exhibit CDA-19 may be (indirect) evidence that, in one particular instance, Embraer offered BNDES financing in conjunction with PROEX support. It is not evidence that the Brazilian government offered PROEX support through BNDES. Even disregarding this critical distinction (see footnote 27), exhibit CDA-19 cannot serve as conclusive evidence in respect of PROEX III since it reproduces information allegedly received by the Bombardier employee in question on 20 October 2000, a date well before the date of enactment of BCB Resolution 2799 and thus before the date of the entry into force of PROEX III. With these considerations in mind, we have made appropriate changes to footnote 24 in order to clarify the issue raised by Canada.

4.4 Canada recalls that Article 1.1(b) of the SCM Agreement requires, as one of the conditions for the existence of a subsidy, that "a benefit is thereby conferred". According to Canada, Article 1.1(b) does not specify which participant in a subsidized transaction must be the recipient of that benefit. Canada asserts, therefore, that the text of the SCM Agreement does not support what it

19 Since Brazil has not responded to Canada's argument that the private lawyers in question are subject to a confidentiality agreement, there are no grounds for assuming that that agreement inadequately protects confidential information.

20 Pursuant to Article 15.3 of the DSU, the findings of the final panel report shall include a discussion of the arguments made at the interim review stage. This Section of our report is, therefore, part of our findings.
understands to be the Panel's view, namely that, so long as the benefits of PROEX III payments could be retained entirely by the lender, Brazil maintains at least a theoretical discretion not to confer a benefit within the meaning of Article 1.1(b). Brazil does not agree that Canada has identified any flaws or inconsistencies in the Panel's analysis. Brazil states that the Panel's analysis appears to be consistent with both the text of Article 1 of the SCM Agreement and with relevant statements of the Appellate Body. The Panel, in considering this issue, and without endorsing Canada's re-statement of its view, recalls that it has explained its analytical approach in paras. 5.27-5.29 and accompanying footnotes. It is true, as Canada notes, that Article 1.1(b) does not specify or define "which participant in a subsidized transaction must be the recipient of [a] benefit". It should be recalled, however, that the SCM Agreement is a Multilateral Agreement on Trade in Goods in Annex 1A of the WTO Agreement. Thus, the SCM Agreement only regulates subsidies in the goods sector. In our view, the text of Article 1.1(b) must be read in this light. We fail to see how a subsidy to a provider of financial services can be a subsidy in the goods sector in cases where the benefit is retained exclusively by the services provider. We are, therefore, not persuaded by Canada's implied argument that, as long as a financial contribution by a government confers a benefit on any of the participants to the supported transaction, there is, without more, a subsidy within the meaning of Article 1.1 of the SCM Agreement. On these grounds, we decline Canada's invitation to modify our findings in paras. 5.27-5.51.

4.5 Canada considers that, contrary to the Panel's statement in para. 5.49, it has specifically responded to Brazil's contention that Brazil has discretion not to apply PROEX III in situations where doing so would confer a benefit. In support of its contention, Canada refers the Panel to two of its statements, which the Panel has referenced in footnote 41 and para. 5.24. Brazil considers that, in the context of para. 5.49, the Panel's statement is accurate. Brazil is of the view that Canada has not responded to Brazil's contention that the language of the PROEX III regulations permits Brazil not to provide PROEX III payments where to do so would confer a benefit. Although the Panel is not sure that the statements referred to by Canada specifically address the issue of whether or not Brazil has discretion not to apply PROEX III in certain factual situations, it acknowledges that these statements could be deemed relevant to the issue. Accordingly, para. 5.49 has been modified appropriately.

4.6 Canada has also drawn the Panel's attention to a number of typographical errors. The Panel corrected those.

B. COMMENTS BY BRAZIL

4.7 Brazil notes that, in para. 5.92, the Panel has accurately summarized Brazil's position on the meaning and scope of the term "interest rates provisions" in the second paragraph of item (k). Brazil submits, however, that the Panel's findings in para. 5.98 appear to be inconsistent with the Panel's summary of Brazil's arguments on this issue. In the Panel's view, there is no inconsistency between the two paragraphs referred to by Brazil. In order to avoid any misunderstandings in this regard, we nevertheless found it appropriate to slightly re-draft para. 5.98.

4.8 Brazil has also drawn the Panel's attention to typographical errors. The Panel corrected those.

V. FINDINGS

A. MEASURE AT ISSUE AND TASK OF THE PANEL

5.1 Canada submits that the only issue to be decided in these second Article 21.5 proceedings is whether PROEX III is consistent with the SCM Agreement. Canada notes that, so long as Brazil continues to make payments pursuant to letters of commitment issued under PROEX I and II, it will remain non-compliant with the recommendations of the DSB of 18 November 1999 that it withdraw its prohibited export subsidies.
5.2 Canada states that it is challenging the PROEX III scheme in so far as it relates to the financing of exports of regional aircraft because, no matter how it is delivered, it enables Brazil to continue to grant prohibited export subsidies. Canada is also challenging PROEX III payments made in support of regional aircraft exports because payments under PROEX III remain prohibited export subsidies. With respect to its challenge to PROEX payments, Canada refers to the original Panel Report in this dispute, which stated that "we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft."\(^{21}\)

5.3 Brazil agrees that the sole issue before the Panel is whether PROEX III complies with the requirements of the SCM Agreement. Brazil also agrees that the commitments made under PROEX I and II for aircraft which have not yet been delivered are not at issue in these second Article 21.5 proceedings.

5.4 Brazil considers that the Panel must review PROEX III on its face and by its terms. Brazil points out in this regard that no payments have been made under PROEX III in support of exports of regional aircraft and that Brazil has not issued any letters of commitment under PROEX III in respect of exports of regional aircraft.

5.5 The Panel notes that it is common ground that these second Article 21.5 proceedings relate exclusively to the latest revision of the PROEX programme (which we will refer to hereafter as "PROEX III") in so far as it concerns the financing of exports of regional aircraft.\(^{22}\) It is also not in dispute that the revised PROEX programme is a measure which was taken to comply with the 18 November 1999 and 20 August 2000 recommendations and rulings of the DSB in the sense of Article 21.5 of the DSU.\(^{23}\) PROEX III is, therefore, a proper subject of proceedings under Article 21.5 of the DSU.\(^{24}\)

5.6 Regarding the nature of Canada's complaint, it is clear that, in these proceedings, Canada challenges the PROEX III programme as such.\(^{25}\) In our view, it is not open to question, and Brazil

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\(^{22}\) Both parties agree that any payments on exports of regional aircraft Brazil may have made or may continue to make pursuant to commitments made under PROEX I and II are outside the scope of the present proceedings. We also observe that these proceedings, like the original proceedings, relate only to that aspect of the PROEX scheme involving interest rate equalisation. They do not, therefore, relate to direct export financing under PROEX III. See Original Panel Report on Brazil – Aircraft, supra, footnote 184.


\(^{24}\) Canada contends that PROEX financing now appears to be offered not only in the form of traditional PROEX payments, but also in conjunction with, or as part of, export financing packages provided by Brazil's development bank, the Banco Nacional de Desenvolvimento Econômico e Social (BNDES). Brazil responds that it is confused by Canada's reference to BNDES lending, which it submits is not within the terms of reference of this Panel. In considering this issue, we note that, to the extent Canada is alleging merely that BNDES lending is being supported by PROEX III interest rate equalisation, there is no need to address that situation separately. To the extent Canada is challenging BNDES financing as a prohibited export subsidy separate from PROEX III, we agree with Brazil that such financing is not identified in Canada's request for establishment of a panel (WT/DS46/26) and is thus outside our terms of reference. In any event, Canada has offered no convincing evidence that such financing has actually been provided in respect of exports of regional aircraft, nor even that BNDES offered to provide such financing. At most, it has established that Embraer "offered" BNDES financing in conjunction with PROEX support in respect of one particular transaction.

\(^{25}\) It should be recalled that, by contrast, in the original proceedings, Canada did not challenge the PROEX programme per se. See Original Panel Report on Brazil – Aircraft, supra, footnote 187.

5.7 Canada also challenges \textit{payments} under PROEX III, by which it means "the practice involving PROEX payments". Canada has not, however, disputed Brazil's contention that, under PROEX III, no payments have yet been made, nor letters of commitment issued, in respect of exports of regional aircraft. Therefore, and in the absence of specific evidence to the contrary\footnote{Canada has alleged that PROEX support was "offered" by the Brazilian regional aircraft manufacturer, Embraer, in negotiations to sell regional aircraft which would have been governed by PROEX III. See Canada's Rebuttal Submission, paras. 32-38 (Annex A-2). We recall, however, that an exporter that seeks PROEX interest rate equalisation submits a request, setting forth the proposed terms and conditions for a transaction, to the Export Credit Committee. Only if the Committee approves the transaction does the Committee issue a "letter of commitment" committing the Government of Brazil to provide PROEX support if a contract is concluded according to the terms and conditions contained in the request. See Panel Report on \textit{Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, WT/DS46/R/W}, adopted 4 August 2000, para. 2.5 (hereafter "Article 21.5 Panel Report on \textit{Brazil - Aircraft}"). Brazil has confirmed that it has issued no letters of commitment in respect of regional aircraft under PROEX III, and that, with respect to the negotiations for sales of regional jets to Air Wisconsin Airlines Corporation raised by Canada, no application for interest rate support had been received. See Brazil's Response to Canada's Question 1 (AnnexB-5). Canada has not contested those statements, much less offered any evidence to the contrary. Nor has Brazil provided any evidence that the Government of Brazil, as opposed to Embraer sales representatives, has otherwise "offered" interest rate support under PROEX III in respect of regional aircraft. We do not believe that we can establish the existence of a practice by the Government of Brazil on the basis of offers by a private entity. To the extent that Canada's challenge to PROEX III payments may be understood as a challenge to the legal framework governing the provision of PROEX III payments for exports of regional aircraft, that challenge would be subsumed, in our view, within Canada's challenge to the PROEX III programme \textit{per se}. Indeed, where this Report uses the term "PROEX III payments", it is to be understood in the aforementioned sense.}, we are not in a position to review the consistency either of individual PROEX III payments in respect of regional aircraft or a "practice" in respect of such payments with the \textit{SCM Agreement}.\footnote{In the original proceedings, Canada defined the regional aircraft market as consisting of commercial aircraft of 20-90 seats, whether turboprop or jet. See Original Panel Report on \textit{Brazil – Aircraft, supra}, footnote 188. We see no reason to deviate from that definition in these Article 21.5 proceedings.} It is evident to us that, in the absence of \textit{any} payments or letters of commitment under PROEX III in respect of regional aircraft, there is no "practice" that we could review.

5.8 It follows from the foregoing that our task in these proceedings is to examine the consistency with the \textit{SCM Agreement} of the PROEX III programme \textit{per se}, i.e. the legal framework of PROEX III, in so far as it relates to exports of regional aircraft\footnote{To the extent that Canada's challenge to PROEX III payments may be understood as a challenge to the legal framework governing the provision of PROEX III payments for exports of regional aircraft, that challenge would be subsumed, in our view, within Canada's challenge to the PROEX III programme \textit{per se}. Indeed, where this Report uses the term "PROEX III payments", it is to be understood in the aforementioned sense.}.

\textbf{B. REVIEW OF LEGISLATION \textit{PER SE}}

5.9 Our conclusion regarding the nature of the measure before us has implications with respect to the nature of the findings we must make with respect to the consistency of the measure with the \textit{SCM Agreement}. Specifically, we observe that, in both WTO and GATT dispute settlement involving challenges to legislation \textit{as such}, a distinction has been made between mandatory and discretionary legislation. Under this approach, panels have \textit{not} found legislation \textit{as such} to be inconsistent with GATT/WTO obligations, unless that legislation mandated, or required, the executive branch to take...
action which was not in conformity with a Contracting Party's/Member's obligations under the GATT 1947/WTO Agreement.

5.10 This principle was most recently explained by the Appellate Body in *United States – Anti-Dumping Act of 1916* as follows:

The concept of mandatory as distinguished from discretionary legislation was developed by a number of GATT Panels as a threshold consideration in determining when legislation as such – rather than a specific application of that legislation – was inconsistent with a Contracting Party's GATT 1947 obligations. 30

The Appellate Body further explained that:

[...]


5.11 The principle was also applied by the Panel in *Canada – Measures Affecting the Export of Civilian Aircraft*. In that dispute, the Panel found that Brazil had not established that certain Canadian programmes which were alleged by Brazil to constitute prohibited export subsidies mandated the grant of subsidies and that, as a result, no findings could be made in respect of those programmes *per se*. 33

5.12 We are aware that the Panel in *United States – Section 301-310 of the Trade Act of 1974* found that even discretionary legislation could violate certain WTO obligations. 34 We recall that that Panel was considering an alleged violation of Article 23 of the *DSU* and focused on the specific nature of the obligations in that Article in concluding that Article 23 itself prohibited certain legislative discretion. Neither party has suggested that Article 3.1(a) of the *SCM Agreement* prohibits legislation that would permit, but not require, the grant of prohibited subsidies. We agree. In fact, we recall that the original Panel in *Canada – Aircraft* applied this approach in the context of a claim under Article 3.1(a). Thus, we see no reason to deviate from the distinction between mandatory and discretionary legislation in the context of claims pursuant to Article 3.1(a) of the *SCM Agreement*. 35


35 Canada does not specifically contest the relevance of the distinction between mandatory and discretionary legislation to claims under Article 3.1(a) of the *SCM Agreement*. It asserts, however, that the distinction does not apply in the context of an affirmative defence such as the second paragraph of item (k) of
5.13 For the foregoing reasons, in reviewing whether the PROEX III scheme per se is a prohibited export subsidy, our examination will entail a consideration as to whether PROEX III requires Brazil to provide subsidies prohibited by Article 3.1(a) of the SCM Agreement.

C. OVERVIEW OF THE PARTIES' ARGUMENTS

5.14 Canada considers that PROEX III support in respect of exports of regional aircraft, however it is delivered, is a subsidy contingent upon export performance prohibited by Article 3.1(a) of the SCM Agreement. Canada further argues that PROEX III is not in conformity with the interest rates provisions of the OECD Arrangement on Guidelines for Officially Supported Export Credits (hereafter the "OECD Arrangement") and thus does not qualify for the "safe haven" in the second paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the SCM Agreement (hereafter "item (k)"). Canada submits, finally, that there is no a contrario exception under the first paragraph of item (k) and that, even if there were, PROEX III support would not qualify for it. For these reasons, Canada requests the Panel to find that Brazil has failed to implement measures that would bring it into compliance with the applicable recommendations and rulings of the DSB.

5.15 Brazil submits that Canada has not sustained its burden of proving that PROEX III confers a benefit and is thus a subsidy within the meaning of Article 1 of the SCM Agreement. Brazil argues, moreover, that, even if it were considered to be a subsidy contingent upon export performance, PROEX III conforms to the interest rates provisions of the OECD Arrangement and thus falls within the "safe haven" provided for in the second paragraph of item (k). Brazil further contends that, even if PROEX III were not eligible for the safe haven in the second paragraph of item (k), PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k). Brazil argues, in this regard, that the first paragraph of item (k) may be read a contrario to permit a payment that is not used to secure a material advantage. Brazil therefore requests the Panel to reject Canada's claims and to find that PROEX III is in conformity with the SCM Agreement.

5.16 The Panel finds it appropriate, in the light of the claims and arguments presented by the parties, to begin its examination by considering whether PROEX III is a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement.\textsuperscript{36} We will next consider the affirmative claims put forward by Brazil in its defence. Consistently with Brazil's submissions, the Panel will address first Brazil's affirmative "safe haven" defence under the second paragraph of item (k) in Annex I to the SCM Agreement. The Panel will then proceed to consider Brazil's assertion that PROEX III is not used to secure a material advantage within the meaning of the first paragraph of item (k) and is thus "permitted".

D. ARTICLE 3 OF THE SCM AGREEMENT

1. General

5.17 Article 3.1(a) of the SCM Agreement provides that:

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

\textsuperscript{36} We recall that, in the original proceedings, this Panel found that Brazil did not benefit from the transition period for developing country Members set forth in Article 27.4 of the SCM Agreement because it did not comply with certain conditions contained in that provision and that, as a result, the prohibition of Article 3.1(a) of the SCM Agreement applied to Brazil. See Original Panel Report on Brazil – Aircraft, supra, para. 8.1. In the present proceedings, Brazil does not argue that Article 3.1(a) is not applicable to it.
(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I (footnotes omitted).\(^{37}\)

5.18 Article 1.1 of the *SCM Agreement* sets out a general definition of a subsidy. It provides that a subsidy is deemed to exist, *inter alia*, if there is "a financial contribution by a government" and "a benefit is thereby conferred".

5.19 From the provisions of Articles 1.1 and 3.1(a) it may be deduced, then, that, a prohibited export subsidy exists where (i) there is a subsidy, i.e. there is a financial contribution by a government, and a benefit is thereby conferred, and (ii) the subsidy is contingent upon export performance.

2. **Examination of PROEX III**

(a) Financial Contribution by a Government

5.20 Canada submits that PROEX III payments involve a direct transfer of funds from the Government of Brazil within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. Canada argues that PROEX payments are "essentially grants". Canada notes that PROEX III is not different in this regard from PROEX I.

5.21 Brazil does not specifically contest that PROEX III support involves a direct transfer of funds from the Government of Brazil.

5.22 The Panel considers that PROEX III payments in respect of exports of regional aircraft, like the payments under PROEX I and II\(^{38}\), are financial contributions by the Government of Brazil. As noted, PROEX III payments are made to the recipients in the form of so-called NTN-I bonds which are redeemable.\(^{39}\) Article 1.1(a)(1)(i) of the *SCM Agreement* provides that there is a financial contribution by a government where "a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion)". In our view, this particular practice constitutes a direct transfer of funds. Brazil does not, in any event, contest that PROEX III payments are financial contributions by its Government.

5.23 We therefore conclude that PROEX III payments in respect of exports of regional aircraft constitute financial contributions by the Brazilian government within the meaning of Article 1.1 of the *SCM Agreement*.

(b) Conferral of a Benefit

5.24 Canada considers that, like PROEX I and II, PROEX III confers a benefit on the recipient. Canada argues that PROEX III is constructed as a buy-down of interest rates that have already been freely negotiated by the buyers of Brazilian Embraer regional aircraft, in the marketplace. Canada asserts, in other words, that PROEX III allows an aircraft purchaser to seek the best export credit terms available in the market, whether from a Brazilian or foreign financial institution, and then receive a buy-down of that interest rate in the amount of the PROEX III payments. From this it follows, according to Canada, that any such buy-down below freely negotiated interest rates necessarily results in net interest rates more favourable than those available to Embraer's customers in the market. Canada notes that, under the Appellate Body's definition, this amounts to a "benefit"

\(^{37}\) Article 3.2 of the *SCM Agreement* specifies that subsidies of the kind referred to in Article 3.1 must neither be granted nor maintained.

\(^{38}\) See Original Panel Report on *Brazil – Aircraft*, *supra*, para. 7.13; Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.21.

\(^{39}\) See Articles 5-7 of BCB Resolution 2799.
within the meaning of Article 1.1 of the SCM Agreement. Canada adds that, if Embraer's customers could achieve financing in the marketplace at rates equivalent to those achieved by PROEX III buy-downs, there would be no need for PROEX III.

5.25 **Brazil** argues that it is inaccurate to say that PROEX III is a buy-down of interest rates that have already been freely negotiated by the recipients in the marketplace. Brazil notes that PROEX III is not a system whereby the customer negotiates for the most favourable rate and then uses that as a starting point in applying for PROEX III support, which, if granted, would further reduce the commercially negotiated rate. Brazil maintains that, to the contrary, PROEX III is part of the transaction itself, a transaction which is limited by the market, as reflected in the CIRR, a 10-year term, 85 percent maximum financing and by the requirement that the resulting transaction be compatible with the international market. In Brazil's view, PROEX III payments which result in net interest rates at or above the CIRR in any event do not confer a benefit, because the CIRR reflects with reasonable precision market rates and may in fact be higher than market rates. In addition, Brazil asserts that PROEX III requires the Export Credit Committee to follow the rates prevailing in the international marketplace in deciding whether to approve PROEX III support. Thus, according to Brazil, PROEX III merely allows particular financial institutions to provide export credit financing on the terms and conditions available in the marketplace. Brazil considers, therefore, that PROEX III does not provide for net interest rates that are more favourable than those a customer could obtain in the market or, at a minimum, that it does not necessarily so provide.

5.26 **Canada** counters that nothing in PROEX III limits the amount of payments that may be made to the difference between what a borrower could obtain elsewhere in the marketplace and the rate at its preferred bank. Canada notes, moreover, that, PROEX III payments are conditional on the purchase of Brazilian aircraft. According to Canada, this would be illogical if the purpose of PROEX III was simply to assist banks in Brazil and in foreign countries. Canada maintains that, in fact, PROEX III subsidizes exported Embraer aircraft and not just lending institutions.

5.27 In considering whether PROEX III payments confer a benefit, the **Panel** notes that the financial contribution in this case is in the form of a (non-refundable) payment, rather than in the form of a loan. As a usual matter, of course, a non-refundable payment will confer a benefit. Thus, there would be no need for complex benefit analysis if PROEX III payments were made directly to producers or to purchasers of Brazilian regional aircraft. In this case, however, the payment is not provided to a producer of regional aircraft. Rather, PROEX III payments are provided to a lender in support of an export credit transaction relating to Brazilian regional aircraft.40 Thus, while there can be no doubt that PROEX III payments confer a benefit, we consider that the question remains whether PROEX III payments confer a benefit to producers of regional aircraft.41

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40 Canada itself acknowledges this. See Canada's Comments on Brazil's Responses to the Panel Questions 2 and 3, para. 4 (Annex A-5). See also Article 5 of BCB Resolution 2799.

41 At a late stage in these proceedings, Canada suggested that, because PROEX III payments are "essentially grants", they per se confer a benefit irrespective of how the payments are used by the recipient. See Canada's Comments on Brazil's Responses to Panel Questions 2 and 3 (Annex A-5). While this might well be the case where the recipient is a producer of the product in question, the recipient of the financial contribution in this case is a lender. As the SCM Agreement is an Annex 1A agreement on trade in goods, and as this case relates to alleged export subsidies in respect of a particular good -- Brazilian regional aircraft -- it is incumbent upon Canada to establish that the benefit derived from PROEX III payments is not retained exclusively by the lender but rather is passed through in some way to producers of regional aircraft. Separately, Canada argued that PROEX III confers a benefit by providing regional aircraft purchasers with a greater choice of lenders to handle a particular transaction than would have been available in the market. See Canada's Comments on Brazil's Responses to Panel Questions 2 and 3 (Annex A-5). However, we do not believe that Canada has established that this in itself constitutes a benefit to regional aircraft producers within the meaning of Article 1.1 of the SCM Agreement.
5.28 In our view, whether the financial contribution has conferred a benefit to producers of regional aircraft -- as opposed merely to a benefit to suppliers of financial services -- depends upon the impact of PROEX III payments on the terms and conditions of the export credit financing available to purchasers of Brazilian regional aircraft. In fact, the arguments of the parties have focused on precisely this question.\(^{42}\)

5.29 The Appellate Body has found that the existence of a benefit is to be established by reference to the market.\(^{43}\) Accordingly, our inquiry regarding benefit will concentrate on whether, as a result of PROEX III payments, purchasers of Brazilian regional aircraft obtain export credits on terms more favourable than those available to them in the market. We consider it evident that the "market" to which reference must be made is the commercial market, i.e. a market undistorted by government intervention.

(i) Structure and Design of PROEX III

5.30 Having stated the test for determining whether PROEX III confers a benefit, we now proceed to apply it to PROEX III. We first consider Canada's argument that, by reason of the very structure and design of PROEX III, PROEX III payments will necessarily result in net interest rates that are more favourable than those available to purchasers of Brazilian regional aircraft in the market.

5.31 It should be recalled, in this respect, that, through PROEX III payments, the Government of Brazil intervenes in a transaction between a lender and a borrower which plans to purchase Brazilian regional aircraft. It is clear to us that the purpose of PROEX III payments is to allow the lender to offer better export credit terms with respect to a transaction than it could otherwise make available. We do not understand Brazil to dispute that this is the case.\(^{44}\) It should also be noted that Brazil does not impose any limit on the nature of the lender that may be the recipient of PROEX III payments. Specifically, the lender could be a financial institution in Brazil, in another developing country, or a major international lending institution anywhere else in the world. Thus, the borrower is free to choose the financial institution which is prepared to offer it the most competitive rates.

5.32 It follows from these elements -- that the borrower is free to select the lender, whether Brazilian or otherwise, that offers him the best terms, and that PROEX III payments allow that lender to offer better export credit terms than he could otherwise provide -- that PROEX III payments may, in the absence of some limitation placed by Brazil on the degree of concessionality of export credits supported by interest rate equalisation, be expected to allow purchasers of Brazilian regional aircraft to obtain export credits on terms more favourable than those available to them in the commercial market, and thus to confer a benefit.\(^{45}\)

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\(^{42}\) We note that PROEX III payments are made in support of export credits extended to the purchaser, and not to the producer, of Brazilian regional aircraft. In our view, however, to the extent Canada can establish that PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a prima facie case that the payments confer a benefit on the producers of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products. We do not understand the parties to dispute this proposition.


\(^{44}\) Neither party has suggested that lenders might not, in response to the offer of PROEX III support, offer improved terms of conditions for export credits offered to buyers of Brazilian regional aircraft. We consider that it is very unlikely that lenders will not pass on at least part of the PROEX III payments in the form of better credit terms. Otherwise, borrowers could simply choose other lenders.

\(^{45}\) See, e.g., Canada’s Rebuttal Submission, para. 12 (Annex A-2); Canada’s Comments on Brazil’s Response to Panel Question 1, para. 3 (Annex A-5).
5.33 Brazil has identified two features of PROEX III which it considers ensure that PROEX III does not confer a benefit in respect of regional aircraft. First, Brazil argues that BCB Resolution 2799 establishes a minimum net interest rate of the CIRR for all PROEX-supported transactions. Second, Brazil contends that BCB Resolution 2799 employs the "international market" as a benchmark for determining whether or not PROEX III support may be granted. We will consider these alleged features in turn.

(ii) CIRR as Minimum Interest Rate

5.34 First we turn to Brazil's broad assertion that PROEX III support which results in net interest rates at or above the CIRR does not confer a benefit on buyers of Brazilian regional aircraft. As a preliminary matter, we agree with Brazil that BCB Resolution 2799 establishes a minimum interest rate of the CIRR for all PROEX-supported transactions relating to regional aircraft. Article 1, paragraph 1 of that Resolution specifically provides that:

When financing exports of regional aviation aircraft, interest rate equalization shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation, complying with the Commercial Interest Reference Rate (CIRR) published monthly by the OECD corresponding to the currency and maturity of the operation. 47

5.35 In considering Brazil's argument regarding the CIRR, it is important to bear in mind that the CIRR is "a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets." 48 It is, therefore, at best a rough proxy for commercial interest rates. Moreover, the CIRR is designed to correspond to commercial interest rates for "first-class" borrowers. 49 It is certainly not a precise market proxy for rates which borrowers of lesser creditworthiness could obtain in the market. 50

5.36 Brazil has not suggested to us that all buyers of regional aircraft are first-class borrowers and, hence, could obtain funds at rates close to the CIRR. In fact, there is evidence on record to suggest that many actual or potential buyers of regional aircraft are not first-class borrowers. 51 It follows that,

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46 We note that Brazil did not assert, either in the original proceedings or in the first Article 21.5 proceedings, that PROEX payments did not confer a benefit within the meaning of Article 1.1 of the SCM Agreement. To the contrary, Brazil conceded in those proceedings that PROEX I and II did confer a benefit. See Original Panel Report on Brazil – Aircraft, supra, para. 7.12; Article 21.5 Panel Report on Brazil – Aircraft, supra, para. 6.21.
47 Canada's argument that the wording of Article 1, paragraph 1 of BCB Resolution 2799 does not preclude Brazil from supporting net interest rates at below CIRR-level, is addressed at para. 5.141.
48 Appellate Body Report on Brazil – Export Financing Programme for Aircraft, WT/DS/46/AB/RW, adopted 4 August 2000, para. 64 (footnote omitted) (hereafter "Article 21.5 Appellate Body Report on Brazil – Aircraft"). The CIRR may be out of line with commercial rates because it is constructed on the basis of government bond yields plus a fixed margin and also because, due to the method of its fixation, it may lag behind the market.
49 See Article 15 of the 1998 OECD Arrangement.
50 Brazil's argument that net interest rates at the CIRR level would not confer a benefit appears to rest, at least in part, on the Appellate Body's view that net interest rates at the CIRR level would not secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k). In making this argument, Brazil seems to interpret the term "benefit" in Article 1.1 of the SCM Agreement to have the same meaning as the "material advantage" advantage clause in the first paragraph of item (k), something the Appellate Body specifically said is impermissible. See Appellate Body Report on Brazil – Export Financing Programme for Aircraft, WT/DS/46/AB/R, adopted 20 August 2000, para. 179 (hereafter "Original Appellate Body Report on Brazil – Aircraft").
51 We note, based on evidence submitted by Canada, that, as of 31 January 2001, out of thirteen US airlines, including the major ones, none had a "first-class" rating for unsecured debt. Thus, none of the thirteen airlines had “triple A” rating or, for that matter, any "A" rating at all. See Exhibit CDA-17, p. 6. Brazil itself
even if the CIRR did accurately reflect commercial market rates for first-class borrowers, the requirement in BCB Resolution 2799 that PROEX III support must not result in net interest rates below the CIRR does not mean that PROEX-supported interest rates are no more favourable than those which particular purchasers of Brazilian aircraft could have obtained in the commercial marketplace. We therefore find that the prescription of a CIRR floor for financing operations involving regional aircraft does not establish the absence of a benefit for the buyers of such aircraft.

5.37 We recognise the theoretical possibility that a particular purchaser of Brazilian regional aircraft might be able to obtain export credit financing at (or even below\(^{52}\)) CIRR rates in the commercial marketplace. Even if, as a result, PROEX III did not always confer a benefit on the buyer of Brazilian regional aircraft, it is important to bear in mind that this Panel's task is to review the PROEX III programme as such (insofar as it relates to exports of regional aircraft), not just specific situations which may arise under it. We are concerned, in this case, with all situations in which PROEX III may reasonably be expected to be involved. Thus, to the extent that PROEX III required Brazil, in some situations, to make PROEX III payments that would result in a benefit being conferred in respect of regional aircraft, the PROEX III programme would be mandatory legislation (in respect of the conferral of a benefit)\(^{53}\) and thus a subsidy potentially inconsistent with the SCM Agreement\(^{54}\).

(iii) International Market Benchmark

5.38 Next we must turn to Brazil's argument that it cannot, as a matter of law, use PROEX III in such a way as to confer a benefit on the buyers of Brazilian regional aircraft.\(^{55}\) Specifically, Brazil refers to Article 8, paragraph 2 of BCB Resolution 2799, which reads as follows:

In the process of analyzing received requests for eligibility, the [Export Credit Committee] shall have as reference the financing terms practiced in the international market.

5.39 We have addressed a series of questions to Brazil regarding the meaning of Article 8, paragraph 2. In response, Brazil has stated, inter alia, that Article 8, paragraph 2 imposes an affirmative requirement on the Export Credit Committee to ensure consistency with the terms practised in the international market; that the relevant "international market" is the market for the product for which PROEX III support is requested; that the relevant financing "practices" are those which do not include official financing support; and that the benchmark "financing terms" are those which would be available to the buyer in question for a comparable transaction in the commercial marketplace.\(^{56}\) These statements are, in principle, consistent with Brazil's contention that Article 8, paragraph 2 sets forth a mandatory "benefit to recipient" test within the meaning of Article 1.1 of the SCM Agreement.

\(^{52}\) We believe it may be inferred from the Appellate Body's statement that the CIRR "does not always necessarily reflect the actual state of the credit markets" that it is possible, in principle, for commercial interest rates to fall below the CIRR, at least temporarily. See Article 21.5 Appellate Body Report on Brazil – Aircraft, supra, para. 64.

\(^{53}\) The issue of whether PROEX III requires Brazil to confer a benefit in respect of regional aircraft is discussed in Section D.2(b)(iv) infra.

\(^{54}\) Of course, a subsidy is not prohibited by the SCM Agreement, unless it falls within the scope of Article 3 of the SCM Agreement, and unless defences such as the second paragraph of item (k) (discussed in Section E infra) are unavailable.

\(^{55}\) See Brazil's First Submission, para. 15 (Annex B-1); Brazil's Oral Statement, paras. 20 and 23 (Annex B-3).

\(^{56}\) See Brazil's Responses to Panel Questions 14(a), 14(c), 14(d) and 14(e) (Annex B-5).
5.40 However, Brazil has also noted that "there may be situations in which the CIRR is below the marketplace rates [...] In those circumstances, the Committee could provide PROEX support [in accordance with the provisions of the second paragraph of item (k)]."\(^{57}\) We understand this statement to mean that Article 8, paragraph 2 would not preclude Brazil from granting PROEX III support to reduce net interest rates below those which could be obtained commercially.\(^{58}\) This reply squarely contradicts some of the aforementioned statements by Brazil.

5.41 Since we have no grounds for believing that Brazil's latter statement was made inadvertently\(^{59}\) and since we see no possibility of resolving the inconsistencies in Brazil's statements other than in favour of Brazil's latter statement\(^{60}\), we are not persuaded by Brazil's argument that Article 8, paragraph 2 of BCB Resolution 2799 legally precludes Brazil from conferring a benefit to the buyers of Brazilian regional aircraft.

(iv) **Mandatory versus Discretionary Conferral of a Benefit**

5.42 To recapitulate, we have found, thus far, that PROEX III payments may, in the absence of some limitations placed by Brazil on the degree of concessionality of export credits supported by interest rate equalisation, be expected to allow purchasers of Brazilian regional aircraft to obtain export credits on terms more favourable than those available to them in the commercial market. We have further found that neither of the limitations identified by Brazil -- the minimum interest rate of the CIRR provided for in Article 1, paragraph 1 of BCB Resolution 2799, and the "international market" benchmark established by Article 8, paragraph 2 of that Resolution -- precludes Brazil from conferring a benefit through PROEX III interest rate equalisation. The issue which arises, then, is whether our findings up to this point are sufficient for us to conclude that the PROEX III programme, as such, is inconsistent with Article 3.1(a) of the SCM Agreement.

5.43 As previously discussed, we are dealing, in this case, with a claim in respect of the PROEX III programme per se. Thus, we apply the distinction between mandatory and discretionary legislation. Specifically, the question we must answer is whether PROEX III requires the executive branch of the Government of Brazil to act inconsistently with its obligations under Article 3.1(a) of the SCM Agreement, and in particular whether PROEX III requires the executive branch to confer a benefit on buyers of Brazilian regional aircraft. In our view, a conclusion that PROEX III could be applied in a manner which confers a benefit, or even that it was intended to be and most likely would be applied in such a manner, would not be a sufficient basis to conclude that PROEX III as such is mandatory legislation susceptible of inconsistency with Article 3.1(a) of the SCM Agreement.

5.44 In considering this issue, we note that BCB Resolution 2799 contains a number of elements which indicate a degree of discretion with respect to the implementation of PROEX III in particular cases. First, we note that Article 1 of BCB Resolution 2799 states in relevant part that:

57 Brazil's Response to Panel Question 14(e) (footnote omitted) (AnnexB-5). Brazil made a similar assertion in its Closing Statement to the Panel: "In sum, the Committee, operating under PROEX III will either operate under the safe haven of the second paragraph of item (k) or, when providing terms of interest rates [sic] support consistent with the market under the exception, will confer no 'benefit.'" See Brazil's Closing Statement, para. 11 (Annex B-4).

58 See also Canada's Comments on Brazil's Response to Panel Question 14, para. 7 (Annex A-5).

59 Brazil specifically reiterated the relevant statement in its response to Panel Question 14(g) (Annex B-5).

60 We note that nothing on the face of the phrase "the financing terms practiced in the international market" suggests that the benchmark terms must necessarily be the commercial terms available to the buyer in question for a comparable transaction. See also Canada's Comments on Brazil's Response to Panel Question 14, para. 4 (AnnexA-5).
… the National Treasury *may* provide to the financing or re-financing agency […] equalization enough to render financing costs compatible with those practiced in the international market. (emphasis added)\(^{61}\)

5.45 Brazil considers that, pursuant to this provision, the Export Credit Committee retains discretion regarding whether or not a request for PROEX III support is approved even when all the eligibility criteria are met.\(^{62}\) On its face, this would appear to be a reasonable interpretation of the text of Article 1. It follows that the Committee would be in a position to deny PROEX III interest rate equalisation in cases where the underlying export credit would, as a result of PROEX III support, be on terms that the borrower could not otherwise obtain in the commercial market.

5.46 We note a further element of the text of BCB Resolution 2799 which would appear to give the Export Credit Committee flexibility to modulate the amount of PROEX III interest rate equalisation depending on the terms of the underlying export credits. Article 1, paragraph 1 of the Resolution provides that:

… interest rate equalization shall be established *on a case-by-case basis, at levels that may vary according to the characteristics of each operation*, complying with the Commercial Interest Reference Rate (CIRR) … (emphasis added)

5.47 Brazil contends that this means that the Committee is not required to approve a net interest rate as low as the CIRR in every case, nor to approve 2.5 per cent support in every case.\(^{63}\) Again, this would appear to be a reasonable reading of this provision. Thus, in addition to having the discretion to deny interest rate equalisation altogether in certain cases, Brazil would appear to have the discretion to reduce the amount of interest rate equalisation in cases where the underlying export credit would, as a result of the full 2.5 per cent equalisation, be on terms that the borrower could not otherwise obtain in the commercial market.

5.48 Finally, we recall that Article 8, paragraph 2 of Resolution 2799 provides that, "[i]n the process of analyzing received requests for eligibility, the [Export Credit Committee] shall have as reference the financing terms practiced in the international market." We have previously rejected, based primarily upon inconsistent statements by Brazil itself regarding the meaning of this text, Brazil's contention that, as a result of this provision, Brazil could not, as a matter of law, use PROEX III in such a way as to confer a benefit in respect of Brazilian regional aircraft.\(^{64}\) We consider, however, that this provision offers Brazil substantial discretion to decide how to apply PROEX III. In particular, we consider that Brazil *could* consistently with this language decline to offer PROEX III interest rate equalisation in cases where the underlying export credit would, as a result of PROEX III support, be on terms that the borrower could not otherwise obtain in the commercial market.

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\(^{61}\) The term "may" is expressed as "pode ser" in the original Portuguese-language text.

\(^{62}\) Brazil also refers to another provision which it considers supports its contention that the Export Credits Committee has discretion regarding whether or not PROEX III support is provided. The provision in question, Article 2 of BCB Resolution 2799, states that "["]equalization may be granted when financing the importer, for cash payments to the exporter established in Brazil, as well as when re-financing granted to the latter." We are not persuaded that Article 2 is meant to confer discretion on the Committee as Brazil suggests. Rather, we think Article 2 simply makes clear *in what situations* interest equalisation is possible (Article 2 mentions three). Thus, it does not appear to address the issue of whether the Committee has discretion to refuse to grant interest rate equalisation for financing, say, to an importer when the relevant request meets all other eligibility criteria of PROEX III.

\(^{63}\) See Brazil's Response to Panel Question 13 (AnnexB-5)

\(^{64}\) See Section D.2(b)(iii) *supra*. 
5.49 We note that Canada itself has asserted that Brazil's executive branch has broad discretionary authority with respect to the administration of PROEX III.65 Further, Canada has recognised that, under the traditional distinction between mandatory and discretionary legislation, it is incumbent on the complaining party to establish that the executive branch of the responding party is required to act inconsistently with its obligations under the WTO Agreement.66

5.50 In the light of the foregoing, we conclude that Canada has failed to establish that Brazil is required by PROEX III to confer a benefit on producers of Brazilian regional aircraft through interest rate equalisation payments.67

5.51 We emphasize that our ruling is limited to a finding that Brazil is not required by PROEX III to confer a benefit on producers of Brazilian regional aircraft through interest rate equalisation payments. We do not mean to suggest that Brazil will not confer a benefit in some if not most cases in which PROEX III interest rate equalisation is provided. To the contrary, we believe that the very logic of PROEX III would be undermined if Brazil were to limit the provision of PROEX III interest rate equalisation to cases where no benefit was conferred.68 We recall, however, that Brazil may avoid violating Article 3.1(a) of the SCM Agreement either by not conferring a benefit (such that no subsidy contingent upon export performance exists) or by taking advantage of the "safe haven" provided for in the second paragraph of item (k)69, and that Brazil has asserted that it will operate PROEX III in such a manner70.

(c) Export Contingency

5.52 Canada argues that PROEX III payments are de jure contingent on export performance.

5.53 Brazil does not contest that PROEX III payments are de jure contingent upon export performance.

5.54 The Panel considers that PROEX III payments are contingent in law upon export performance within the meaning of Article 3.1(a). PROEX III, by name and design, is an export financing programme. Moreover, the legal instruments at issue in these proceedings, by their terms,

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65 See, e.g., Canada's Comments on Brazil's Response to Panel Question 8, para. 3 (Annex A-5).
67 This is not a case where PROEX III interest rate equalisation would necessarily confer a benefit, and where the only discretion available is that of not providing the equalisation at all. We do not express a view as to whether our approach in this case would be equally applicable in such factual circumstances. Rather, this is a case where Brazil has discretion to operate PROEX III interest rate equalisation in such a manner that it does not confer a benefit. Further, we note that the facts before us are unlike those before the Appellate Body in Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items. In that case, the Appellate Body was reviewing mandatory legislation. See Appellate Body Report on Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, WT/DS56/AB/R, adopted 22 April 1998, paras. 49 and 54.
68 Brazil has stated that PROEX III payments are intended to enable Embraer to avoid a competitive disadvantage vis-à-vis other regional aircraft manufacturers the sales of which are enjoying official support. See Brazil's Response to Panel Question 4 (Annex B-5). To the extent that PROEX III payments do not allow purchasers of Brazilian regional aircraft to obtain export credit financing on terms more favourable than would be available to them in the commercial market, it is hard to see how this stated purpose would be served. Rather, the sole beneficiaries of PROEX III payments in such cases would be lenders. In other words, PROEX III payments in such cases would be subsidies in respect of financial services, rather than regional aircraft. Given that the lender receiving PROEX III payments need not be Brazilian, this is an unlikely scenario.
69 See Section E infra.
70 See Brazil's Closing Statement, para. 11 (Annex B-4).
apply only to export financing operations. Again, Brazil does not dispute that PROEX III payments are export-contingent.

3. Conclusion

5.55 On the basis of all the foregoing considerations, we find that PROEX interest rate equalisation payments are financial contributions within the meaning of Article 1.1 and that they are contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement. However, we further find that Brazil maintains the discretion to limit the provision of PROEX III interest rate equalisation payments to circumstances where a benefit is not conferred in respect of regional aircraft. Accordingly, we conclude that Brazil is not required by the PROEX III scheme to provide, in respect of the export of regional aircraft, a subsidy within the meaning of Article 1.1 of the SCM Agreement which is contingent upon exportation in the sense of Article 3.1(a).

5.56 In the light of our conclusion with respect to Canada's claim under Article 3.1(a) of the SCM Agreement, we could exercise judicial economy and end our analysis at this point. We consider, however, that a more complete analysis of the issues before us would facilitate the work of the Appellate Body in the event that this Panel Report is appealed. We further recall Brazil's statement that "the [Export Credit] Committee, operating under PROEX III will either operate under the safe haven of the second paragraph of item (k) or, when providing terms of interest rates [sic] support consistent with the market under the exception [provided for in Article 8, paragraph 2 of BCB Resolution 2799], will confer no 'benefit'." In the light of Brazil's stated intention to rely on the "safe haven" in certain circumstances, and in the interests of promoting a full resolution of this dispute, we proceed to consider Brazil's arguments in respect of the "safe haven" in the second paragraph of item (k).

E. SECOND PARAGRAPH OF ITEM (K)

5.57 As previously outlined, it is Brazil's position that, even if Canada were correct and PROEX III were, in fact, an export subsidy within the meaning of Article 3.1(a) of the SCM Agreement, PROEX III would nevertheless be justified under the "safe haven" in the second paragraph of item (k). Brazil did not invoke the second paragraph of item (k) during the previous proceedings in this dispute. It is, therefore, appropriate to discuss this particular defence in some detail.

1. Burden of Proof

5.58 Brazil contends that, even if PROEX III conferred a benefit and was thus a subsidy contingent upon export performance within the meaning of Article 3.1(a), Brazil in practice applies the interest rates provisions of the relevant OECD Arrangement and is thus covered by the safe haven of the second paragraph of item (k). Brazil does not dispute that it is incumbent on the party invoking the second paragraph of item (k) to demonstrate that the requirements of the second paragraph of item (k) are satisfied.

5.59 Canada does not contest that an export credit practice which is in conformity with the interest rates provisions of the relevant OECD Arrangement is not a prohibited export subsidy. Canada contends, however, that whoever invokes the second paragraph as an affirmative defence must bear the burden of proving that the measure for which justification is claimed meets all of the conditions of

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71 See Article 1 and Article 1, paragraph 1 of BCB Resolution 2799.
72 Closing Statement of Brazil, para. 11 (emphasis added) (Annex B-4).
73 There is, in our view, particular justification for facilitating a full resolution of this particular dispute in view of the fact that this is the second time that Canada has asked us to review Brazil's measures taken to comply with the relevant recommendations and rulings of the DSB.
the second paragraph. Specifically, it is necessary, according to Canada, to establish conformity with all of the "interest rates provisions" of the relevant OECD Arrangement.

5.60 The Panel recalls that the text of 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. (emphasis added)

5.61 On a reading which gives meaning to all of the terms used, the second paragraph suggests that export credit practices which are in conformity with the interest rates provisions of the relevant international undertaking are export subsidies -- and, as such, would normally be prohibited under the provisions of Article 3 of the SCM Agreement --, but that they are nevertheless not prohibited under the SCM Agreement.

5.62 This interpretation leads us to the conclusion that the second paragraph of item (k) provides for an exception from any prohibition on export subsidies laid down elsewhere in the SCM Agreement. The fact that the second paragraph does not, itself, impose obligations supports that conclusion.

5.63 Consistently with our view that the second paragraph of item (k) makes available an exception, it must be possible to invoke it as an affirmative defence to a claim of violation. As is clear from relevant WTO jurisprudence, the burden of establishing an affirmative defence rests with the party raising it.74

2. Specific Interpretative Issues

5.64 A number of specific interpretative issues need to be resolved before the provisions of the second paragraph of item (k) can be applied to the facts of the present case. In particular, it is necessary (a) to address what are "export credit practices", (b) to determine which is the relevant "international undertaking on export credits", and (c) to identify the "interest rates provisions" of the relevant undertaking and to establish what it means to be "in conformity" with those provisions. These issues are addressed in turn.

(a) "Export Credit Practices"

5.65 The Article 21.5 Panel in Canada – Aircraft considered that there is "... 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)."75

5.66 The term "export credit practice" is a broad one which on its face encompasses any practice relating to export credits. Further, neither party to these proceedings has disputed that the term should be read in this manner. We, therefore, adopt the view of the Article 21.5 Panel in Canada – Aircraft.

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75 Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.81 (footnote omitted).
5.67 Brazil recalls that the second paragraph refers not only to the OECD Arrangement as it existed in 1979, but also to "a successor undertaking which has been adopted" by the original Members. Brazil considers that the phrase "a successor undertaking which has been adopted" can only be interpreted to refer to the 1992 OECD Arrangement on Guidelines for Officially Supported Export Credits (hereafter the "1992 OECD Arrangement"). In support of its interpretation, Brazil adduces the fact that the aforementioned phrase uses the present perfect tense. According to Brazil, the term "has been" refers to a time regarded as present when the provisions of item (k) became effective, i.e. 1 January 1995. Brazil notes that, at that time, the only "successor undertaking" already in existence was the 1992 OECD Arrangement.

5.68 Brazil further contends that, if, instead, the phrase "a successor undertaking which has been adopted" were interpreted to refer to versions of the OECD Arrangement adopted after the entry into force of the SCM Agreement, this would lead to an absurd and unreasonable result. According to Brazil, such an interpretation would effectively give a handful of OECD countries carte blanche to amend the scope of the safe haven in the second paragraph of item (k). Brazil points out, for example, that nothing would prevent the Participants to post-1995 versions of the OECD Arrangement from including in the second paragraph of item (k) export credit practices they engage in while excluding export credit practices of other WTO Members that are not members of the OECD. Brazil notes that this could be done without official notification to the WTO and even though most WTO Members are not even eligible to join the OECD. In Brazil's view, this would also completely evade the regular process for amending WTO provisions. Brazil submits that, in such circumstances, the Panel should adopt Brazil's interpretation of the "has been adopted" clause, which is a possible interpretation and which avoids an absurd and unreasonable result.

5.69 Canada disagrees with Brazil's interpretation. According to Canada, the text "has been" does not focus on the past, i.e. 1 January 1995, as Brazil suggests, but on the time of the consideration of the application of item (k). The present perfect tense is used in the second paragraph of item (k), in the view of Canada, to make clear that an undertaking must be adopted before it can take effect. On that basis, Canada considers that the currently relevant OECD Arrangement is the 1998 OECD Arrangement on Guidelines for Officially Supported Export Credits (hereafter "the 1998 OECD Arrangement"), because it is the most recent version of the OECD Arrangement which has been adopted. Canada also argues that the 1998 OECD Arrangement is clearly a "successor undertaking" to the 1978 Arrangement. Canada considers that the term "successor" is forward looking. Canada adds, in this regard, that the OECD Arrangement has developed since its inception and continues to do so. Canada argues that the drafters of item (k) could not have been unaware of this evolving character of the OECD Arrangement on 1 January 1995, since, by that time, the OECD Arrangement had undergone several changes, e.g. in 1987, 1991 and 1994.

5.70 In respect of Brazil's interpretation, Canada argues that if the drafters had meant to refer to the 1992 OECD Arrangement, they could simply have done so. Canada also recalls that the second paragraph of item (k) tracks the text of the 1979 GATT Subsidies Code. Canada notes that the 1979 GATT Subsidies Code also referred to a "successor undertaking" to the 1978 OECD Arrangement. Canada considers that the term "successor" is forward looking. Canada adds, in this regard, that the OECD Arrangement has developed since its inception and continues to do so. Canada argues that the drafters of item (k) could not have been unaware of this evolving character of the OECD Arrangement on 1 January 1995, since, by that time, the OECD Arrangement had undergone several changes, e.g. in 1987, 1991 and 1994.

5.71 Among third parties, the European Communities argues that the 1998 version of the OECD Arrangement is the only one relevant to the present proceedings. The second paragraph of item (k) makes a dynamic reference to the OECD Arrangement in line with the fact that the Arrangement is an evolving understanding. The United States considers that the version of the OECD Arrangement in effect on the date that a Member grants the export credit at issue is the "relevant undertaking" with which the Member must comply. The drafters of the SCM Agreement were aware of the need for
flexibility to update agreements and, therefore, included the possibility of an updated OECD Arrangement in the language "a successor undertaking".

5.72 The task facing the Panel is to determine the relevant "international undertaking on official export credits". It is well to begin that task by setting out the relevant part of the text of the second paragraph of item (k). It reads:

… 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) …

5.73 It is not in dispute that the phrase "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979" is a reference to the OECD Arrangement in effect on 1 January 1979. Nor is it in contention that the bracketed phrase "a successor undertaking which has been adopted […]" refers to a "successor undertaking" to the OECD Arrangement in effect in 1979. The parties differ, however, regarding whether the relevant "successor undertaking" is the 1992 version of the OECD Arrangement or the 1998 version.

5.74 Brazil submits that the relevant successor undertaking is the 1992 OECD Arrangement because it was in effect at the time the SCM Agreement came into force, i.e. 1 January 1995. Canada, on the other hand, argues for the 1998 OECD Arrangement on the grounds that it is the current version. Simply put, then, the issue we must decide is whether the second paragraph of item (k) uses the most recent adopted version of the OECD Arrangement as a reference or a historic version thereof.

5.75 In interpreting the phrase "a successor undertaking which has been adopted […]", we focus first on the language "has been adopted". Brazil attaches great importance to the fact that that language is in the present perfect tense. The present perfect tense, Brazil maintains, refers to a time regarded as present. We agree. Brazil goes on to argue, however, that the relevant present is the time when the SCM Agreement entered into force. From this Brazil concludes that only those successor undertakings which had been adopted before the entry into force of the SCM Agreement are, textually, within the scope of the second paragraph of item (k). We are not persuaded by that view.

5.76 The second paragraph of item (k) does not say that only a successor undertaking which has been adopted "at the date of entry into force of the WTO Agreement" is relevant. Nor is there any other indication in the text of the second paragraph which would support Brazil's argument. It is true, of course, that the SCM Agreement began to speak, as it were, in 1995. It does not follow, however, that every time that Agreement speaks in the present tense or the present perfect tense this necessarily refers to the present of its drafters, i.e. 1 January 1995. To the contrary, as a general matter, we would expect that the present tense and present perfect tense are used in the SCM Agreement, including in the second paragraph of item (k), to refer to the present of the addressees of the SCM Agreement. After all, the SCM Agreement is meant to regulate the conduct of Members and must, therefore, inform Members as to what their rights and obligations are at the time they refer to the Agreement.

5.77 Another phrase contained in the second paragraph of item (k) reinforces our view. That phrase reads: "[…] if a Member is a party to […] a successor undertaking […]" (emphasis added). On Brazil's view, as Canada notes, that phrase would cover only Members that were parties to the 1992 OECD Arrangement on 1 January 1995. A Member that becomes a party after that time would not fall within the terms of that phrase, even though they would clearly be a party to the Arrangement.

76 See also Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.78.
There is, to be sure, another relevant phrase in the second paragraph which reads: "[…] if in practice a Member applies the interest rates provisions of the relevant undertaking". However, a Member that becomes a party to the 1992 OECD Arrangement after 1995 would not be covered by that phrase either. It would apply the 1992 OECD Arrangement as a matter of law. It cannot, in our view, be said to apply that Arrangement as a matter of practice. Thus, such a Member would, in effect, be precluded from successfully invoking the safe haven in the second paragraph of item (k), a result which we think the drafters could not have intended.

5.78 It should be noted, moreover, that, on our interpretation, the language "has been adopted" retains meaning and effect. Thus, the use of the present perfect tense tells Members that any time they seek to determine the relevant successor undertaking, they should consider only those successor undertakings which, at that time, have been adopted by the relevant OECD Members. In other words, Members are not allowed to rely on, nor are they bound by the relevant provisions of a successor undertaking which has not yet been formally accepted by the relevant OECD Members. A successor undertaking which is merely being proposed for adoption or which exists only in draft form could not, therefore, constitute a successor undertaking which "has been adopted".

5.79 On the basis of the foregoing considerations, we find that the phrase "has been adopted" is properly read as referring to the present of its addressees rather than as referring to an act of adoption prior to the entry into force of the SCM Agreement, i.e. prior to 1 January 1995.

5.80 Turning next to the term "successor undertaking", we note that, in its ordinary meaning, this term refers to an undertaking which "succeeds [i.e. follows] another in […] function". There can be no question, in our view, that both the 1992 and the 1998 version of the OECD Arrangement constitute "successor" undertakings to the OECD Arrangement in effect in 1979. It should be pointed out, in this regard, that the 1998 OECD Arrangement is the latest adopted version of the OECD Arrangement and, as such, is currently in effect, whereas the 1992 OECD Arrangement is no longer in effect. This raises the question of which successor undertaking is the relevant successor undertaking if there is more than one. The text of the second paragraph of item (k) does not explicitly answer that question.

5.81 We consider that the relevant successor undertaking is the most recent successor undertaking which has been adopted. It would not, in our view, have been rational for the drafters to consider, without specifying so, that, say, the fifth successor undertaking should be the relevant one. Indeed, the fact that the drafters used the simple and unqualified term "a successor undertaking" strongly suggests to us that they intended to incorporate, and thus give effect to, the relevant provisions of all adopted successor undertakings. This, however, would not logically be possible, unless effect is given also to the changes introduced by the most recent successor undertaking. On that basis, we find that, in the absence of other textual directives, the most recent successor undertaking is the relevant benchmark undertaking for purposes of the second paragraph of item (k), subject to the one condition that it must have been adopted.

5.82 Specifically with respect to the issue of whether the 1992 OECD Arrangement or the 1998 OECD Arrangement is the relevant successor undertaking, it should be noted that the 1992 OECD Arrangement as of 1995 and those Members parties to that Arrangement as of a later date.

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77 We do not, in any event, see what purpose would be served by drawing a legally relevant distinction, in the second paragraph of item (k), between those Members parties to a particular version of the 1992 OECD Arrangement as of 1995 and those Members parties to that Arrangement as of a later date.


79 For the 1998 OECD Arrangement, see its Introduction, p. 7 ("Status").

80 It is clear to us, however, that the drafters could not have left the addressees of the second paragraph free to choose among different successor undertakings. Were it otherwise, complainants could select the strictest successor undertaking with as much justification as respondents could select the most generous successor undertaking. The second paragraph would then fail to do what it is there to do, i.e. to inform Members regarding what their rights and obligations are.
Arrangement was in existence at the time the SCM Agreement was negotiated. Had Members intended the 1992 OECD Arrangement to be the relevant successor undertaking, they could simply have expressed that intention in the text of the second paragraph of item (k). It is significant, in our view, that they did not do so and instead chose to refer, broadly, to "a successor undertaking".

5.83 In view of the foregoing, we conclude that the "successor undertaking" at issue in the second paragraph of item (k) is the most recent successor undertaking which has been adopted prior to the time that the second paragraph is considered. For purposes of these proceedings, we conclude that the most recent successor undertaking which has been adopted is the 1998 OECD Arrangement.\(^8^1\)

5.84 In reaching our conclusion, we have carefully considered Brazil's assertion that to interpret the phrase "a successor undertaking which has been adopted" to refer, at the present time, to the 1998 OECD Arrangement leads to a result which is manifestly absurd and unreasonable. Specifically, while Brazil acknowledges that the safe haven in the second paragraph of item (k) is available both to Participants and non-Participants to the OECD Arrangement, it argues that this means accepting that a sub-group of Members -- the Participants to the OECD Arrangement -- could modify the scope of the second paragraph of item (k), and thus the exception it sets forth, by modifying the relevant provisions of the OECD Arrangement. In fact, Brazil contends, they would have carte blanche to "perpetually legislate on behalf of the overwhelming majority of the membership". But not only that - they could legislate in such a way as to accommodate their own preferences at the cost of the rest of the Members. Brazil submits that the Panel must avoid interpreting the second paragraph of item (k) to allow such a result.

5.85 We do not agree that the interpretation of the second paragraph of item (k) which we found to be the correct one and which is based on Article 31 of the Vienna Convention on the Law of Treaties "leads to a result which is manifestly absurd or unreasonable" within the meaning of Article 32 of the Vienna Convention.\(^8^2\)

5.86 It is true that, under our interpretation, the Participants to the OECD Arrangement could modify the 1998 OECD Arrangement, and thus effectively the scope of the safe haven in the second paragraph of item (k), without Members' consent.\(^8^3\) As the Article 21.5 Panel in Canada – Aircraft (hereafter "the Article 21.5 Panel") has remarked:

81 It should be reiterated here that the 1992 OECD Arrangement is no longer in effect.
82 Article 31(1) of the Vienna Convention reads:

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.

Article 32 of the Vienna Convention reads:

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) Leaves the meaning ambiguous or obscure; or
(b) Leads to a result which is manifestly absurd or unreasonable.

83 We are unable, however, to agree with the view of Brazil that this would amount to an impermissible circumvention of the regular process for amending WTO provisions. Members themselves have agreed to the provisions of the second paragraph of item (k) and to granting to the Participants to the OECD Arrangement, de facto, the power of modifying the scope of the safe haven. There can thus be no question of "circumvention" of the amendment provisions set forth in the WTO Agreement. Brazil further argues that our interpretation would have serious constitutional implications for Members such as Brazil that incorporate WTO rules into their
... 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.84

5.87 Like the Article 21.5 Panel, we find the provisions of the second paragraph of item (k) unusual. We further recognise that, as Brazil argues, the Participants to the 1998 OECD Arrangement could conceivably abuse their de facto power to modify the scope of the safe haven in a way which benefits them but does not equally benefit the rest of the WTO membership. 85

5.88 We consider, however, that the drafters of the second paragraph could well have considered that such a "delegation" was justifiable. They could have reached that conclusion on the basis, for instance, that the Participants, at the time, had greater expertise in the area of officially supported export credits. Similarly, they could have considered that it was inappropriate to "freeze" the scope of the safe haven in the light of the fact that the OECD Arrangement was -- and still is -- in a process of evolution.

5.89 We do not intend to express a view about the relative weight of these considerations. That is the task of the parties to a negotiation, not a dispute settlement panel. Our sole task is to consider whether the interpretation we have reached on the basis of customary principles of public international law is so outlandish as to be "manifestly absurd or unreasonable". As already mentioned, we think it is not.86

5.90 Assuming arguendo that Brazil was correct and our interpretation led to a manifestly absurd or unreasonable result, the consequence would be that we would be entitled to have recourse to supplementary means of interpretation, including the negotiating history. Based on the arguments the parties have presented in this regard, it seems to us that the negotiating history of the second paragraph of item (k) tends to confirm rather than undermine the conclusion we have reached on the basis of our application of Article 31 of the Vienna Convention.

domestic legal order, inasmuch as it would allow other governments to effect changes in Brazil's domestic law without Brazil's consent. We limit ourselves to observing, in this regard, that the WTO Agreement, once ratified, is binding on Members, whether they incorporate it into their domestic legal order or not (pacta sunt servanda). Even if Brazil had not incorporated the WTO Agreement, it would still be required to make changes to its domestic law if a modification of the scope of the second paragraph of item (k) so required. We do not, therefore, see great force in that argument.

84 Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.132.
85 Brazil refers to a passage in the Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.132, where the Article 21.5 Panel stated that:

... it is important that the second paragraph of item (k) not be interpreted in a manner that allows [the Participants to the OECD Arrangement] to create for [themselves] de facto more favourable treatment under the SCM Agreement than is available to all other WTO Members.

We agree with that statement. However, it must be noted that this statement does not support Brazil's position. In fact, the Article 21.5 Panel never referred to anything other than the 1998 OECD Arrangement. The Article 21.5 Panel made the above-quoted statement in a different context, namely in support of its interpretation of the concept of "conformity" with the interest rates provisions of the 1998 OECD Arrangement.

86 In any event, we must assume that the drafters were aware that the OECD Arrangement had undergone a number of changes pre-1995 (see Exhibit CDA-31) and, hence, were equally aware of the possibility of the scope of the safe haven being modified post-1995. Thus, this result in our view reflects a negotiated balance of rights and obligations, which is not for a panel to upset. If the Participants were to abuse their power to modify the scope of the safe haven, the recourse of other Members would be to renegotiate the second paragraph of item (k).
5.91 As noted by Canada, the 1979 GATT Subsidies Code contained a provision the wording of which was almost exactly identical to that of the second paragraph of item (k) as it appears in the SCM Agreement. Specifically, the 1979 GATT Subsidies Code also used as benchmarks the OECD Arrangement as in effect in 1979 or a "successor undertaking which has been adopted by those original signatories". Applying Brazil's interpretation of the SCM Agreement to the 1979 GATT Subsidies Code, the relevant "successor undertaking" for purposes of the 1979 GATT Subsidies Code would need to be one that "ha[d] been adopted" in 1979 or on 1 January 1980, when the GATT Subsidies Code came into force. However, neither in 1979 nor on 1 January 1980 was there a "successor undertaking". This confirms our view that the present perfect "has been adopted" cannot be read to refer to the drafters' present, i.e. 1 January 1980.

5.92 Brazil considers that the term "interest rates provisions" in the second paragraph of item (k) should be interpreted narrowly because that term, in and of itself, calls for a narrow interpretation. Brazil recalls, in this regard, that the second paragraph narrowly refers to the "interest rates provisions" of the OECD Arrangement, and not to the provisions governing the terms and conditions of export credits. On those grounds, Brazil disagrees with the Article 21.5 Panel in Canada – Aircraft (hereafter "the Article 21.5 Panel"), which, in its view, used a broad approach to identify the interest rates provisions of the 1998 OECD Arrangement. According to Brazil, the relevant interest rates provisions of the 1998 OECD Arrangement are those set forth in Articles 15 through 19 of the main text and Article 22 of Annex III on civil aircraft.

5.93 Canada argues that the interest rates provisions at issue in the second paragraph of item (k) include all those identified by the Article 21.5 Panel, that is to say, Articles 7-10 and 12-26 of the main text of the OECD Arrangement as well as Articles 18-24 and Articles 27-29(a)-(c) of Annex III. Canada also submits, however, that the term "interest rates provisions" arguably has a broader meaning than that given to it by the Article 21.5 Panel.

5.94 As to third parties, the European Communities understands the term "interest rates provisions" of the OECD Arrangement to refer to all provisions that may affect the interest rate of a transaction, that is to say, all provisions containing substantive rather than procedural obligations. The substantive provisions include those relating to the risk involved in a transaction. The European Communities also considers that the matching of supported rates in accordance with Article 29 of the OECD Arrangement is in conformity with the interest rates provisions of the OECD Arrangement. The United States submits that the term "interest rates provisions" encompasses all the terms and conditions of the OECD Arrangement. It would be illogical if a Member were unable to use the matching provisions of the key enforcement provisions of the OECD Arrangement for fear that such action might be deemed an export subsidy under the SCM Agreement.

5.95 The Panel notes that the parties disagree over the meaning of the term "interest rates provisions" as it appears in the second paragraph of item (k). We further note that this issue has been addressed recently and in great detail by the Article 21.5 Panel. Further, the parties have used the findings of that Panel as a point of reference for their arguments. We will therefore take the relevant findings of the Article 21.5 Panel as a starting point in our consideration of this issue.

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87 Brazil's argument that the term "successor undertaking" was included in the GATT Subsidies Code to refer to any possible action within the OECD between 1 January 1979, i.e. the effective date of the OECD Arrangement, and 1 January 1980, i.e. the effective date of the GATT Subsidies Code, is not convincing. Had the drafters intended to do so, they could have referred to the date of the entry into force of the GATT Subsidies Code. In fact, we believe they would have done so precisely to preclude an interpretation of the term "successor undertaking" which allows for the incorporation of successor undertakings which post-date the effective date of the GATT Subsidies Code.
The Article 21.5 Panel began its inquiry into what were the "interest rates provisions" of the OECD Arrangement by noting that, unlike the second paragraph of item (k), the OECD Arrangement did not use or define the term "interest rates provisions". 88 It was therefore incumbent on that Panel to construe the term "interest rates provisions". It found that the "interest rates provisions" of the OECD Arrangement were those provisions which "specifically" or "directly or explicitly" address interest rates "as such". 89 With that interpretation in mind, the Article 21.5 Panel turned to the OECD Arrangement to identify those provisions which were consistent with its interpretation of the term "interest rates provisions". It indicated that it would base its conclusions on a reading of the OECD Arrangement which was in accordance with the customary rules of interpretation of public international law and which, in particular, was consistent with the ordinary meaning of the text of the OECD Arrangement. 90

The Article 21.5 Panel concluded that the following provisions of the OECD Arrangement directly or explicitly pertain to interest rates as such: Article 15 (on minimum interest rates); Article 16 (on the construction of CIRRs); Article 17 (on the application of CIRR); Article 18 (on cosmetic interest rates) and Article 19 (on official support for cosmetic interest rates). 91 It pointed out, moreover, that the Sector Understanding on Export Credits for Civil Aircraft in Annex III to the OECD Arrangement contained additional "interest rates provisions". Specifically with respect to regional aircraft, the Article 21.5 Panel considered Articles 22 (on minimum interest rates with respect to new aircraft) and 28b) (on minimum interest rates with respect to used aircraft) of the Sector Understanding to constitute "interest rates provisions". 92

In the instant proceedings, neither Brazil nor Canada disputes that the provisions of the OECD Arrangement identified by the Article 21.5 Panel as pertaining directly or explicitly to interest rates as such are, in fact, "interest rates provisions" within the meaning of the second paragraph of item (k). 93 We, for our part, are of the view that all of those provisions are properly viewed as "interest rates provisions" within the meaning of that provision. 94

We note that Canada as well as two third-party participants -- the European Communities and the United States -- argue for a broader reading of the term "interest rates provisions". Concretely, the European Communities invites us to read the term "interest rates provisions" as meaning all of the "substantive provisions [of the OECD Arrangement] which can affect interest rates". 95 The United States, on the other hand, would have us understand the term "interest rates provisions" as a shorthand for "all of the terms and conditions of the Arrangement". 96

Like the Article 21.5 Panel, we consider that the term "interest rates provisions" is not readily susceptible of the broad meaning ascribed to it by Canada. As a matter of textual interpretation, we are not persuaded that any substantive provision of the OECD Arrangement, by the mere fact that it "affects" the minimum interest rates envisioned by the OECD Arrangement, ipso facto becomes an "interest rate" provision. Nor do we see a possibility of reconciling the specific term "interest rates provisions" with the view that "all" terms and conditions of the OECD Arrangement are interest rates provisions.

88 Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.83.
89 Ibid., paras. 5.83 and 5.91.
90 Ibid., paras. 5.83 and 5.91.
91 Ibid., 5.74 and 5.83.
92 Ibid., 5.83.
93 Ibid., 5.83 and 5.84.
94 See the parties' responses to Panel Question 25. The parties have not specifically discussed Article 28b) (on minimum interest rates with respect to used aircraft). There can be no question, in our view, that Article 28b) is an interest rate provision within the meaning of the second paragraph of item (k).
95 We consider that Article 19 of Annex III (on best endeavours to respect customary market terms) also directly addresses interest rates.
96 EC Submission, footnote 21 (Annex C-1).
97 US Submission, para. 23 (Annex C-3).
provisions. To accept that view would, in our opinion, be to disregard, even to render nugatory, the explicit textual reference to "interest rates" provisions. This we do not feel entitled to do.  

5.101 We further note that, if an expansive reading of the term "interest rates provisions" were adopted, then export credit practices with respect to which the 1998 OECD Arrangement establishes no minimum interest rates -- and with respect to which the Arrangement establishes no disciplines regarding interest rates -- would nevertheless be "in conformity with the interest rates provisions" of the 1998 OECD Arrangement. In our view, it is not possible to read the second paragraph of item (k) in such a manner that export credit practices which are not subject to the minimum interest rates set forth in the 1998 OECD Arrangement are nevertheless in conformity with the interest rates provisions of the Arrangement. 

5.102 In this respect, we agree with the Article 21.5 Panel that the only export credit practices which are subject to the interest rates provisions of the 1998 OECD Arrangement at present and which, therefore, are potentially "in conformity" with those provisions are those which are (i) in the form of "official financing support", i.e. direct credits/financing, refinancing or interest rate support, (ii) have repayment terms of at least two years and (iii) have fixed interest rates. It is only in respect of these categories of export credit practices that any minimum interest rates apply.

5.103 While the Article 21.5 Panel did not take a broad view of the term "interest rates provisions", it considered that adherence to the "interest rates provisions" alone was insufficient for export credit practices to qualify for the safe haven in the second paragraph of item (k). Brazil, however, contests that the safe haven clause contemplates compliance with any provisions of the OECD Arrangement other than its interest rates provisions. In the light of Brazil's challenge, it is appropriate to examine the reasons which support the view adopted by the Article 21.5 Panel.

5.104 The analysis of the Article 21.5 Panel is premised on the proposition that a requirement to apply minimum interest rates, as envisaged in the OECD Arrangement (and thus also in the safe haven clause), could not, in and of itself, place an effective limitation on the terms of official financing

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97 In declining to make an expansive reading of the term "interest rates provisions", we are mindful of the argument, advanced notably by the European Communities and the United States, that it would defeat the purpose of the safe haven in the second paragraph of item (k) to make eligibility for the safe haven conditional on conformity with nothing more than the interest rates provisions narrowly construed. We note, however, that the Article 21.5 Panel addressed this argument through a consideration of what it meant for a practice to be "in conformity with" the interest rates provisions of the OECD Arrangement. This issue is discussed at paras. 5.103 et seq.

98 Export credits benefiting from official support in the form of export credit insurance and guarantees, while subject to certain provisions of the 1998 OECD Arrangement, are not currently subject to any minimum interest rates. As explained by the Article 21.5 Panel, the implication of a broad interpretation of "interest rates provisions" is that official support for export credit insurance and guarantees would qualify for the safe haven even if the supported export credits were at interest rates below the minimum interest rates defined in the OECD Arrangement. See Article 21.5 Panel Report in Canada – Aircraft, supra, para. 5.137 and footnote 117. In addition, if export credit guarantees were covered by the safe haven, this would accord, de facto, more favourable treatment to developed country Members than to developing country Members. To appreciate this, it is necessary to recall that, through export credit guarantees, governments can effectively make their borrowing rates available to borrowers. However, the borrowing rates for developed country governments are generally lower than those of developing country governments. As a result, developing country Members -- to the extent no longer exempt from the export subsidy prohibition -- could never meet the financing terms secured by developed country Members through government guarantees. See Article 21.5 Panel Report in Canada – Aircraft, supra, para. 5.136. In our view, these implications do not support the broad interpretation of the term "interest rates provisions" advocated by the European Communities and the United States.

99 See Article 21.5 Panel Report on Canada – Aircraft, supra, paras. 5.81 and 5.106.

100 There is no need, however, to duplicate the reasoning of the Article 21.5 Panel. It is sufficient, for present purposes, to outline the main analytical steps of the approach followed by the Article 21.5 Panel.
support. The Article 21.5 Panel submitted that any financing transaction consisted of a package of financing terms and conditions, many of which affect the interest rate. Among these were the maximum repayment term, the amount of the cash down payment and the timing of principal and interest payments. The Article 21.5 Panel concluded on that basis that, if minimum interest rates were prescribed when no limitations existed for those terms and conditions which could affect the minimum interest rate, it would be easy to circumvent the limiting effect of that minimum interest rate. The Article 21.5 Panel pointed out, however, that the OECD Arrangement did impose limitations on the generosity of the terms which affect its minimum interest rates provision.

5.105 The safe haven clause, of course, only refers to the "interest rates provisions" of the OECD Arrangement, including its minimum interest rates provision. The Article 21.5 Panel recalled, however, that the safe haven clause spoke of "conformity with" the interest rates provisions of the OECD Arrangement. In the view of the Article 21.5 Panel, it was appropriate to adopt a sufficiently broad interpretation of the concept of "conformity" so as to guard against the possibility of circumvention of the minimum interest rates provision. More specifically, the Article 21.5 Panel considered that conformity with the interest rates provisions of the OECD Arrangement had to be judged on the basis of (i) conformity with the minimum interest rates provision, i.e. the CIRR, and (ii) adherence to those provisions of the OECD Arrangement which "operate to support or reinforce the minimum interest rate rule".

5.106 The Article 21.5 Panel then considered which provisions of the OECD Arrangement operate to support or reinforce the minimum interest rates provision. It concluded that the following provisions performed a supporting or reinforcing function in respect of the minimum interest rates provision: Article 7 (on minimum cash payments), Article 8 (on the definition of repayment terms), Article 9 (on the definition of the starting point of credit), Article 10 (on maximum repayment terms), Article 12 (on the classification of countries for maximum repayment terms), Article 13 (on the repayment of principal), Article 14 (on the payment of interest), Article 20, as well as the related Articles 21-24 (on minimum premium benchmarks), Article 25 (on local costs) and Article 26 (on the maximum validity period for export credits). With respect to regional aircraft, that Panel found that the following provisions of Sector Understanding on Export Credits for Civil Aircraft in Annex III to the OECD Arrangement also had to be respected, in addition to the minimum interest rates provision: Article 21 (on maximum repayment terms for new aircraft), Article 28 (on maximum repayment terms for used aircraft), Article 23 (on insurance premium and guarantee fees), Article 24 (on aid support), Article 29a-c) (on the financing of spare engines and spare parts) and Article 30 (on support for maintenance and service contracts). In identifying the above provisions, the Article 21.5 Panel stressed that not all of them would necessarily be applicable to every transaction enjoying official financing support.

5.107 The Article 21.5 Panel next considered various provisions of the OECD Arrangement which authorize exceptions and derogations from the aforementioned terms and conditions. Specifically, the issue was whether official financing support provided under those exceptions and derogations could be viewed as being "in conformity" with the interest rates provisions within the meaning of the safe haven clause. The Article 21.5 Panel stressed, in this regard, that the OECD Arrangement, by its own terms, "seeks to encourage competition among exporters … based on quality and price of goods and services exported rather than on the most favourable officially supported [export credit] terms" by placing "limitations on the terms and conditions of export credits that benefit from official support". See ibid., paras. 5.82 and 5.110.

101 Ibid., para. 5.109. The Article 21.5 Panel stressed, in this regard, that the OECD Arrangement, by its own terms, "seeks to encourage competition among exporters … based on quality and price of goods and services exported rather than on the most favourable officially supported [export credit] terms" by placing "limitations on the terms and conditions of export credits that benefit from official support". See ibid., paras. 5.82 and 5.110.
102 Ibid.
103 Ibid., para. 5.110.
104 Ibid.
105 Ibid., para. 5.114.
106 Ibid., paras. 5.116-5.117.
107 Ibid., para. 5.118.
108 Ibid., para. 5.119.
haven clause. The Article 21.5 Panel noted that the *OECD Arrangement*, by its terms, drew a distinction between "permitted exceptions" and "derogations". It found that permitted exceptions were "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was specifically foreseen and permitted. The Article 21.5 Panel thus concluded that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could qualify for the safe haven in the second paragraph of item (k).

5.108 With respect to derogations, on the other hand, the Article 21.5 Panel considered that they were not "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was not foreseen and not permitted. Accordingly, where official financing support "derogated" from one of the provisions which could affect the minimum interest rates provision, the underlying transaction would not be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could not qualify for the safe haven in the second paragraph of item (k).

5.109 The Article 21.5 Panel also addressed the so-called "matching" provisions of the *OECD Arrangement* which permit the Participants to the *OECD Arrangement*, within certain limits, to "match" the terms and conditions offered by other Participants and by non-Participants. On this issue, the Article 21.5 Panel took the view that matched permitted exceptions "conformed" with the provisions of the *OECD Arrangement* and, hence, also "conformed" with the interest rates provisions in the sense of the safe haven clause. In contrast, matched derogations were not "in conformity" with the provisions of the *OECD Arrangement* and, as a result, were also not "in conformity" with the interest rates provisions in the sense of the safe haven clause. The Article 21.5 Panel stated, in this regard, that, if it were accepted that matched derogations were "in conformity" with the interest rates provisions of the *OECD Arrangement*, then the concept of "conformity" could not possibly discipline official financing support. The Article 21.5 Panel also recalled that non-Participants to the *OECD Arrangement* would not, as a matter of right, have access to information regarding the terms and conditions offered or matched by Participants. Such information was available only to Participants. Thus, if matched derogations were eligible for the safe haven in the second paragraph of item (k), non-Participants would be at a systematic disadvantage vis-à-vis Participants.

5.110 Brazil argues that the approach taken by the Article 21.5 Panel is too broad and that the safe haven clause only requires conformity with the interest rates provisions of the *OECD Arrangement*, as identified by the Article 21.5 Panel. We disagree. The Article 21.5 Panel was correct, in our view, in its underlying assumption that the *OECD Arrangement* provides for minimum interest rates in order to discipline official financing support and that it was on the same grounds that the minimum interest rates provision was incorporated into the safe haven clause. We also agree that minimum interest
rates, on their own, could not meaningfully exercise a limiting effect. As we see it, the minimum interest rates were fixed, at a particular level, in the light of and with regard for the fixing of other relevant parameters, i.e. credit terms and conditions. The intended limiting effect of the minimum interest rates cannot, therefore, be achieved unless the relevant parameters are fully respected. Consequently, the Article 21.5 Panel was justified, in our view, in adopting a reading of the concept of "conformity with the interest rates provisions" which safeguards the intended limiting effect of the minimum interest rates provision of the OECD Arrangement by requiring adherence also to those terms and conditions of the OECD Arrangement which support or reinforce the minimum interest rates provision. We therefore conclude that eligibility of an individual financing transaction for the safe haven in the second paragraph of item (k) cannot be judged on the basis of conformity with minimum interest rates alone.

5.111 As concerns the list of provisions of the OECD Arrangement identified by the Article 21.5 Panel as reinforcing the minimum interest rates, we note that that list has not prompted specific comments by the parties, with two exceptions. Brazil considers that Articles 7 of the main text and 29a) of Annex III do not affect interest rates. Brazil argues that Article 7 (on minimum cash payments) affects the amount of the loan at issue, but not the interest rate. In our view, it may be expected that, all other things being equal, a borrower seeking 100 per cent financing will have to pay higher interest than a borrower which is prepared to put 15 per cent down. This will be especially true in cases where the financing is secured by the property being financed. In any event, there can be no doubt that Article 7 supports and reinforces the minimum interest rates provision as defined in the OECD Arrangement. Assuming the applicable minimum interest rate is the same, a borrower receiving an officially supported export credit which covers 100 per cent of the value of the export credit is better off than a borrower receiving an officially supported export credit which covers only 85 per cent of the value of the export credit. The disciplining effect of the minimum interest rate defined in the OECD Arrangement is not the same in each case.

5.112 With respect to Article 29a) (on financing of spare parts for aircraft), Brazil notes that that Article limits spare parts financing to 15 or 10 per cent of the value of the transaction and that this limitation does not affect the interest rate for the transaction. It should be noted that Article 29 distinguishes between financing for spare parts when ordered with aircraft and when not ordered with aircraft. In the latter case, spare parts may be financed for either 5 or 2 years.\(^{118}\) In cases where spare parts are ordered together with aircraft, the total order comprising the aircraft plus spare parts may be financed for 10 years (in the case of regional aircraft).\(^{119}\) In either situation, the minimum interest rate is the same.\(^{120}\) It may, in our view, be inferred from this distinction that financing at the minimum interest rate defined by the OECD Arrangement -- i.e. at the level of the relevant CIRR -- is "appropriate" in the case of spare parts not ordered with aircraft for 2 or 5 years. Seen in this light, we believe that Article 29a) is meant to prevent the "appropriate" rate for spare parts from being circumvented. For Article 29a) places a limit on the percentage of spare parts that may be financed at the "appropriate" rate for regional aircraft. Thus, we agree with the Article 21.5 Panel that Article 29a) operates to support or reinforce the minimum interest rate for spare parts not ordered with aircraft.

5.113 We also concur with the Article 21.5 Panel regarding the other provisions it identified as constituting provisions which operate to support or reinforce the minimum interest rates.\(^{121}\) In respect of these other provisions, it should be noted, however, that particularly the European Communities and the United States are of the view that the Article 21.5 Panel erred in concluding that financing

\(^{118}\) See Article 29b).
\(^{119}\) See Article 29a) in conjunction with Article 20 of Annex III.
\(^{120}\) See Article 15 and Article 22 of Annex III.
\(^{121}\) In our view, Article 19 of Annex III of the OECD Arrangement (on best endeavours to respect customary market terms) may also be viewed as being one of the provisions which operates to support or reinforce the minimum interest rates provision.
transactions involving matching of derogations were not eligible for the safe haven in the second paragraph of item (k). We find the reasoning of the Article 21.5 Panel in this regard persuasive. There is nothing in the arguments advanced by the two third parties which would give us grounds for deviating from the findings of the Article 21.5 Panel.

5.114 It seems to us that both third parties tend to argue -- incorrectly -- from the standpoint of the OECD Arrangement rather than from the standpoint of the safe haven clause and the SCM Agreement. The United States considers that it would be unfortunate if Participants to the OECD Arrangement were dissuaded from using its matching provisions for fear that doing so might be contrary to the provisions of the SCM Agreement. The United States appears to suggest that, deprived of the possibility of matching, Participants would somehow be left defenceless in the face of non-conforming practices under the OECD Arrangement. This is not the case, however. It notably overlooks the fact that, to the extent those non-conforming practices are covered by the SCM Agreement, they would be enforceable through the WTO dispute settlement mechanism.

5.115 The European Communities asserts that the reasoning on matching by the Article 21.5 Panel ignores the fact that the OECD Arrangement is a non-binding gentlemen's agreement. The Article 21.5 Panel was well aware of the nature of the OECD Arrangement. As we understand it, however, the Article 21.5 Panel based its view on the provisions of the SCM Agreement and the need to prevent the scope of the safe haven clause from being improperly enlarged. It convincingly stated that, to accept, for purposes of the SCM Agreement, that even non-conforming departures from the provisions of the OECD Arrangement were covered by the safe haven, would, in effect, remove any disciplines on official financing support for export credits. The European Communities contests that statement, arguing that the Participants to the OECD Arrangement consider matching to be compatible with effective disciplines on officially supported export credits. However, the fact that the OECD Arrangement allows matching of derogations does not logically imply that it should also be allowed under the SCM Agreement. Indeed, the OECD Arrangement and the SCM Agreement are very different. The European Communities itself acknowledges that the OECD Arrangement is a non-binding gentlemen's agreement. In those circumstances, matching may serve an important deterrent and enforcement function. That rationale for matching does not apply to the SCM Agreement. The SCM Agreement is a binding instrument, and it is enforceable through the WTO dispute settlement mechanism. The European Communities' argument is therefore unavailing.

5.116 What is more, the Article 21.5 Panel correctly noted that, if matching of derogations were not subject to challenge under the SCM Agreement, Members could, in principle, match the practices of non-Members. This would lead to the odd and unjustifiable result that a Member could justify the provision of an otherwise prohibited export subsidy on the basis of measures taken by a non-Member. Another argument advanced by the Article 21.5 Panel which the European Communities fails to mention is that matching could, de facto, lead to the elimination of special and differential treatment of developing country Members provided for in Article 27 of the SCM Agreement, in so far as export credit practices are concerned. To appreciate this, it is sufficient to recall the example given by the Article 21.5 Panel, whereby a developed country Member matches the subsidized terms of a developing country Member, even though those terms are in accordance with a provision according special and differential treatment to that Member, such as Article 27 of the SCM Agreement.

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122 It is worth noting here that, arguably, the findings of the Article 21.5 Panel in Canada – Aircraft did not, in any event, affect the provisions of the OECD Arrangement requiring notification to other Participants of non-conforming terms. Thus, if anything, Participants would be at an advantage vis-à-vis non-Participants in terms of their abilities of monitoring compliance with the SCM Agreement.
123 See Article 21.5 Panel Report in Canada – Aircraft, supra, para. 5.82.
124 See ibid., para. 5.137.
125 Ibid., para. 5.138.
126 Ibid., para. 5.136.
5.117 Finally, we note the European Communities’ view that the fact that non-Participants do not receive the notifications of non-conforming terms which Participants receive should not stop them from matching non-conforming offers. According to the European Communities, non-Participants could simply proceed to match if they did not receive adequate information from the party which they suspect of offering non-conforming terms. Even were we to accept this point, non-Participants would still be at a systematic disadvantage compared to Participants in all those situations where Participants notify other Participants, on their own motion, of non-conforming terms, as required by the *OECD Arrangement*. The European Communities’ point fails to dispose of this argument.

5.118 In conclusion, having carefully considered the reasoning of the Article 21.5 Panel and the arguments presented by the parties and third parties to these proceedings, we adopt the interpretation adopted by the Article 21.5 Panel of the phrase "in conformity with [the interest rates provisions of the *OECD Arrangement*]."

3. Examination of PROEX III

5.119 In the preceding Sections, we have considered a number of issues relating to the interpretation of the second paragraph of item (k). We must now consider whether, in the light of our resolution of those issues, PROEX III payments represent an export credit practice which is in conformity with the interest rates provisions of the 1998 *OECD Arrangement*.

(a) The Distinction between Mandatory and Discretionary Legislation in the Context of an Affirmative Defence

5.120 It will be recalled that we have found that it is the PROEX III scheme as such, i.e. the legal framework for PROEX III, which is before this Panel, and that, applying the distinction between mandatory and discretionary legislation, the question presented is whether Brazil is *required* to apply PROEX III in a manner that gives rise to a prohibited export subsidy. However, at this point in our analysis, we are dealing with an affirmative defence raised by Brazil under the second paragraph of item (k). Thus, we are confronted with the preliminary issue of whether the distinction between mandatory and discretionary legislation is applicable in the context of an affirmative defence under the second paragraph of item (k).

5.121 *Canada* contends that the distinction between mandatory and discretionary legislation is not applicable to the question of what a Member must do in order to invoke the second paragraph of item (k) as an affirmative defence. *Canada* contends that a Member invoking the second paragraph of item (k) must establish that its challenged actions are in conformity with the interest rates provisions of the *OECD Arrangement*. According to *Canada*, a demonstration that the Member's internal law allows it to act in conformity with the interest rates provisions of the *OECD Arrangement* would be insufficient. *Canada* notes that, given the presumption that a Member will act in accordance with its domestic legal requirements, one way for a Member to meet its burden would be to show that its internal law requires it to act in conformity with the interest rates provisions of the *OECD Arrangement*.

5.122 *Brazil* responds that, while it invokes the second paragraph of item (k) as an affirmative defence, the mandatory/discretionary standard has nothing to do with the burden of proof. Rather, it is a substantive standard. Once Brazil has established a *prima facie* case that PROEX III allows

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127 The European Communities considers that this would, in fact, be analogous to what is provided for in Article 53 of the *OECD Arrangement*. See EC Oral Statement, para. 22 (Annex C-4).

128 It is interesting to note, in this regard, that the United States appears to argue that the option pointed out by the European Communities is inadequate in that the United States would require even non-Participants to notify non-conforming terms to Participants. See US Submission, para. 24 (Annex C-3).

129 See para. 5.43.
compliance with the interest rates provisions of the OECD Arrangement, PROEX III should, under the traditional mandatory vs. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise.

5.123 The Panel considers that the distinction between mandatory and discretionary legislation is applicable in the context of the second paragraph of item (k). It is of course correct that, in the present context, we are concerned not with conformity with a WTO obligation, but with conformity with conditions attached to a WTO exception. This fact alone does not, however, render the GATT/WTO distinction between mandatory and discretionary legislation inapplicable or inappropriate. 130

5.124 In our understanding, the rationale underpinning the traditional GATT/WTO distinction between mandatory and discretionary legislation is that, when the executive branch of a Member is not required to act inconsistently with requirements of WTO law, it should be entitled to a presumption of good faith compliance with those requirements. We consider that that rationale is no less valid in the context of WTO exceptions than it is in the context of WTO obligations. Indeed, were we to take the opposite view, we would, in effect, create a situation where Members would be entitled to a presumption of good faith compliance with their WTO obligations, but not with the conditions attached to WTO exceptions. Such a situation would, in our view, be unwarranted and contrary to logic. 131

5.125 We have stated above that the Member invoking an exception as an affirmative defence has the burden of establishing it. In our view, the allocation of the burden of proof is a procedural issue 132 which is distinct from the substantive standard to be applied in assessing the conformity of legislation with a particular provision of the WTO Agreement. Simply put, the allocation of the burden of proof determines who must show something. On the other hand, the GATT/WTO distinction between mandatory and discretionary legislation determines what somebody must show. We believe the standard to be applied in judging the conformity of a piece of legislation with WTO requirements should be the same irrespective of who has the burden of adducing argument and evidence sufficient to establish a prima facie case of conformity.

5.126 Accordingly, the task before us is to examine whether, under PROEX III, Brazil is required to act in a manner that is not in conformity with the interest rates provisions of the 1998 OECD

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130 We are aware that the Article 21.5 Panel in Canada – Aircraft employed a different substantive standard in determining whether certain Canadian measures qualified for the safe haven of the second paragraph of item (k). Specifically, its inquiry focused on whether certain policy guidelines were sufficient to "ensure" the conformity of the future application of a Canadian subsidy programme with the second paragraph of item (k). See Article 21.5 Panel Report on Canada – Aircraft, supra, para. 5.141. Three observations should be made in this respect. First, the Article 21.5 Panel adopted the "ensure" standard on the basis that Brazil and Canada effectively agreed that this should be the applicable standard. In the present proceedings, the parties do not agree that this Panel should apply the "ensure" standard. Second, the Appellate Body, in reviewing the report of the Article 21.5 Panel, expressed some discomfort with the possible implications of applying a strict "ensure" standard. The Appellate Body considered that no Member could provide "a strict guarantee or absolute assurance as to the future application of [a measure] [...] since no one can predict how unknown administrators would apply, in the unknowable future, even the most conscientiously crafted compliance measure". See Article 21.5 Appellate Body Report on Canada – Aircraft, supra, para. 38. Third, we recall that the Article 21.5 Panel in Canada – Aircraft was reviewing a subsidy programme as applied, and not a subsidy programme as such. In the light of the foregoing, we think it would not be appropriate, in this case involving a challenge to the PROEX III programme per se, to require Brazil to demonstrate that it is "ensuring" that all future PROEX III payments in respect of regional aircraft will satisfy the requirements of the second paragraph of item (k).

131 It should be pointed out that the various exceptions provided for in the WTO Agreement are an integral and important part of the carefully negotiated balance of rights and obligations of Members.

132 We note the Appellate Body's view that "... the burden of proof is a procedural concept which speaks to the fair and orderly management and disposition of a dispute." (Original Appellate Body Report on Canada – Aircraft, supra, para. 198)
Arrangement\textsuperscript{133} or, expressed otherwise, whether PROEX III allows compliance with the interest rates provisions.\textsuperscript{134}

(b) Applicability of the Second Paragraph of Item (K)

5.127 As noted above, while the concept of "export credit practices" is a broad one, the only export credit practices that are subject to the interest rates provisions of the 1998 OECD Arrangement and thus potentially "in conformity" with those provisions are those which take the form of "official financing support", i.e. direct credits/financing, refinancing and interest rate support.\textsuperscript{135} Thus, in examining whether PROEX III allows compliance with the interest rates provisions of the 1998 OECD Arrangement, we must first consider whether PROEX III payments are "official financing support".

5.128 Brazil does not assert that PROEX III payments represent direct credits/financing or refinancing. It does, however, assert that PROEX III payments are interest rate support. Brazil recalls that the OECD Arrangement does not define "interest rate support". Brazil notes that the OECD Arrangement says that the Participants themselves do not agree on the definition of the term. Brazil also states that it has tried to find out from the OECD and OECD members what is meant by "interest rate support", but that it has not received any useful answers. Brazil argues that, in any event, PROEX III payments support the interest rate for a given transaction. Brazil considers, therefore, that they are a form of interest rate support within any reasonable definition of the term.

5.129 Canada does not specifically contest that PROEX III payments are interest rate support. It does, however, argue that PROEX III payments are significantly different from the interest rate support practices of the Participants to, and do not conform to the interest rates provisions of the 1998 OECD Arrangement. Canada points out, first, that the level of buy-down provided by PROEX III is divorced from the interest rate which prevails in the market when the transaction is approved. Canada notes, second, that interest rate equalisation normally varies according to the difference between the short-term interest rate during the period over which the financing is provided and the level at which the interest rate was fixed for the borrower. When the market rate is below the rate at which support was fixed, the financial institution would be required to pay back part of the interest rate support. Canada submits that PROEX III payments constitute a one-way flow from the government to a financial institution and there is no requirement to pay back part of the support depending on the market situation. Canada asserts, finally, that credit risk insurance or guarantee is usually provided in association with interest rate support, which is not the case under PROEX III.

5.130 Among third parties, the European Communities considers that "interest rate support" covers measures by which "official" bodies support interest rates without directly financing or refinancing transactions or providing guarantees or insurance. Because PROEX III is a government measure that allows the effective rate of interest to be lower than it would otherwise be, it is interest rate support. Korea contends that a government can provide interest rate support by buying down financing provided by a commercial lender, but declines to express a view as to whether PROEX III is

\textsuperscript{133} Were we to ask Brazil to establish that PROEX III requires Brazil to act in a manner consistent with the interest rates provisions of the 1998 OECD Arrangement, legislation governing export credit practices would need to set forth highly detailed, binding rules in order to benefit from the safe haven. Further, legislation that allowed Participants the discretion to match non-conforming terms offered by other Participants or non-Participants might also be WTO-inconsistent.

\textsuperscript{134} In a challenge to a particular application of legislation governing export credits, of course, the Member invoking the second paragraph of item (k) as an affirmative defence would have to show actual conformity with the interest rates provisions of the 1998 OECD Arrangement.

\textsuperscript{135} It is not in dispute that PROEX III is an "export credit practice" within the meaning of the second paragraph of item (k); that PROEX III is available for export credit financing for regional aircraft with repayment terms of two years or more; and that PROEX III applies in respect of export credits with fixed interest rates. We see no need to disagree with the parties regarding these points.
interest rate support. The United States notes that "interest rate support" refers to practices under which a government enters into an agreement on interest rates with a commercial bank that is providing the export credit financing for an export credit transaction, but is not sufficiently familiar with the facts to opine as to whether PROEX III payments, as applied, constitute interest rate support.

5.131 The Panel notes that the 1998 OECD Arrangement does not define the term "interest rate support". It merely states that "interest rate support" is a form of official financing support. Since the 1998 OECD Arrangement does not give a special meaning to the term "interest rate support", we must read it in accordance with its ordinary meaning in context.

5.132 We consider that, in its ordinary meaning, the term "interest rate support" relates broadly to official support for one particular export credit term, namely the interest rate to be paid in connection with export credits. Moreover, as a matter of relevant context, it is clear from the 1998 OECD Arrangement that interest rate support is distinct from direct credits/financing, refinancing, export credit insurance and guarantees. From this it may be deduced that official interest rate support will normally involve government payments to providers of export credits. For such payments to amount to "support", we think they need to be made with the aim or effect of securing net borrowing rates for the recipients of export credits which are lower than they would have been in the absence of official financing support.

5.133 Turning to PROEX III, we note that BCB Resolution 2799 envisages payments by the Government of Brazil to financial institutions "enough to render financing costs [i.e. net interest rates] compatible with those practiced in the international market." Thus, PROEX III provides for support for interest rates ("financing costs"), involves payments by the Brazilian Government to commercial providers of export credits and is designed to lower the net interest rates charged by particular commercial lenders to levels which are compatible with those prevailing in the international market. In light of this, we conclude that PROEX III support constitutes "interest rate support" as we understand that term.

5.134 The above considerations also lead us to conclude that PROEX III is an export credit practice subject to the interest rates provisions of the 1998 OECD Arrangement. Accordingly, PROEX III is potentially in conformity with the interest rates provisions of the OECD Arrangement.

(c) Conformity with the Interest Rates Provisions of the 1998 OECD Arrangement

5.135 The safe haven of the second paragraph of item (k) is available, by its terms, to Participants to the relevant undertaking on official export credits, i.e. the OECD Arrangement, as well as to those

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136 See the Introduction to the 1998 OECD Arrangement. In fact, notes to the 1992 OECD Arrangement indicate that "it has not proved possible to establish common definitions of interest rate and official support in light of differences between long-established national systems ..." See Article 24(m) 1992 OECD Arrangement. We see no indication in the text of the 1998 OECD Arrangement that these differences of view among Participants have been resolved.

137 See the Introduction and Articles 2 and 15 of the 1998 OECD Arrangement.


139 Canada argues that PROEX III payments are "significantly different from the interest rate support practices of the Participants" (Canada's Response to Panel Question 17; Annex A-4). Our task, however, is not to determine whether PROEX III is like practices of the Participants to the 1998 OECD Arrangement, but whether it involves interest rate support within the meaning of the Arrangement. As for Canada's argument that, whether or not PROEX III payments are interest rate support, they are not in conformity with the interest rates provisions of the 1998 OECD Arrangement, we will address this in the context of our examination of whether PROEX III allows Brazil to provide payments in conformity with those provisions.

140 Article 1 of BCB Resolution 2799. See also Article 1, paragraph 1 of the same Resolution, which specifically relates to interest rate equalisation for export financing operations involving regional aircraft.

141 None of the Participants in these proceedings has specifically contended that PROEX III is properly viewed as one form of "interest rate support".
Members that "in practice … appl[y] [its] interest rates provisions". Brazil is not a Participant to the 1998 OECD Arrangement, but claims that it will in practice apply the interest rates provisions of the Arrangement. We are satisfied, therefore, that PROEX III can, in principle, qualify for protection under the second paragraph of item (k) and that we may entertain Brazil's claim of justification under that paragraph.\textsuperscript{142} Canada has not suggested otherwise.

5.136 Accordingly, we proceed to analyse whether PROEX III, as such, is "in conformity with the interest rates provisions" of the 1998 OECD Arrangement. We will first turn to the interest rates provisions of the Arrangement and will then consider the Arrangement provisions supporting or reinforcing the interest rates provisions.

(i) Interest Rates Provisions\textsuperscript{143}

Article 22 of Annex III (on minimum interest rates)\textsuperscript{144}

5.137 Brazil argues that BCB Resolution 2799 has brought a significant change to the PROEX programme, in that it provides that interest rate support must not bring the net interest rate below the CIRR. According to Brazil, PROEX III thus uses the CIRR as a floor. Brazil considers that, by requiring that all PROEX III support "comply with"\textsuperscript{145} the CIRR, PROEX III conforms to Article 15 of the main text of the 1998 OECD Arrangement and Article 22 of Annex III thereof.

5.138 Canada does not dispute that BCB Resolution 2799 has revised PROEX II by adding the requirement that interest rate support must be established "in accordance with"\textsuperscript{146} the CIRR. Canada argues, however, that the phrasing "in accordance with" imposes no explicit prohibition on interest rate buy-downs to levels below the relevant CIRR.

5.139 The Panel recalls that Article 22 of Annex III requires the Participants providing official financing support, including interest rate support, to apply minimum interest rates. More specifically, the Participants are to "apply the relevant CIRR".\textsuperscript{147} Brazil submits that by promulgating Article 1, paragraph 1 of BCB Resolution 2799 it has met the requirements of Article 22. We agree, and so conclude, for the following three reasons.

5.140 First, Article 1, paragraph 1 explicitly refers to the "CIRR" published monthly by the OECD. Second, Article 1, paragraph 1 makes clear that the applicable or "relevant" CIRR is the CIRR "corresponding to the currency and maturity of the operation". And third, Article 1, paragraph 1 requires "compliance with" and, hence, "application" of the relevant CIRR.\textsuperscript{148}

\textsuperscript{142} We do not think that the mere fact that PROEX III has not yet been applied should preclude us from entertaining Brazil's claim under the second paragraph.

\textsuperscript{143} For the sake of convenience Article 19 of Annex III (on best endeavours) is discussed below under the heading "Provisions Supporting or Reinforcing the Interest Rates Provisions" even though it is also an interest rates provision within the meaning of the second paragraph of item (k).

\textsuperscript{144} The conformity of PROEX III with Article 28b) of Annex III (on minimum interest rates for used aircraft) is not specifically discussed here. However, we discuss the conformity of PROEX III with Article 28a) below under a separate sub-heading. Our findings under that sub-heading are applicable, mutatis mutandis, to Article 28b) as well. In any event, Article 28b), like Article 22 of Annex III, incorporates by reference the requirements of Article 15 of the main text of the 1998 OECD Arrangement.

\textsuperscript{145} Brazil translates the Portuguese phrase "respeitada a … CIRR" as "complying with" the CIRR.

\textsuperscript{146} Canada translates the Portuguese phrase "respeitada a … CIRR" as "in accordance with" the CIRR.

\textsuperscript{147} We note that Article 22 refers to Article 15 of the main text of the 1998 OECD Arrangement. Article 15 contains the general minimum interest rates provision. Its wording is essentially identical to that of Article 22 of Annex III, except that Article 15 spells out, in addition, the principles according to which the CIRRs are to be established. For purposes of the present examination, these principles are not relevant.

\textsuperscript{148} It is our understanding from Brazil's submissions that, notwithstanding the provisions of Article 8, paragraph 2 of BCB Resolution, the Export Credit Committee must comply with the CIRR in all cases involving
5.141 Canada disagrees with the last point, arguing that the wording of Article 1, paragraph 1 would not prevent Brazil from supporting net interest rates at below-CIRR level. The Portuguese version of BCB Resolution 2799 uses the words "respeitada a … CIRR", which Brazil translates as "complying with". We are satisfied that this is an accurate translation and also that this language requires Brazil to "respect" or "comply with" the relevant CIRR.\(^{149}\)

5.142 In any event, we recall that we are examining the consistency of the PROEX III scheme as such and that the question before us is, therefore, whether PROEX III allows compliance with the interest rates provisions of the 1998 OECD Arrangement. Even if Canada were correct that BCB Resolution 2799 did not require that net interest rates supported by PROEX III be at or above the CIRR, it certainly envisions that they will be. Thus, we cannot say that PROEX III does not allow compliance with Article 22 of Annex III.

Article 16 (on the construction of CIRRs) and Article 17 (on the application of CIRRs)

5.143 Brazil notes that Article 16 deals with the construction of CIRRs. Brazil points out, in this regard, that it does not construct CIRRs. Rather, Brazil explains, it follows and applies them, particularly the CIRR constructed by the United States for the dollar. With respect to Article 17a), Brazil argues that it is not relevant to PROEX III because PROEX III does not fix the interest rate. According to Brazil, Article 17b) is also not relevant because it deals with floating interest rates. Brazil recalls that PROEX III, by its terms, only applies to fixed rates.

5.144 Canada considers that Brazil has offered no evidence of conformity with Article 17. According to Canada, Article 17 contains important conditions on how to define the interest rate that is appropriate for a given transaction. Canada submits, in particular, that, given the expansive discretion enjoyed by the Government of Brazil, it can only be expected that Brazil would use this discretion in applying Article 17 and waive the 20 basis point margin to be added to the CIRR in cases where the terms of the official financing support are fixed before the contract date.

5.145 The Panel first turns to Article 16, which deals with the construction of CIRRs. There is no indication in the evidence on record that Brazil itself constructs CIRRs. Moreover, Article 1, paragraph 1 of BCB Resolution 2799 states that interest rate support for transactions involving regional aircraft must comply with the CIRR "published monthly by the OECD corresponding to the currency and maturity of the operation". Thus, Brazil simply adopts the relevant CIRR as published by the OECD. It also follows that Brazil uses the base rate system selected by the Participants for their own national currencies.\(^{150}\) For these reasons, we conclude that PROEX III is consistent with the provisions of Article 16.

5.146 Article 17 has two sub-paragraphs. Article 17a) states that the interest rate applying to a transaction shall not be fixed for a period longer than 120 days. It also requires that a margin of 20 basis points be added to the CIRR if the terms of the official financing support are fixed before the contract date.

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\(^{149}\) Canada translates the phrase "respeitada a … CIRR" as "in accordance with the CIRR". According to the Appellate Body, however, the expression "in accordance with" is synonymous with "in conformity with". See Appellate Body Report on Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para. 111. Thus, even accepting Canada's translation as accurate, BCB Resolution 2799 would be consistent with Article 22.

\(^{150}\) See Article 16d).
5.147 In reviewing PROEX III for conformity with Article 17(a), it must be borne in mind that, once the Export Credit Committee has approved a request for PROEX III support, a letter of commitment is issued to the applicant. As we explained in our previous Article 21.5 report, such a letter

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

5.148 PROEX III is not different from PROEX II with respect to the maximum period for offers of interest rate support. We therefore have no basis for finding, at this point, that offers of PROEX III support will not be in conformity with the 120-day maximum period laid down in Article 17(a).

5.149 We also found in our previous Article 21.5 report that applicants requested letters of commitment prior to conclusion of a formal agreement with the buyer. Assuming that remains the case, the minimum net interest rate Brazil could fix would be the relevant CIRR plus 20 basis points. It should be noted, in this regard, that Article 1, paragraph 1 of BCB Resolution 2799 requires that the CIRR be the floor rate. It does not oblige Brazil to approve interest rate support at the CIRR in all cases. In fact, it specifically states that the extent of the interest rate support to be provided is to be established "on a case-by-case basis". On its face, PROEX III is not, therefore, inconsistent with the provisions of Article 17(a). At a minimum, we cannot say that PROEX III does not allow Brazil to comply with this provision.

5.150 Article 17(b) applies to situations where official financing support is provided for floating rate loans. It provides that financial institutions must not be allowed to offer borrowers the option of the lower of either the CIRR, at the level prevailing on the date of the original contract, or the short-term market rate throughout the life of the loan. Brazil submits that PROEX III only applies to fixed rate export credits. We consider that this assertion is consistent with Article 1, paragraph 1 of BCB Resolution 2799, which, to recall, stipulates that PROEX III support must not reduce net interest rates below the CIRR level. This suggests to us that Brazil could not support export credits which entail the possibility, envisaged in Article 17(b), of net interest rates (temporarily) below the CIRR. We therefore agree with Brazil that Article 17(b) is not applicable to PROEX III. At a minimum, we cannot say that PROEX III does not allow Brazil to comply with this provision.

Articles 18 and 19 (on official support for cosmetic interest rates)

5.151 Brazil notes that Articles 18 and 19 concern cosmetic interest rates, which are rates below the CIRR. Brazil recalls that PROEX III sets the CIRR as the minimum interest rate. Brazil considers, therefore, that Articles 18 and 19 are not relevant to PROEX III.

5.152 Canada submits that, if PROEX III payments are interest rate support, Articles 18 and 19 are relevant to PROEX III.
5.153 The Panel agrees with Canada that Articles 18 and 19 apply to official financing support in the form of interest rate support. Interest rate support must not, therefore, be offered at cosmetic interest rates. Article 18 defines cosmetic interest rates as rates below the relevant CIRR which benefit from official support.

5.154 PROEX III does not allow for interest rate support to bring down net interest rates below the level of the relevant CIRR. PROEX III does not, in other words, allow Brazil to offer interest rate support at cosmetic rates. We are satisfied, therefore, that PROEX III is in conformity with the relevant provisions of Articles 18 and 19. At a minimum, we cannot say that PROEX III does not allow Brazil to comply with this provision.

(ii) Provisions Supporting or Reinforcing the Interest Rates Provisions

Article 7 (on minimum cash payments)

5.155 Brazil argues that according to Article 5 of Directive 374 interest rate support is limited to 85 per cent financing of the value of the sale. Brazil submits that this conforms to the requirements of Article 7. Brazil acknowledges that Article 8, paragraph 2 of BCB Resolution 2799 allows the Export Credit Committee to depart from the 85 per cent rule. Brazil contends, however, that the Committee may provide interest rate support based on more than 85 per cent of the export value of the sale only if the applicant in question can convince the Committee that this would be consistent with the terms prevailing in the international market. According to Brazil, the Committee is not obliged to deviate from the 85 per cent rule.

5.156 Canada submits that Brazil has failed to establish that PROEX III support is limited to 85 per cent of the value of the aircraft. Canada notes that Directive 374 is not a measure taken to revise PROEX II, but one that already applied to PROEX II. Canada considers that Article 5 of Directive 374 imposes only a nominal limitation, given that Brazil has the authority to waive the 85 per cent limit. Canada also refers to certain reported statements by Brazilian officials, among them a statement by Brazil's then-Foreign Minister Lampreia, reported in Brazil's press in the weeks before BCB Resolution 2799 was made operational, to the effect that Brazil would provide financing for 100 per cent of the value of the aircraft. Canada argues that these statements confirm that there will be waivers of the 85 per cent rule under PROEX III.

5.157 The Panel notes that Article 7 obliges the Participants to the 1998 OECD Arrangement to require purchasers of goods which are the subject of official support to make cash payments of a minimum of 15 per cent of the export contract value at or before the starting-point of credit. Both Canada and Brazil interpret Article 7 to require that official support for export contracts must not exceed 85 per cent of the export contract value. We see no need to disagree with that interpretation and, accordingly, conduct our analysis on that basis.

5.158 Brazil's claim of conformity with Article 7 is based, in the main, on Article 5 of Directive 374. Article 5 stipulates that the maximum percentage admitted for purposes of interest rate equalisation is 85 per cent of the export value under a contracted sale, limited to the financed part. Canada has not argued that Article 5 fails to satisfy the requirements of Article 7. For our part, we are satisfied that the provisions of Article 5 are not, as such, inconsistent with those of Article 7.

5.159 Brazil acknowledges that, notwithstanding the provisions of Article 5, the Export Credit Committee may approve requests for PROEX III support even if such support exceeds 85 per cent of the export contract value. According to Brazil, this discretionary power is granted to the Committee.

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157 See the first tiret of Article 19b).
158 See ibid.
159 See Article 1, paragraph 1 of BCB Resolution 2799.
under Article 8, paragraph 2 of BCB Resolution 2799. Brazil argues that, in accordance with the provisions of that Article, the Committee could -- but would not be required to -- approve interest rate support in excess of 85 per cent of the export contract value only if this were consistent with the terms prevailing in the international market.

5.160 We note that it is legally possible for Brazil to approve interest rate support exceeding the 85 per cent limit, but that Brazil is not obliged to do so. Thus, by necessary implication, PROEX III allows Brazil to comply with Article 7. In fact, the Export Credit Committee is required to adhere to the maximum percentage set forth in Article 5 of Directive 374 unless it affirmatively decides to use the discretion conferred on it under Article 8, paragraph 2 of BCB Resolution 2799.\textsuperscript{160}

5.161 This finding is unaffected by Canada's argument that Article 5 of Directive 374 existed already prior to PROEX III. Even if Article 5 did not, as Canada alleges, impose any disciplines in respect on PROEX II, we see no justification for assuming, on the basis of an alleged past practice, that Brazil will, much less that it is required to apply PROEX III in a manner inconsistent with Article 7.

5.162 Canada relies on public statements by certain Brazilian officials, as reported in the Brazilian press, for its claim that Brazil will not apply PROEX III in such a way that it will respect the requirements of Article 7. We do not preclude that official statements of a Member regarding how it intends to apply a programme could be relevant to an assessment of the WTO-consistency of that programme \textit{per se} to the extent they could be seen as committing the relevant Member under its domestic legal system to apply the programme in a certain manner. However, in our view, the statements referred to by Canada cannot properly be seen as legally committing the Government of Brazil to apply PROEX III in a particular manner. Nor do we understand Canada to so argue.\textsuperscript{161}

5.163 In conclusion, therefore, we find that PROEX III, as such, is in conformity with Article 7.

\textbf{Article 13 (on repayment of principal) and Article 14 (on payment of interest)}

5.164 Brazil is of the view that Article 13 does not contain mandatory provisions. Brazil submits, moreover, that, in any event, Article 4 of BCB Resolution 2799 conforms with the requirements of Articles 13 and 14 in that it provides for the calculation of the amounts due for equalisation purposes on a six-month basis, the issuance of NTN-I bonds also on a six-month basis and a maximum grace period of six months for the repayment of the principal sum.

5.165 Canada accepts that the Participants may have a certain amount of flexibility under Article 13 with respect to some aspects of the repayment schedule which may be used. According to Canada, Article 13 leaves Participants no flexibility, however, with respect to the timing of the first installment of principal. In this regard, Canada alleges that Article 2 of Directive 374 enables Brazil to approve transactions in which, contrary to Article 13, the first payment of principal is made more than six months after the starting point of credit. Canada further submits that Article 14 requires more than just the payment of interest on a six-monthly basis. Specifically, Canada notes that, to the extent

\textsuperscript{160} Canada does not argue that Brazil is required to depart from the provisions of Article 5 of Directive 374. It goes without saying that, if Brazil were to make use of that possibility, it would not be operating within the legal constraints imposed by the second paragraph of item(k).

\textsuperscript{161} The most pertinent statement submitted by Canada is that of the then-Foreign Minister of Brazil who is reported to have said, some time before PROEX III entered into force, that the maximum percentage of interest rate support would be 100 per cent. We agree with Canada that the Minister's statement, assuming it was accurately reported, suggests that Brazil does not intend to apply PROEX III in a manner that would comply with the safe haven. On the other hand, we note that the statement in question was made before PROEX III came into force and, hence, before Brazil formally claimed to be in conformity with its WTO obligations. We further note that the relevant comments were made by a Minister who was not in charge of the administration of PROEX and that they were apparently made to a journalist.
PROEX III is used to buy down risk premiums, Brazil would not be providing interest rate support as envisaged in Article 14.

5.166 The Panel recalls that Article 13 of the 1998 OECD Arrangement requires that the principal sum of an export credit must normally be repaid in equal and regular instalments not less frequently than every six months, with the first instalment to be made no later than six months after the starting point of credit. Article 14 of the 1998 OECD Arrangement stipulates that interest must not normally be capitalised during the repayment period, but must be paid not less frequently than every six months, with the first payment to be made no later than six months after the starting point of credit.

5.167 We recall that we have agreed with the Article 21.5 Panel in Canada – Aircraft that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be in conformity with the interest rates provisions of the 1998 OECD Arrangement. We note that Articles 13a) and 14a) provide that principal and interest "shall normally" be treated in a particular fashion. We further note that Article 49 of the 1998 OECD Arrangement, entitled "Permitted Exceptions: Prior Notification Without Discussion" includes notification of a Participant's intention "not to follow normal payment practices with respect to the principal or interest referred to in Articles 13 a), b) and 14 a)". Thus, we conclude that Brazil may be in conformity with the interest rates provisions of the 1998 OECD Arrangement even if it does not respect these provisions.

5.168 We agree with Canada that one element of Article 13a), the requirement that the first instalment of principal be made within six months after the starting point of credit, is subject to a non-derogation engagement under Article 27 of the 1998 OECD Arrangement. It thus is not a permitted exception. Canada alleges that Article 2 of Directive 374 enables Brazil to approve transactions which do not comply with this element of Article 13a). Canada does not, however, contend that Brazil is required to approve transactions that do not comply. Further, Canada does not address Article 3 of BCB Resolution 2799, which specifically requires that the principal of the underlying commercial export credit be repaid in six-monthly instalments and that the first instalment be made six months after one of certain specified events. In the absence of a response from Canada, we see no reason to reject Brazil's assertion that Article 3 of BCB Resolution 2799 may be applied consistently with Article 13a).

Articles 20–24 (on minimum premium benchmarks)

5.169 Brazil considers that the provisions of the 1998 OECD Arrangement on minimum premiums do not apply to interest rate support and are, therefore, not relevant to PROEX III. Brazil notes that

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162 See Section E.2(c) supra.
163 Article 49a(2) of the 1998 OECD Arrangement.
164 We note that Article 3 of BCB Resolution 2799 in any event appears to require that both principal and interest be repaid in six-month (or "semi-annual") instalments.
165 Article 2 of Directive 374 does not appear to place any limit on the grace period for principal which may be negotiated for exports.
166 Brazil has explained to us that Article 3 of BCB Resolution 2799, which post-dates Directive 374, limits any flexibility which exists under Article 2 of Directive 374. See Brazil's Comments on Canada's Response to Panel Question 16 (Annex B-6). We see no reason to disagree with Brazil on this point.
167 PROEX III stipulates that, depending on the case, the starting point of credit is the date of shipment or delivery of the goods, of the invoice, or of the commercial or financing contract. Article 9 of the 1998 OECD Arrangement provides that the starting point of credit "in the case of a contract for the sale of capital goods […] useable in themselves (e.g. locomotives)" is the date on which the buyer takes possession of the goods in his own country. We assume regional aircraft fall within the scope of this provision. The reference in PROEX III to the date of "delivery of the goods" is, in our view, consistent with the language of Article 9. As regards the other starting points contemplated under PROEX III, we consider that they would, likewise, be consistent with Article 9 to the extent that the relevant events do not occur after the delivery of the goods.
the language of Article 20 expressly omits interest rate support from the application of the minimum premiums. Brazil also points out that PROEX III does not provide protection to the lender for possible default by the borrower. Brazil considers that there is, therefore, no need for charging a premium.

5.170 Canada agrees that interest rate support is not covered by Article 20 because its provision does not remove the risk of non-repayment by the borrower for the lending institution. Canada also acknowledges that this risk can only be assumed when a government provides interest rate support in association with a guarantee or insurance in respect of the credit risk.

5.171 The Panel notes that Article 20 requires the Participants to the 1998 OECD Arrangement to charge the appropriate minimum premium rate when providing official support through direct credits/financing, refinancing, export credit insurance and guarantees. Article 20 conspicuously fails to include interest rate support in the categories of official support for which a minimum premium is to be charged. This raises the issue of whether this omission should be given meaning. No party or third party to these proceedings suggests that, under the 1998 OECD Arrangement, governments must necessarily provide interest rate support in conjunction with credit risk insurance or guarantees. This being so, it is not apparent why governments should be required to charge a premium when they do not assume an obligation to compensate exporters or financial institutions in the case of default by borrowers.\(^{168}\) In the light of this, we consider it implausible that the concept of interest rate support was omitted in Article 20 by inadvertence. We therefore conclude that interest rate support is not covered by the provisions of Article 20 or the other provisions dealing with the issue of minimum premiums, i.e. Articles 21-24.\(^{169}\)

5.172 Since we have found that PROEX III support constitutes interest rate support and since it has not been suggested that PROEX III requires the Government of Brazil to provide interest rate support in association with credit risk insurance or guarantees, we conclude that PROEX III is not subject to the provisions of Articles 20-24.\(^{170}\)

Article 25 (on local costs) and Article 26 (on maximum validity periods for export credit terms)

5.173 Brazil notes with respect to Article 25 that PROEX III does not provide for the financing of local costs. As concerns Article 26, Brazil considers that the maximum validity periods for lines of credits do not apply to interest rate support such as PROEX III.

5.174 Canada has not addressed the conformity of PROEX III with Articles 25 and 26.

\(^{168}\) For the same reason, we do not appreciate the European Communities' assertion that the provision of pure interest support amounts to a circumvention of the minimum premium provisions of the 1998 OECD Arrangement. See the European Communities' Response to Panel Question 27 (AnnexC-6).

\(^{169}\) It is important to note, however, as did the Article 21.5 Panel in Canada – Aircraft, that "[...] a transaction that involve[s] 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 [...] to be 'in conformity' with the interest rate provisions of the Arrangement." (Article 21.5 Panel Report on Canada – Aircraft, supra, footnote 103; emphasis added.)

\(^{170}\) The European Communities, in our view, mischaracterizes PROEX III when it asserts that it is the economic equivalent of an insurance or guarantee. See the European Communities' Response to Panel Question 27 (AnnexC-6) and also Canada's Comments on Brazil's Response to Panel Question 11 (Annex A-5). It is true that interest rate support under PROEX III may, in effect, reduce the risk of non-repayment by the borrower inasmuch as lower interest rates make it easier for the borrower to meet its obligation to repay the principal sum and pay interest. However, this kind of risk reduction is not at issue in Articles 20-24, which are not concerned with interest rate support. It is also very different from the kind of risk reduction associated with export credit insurance and guarantees. Unlike in the case of pure interest rate support, credit risk insurance or guarantees require a government to compensate the lender in case the borrower actually fails to repay the principal sum or pay interest. No such requirement is envisaged under PROEX III.
5.175 The Panel is not aware, and has not been made aware, of any requirement or authorization, under PROEX III, of official support for local costs. Article 25 on local costs is not, therefore, relevant to the issue of whether or not PROEX III is in conformity with the second paragraph of item (k).

5.176 As regards Article 26, we note that it lays down a six-month maximum validity period for individual offers of particular export credit terms. Assuming that Article 26 applies to interest rate support (a question we do not here decide), we see nothing in the legal instruments submitted to us which would require Brazil to fix the credit terms under PROEX III for a period exceeding six months. To the contrary, we recall that letters of commitment issued by the Export Credit Committee as a usual matter are valid for 90 days. We therefore have no basis for finding that PROEX III support will not be in conformity with the six-month maximum validity period laid down in Article 26.

Article 19 of Annex III (on best endeavours)

5.177 Brazil submits that Article 19 imposes a hortatory burden on Participants to use best endeavours to respect the terms of that chapter of Annex III which deals with new non-large civil aircraft. Brazil argues that PROEX III is in conformity with this article since it requires that the relevant CIRR be the minimum interest rate which may be offered.

5.178 Canada notes that Article 19 talks about the most generous terms that Participants may offer when providing official support. Canada is of the view that Brazil cannot, therefore, claim conformity with Article 19 on the sole basis that PROEX III requires a minimum interest rate of the CIRR.

5.179 The Panel notes that Article 19 has two sentences. The first sentence makes clear that the Participants to the 1998 OECD Arrangement must not offer more favourable terms than those set forth in the chapter of Annex III which deals with new non-large civil aircraft, specifically in Articles 21-24. For reasons which are explained under the relevant headings of our inquiry, we are satisfied that PROEX III does not envisage, much less require, that Brazil provide more generous terms than those permitted under Articles 21 (on maximum repayment terms), 22 (on minimum interest rates), 23 (on insurance premium and guarantee fees) and 24 (on aid support).

5.180 The second sentence of Article 19 requires the Participants to continue to respect "customary market terms" for the different categories of aircraft and to "do everything in their power" to prevent these terms from being eroded. In considering whether PROEX III "respect[s] the customary market terms" for regional aircraft, we must recall the provisions of Article 8, paragraph 2 of BCB Resolution. They instruct the Export Credit Committee to approve only those requests for PROEX III support which are consistent with "the financing terms practiced in the international market". We are of the view that this language is compatible with that of Article 19. With respect to the other

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171 See also our discussion above, at paras. 5.146-5.148, of Article 17 of the 1998 OECD Arrangement.
172 We recall that no letters of commitment have been issued under PROEX III in respect of regional aircraft. See Brazil's Response to Panel Question 10 (Annex B-5).
173 We note that Article 19 refers to the "provisions of this Chapter". The Chapter of which Article 19 is part is entitled "Scope" and does not discuss the "terms that Participants may offer". It seems to us, therefore, that the reference to "this Chapter" must be a reference to the Chapter entitled "Provisions for Export Credits and Aid", which includes Articles 21-24. That Chapter does address the terms which Participants may offer.
174 Article 19 is entitled "Best Endeavours", but in the operative text uses the term "shall". It is not necessary, for purposes of our inquiry, to take a position on whether Article 19 is mandatory in nature.
175 As we have explained above, we do not understand Article 8, paragraph 2 to use only "commercial" market terms as a benchmark. On the other hand, the ordinary meaning of the term "customary market terms" as it appears in Article 19 does not appear to be so limited either. In fact, it appears that, in practice, the "customary market terms" for regional aircraft are terms which result from some form of official support. See
requirement in the second sentence of Article 19 -- that Participants must do everything in their power to prevent an erosion of the customary market terms -- we think that Brazil, by promulgating Article 8, paragraph 2 of BCB Resolution 2799, has "done" enough to bring PROEX III, as such, in conformity with this requirement.

5.181 In view of the foregoing, we conclude that PROEX III, as such, is in conformity with the provisions of Article 19 of Annex III.

Article 21 of Annex III (on maximum repayment terms)

5.182 Brazil submits that PROEX III complies fully with the requirements of Article 21 of Annex III, which stipulates that the maximum repayment term for Category A aircraft, such as those of Embraer, is 10 years. Brazil argues that the basis for its assertion that the maximum length of the financing term under PROEX III is 10 years is the specific requirement to that effect in Directive 374 and the requirement of Article 1, paragraph 1 of BCB Resolution 2799 that interest rate equalisation must be provided in compliance with the CIRR as well as BCB Circular Letter 2881. Brazil notes that Article 8, paragraph 2 of BCB Resolution 2799 contains an exception. According to Brazil, that provision allows, but would not require, the Export Credit Committee to approve requests for interest rate support in excess of 10 years, if doing so would be consistent with the terms prevailing in the international market.

5.183 Canada considers that PROEX III is inconsistent with Article 21 of Annex III in that it allows for a repayment term in excess of 10 years for regional aircraft. Canada asserts that the limitations referred to by Brazil, specifically those in Directive 374, BCB Resolution 2799 and BCB Circular Letter 2881, are meaningless in the light of Brazil's admission that it can waive the 10-year requirement under the provisions of Article 8, paragraph 2 of BCB Resolution 2799. Canada notes that Brazil has admitted, in the first Article 21.5 proceedings, that, notwithstanding the fact that Directive 374 and BCB Circular Letter 2881 already existed at the time, the 10-year term was frequently waived for regional aircraft. Canada also refers to certain reported statements by Brazilian officials, among them a statement by Brazil's then-Foreign Minister Lampreia, reported in Brazil's press in the weeks before BCB Resolution 2799 was made operational, to the effect that there would be no limits on the length of terms. Canada argues that these statements provide confirmation of the fact that there will be waivers of the 10-year maximum financing term under PROEX III. Canada submits, finally, that Brazil's actual practice confirms its non-conformity with the 10-year requirement. Canada alleges that, in two recent cases, Brazil offered financing support through Embraer that did not respect the 10-year maximum term.

5.184 The Panel notes that Article 21 of Annex III provides that the maximum repayment term for Category A aircraft is 10 years. It is common ground that Brazilian regional aircraft fall within Category A. Both Brazil and Canada have construed the provisions of Article 21 -- in the context of these proceedings concerning PROEX III -- as placing a limitation on the amount of time for which interest rate support may be granted. We consider it appropriate to adopt that interpretation for purposes of our analysis.

5.185 We begin our analysis with Article 3, paragraph 1, sub-paragraph II of Directive 374. According to that provision, the term for interest rate equalisation may not exceed the maximum term indicated for the good in the annex to Directive 374. The annex in question specifies, in relevant part, Brazil's Response to Panel Question 4 (Annex B-5). This reinforces our view that Article 8, paragraph 2 is not, as such, inconsistent with Article 19.

176 We note that Article 10 of the main text of the 1998 OECD Arrangement also contains rules on the maximum repayment term. However, pursuant to Article 3c) of the 1998 OECD Arrangement, Annex III of the OECD Arrangement prevails where it contains a corresponding provision. We believe Article 21 of Annex III is a corresponding provision within the meaning of Article 3c). There is, therefore, no need separately to examine the conformity of PROEX III with Article 10.
that the maximum financing term for aeroplanes (HS code 8802, except 8802.11 and 8802.20) is 120 months, i.e. 10 years. This, in our view, is fully consistent with Article 21 of Annex III. As an additional matter, it is worth pointing out that the other provisions relied on by Brazil, that is to say, Article 1, paragraph 1 of BCB Resolution 2799 and BCB Circular Letter 2881, support that conclusion, albeit indirectly.\textsuperscript{177}

5.186 Article 8, paragraph 2 of BCB Resolution 2799 allows, but does not require, the Export Credit Committee to approve requests for interest rate support with maximum terms exceeding 10 years, provided that this is consistent with the terms prevailing in the international market. Thus, Brazil could, in our view, apply PROEX III in such a way that it would respect the 10-year maximum term in all cases, simply by declining to use its discretion to waive the 10-year maximum term set forth in Directive 374.

5.187 We note that, in accordance with Article 3, paragraph 2 of Directive 374, the term for equalisation payment referred to in Article 3, paragraph 1, sub-paragraph II (on maximum equalisation terms) "may be extended" up to a maximum of 96 months, depending on the unit value of the good in the place of shipment. The parties differ regarding the meaning of Article 3, paragraph 2. It is not necessary for us to take position on this issue. Even if Article 3, paragraph 2 allowed Brazil to extend the maximum term of interest rate support for regional aircraft by a maximum of 8 years beyond the 10-year maximum found in the Annex to Directive 374, it is quite clear that that provision does not require Brazil to grant extensions.\textsuperscript{178} Thus, the mere existence of Article 3, paragraph 2 of Directive 374, assuming that it allows extensions of the maximum equalisation terms, does not warrant the conclusion that PROEX III, as such, is not in conformity with Article 21 of Annex III.

5.188 Canada submits that, in the recent past, Brazil frequently waived the requirements set forth in Article 3, paragraph 1, sub-paragraph II, as well as under BCB Circular Letter 2881, which, in Canada's view, establishes that those requirements impose no real discipline. Even if these requirements were waived in the past, we see no justification for assuming, on the basis of an alleged past practice, that Brazil will, much less that it is required to apply PROEX III in a manner inconsistent with Article 21 of Annex III.\textsuperscript{179}

5.189 Canada considers that indications already exist as to how PROEX III will be applied. In support of this contention, Canada refers to a number of press reports and reported statements by Brazilian officials. According to one such statement, attributed to the then-Foreign Minister of Brazil, Brazil will not respect the 10-year maximum term for interest rate equalisation. As we have stated, when addressing Article 7 of the 1998 OECD Arrangement, we do not preclude that official statements of a Member regarding how it intends to apply a programme could be relevant to an assessment of the WTO-consistency of that programme per se to the extent they could be seen as committing the relevant Member under its domestic legal system to apply the programme in a certain manner. However, in our view, the statements referred to by Canada cannot properly be seen as legally committing the Government of Brazil to apply PROEX III in a particular manner. Nor do we understand Canada to so argue.

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\textsuperscript{177} Article 1, paragraph 1 of BCB Resolution 2799 refers to the relevant CIRR. Both parties agree that there is currently no CIRR for loan terms in excess of 10 years. To that extent, Brazil is correct that, as a practical matter, Brazil could not offer financing in excess of 10 years \textit{at the CIRR level}. With respect to BCB Circular Letter 2881, it is sufficient to note that it is consistent with Brazil's contention that there is a 10-year maximum term for interest rate equalisation. We need not decide here whether Circular Letter 2881, on its own, imposes limits the maximum term for equalisation. In fact, we note that Article 4, paragraph 1 of BCB Resolution 2799 states that the maximum terms for equalisation are to be established by means of a Ministerial Directive. Circular Letter 2881 does not appear to constitute a Ministerial Directive.

\textsuperscript{178} Article 3, paragraph 2 uses the phrase "may be extended".

\textsuperscript{179} See also our findings concerning the conformity of PROEX III with Article 7 of the 1998 OECD Arrangement, which address the same issue.
5.190 We are left, then, with Canada's allegation that, in two recent cases, Brazil has offered interest rate support, through Embraer, on terms which do not satisfy the requirements of Article 21 of Annex III. Brazil states that it has not issued any letters of commitment under PROEX III with respect to regional aircraft and that the Government of Brazil is not responsible for what sales persons from Embraer may or may not "offer" to prospective buyers of regional aircraft. We recall our finding that Brazil has not, under PROEX III, issued any letters of commitment concerning regional aircraft. Canada has not contested these statements, much less offered any evidence to the contrary. Nor has Canada provided any evidence that the Government of Brazil, as opposed to Embraer sales representatives, has otherwise "offered" interest rate support under PROEX III for terms in excess of 10 years.\(^{180}\) Canada has, therefore, failed to establish that PROEX III has been applied, in two recent cases, in a manner inconsistent with Article 21 of Annex III.\(^{181}\)

5.191 For the reasons set forth above, we conclude that PROEX III, as such, meets the requirements of Article 21 of Annex III.

**Article 23 of Annex III (on insurance premium and guarantee fees) and Article 24 of Annex III (on aid support)**

5.192 Brazil submits that the provisions of Article 23 do not apply to PROEX III, because it does not involve guarantees. Brazil also notes that PROEX III does not contain provisions permitting aid support.

5.193 Canada does not specifically address the conformity of PROEX III with Articles 23 and 24.

5.194 The Panel recalls that there is nothing in the record which would indicate that PROEX III support will include credit risk insurance or guarantees or that it will be used for aid purposes.\(^{182}\) For that reason, Articles 23 and 24 of Annex III are not, in our view, relevant to our examination of PROEX III.

**Article 28a) of Annex III (on used aircraft)**

5.195 Brazil argues that PROEX III does not contemplate the issue of used aircraft or the possibility of PROEX III support for used aircraft sales. Brazil states that it is not aware that the Brazilian industry has made any sales of used aircraft and points out that no PROEX commitments have been made to support sales of used aircraft. In the view of Brazil, Articles 27 and 28 are not, therefore, relevant to PROEX III.

5.196 Canada submits that, as the regional aircraft market matures, it is possible that Brazil could be in a position to market used aircraft in the future. Canada considers that Articles 27 and 28 would be relevant to PROEX III.

5.197 The Panel notes that, on its face, PROEX III does not specifically envisage supporting export financing operations involving used regional aircraft. The Panel also takes note of Brazil's statement that no PROEX commitments were made in the past in respect of export sales of used aircraft. Canada has offered no evidence to the contrary. It is true, as Canada points out, that Brazil could, in the future, be in a position to sell used regional aircraft. However, until and unless it does so, we do

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\(^{180}\) Canada has provided us with sworn declarations of people who claim to know about the terms offered by Embraer in the relevant sales campaigns involving regional aircraft.

\(^{181}\) We recall our finding that we cannot review the practice involving PROEX III payments because Brazil has not issued any letters of commitment under PROEX III in respect of regional aircraft. See Section A supra. It is precisely for this reason that our review is restricted to PROEX III as such.

\(^{182}\) See Brazil's Comments on Canada's Response to Panel Question 24 (AnnexB-6).
not think Brazil is obliged, at this point, to establish the conformity of PROEX III with Article 28a) of Annex III.\textsuperscript{183}

Article 29a) of Annex III (on spare engines and spare parts ordered with aircraft)

5.198 **Brazil** points out that Article 6 of Directive 374 permits applicants to include spare parts financing in their application for equalisation support and gives the Export Credit Committee the discretion to finance up to 20 per cent of the spare parts included in a transaction. Brazil argues, however, that the Committee is not required to do so and will not do so with respect to regional aircraft because of the insignificant percentage of the value of the spare parts included in regional aircraft export sales. Brazil considers, therefore, that Article 6 conforms to the requirements of Article 29a).

5.199 **Canada** submits that Article 6 of Directive 374 allows for financing of up to 20 per cent for spare parts, whereas Article 29a) limits financing for spare parts to a maximum of 15 per cent of the aircraft price for the first five aircraft and to 10 per cent for the sixth and subsequent aircraft. Canada considers, therefore, that Article 6 explicitly exceeds the limit laid down in Article 29a). Canada also asserts that, in any event, Brazil regularly uses its discretion to waive the limits on PROEX.

5.200 The Panel notes the provisions of Article 29a), according to which spare engines and spare parts, when ordered with aircraft, may be financed on the same terms as the aircraft.\textsuperscript{184} However, Article 29a) makes this possibility subject to the requirement that account be taken of the size of the fleet of each aircraft type. Accordingly, for the first five aircraft of a particular type in the fleet, financing of spare engines and spare parts may be provided up to an amount equivalent to 15 per cent of the aircraft price. For the sixth and subsequent aircraft of that type in the fleet the financing of spare engines and spare parts must not exceed an amount equivalent to 10 per cent of the aircraft price.

5.201 The parties disagree over whether PROEX III, and in particular Article 6 of Directive 374, is consistent with the provisions of Article 29a). Article 6 states:

Parts and spares may be included in a transaction, in a consolidated form, up to a limit of twenty percent (20%) of the aggregate value of the other goods.

5.202 As an initial matter, we note that Brazil does not contest that Article 6 applies to the financing of spare parts for regional aircraft. We further note that the provisions of Article 6, on their face, set a maximum percentage for spare parts financing which exceeds that set out in Article 29a), no matter what the size of the fleet of a given aircraft type. Brazil does not dispute this either. Instead, it argues that Article 6 is a discretionary provision. According to Brazil, Article 6 gives the Export Credit Committee the discretion to approve spare parts financing equivalent to a maximum of 20 per cent of the aircraft price, but does not require it to do so.

5.203 In considering this issue, we focus on the phrase "may be included in a transaction". It is clear to us that the "transaction" at issue in Article 6 is the transaction for which PROEX III support is sought. The characteristics of the transaction for which PROEX III support is requested are

\textsuperscript{183} We note that Article 27 of Annex III states that certain of the provisions dealing with new non-large aircraft are applicable also to used non-large aircraft. However, since Brazil has not been shown to support or to envisage supporting export credits for used aircraft, it is not required, at this point, separately to establish the conformity of PROEX III with those provisions.

\textsuperscript{184} Sub-paragraphs b) and c) of Article 29 deal with new spare engines and spare parts which are not ordered with aircraft. As Canada's complaint is directed at those parts of the PROEX III programme which relate to the financing of exports of regional *aircraft*, we need not examine the conformity of PROEX III with these provisions. Article 29c) is, in any event, not relevant to these proceedings since it deals with new spare engines for *large* rather than *regional* aircraft.
negotiated by the exporter and the buyer. They decide whether or not to “include” spare parts in a transaction. Article 6, as we understand it, makes clear that transactions for which PROEX III support is requested may include spare parts and are thus eligible, in principle, for PROEX III support. It is also apparent from Article 6 that if transactions include spare parts worth in excess of 20 per cent of the price of the principal good of the transaction, they are not eligible for PROEX III support. Thus, we are not convinced that the Committee could, on the basis of Article 6, refuse to approve a request for PROEX III support for a transaction which includes spare parts worth up to 20 per cent of the price of the principal good in question.

5.204 We recall, however, Brazil’s uncontested statement to the effect that the Export Credit Committee has discretion regarding whether or not PROEX III support is provided, even where a request for PROEX III support meets all applicable eligibility criteria. It follows that the Committee could deny PROEX III interest rate equalisation in cases where the value of the spare parts exceeded the maximum percentage set forth in Article 29a).

5.205 We therefore conclude that PROEX III, as such, does not require Brazil to act in a manner that is not in conformity with Article 29a).

4. Conclusion

5.206 For the foregoing reasons, we conclude that PROEX III, as such, allows Brazil to act in conformity with the 1998 OECD Arrangement. Thus, Brazil has successfully invoked the safe haven provided for in the second paragraph of item (k) in respect of PROEX III as such.

5.207 It should be emphasized that the scope of our ruling is limited to PROEX III as such. We do not express any view as to whether the actual provision of PROEX III interest rate equalisation payments in respect of regional aircraft will benefit from the safe haven in the second paragraph of item (k).

5.208 We have concluded thus far that PROEX III, as such, is not inconsistent with Article 3.1(a) of the SCM Agreement and that it is, in any event, justified under the safe haven in the second paragraph of item (k). Therefore, we could exercise judicial economy and thus not examine Brazil’s alternative defence under the first paragraph of item (k). We recall, however, that this is the second time we are called on to review Brazil’s measures to comply with the recommendations and rulings of the DSB. In these circumstances, we consider that providing a complete resolution of the issues before us will not only assist the parties in achieving a full and effective solution to this dispute, but will also facilitate the Appellate Body’s task in case this Panel Report is appealed.

F. FIRST PARAGRAPH OF ITEM (K)

5.209 It will be recalled that Brazil argues that even if PROEX III constituted an export subsidy within the meaning of Article 3.1(a) of the SCM Agreement, PROEX III would nonetheless not constitute a prohibited export subsidy. We have completed our analysis of Brazil’s first affirmative claim in its defence, i.e. Brazil’s claim that PROEX III is covered by the safe haven of the second paragraph of item (k). We now examine Brazil’s other affirmative claim in its defence, which relies on the provisions of the first paragraph of item (k) of the Illustrative List.

1. General

5.210 Brazil argues that, even if PROEX III constituted an export subsidy within the meaning of Article 3.1(a) of the SCM Agreement, and even if it were not covered by the “safe haven” of the

185 See Brazil’s Response to Panel Question 5 (Annex B-5). For a discussion of the discretionary features of PROEX III see Section D.2(b)(iv) supra.
second paragraph of item (k), it would nevertheless not be prohibited because PROEX III payments do not secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k). Brazil accepts that, for this defence to succeed, it must establish (i) that the first paragraph of item (k) may be used to establish that PROEX III is not a prohibited export subsidy (possibility of an a contrario interpretation of the first paragraph), (ii) that PROEX III payments are payments within the meaning of the first paragraph of item (k) and (iii) that PROEX III payments are not used to secure a material advantage in the field of export credit terms.

5.211 Canada rejects Brazil's defence under the first paragraph of item (k). Canada agrees, however, that it is up to Brazil to make a prima facie case with respect to each of the three elements referred to by Brazil. Canada also invites the Panel to make detailed findings in respect of all three elements in order to facilitate the effective resolution of the present dispute.

5.212 The Panel recalls that the first paragraph of item (k) identifies as an export subsidy:

The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms. (emphasis added)

5.213 Brazil submits that PROEX III payments are payments by the Government of Brazil "of the costs incurred by exporters or financial institutions in obtaining credits". Brazil maintains, however, that PROEX III payments are not "used to secure a material advantage in the field of export credit terms" and that, therefore, they are not prohibited export subsidies.

5.214 In our view, Brazil's claim presents three issues. First, is Brazil correct, as a legal matter, that the first paragraph of item (k) may operate as an affirmative defence? Second, are PROEX III payments "payments" within the meaning of the first paragraph of item (k)? Third, are PROEX III payments used to secure a material advantage in the field of export credit terms? We agree with the parties that, if Brazil is correct that the first paragraph of item (k) may operate as an affirmative defence, then Brazil would have the burden of proof with respect to the latter two issues. We further note that, if Brazil is unsuccessful with respect to any of the three issues presented, Brazil's alleged affirmative defence must fail.186

2. Payment of the Costs Incurred in Obtaining Credits

5.215 We first examine whether Brazil has demonstrated that PROEX III payments are payments within the meaning of the first paragraph of item (k).

5.216 Brazil contends that PROEX III payments are "payments" within the meaning of the first paragraph of item (k). Brazil further argues that the language "payment of [...] the costs incurred by exporters or financial institutions in obtaining credits" contemplates that exporters and financial institutions "obtain" credits. Neither exporters nor financial institutions, however, "obtain" credits simply to hoard them. In Brazil's view, both "provide" to export purchasers the credits they have previously "obtained". Brazil considers that the first sentence of the first paragraph of item (k) supports this view. That sentence deals with the grant by governments "of export credits at rates below those which they actually have to pay for the funds so employed". Brazil argues that, just as the use of the term "export credits" in the first part of the first paragraph of item (k) justifies an

186 See Article 21.5 Appellate Body Report on Brazil – Aircraft, supra, para. 58.
interpretation of "credits" as meaning the same in the latter part, so the reference to "the funds so employed" in the first part justified an interpretation of the word "obtaining" in the second part as meaning "obtaining the funds [that are] so employed" when they are subsequently provided to export purchasers.

5.217 Brazil argues that the Government of Brazil, in making PROEX III payments, bears all or part of the costs incurred by exporters or financial institutions in obtaining credits. According to Brazil, in situations where the lending institution is outside of Brazil, PROEX III offsets, at least partially, the costs faced by Embraer, the Brazilian exporter, in obtaining for its customer a financial package that is competitive in the market. On the other hand, in situation where the lending institution is in Brazil, it is, in Brazil's view, the bank in Brazil itself which must obtain dollars in the market in order to provide dollar credits. PROEX III payments offset, at least in part, the added costs faced by Brazilian institutions in obtaining the credits they provide. Therefore, in Brazil's view, PROEX III is covered by the first paragraph of item (k).

5.218 Canada notes that the "payment" clause in the first paragraph of item (k) refers to situations where an exporter or a financial institution incurs costs by obtaining credits at rates higher than those at which it lends to a purchaser, and a government pays for all or part of this difference. According to Canada, PROEX III payments are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases. In Canada's view, they are simply cash grants made for the benefit of purchasers of Brazilian exported regional aircraft. As such, they are not "payments" within the meaning of the first paragraph of item (k).

5.219 Canada further submits that PROEX III payments are available to purchasers even when they finance their purchases outside Brazil and through non-Brazilian banks. In such instances, any "payments" by Brazil do not cover the cost incurred by a financial institution or an exporter in "obtaining credits". Canada adds that, even if financing is offered by Brazilian financial institutions, PROEX III payments are made to reduce interest rates below market rates, rather than to reimburse an exporter or a financial institution for costs incurred in obtaining credits. Canada submits that there is no evidence that PROEX III payments reimburse an exporter or financial institution for anything.

5.220 Among the third parties, the European Communities considers that the interpretation of the "payment" clause should not turn on who formally receives the payment or incurs the cost. The European Communities considers that such an approach would allow circumvention of the disciplines. According to the European Communities, the purpose underlying item (k) is to avoid distortions of competition arising out of export credit practices. Therefore, in the view of the European Communities, it is the attractiveness of the package for the buyer that is important, not the details of the payments between the actors involved. The United States believes that interest rate buy-downs such as PROEX III fall within the scope of the "payment" clause. For the United States, the intent of the "payment" clause is to reduce the risk to the exporter or financial institution lending money to a borrower. The United States submits that buying down interest rates reduces the risk incurred by the exporter or financial institution, which, in turn, results in lower lending costs. The savings thus gained by the exporter or financial institution constitute the "payment" within the meaning of the first paragraph of item (k).

5.221 The Panel recalls that the "payment" clause of the first paragraph of item (k) reads as follows:

… the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits …

5.222 In the previous Article 21.5 proceedings, we said the following in respect of the meaning of the "payment" clause:
… we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to obtaining export credits, and not costs relating to providing them.

[...]

Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so.\(^\text{187}\)

5.223 Based on this interpretation, we found that the financial institutions involved in financing PROEX-supported transactions provided export credits, but that they could not be seen as obtaining export credits. We therefore concluded that PROEX II payments were not "payments" within the meaning of the first paragraph of item (k). That conclusion remains correct also with respect to payments under PROEX III.

5.224 In the present proceedings, however, Brazil submits that our interpretation of the "payment" clause was incorrect and that the clause should instead be construed to refer to the "payment of … the costs incurred by exporters or financial institutions in obtaining the [export] credits [they provide to borrowers]".\(^\text{188}\) Brazil argues that, thus interpreted, the "payment" clause covers PROEX III payments.

5.225 For purposes of resolving the issue before us, we need not take position on the interpretation of the "payment" clause advocated by Brazil.\(^\text{189}\) Even assuming Brazil's interpretation were correct, Brazil has, in our view, failed to demonstrate that PROEX III payments are payments by the Government of Brazil of all or part of the costs incurred by Embraer or financial institutions "in obtaining the export credits they provide".

5.226 Brazil argues that, when the financial institution is outside of Brazil, Embraer, i.e. the Brazilian exporter, faces costs in obtaining export credits for its customers. While this may or may not be true, PROEX III payments are made to financial institutions financing exports of regional aircraft, not to Embraer. Thus, we fail to perceive how PROEX III payments could represent the payment of all or part of the costs incurred by Embraer in "obtaining the export credits they provide".

5.227 Brazil further argues that, when the financial institutions are Brazilian banks, PROEX III payments help offset those banks' higher cost of raising funds internationally (Brazil risk). We thus understand Brazil to argue that PROEX III payments are used where a Brazilian financial institution provides export credits at rates which are below those it had to pay to obtain the export credits. However, we see nothing in PROEX III that relates the availability of PROEX III payments to a situation where the export credits are being provided by a Brazilian financial institution at below its costs. In fact, nothing in PROEX III links interest rate equalisation in any way to costs incurred by financial institutions "in obtaining the export credits they provide".

\(^{187}\) Article 21.5 Panel Report on Brazil – Aircraft, supra, para. 6.71 and 6.72.

\(^{188}\) See Brazil's Oral Statement, para. 74 (Annex B-3).

\(^{189}\) We note that, like Brazil, the United States considers that PROEX III payments are covered by the "payment" clause, albeit for different reasons. According to the United States, measures by Members, including interest rate buy-downs, which reduce the risk to the financial institution lending money to a borrower are within the scope of the "payment" clause. We consider that the United States has failed to substantiate its view on the basis of the text of the "payment" clause, opting instead to rely on the ostensible "intent" of the clause. Moreover, we agree with Canada that the United States' reading of the "payment" clause would improperly enlarge the scope of the "payment" clause, such that it could cover even official support for export credit guarantees and insurance.

\(^{190}\) We recall that Brazil does not argue that Embraer itself provides export credits.
5.228 In accordance with the foregoing, we conclude that PROEX III payments do not fall within the scope of the "payment" clause of the first paragraph of item (k).

3. Material Advantage

5.229 Since we have found that PROEX III payments are not payments within the meaning of the first paragraph of item (k), Brazil has not established its defence under the first paragraph. In the interests of facilitating a full resolution of this dispute, however, we proceed to analyse whether Brazil is correct that PROEX III payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

5.230 To resolve this issue, we must, as an initial matter, identify the appropriate benchmark, in the present case, for determining whether PROEX III is "used to secure a material advantage in the field of export credit terms". Once we have defined the relevant benchmark, we will examine whether PROEX III complies with that benchmark.

(a) Appropriate Benchmark

5.231 Brazil is of the view that the CIRR, on its own, is an appropriate benchmark for assessing whether PROEX III is used to secure a material advantage.

5.232 Canada considers that the determination of whether a material advantage exists must be based on a consideration of all relevant export credit terms rather than on a comparison of only interest rates. Moreover, a CIRR benchmark cannot be conclusive on the issue because it does not take into account the creditworthiness of individual borrowers. Canada submits, finally, that, in the present dispute, the CIRR is not an appropriate interest rate benchmark and that Brazil must, therefore, employ an alternative interest rate benchmark.

5.233 The Panel will first address Brazil's argument that the CIRR alone is an appropriate benchmark and will then consider Canada's argument that a benchmark other than the CIRR should be used in the circumstances of the present case.

(i) Appropriateness of the CIRR Alone

5.234 According to Brazil, it is apparent from the Article 21.5 Appellate Body report on Brazil – Aircraft that, to establish that PROEX III payments are not used to secure a material advantage, Brazil need only establish that the net interest rates under PROEX III are at or above the relevant CIRR. The Appellate Body has determined, in other words, that a payment that results in a net interest rate above a CIRR benchmark does not confer a material advantage.

5.235 Canada agrees that the Appellate Body considered the CIRR an appropriate market benchmark for purposes of the first paragraph of item (k). However, Canada considers that the Appellate Body could not have been referring to the CIRR stripped of the other terms and conditions set out in the OECD Arrangement. The CIRR is an interest rate which is constructed within the context of the OECD Arrangement. The Appellate Body has recognised that, under the OECD Arrangement, the CIRR can only be used when certain other terms and conditions are also respected. As a matter of treaty interpretation, those other requirements constitute context for understanding the relevance of the CIRR as a market benchmark. If those other requirements are not met, the CIRR is not an appropriate market benchmark. Compliance with the CIRR alone cannot, therefore, establish, in and of itself, that PROEX III does not secure a material advantage.

5.236 As always, the starting-point for the Panel’s analysis is the text of the first paragraph of item (k), which identifies as a prohibited export subsidy:
… the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

5.237 We note that the first paragraph of item (k) refers to the securing of a material advantage "in the field of export credit terms". In our view, this broad formulation implies that, when examining whether a payment is used to secure a material advantage, it would not suffice to consider only the interest rate resulting from that payment. Rather, the examination should extend to all relevant terms of the export credit in question. Thus, the first paragraph of item (k) indicates, in its ordinary meaning, that the presence or absence of a material advantage cannot be determined on the basis of the applicable interest rate alone, irrespective of other export credit terms.

5.238 However, we are not, in this case, writing on a blank slate. The Appellate Body has already had occasion to pronounce on what constitutes an appropriate benchmark for assessing whether a "payment" within the meaning of the first paragraph of item (k) is "used to secure a material advantage in the field of export credit terms".

5.239 The parties to these proceedings differ regarding the correct interpretation of relevant statements by the Appellate Body. Brazil attaches particular importance to the following statement made by the Appellate Body in its Article 21.5 report on Brazil – Aircraft:

To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove either: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" identified in the original dispute as an "appropriate" basis for comparison; or, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".

5.240 In these proceedings, Brazil argues for the appropriateness of a "CIRR only" benchmark. The Appellate Body's statement is relevant to this issue in two respects. First, it emerges that Brazil may indeed use the relevant CIRR as an "appropriate market benchmark" for determining whether the net interest rates resulting from the "revised PROEX" are used to secure a "material advantage in the field of export credit terms". Second, the Appellate Body's statement makes no mention of any export credit terms other than interest rates. This could conceivably be construed to support Brazil's view that the CIRR, on its own, is dispositive of the existence of a material advantage.

5.241 However, we must be careful not to read the Appellate Body's statement in isolation and out of context. In this regard, Canada draws our attention to a footnote in the same Article 21.5 report, where the Appellate Body notes that:

… a participant in the OECD Arrangement can always offer borrowers officially-supported export credits if, besides respecting the CIRR, it also respects the other "repayment terms and conditions" of the OECD Arrangement.

5.242 It is clear to us from this statement that the Appellate Body was aware of the fact that, for purposes of the OECD Arrangement, the CIRR can only be offered to borrowers if certain other export credit terms and conditions are respected. In the light of this, we find it implausible to assume that the Appellate Body meant to suggest that, for purposes of the first paragraph of item (k), the

191 Article 21.5 Appellate Body Report, supra, para. 67 (footnote omitted).
192 There is no apparent reason why the Appellate Body's statement should not apply to the "revised PROEX" at issue in these proceedings, i.e. PROEX III.
193 Article 21.5 Report on Brazil - Aircraft, supra, footnote 68 (reference omitted).
CIRR can be offered to borrowers *irrespective* of what the other export credit terms and conditions are. We do not think that the Appellate Body would have introduced such a significant distinction *sub silentio*.

5.243 In fact, when considering the implications of the view that, with respect to the first paragraph of item (k), the CIRR, on its own, is an appropriate market benchmark, we have no hesitation in concluding that the Appellate Body could not have adopted that view. On that view, Members could, for instance, support export credits with net interest rates at CIRR level, repayment terms of 100 years, no cash payment requirement and with the principal sum to be repaid at the very end of the credit term. To accept this possibility would, in our view, deprive the material advantage clause of the first paragraph of item (k) of any useful effect.

5.244 By way of a final consideration, we wish to note that the Appellate Body's failure specifically to acknowledge the importance of export credit terms other than the CIRR itself may well have been inspired by the wording of the second paragraph of item (k). Like the Appellate Body's statement, the second paragraph only refers to an "interest rate" benchmark, which, in essence, is the CIRR. Yet, as discussed above, this reference in the second paragraph to the CIRR does not imply that export credit practices benefit from the safe haven even if they do not conform to those provisions of the *OECD Arrangement* which operate to support or reinforce the CIRR.

5.245 In conclusion, and for the reasons set forth above, we find that the Appellate Body did not mean to suggest, at para. 67 of its Article 21.5 report on *Brazil – Aircraft*, that compliance with the CIRR alone would, *ipso facto*, be dispositive of the issue of whether relevant payment support for export credits is used to secure a material advantage in the field of export credit terms.

5.246 Having found that compliance with the CIRR alone is not sufficient to establish that PROEX III does not confer a material advantage, it is necessary to determine, next, what terms and conditions PROEX III would need to respect, in addition to the CIRR, to justify a finding that PROEX III does not secure a material advantage.

5.247 We recall that, in reaching its conclusion that the CIRR was a relevant international benchmark for determining whether payments were used to secure a material advantage in the field of export credit terms, the Appellate Body relied upon the second paragraph of item (k) as relevant context.

5.248 As we have already seen, the second paragraph of item (k) offers a safe haven for export credit practices that are in conformity with the interest rate provisions of the 1998 *OECD Arrangement*. While compliance with the CIRR is a necessary element for establishing such conformity, we have concluded that, on a proper interpretation, "conformity with" the CIRR cannot be said to be achieved, unless the CIRR as well as all (applicable) rules of the *OECD Arrangement* which operate to support or reinforce the CIRR are complied with.

5.249 As a matter of contextual interpretation, we believe that the concept of "conformity with the CIRR" as it exists in the "material advantage" clause should normally have the same meaning as the

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194 The Appellate Body stated that:

\[\ldots\] the second paragraph of item(k) [constitutes] useful context for interpreting the "material advantage" clause in the text of the first paragraph. (Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 181 (emphasis added)).

195 We realise that the concept of "conformity with the CIRR" does not appear, as such, in the text of the material advantage clause. It is sufficient to note, in this regard, that we must take as given the Appellate Body's interpretation of that clause. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 67 ("To establish that subsidies under the revised PROEX are not 'used to secure a material advantage in the
concept of "conformity with the CIRR" as it exists in the second paragraph of item (k). In our view, there would be little logic to interpreting the first paragraph of item (k) in the light of one element found in the second paragraph of item (k) -- the CIRR -- while neglecting other elements of the second paragraph which are essential to determining whether an export credit practice is in conformity with the CIRR.

5.250 We note that the reasoning which underpins our interpretation of the second paragraph of item (k) applies with equal force to the Appellate Body's interpretation of the "material advantage" clause. In this regard, it is sufficient to recall our view that the CIRR cannot meaningfully perform the limiting function of a minimum commercial interest rate unless it is applied as part of the package of terms and conditions set forth in the OECD Arrangement. If that is a correct view, then it must be correct regardless of whether the CIRR serves as an interest rate benchmark for purposes of the "material advantage" clause or for purposes of the second paragraph of item (k).

5.251 It could be argued that this interpretation of the "material advantage" clause in effect re-creates in the first paragraph of item (k) the standard already provided for in the second paragraph of item (k), at least insofar as the interest rate benchmark used under the first paragraph of item (k) is the CIRR. However, this is an unavoidable implication of the Appellate Body's adoption of the CIRR as an appropriate benchmark for determining the existence of a material advantage. Had we adopted Brazil's view, that is, had we found that compliance with the CIRR, on its own, was sufficient for purposes of establishing that payments are not used to secure a "material advantage" within the meaning of the first paragraph of item (k), we would have made it easier to comply with the first paragraph of item (k) than with the second paragraph of item (k). To the extent that the first paragraph of item (k) could be used a contrario to establish that a payment that is not used to secure a material advantage is not prohibited -- an issue addressed below -- we would, in other words, not only have re-created a safe haven in the first paragraph, but, in fact, would have deprived the second paragraph of all useful effect with respect to the export credit practices at issue in the first paragraph. This we think we must not do.

5.252 For the foregoing reasons, we find that, in order for Brazil to establish by reference to the CIRR that PROEX III interest rate equalisation payments are not used to secure a "material advantage", Brazil must demonstrate that export credits supported by PROEX III respect, in addition to the CIRR itself, the applicable rules of the OECD Arrangement which relate to the application of the CIRR and which operate to support or reinforce the CIRR as a minimum interest rate.

196 It is clear to us that the Appellate Body viewed the CIRR as an appropriate market benchmark for purposes of the "material advantage" clause because it represents a minimum commercial interest rate. See Article 21.5 Appellate Body Report on Brazil – Aircraft, supra, paras. 61-64; Article 21.5 Panel Report on Brazil – Aircraft, supra, para. 6.91. It is useful to reiterate in this context that we find it implausible to assume that the Appellate Body meant to "import" into the "material advantage" clause the CIRR alone, that is, divorced from its surrounding terms and conditions as defined in the OECD Arrangement.

197 See Article 21.5 Panel Report on Brazil – Aircraft, supra, para. 6.87. Of course, the second paragraph of item (k) is broader in scope than the first paragraph of item (k), which only refers to two types of export credit practices. To that extent, the second paragraph of item (k) retains independent meaning also on our interpretation of the "material advantage" clause.

198 Canada appears to have reached the same conclusion. See Canada's First Submission, para. 90 (Annex A-1).

199 See paras 5.97 et seq. and 5.106 et seq. It should be noted that Brazil does not seek to establish, in these proceedings, an appropriate market benchmark other than the CIRR.
(ii) Appropriateness of a Benchmark Other than the CIRR

5.253 **Canada** recalls that the Appellate Body has stated that the CIRR may not always reflect the rates available in the marketplace. In Canada's view, the Appellate Body has therefore recognized that the role of the CIRR is to serve as a proxy for market rates. It follows that, whenever the CIRR is not an adequate proxy for market rates, a benchmark other than the CIRR *must* be used. Specifically, Canada asserts that the CIRR is not an appropriate benchmark with respect to transactions involving regional aircraft, because the CIRR is usually significantly different from the rates available for comparable market transactions involving regional aircraft. Canada notes that the CIRR is significantly different even from the rates available to the airline with the best credit rating, i.e. American Airlines.

5.254 **Canada** argues, in addition, that, in assessing whether PROEX III is used to secure a material advantage in the field of export credit terms, account must also be taken of the creditworthiness of the borrower in question. Canada considers that a lender will certainly confer a material advantage if, by offering financing at the CIRR, it is permitted to offer a less credit-worthy borrower the same low interest rate as a more credit-worthy borrower.

5.255 **Brazil** counters that the CIRR, by its design, is intended to reflect market rates and that, in the view of experts, the CIRR may from time to time actually be higher than market rates. In fact, according to Brazil, the CIRR presently is above the market rates. Brazil argues further that, in any event, it follows from the Appellate Body's Article 21.5 report on *Brazil – Aircraft* that Brazil is entitled to establish a benchmark interest rate and that it may use the CIRR as a benchmark in assessing applications for PROEX assistance.

5.256 The **Panel** agrees with the premise of Canada's argument, namely that the Appellate Body considered (i) that the CIRR represents an example of a *market* benchmark and (ii) that the CIRR need not accurately reflect the marketplace *at all times*. That premise, however, does not lead us to the same conclusion as Canada, because we have a different reading of the Appellate Body's Article 21.5 report on *Brazil – Aircraft*. We consider the following passage of that report to be particularly pertinent:

> Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be *able*, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions.  

5.257 **Canada** would have us construe this statement as *requiring* that a Member that seeks to demonstrate that its payments are not used to secure a material advantage must, in the circumstances referred to, use a benchmark other than the CIRR. We think that the plain words of the Appellate Body do not support such a conclusion. The Appellate Body did not say that a Member "must" establish an alternative benchmark where the CIRR does not reflect the rates available in the marketplace. Instead, the Appellate Body said that a Member should, "in principle", be "able" to do so, that is, that it should have the possibility to do so.

5.258 There is another statement by the Appellate Body which appears to contradict Canada's interpretation. As will be recalled, the Appellate Body stated that:

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200 Article 21.5 Appellate Body Report on *Brazil – Aircraft*, supra, para. 64 (footnote omitted and emphasis added).

201 It is worth noting that we, too, in the previous Article 21.5 proceedings, used permissive rather than mandatory language when addressing this issue ("may"). The Appellate Body reproduced, and agreed with, the relevant statement of our previous Article 21.5 report. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, supra, para. 63.
To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove either: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate" basis for comparison; or, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".  

5.259 This statement confirms, in our view, that the Appellate Body did not mean to suggest that Members were under an obligation to use a benchmark other than the CIRR where the CIRR does not correspond to market rates. To the contrary, this statement suggests to us that the Appellate Body meant to leave it up to an individual Member to decide whether to use a CIRR benchmark or, in the alternative, identify and establish the appropriateness of a different benchmark.

5.260 Accordingly, while we see merit in Canada's argument that the CIRR may not constitute an "appropriate" market benchmark in situations where it differs significantly from the rates available to borrowers in comparable market transactions, we nevertheless cannot accept that argument in view of our understanding of the Appellate Body's Article 21.5 report on Brazil - Aircraft.

5.261 Canada argues that, in examining whether PROEX III is used to secure a material advantage, regard must also be had to the creditworthiness of the borrower in question. We recall that, in our first Article 21.5 report, we explained that:

> The reasoning of the Appellate Body in choosing the CIRR seems to have been that a payment would be used to secure a material advantage … if it resulted in an interest rate that was below the lowest commercial interest rates available to the best borrowers in respect of a particular currency, irrespective of whether that rate would have been available to the borrower in question.

5.262 In other words, in our understanding, the Appellate Body identified the CIRR as an "absolute" benchmark, that is to say, as a benchmark that could be used even where the borrower in question could not have obtained a rate at the CIRR level in the commercial market.

5.263 It should be pointed out that the Appellate Body, in its Article 21.5 report, did not contradict our interpretation of its reasoning. Nor do we see, in that report, any other statements which would make us reconsider our statement. Whereas we find Canada's argument persuasive, as a general matter, this does not provide us with a justification for departing from what we consider to be the Appellate Body's view.

5.264 For these reasons, we reject Canada's argument that the creditworthiness of borrowers must be taken into account when assessing whether PROEX III confers a material advantage within the meaning of the first paragraph of item (k).

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202 Article 21.5 Appellate Body Report, supra, para. 67 (emphasis in the original, but footnote omitted).

203 With respect to the fact that Canada's argument relates specifically to export transactions involving regional aircraft, it is sufficient to note (i) that nothing in the Appellate Body's Article 21.5 report on Brazil - Aircraft suggests that the CIRR benchmark does not apply to transactions involving regional aircraft and (ii) that, in fact, the underlying dispute concerned regional aircraft. We must assume, therefore, that the Appellate Body meant to make it possible for Members to use the CIRR as benchmark in transactions involving regional aircraft.

204 Article 21.5 Panel Report on Brazil – Aircraft, supra, para. 6.91 (underlining added).

205 We note that Canada's argument is similar in content to our original finding that the question of whether there was a "material advantage" was comparable to the question of whether there was a benefit to the recipient. See Panel Report on Brazil – Aircraft, supra, para. 7.23. The Appellate Body, however, overturned our finding on that issue. See Original Appellate Body Report on Brazil – Aircraft, supra, para. 179.
5.265 For the foregoing reasons, we find that a Member may always use the CIRR -- accompanied by the applicable rules of the OECD Arrangement which operate to support or reinforce the CIRR as a minimum interest rate -- as a benchmark to demonstrate that a payment is not used to secure a material advantage in the field of export credit terms.206 Given the nature of the CIRR as a (periodically) constructed interest rate, a Member may, however, attempt to demonstrate that a rate below the CIRR would, at a particular point in time, constitute a more appropriate benchmark.

(b) Examination of PROEX III

5.266 We recall that, to establish that PROEX III is not used to secure a material advantage in the field of export credit terms, Brazil must either (i) demonstrate conformity with the relevant CIRR as well as with all those rules of the 1998 OECD Arrangement which operate to support or reinforce the CIRR, or (ii) identify an appropriate "market benchmark", other than the CIRR, and establish that net interest rates resulting from PROEX III support are at or above that alternative "market benchmark".

5.267 In this case, Brazil claims justification for PROEX III on the basis that it uses a CIRR benchmark for net interest rates.207 In order for us to determine whether Brazil has met its burden of demonstrating conformity with the relevant provisions of the 1998 OECD Arrangement, it is necessary to perform the same type of analysis as that which has already been performed with respect to Brazil's defence under the second paragraph of item (k). Since the provisions of the 1998 OECD Arrangement which are to be addressed are the same and since the factual circumstances are the same, we see no need to repeat the examination we have undertaken in the context of Brazil's defence under the second paragraph. We consider it appropriate, instead, to incorporate, mutatis mutandis, our findings in Section E.3(c) above into the present Section.

5.268 Accordingly, on the basis of the findings set forth in Section E.3(c), we conclude that PROEX III, as such, allows Brazil to provide PROEX III payments in such a manner that it is not used to secure a material advantage in the field of export credit terms.

4. A Contrario Use of the First Paragraph of Item (k)

5.269 Brazil contends that "payments" within the meaning of the first paragraph of item (k) that are not "used to secure a material advantage in the field of export credit terms" are not prohibited by the SCM Agreement. In Brazil's view, the failure to permit such an a contrario interpretation would effectively render the material advantage clause inutile, contrary to the customary rules of interpretation of public international law. Brazil considers that the minimum meaning and effect that can reasonably be given to the clause is that it qualifies the preceding language of the first paragraph of item (k). Thus, according to Brazil, its ordinary, straightforward meaning is that payments that are used to secure a material advantage are prohibited subsidies, whereas payments that are not so used are not prohibited. Brazil recalls that, in the first Article 21.5 proceedings in Brazil – Aircraft, the Appellate Body stated that, if Brazil had discharged its burden to show that PROEX III payments did not confer a material advantage, the Appellate Body "would have been prepared to find" that an a contrario interpretation of the material advantage clause could be used to justify PROEX payments.

5.270 Canada considers that the first paragraph of item (k) cannot be used a contrario in the manner urged by Brazil. Canada considers that, as an explicit exclusionary clause, footnote 5 to the SCM Agreement precludes the possibility of relying on an implied exclusion based on an alleged a contrario exception independent of footnote 5. Canada submits that, otherwise, footnote 5 would be

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206 Otherwise, there would have been no need for the Appellate Body to refer to the CIRR. It could, instead, simply have said that, to establish that relevant payments are not used to secure a material advantage, a Member must identify an appropriate market benchmark and must prove that the net interest rates resulting from the relevant payments are at or above that benchmark.

207 Brazil has not identified a market benchmark other than the CIRR.
redundant and the principle of effective treaty interpretation breached. Nor can Brazil establish, in Canada's view, that a measure impliedly excluded from the list of illustrations in Annex I is a "measure referred to in Annex I as not constituting" an export subsidy. According to Canada, if something must be "referred to" in a written text, the thing must be named or described in words set out in the text. Thus, in Canada's view, footnote 5 requires positive authorizing language in Annex I that a measure is not being categorized as a prohibited subsidy.

5.271 The Panel notes that the first paragraph of item (k) identifies as a prohibited export subsidy:

... the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

5.272 The question before us is whether a measure which has been found to be a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement is nevertheless not prohibited if it is a "payment" which is not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

5.273 We recall that we addressed precisely this issue in the first Article 21.5 panel report in Brazil – Aircraft. The Appellate Body, in considering our findings, stated that it was not "necessary for [it] to rule on these general questions in order to resolve this dispute", and thus declared our findings to be "moot" and "of no legal effect". Nevertheless, given that the issue was considered in detail in that dispute, we begin our examination with a review of the reasoning set forth in that report.

5.274 In the first Article 21.5 panel report on Brazil – Aircraft, we found that the first paragraph of item (k) could not be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement is permitted. In reaching this conclusion, we observed that footnote 5 to the SCM Agreement provides an explicit textual basis for determining whether and under what conditions the Illustrative List may be used to demonstrate that a subsidy which is contingent on export performance is not prohibited. We noted that footnote 5 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." We observed that, in its ordinary meaning, footnote 5 relates to situations where a measure is referred to as not constituting an export subsidy. We considered that the first paragraph of item (k) does not contain any affirmative statement that a measure is not an export subsidy, nor that a measure not satisfying the conditions of that paragraph is not prohibited, and thus does not fall within the scope of footnote 5. We observed that this finding does not render the material advantage clause "ineffective", as the "material advantage" clause nevertheless serves an important role by narrowing the range of measures that would otherwise be subject to the "per se" violation set forth in the first paragraph of item (k). Finally, we noted that a broad reading of footnote 5 could place developing country Members at a permanent, structural disadvantage in the field of export credit terms, a result we considered to be inconsistent with one of the objects and purposes of the WTO Agreement.

5.275 We find the reasoning expressed in the first Article 21.5 panel report on Brazil – Aircraft to be convincing. In our view, Brazil does not, in these proceedings, assert significant new arguments that would call that reasoning into question. Thus, we remain of the view, expressed in our previous Article 21.5 panel report, that the relationship between the Illustrative List and Article 3.1(a) is...

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208 Article 21.5 Appellate Body Report on Brazil – Aircraft, supra, para. 81.
210 See ibid., paras. 6.33-6.34.
211 See ibid., paras. 6.36-6.37.
212 See ibid., paras. 6.42-6.45.
213 See ibid., paras. 6.46-6.66.
governed by footnote 5 to the *SCM Agreement*, and that the first paragraph of item (k) does not "refer to" any measures as "not constituting export subsidies" within the meaning of the footnote. We consider that this reading gives effect both to the material advantage clause *and* to footnote 5. As a result, we incorporate by reference our reasoning in the first Article 21.5 panel report into this Section.

5. **Conclusion**

5.276 We have concluded that, while PROEX III, as such, allows Brazil to make PROEX III payments in such a way that they do not secure a material advantage in the field of export credit terms, PROEX III payments are not the payment by Brazil of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". Brazil has, therefore, failed to demonstrate the required elements for its defence under the first paragraph of item (k). We have further concluded that, in any event, the first paragraph of item (k) cannot, as a legal matter, be invoked as an affirmative defence.

5.277 In the light of this, PROEX III, as such, is not "justified" under the first paragraph of item (k).

VI. **CONCLUSION**

6.1 For the reasons set forth in this Report, we conclude that:

- (a) It has not been established that PROEX III, as such, is inconsistent with Article 3.1(a) of the *SCM Agreement*;
- (b) PROEX III, as such, is, in any event, justified under the second paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the *SCM Agreement*;
- (c) PROEX III, as such, cannot, however, be justified under the first paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the *SCM Agreement*.

6.2 In reaching this conclusion, we once again wish to recall the precise issue which we were called on to resolve. That issue was whether the PROEX III programme, as such, that is to say, on its face and independently of its application, is inconsistent with the *SCM Agreement*. Our conclusion that the PROEX III programme, as such, is *not* inconsistent with the *SCM Agreement* is based on the

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214 We note the following statement of the Appellate Body in the first Article 21.5 proceedings in Brazil – Aircraft:

If Brazil had demonstrated that the payments made under the revised PROEX were not "used to secure a material advantage in the field of export credit terms", and that such payments were "payments" by Brazil of "all or part of the costs incurred by exporters or financial institutions in obtaining credits", then we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List. [...] In making this observation, we wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5, or on the meaning of any other items in the Illustrative List. (Article 21.5 Appellate Body Report on Brazil – Aircraft, supra, para. 80)

Brazil argues on the basis of this statement that the Appellate Body takes the view that the first paragraph of item (k) "should be read a contrario to permit a subsidy that does not confer a material advantage". See Brazil's First Submission, para. 66 (Annex B-1). Although we acknowledge that this statement could be understood in the manner suggested by Brazil, we note that the Appellate Body's statement does not form part of the legal basis for its disposition of the appeal, nor did the Appellate Body explain its statement.
view that it is legally possible for Brazil to operate the PROEX III programme in such a way that it will:

(a) not result in a benefit being conferred on producers of regional aircraft and, hence, not constitute a *subsidy* within the meaning of Article 1.1 of the *SCM Agreement*, or

(b) result in a benefit being conferred on producers of regional aircraft, but conform to the requirements of the safe haven of the second paragraph of item (k), in which case it would not constitute a *prohibited* export subsidy within the meaning of Article 3.1 of the *SCM Agreement*.

6.3 We wish to be clear, however, that it does not necessarily follow from our conclusion that future application of the PROEX III programme will, likewise, be consistent with the *SCM Agreement*. It should be mentioned, in this regard, that Canada is free to challenge such future application in accordance with the provisions of the *DSU* if it considers it not to be in conformity with the *SCM Agreement*. 