

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

Recourse by Brazil to Article 21.5 of the DSU

Report of the Panel

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

I. INTRODUCTION AND FACTUAL BACKGROUND

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

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

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

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

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

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

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

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

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

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

1.9 The Panel was composed as follows:

Chairperson: Mr. David de Pury

Members: Mr. Maamoun Abdel-Fattah

Mr. Dencho Georgiev

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

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

¹ See Annex to document WT/DS70/9.

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

II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

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

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

III. ARGUMENTS OF THE PARTIES AND THIRD PARTIES

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

IV. INTERIM REVIEW

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

A. COMMENTS BY BRAZIL

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

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

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

4.5 With regard to para. 5.37, Brazil questioned our finding that "Brazil has failed to cite to any Canadian submission to the Panel which contains any such argument". Brazil referred to Exhibit CAN-9 in support. However, Exhibit CDN-9 does not contain any argument by Canada that it has

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

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

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

B. COMMENTS BY CANADA

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

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

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

V. FINDINGS

A. TECHNOLOGY PARTNERSHIPS CANADA

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

5.1 In the original *Canada - Aircraft* proceeding, Brazil adduced evidence concerning five TPC transactions in the regional aircraft sector. The Panel noted that "three [of the five] transactions accounted for 68% of TPC contributions to the aerospace and defence sector during the period 1996-1997." The Panel found "that Brazil's arguments concerning these three specific contributions establish a *prima facie* case that TPC assistance to the Canadian regional aircraft industry confers 'benefits' within the meaning of Article 1.1(b) of the SCM Agreement". The Panel therefore found

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

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

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

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

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

3. Summary of the parties' arguments

(a) Brazil

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

5.6 As an argument in the alternative, Brazil also requests repayment of prior TPC assistance to the Canadian regional aircraft industry, if either (1) the Panel considers itself required to follow the reasoning of the *Australia - Leather Article 21.5 panel*², or (2) the Panel finds that there can be no grounds for making a finding concerning *de facto* export contingency under the "new" TPC programme in the absence of actual financial contributions granted under the "new" TPC.

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

(b) Canada

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

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

4. Evaluation by the panel**(a) Scope of the disagreement between the parties**

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

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

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

⁴ Emphasis supplied.

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

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

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

(b) Burden of proof

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

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

(c) Substantive analysis

5.15 Brazil considers that it has discharged its burden of proof by demonstrating "that all the essential elements of the [TPC] program remain unchanged, and that many of these elements will never change".¹¹ In this regard, Brazil claims that the facts surrounding the "new" TPC still support

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

⁷Id.

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

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

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

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

an inference of *de facto* export contingency. In particular, Brazil refers to the following four factors which, in its opinion, lead to an inference that future TPC assistance to the Canadian regional aircraft industry continues to be *de facto* export contingent:

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

We shall examine each of these factors in turn.

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

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

5.17 Thus, we understand Brazil to argue that "nothing has changed" because TPC assistance continues to be "specifically targeted" at the Canadian aerospace or regional aircraft industries, in the sense that these industries will continue to receive the "vast majority", or "lion's share", of TPC assistance. In addressing this argument, we recall that the "specific targeting" concept (in those or other words) did not form part of our reasoning regarding contingency in fact on export performance in that dispute. While we do not exclude the possibility that, in a given case, a factual circumstance of "specific targeting" might be considered by a panel to be part of the totality of facts leading to an inference of export contingency, this was not the case in the original *Canada - Aircraft* dispute. That is, of the factual considerations enumerated by us at para. 9.340 of our Report, **none** concerned the alleged targeting of the Canadian aerospace industry generally, or the Canadian regional aircraft industry in particular, by TPC, **none** concerned the amount of total TPC funding directed at the Canadian aerospace or regional aircraft industries,¹⁷ and **none** concerned the fact that the aerospace or

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

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

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

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

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

¹⁷ We recall that, in our original findings, we referred to the fact that three specific transactions examined by us accounted for approximately 68 per cent of TPC contributions to the aerospace and defence sector during the period 1996-1997 (see para. 9.307 of *Canada - Aircraft*, WT/DS70/R). However, we made

regional aircraft industries were eligible for TPC assistance. Arguing a failure to implement on the grounds that there has been no change in alleged factual circumstances, which themselves were not part of our original ruling, is of questionable merit and logic. Indeed, we consider that the question of whether TPC assistance is "specifically targeted" to the aerospace and regional aircraft industries is not relevant to the present dispute, which concerns the issue of whether or not Canada has implemented the DSB recommendation on TPC assistance to the Canadian regional aircraft industry. That recommendation cannot have required Canada to take implementation action to ensure that TPC assistance is not "specifically targeted" at the aerospace and regional aircraft industries, because such alleged "specific targeting" did not form part of the basis for the finding of *de facto* export contingency that gave rise to that recommendation.¹⁸ The fact that "nothing has changed" concerning the alleged "specific targeting" of the aerospace and regional aircraft industries therefore has no bearing on the present dispute.

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

(ii) *Interest in near-market projects*

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

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

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

this factual reference in the context of our original findings on subsidization. This factual reference played no part whatsoever in our original findings on *de facto* export contingency.

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

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

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

caution when addressing Brazil's arguments regarding the alleged nearness-to-the-export-market of "new" TPC projects in the regional aircraft sector.

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

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

5.24 In our view, the mere fact that the results of a project may in the future be useful in the development of new products, or the modification / improvement of existing products, does not by itself render the project near-market. This view is confirmed by former footnotes 28 and 29 to former Article 8.2(a) of the SCM Agreement²⁵, concerning non-actionable subsidies, which appears to have strongly influenced Canada's choice of wording in the "new" TPC documents cited by Brazil.²⁶ In our view, the non-actionable subsidy projects referred to in former footnotes 28 and 29 concerned "industrial research" and "pre-competitive development activity" projects that were sufficiently removed from the market to suggest that their impact on the market was likely to be minimal. As a result, it would be incongruous for us to find similarly defined TPC projects to be "near-market".

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

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

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

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

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

²⁶ Former footnote 28 provided:

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

Former footnote 29 provided:

The term "pre-competitive development activity" means the translation of industrial research findings into a plan, blueprint or design for new, modified or improved products, processes or services whether intended for sale or use, including the creation of a first prototype which would not be capable of commercial use. It may further include the conceptual formulation and design of products, processes or services alternatives and initial demonstration or pilot projects, provided that these same projects cannot be converted or used for industrial application or commercial exploitation. It does not include routine or periodic alterations to existing products, production lines, manufacturing processes, services, and other on-going operations even though those alterations may represent improvements.

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

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

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

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

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

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

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

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

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

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

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

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

5.32 Without taking any view on the findings of the *Australia - Leather* panel, we note that Brazil has adduced no evidence that "new" TPC assistance to the Canadian regional aircraft industry will be conditioned on the fulfilment of sales targets (as was found to be the case in *Australia - Leather*³⁶). Brazil claims instead that the grant of "new" TPC assistance to the regional aircraft industry is contingent on the fulfilment of sales forecasts. However, in response to a question from the Panel, Brazil was unable to adduce any evidence to substantiate its claim of contingency on sales forecasts. Brazil only adduced evidence to the effect that sales forecasts will be used in the context of the "new" TPC programme.³⁷ In response, Canada explicitly denied that the granting of TPC assistance to the regional aircraft sector is contingent on the fulfilment of sales forecasts.³⁸ In the absence of any evidence to the contrary, we see no reason to doubt Canada's explicit denial. Furthermore, although sales forecasts may be used in the context of "new" TPC assistance to the regional aircraft industry, as

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

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

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

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

³⁵ *Id.*

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

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

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

they were under the "old" TPC,³⁹ this does not by itself mean that "new" TPC assistance to the Canadian regional aircraft industry will be contingent on fulfilment of those sales forecasts. The fact that a subsidy repayment schedule may be based on royalties from forecast sales does not mean that compliance with the sales forecast becomes a condition for the bestowal of the subsidy; it simply means that a sales forecast was used to fix the repayment schedule.⁴⁰ This situation is different from that before the *Australia - Leather* panel, where the relevant payments were "conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets".⁴¹ For these reasons, we disagree with Brazil that the logic of the *Australia - Leather* panel applies in the present case.

5.33 Furthermore, we note that Part 4 of the "new" TPC Investment Decision Document requires TPC administrators to record the "[b]enefits [of the project] to Canada". Section 5 of the "new" TPC Investment Application Guide defines "technological and net economic benefits to Canada" as "increasing economic growth, creating jobs and wealth, and supporting sustainable development". Nowhere in these documents is increased export performance identified as a "technological" or "net economic benefit" to Canada. Indeed, Part 4 of the aforementioned Investment Decision Document explicitly provides that "TPC will not accept or consider information concerning the extent to which a company does or may export". The only conclusion that we can reach from the face of these documents is that projects will be compared against one another, and eventually selected for funding, on the basis *inter alia* of the amount of technological and/or net economic benefits to which they are expected to give rise. While it is clear that for some projects, these benefits will derive largely or exclusively from exports, there is no factual basis in the documents (which are at this point the only available evidence) on which to conclude that projects generating the most *exports* will be those selected for funding. Indeed, the documents indicate that the administrators simply will not have specific information about the volume of exports that might result from any project for which TPC funding is sought. Thus, whereas TPC assistance is conditional on a project having certain technological or net economic benefits to Canada, in our view this simply cannot be assumed to be synonymous with export performance, and therefore it does not mean *ipso facto* that such assistance is contingent on export performance. This remains true even though TPC administrators know that fulfilment of net economic benefits in certain cases may be likely to result in increased exports. The fact that they will have no concrete quantifiable information on exports in our view will act in practical terms to limit their discretion to select projects on the basis of export performance.

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

(iv) *Documentation*

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

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

⁴¹ *Australia - Leather*, para. 9.71.

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

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

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

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

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

5.40 In light of the above, we see no basis for relying on previous TPC documents, which are no longer applicable, and which were a contributory factor that helped to demonstrate the *de facto* export

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

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

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

contingency of "old" TPC assistance to the regional aircraft industry, to conclude that "new" TPC assistance to the regional aircraft industry will also be *de facto* contingent on export performance.

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

Conclusion

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

(d) Alternative implementation methods

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

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

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

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

5.46 Brazil's request for repayment is conditional on either or both of two scenarios materialising: first, if the Panel considers itself required to follow the interpretation of Article 4.7 of the SCM Agreement offered by the panel in *Australia - Leather Article 21.5*; second, if the Panel considers that it cannot render a judgement concerning Brazil's allegations of *de facto* export contingency under the

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

restructured TPC programme as a result of the absence of any financial contributions made under the restructured programme. In the latter case, Brazil considers that it will be left without an "effective remedy" apart from the retroactive repayment of past TPC assistance to the Canadian regional aircraft industry.

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

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

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

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

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

(f) Summary

5.52 In summary, we are unable to accept Brazil's claim that Canada has not implemented the recommendation of the DSB concerning TPC assistance to the Canadian regional aircraft industry.

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

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

⁴⁸ *Id.* at para. 27.

⁴⁹ *Id.* at para. 34.

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

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

Moreover, we have found that it is not necessary to consider the alternative implementation methods identified by Brazil. Finally, we have found that neither of the conditions attached to Brazil's request for repayment have been met.

B. CANADA ACCOUNT

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

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

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

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

2. Summary of the parties' arguments

(a) The measure at issue

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

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

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

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

⁵⁴ WT/DS70/R, para. 10.4.

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

with respect to these past subsidies. Given that there is no “disagreement” between the parties concerning Canada’s implementation in respect of the past Canada Account subsidies, we do not consider further this aspect of that implementation.⁵⁶

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

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

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

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

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

⁵⁸ Exhibit CDN-13.

⁵⁹ See, e.g., Oral statement of Canada (Annex 2-3) at para. 68. We note that Canada uses the term “comply with” in the Policy Guideline and in certain of its arguments, while the second paragraph of item (k) uses the term “conformity with”. We understand Canada’s argument to be that any future Canada Account transactions will be eligible for the safe haven in the second paragraph of item (k). Thus we assume that Canada intends to refer to “conformity with” when it uses the term “comply with”. This assumption appears to be confirmed by Canada’s assertion that the Policy Guideline “does ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement ...” (see para. 5.72 below).

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

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

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

(b) Standard for assessing Canada's implementation

5.63 Our task is to assess whether the Policy Guideline is inconsistent with Canada's obligation to "withdraw" the prohibited subsidies under the Canada Account. We do not believe that it is necessary for us to develop a comprehensive definition of the term "withdraw the subsidy" (the only available remedy for prohibited subsidies pursuant to SCM Article 4.7) to be able to make this assessment. Rather, it is sufficient to conclude (and we note that the parties seem to agree with this) that a Member cannot be understood to have withdrawn a prohibited subsidy if it has not *ceased to provide* such a subsidy, as that Member therefore would not have ceased to violate its WTO obligations in respect of such a subsidy. In our view, therefore, Canada's obligation arising from the DSB's recommendation concerning prohibited subsidies under the Canada Account includes the obligation to cease providing prohibited export subsidies to the regional aircraft sector.

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

5.65 This raises the question of what standard we should use to make such a determination. We note that the parties' arguments indicate that both consider the correct standard to be whether or not the Policy Guideline "ensures" that prohibited subsidies have ceased. Brazil states, for example, that Canada is required, through implementation, "at a minimum to *ensure* that prohibited export subsidies via the Canada Account *cannot* be granted"⁶³. Canada for its part also accepts the appropriateness of the "ensure" standard, as it argues that the Policy Guideline "*ensure[s]* that any future Canada

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

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

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

Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)⁶⁴.

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

(c) Sufficiency of the Policy Guideline

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

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

5.69 Brazil argues that the Guideline simply states that as a policy matter, the Minister for International Trade will not approve transactions that are not in compliance with the *OECD Arrangement*. For Brazil, the Policy Guideline is a "vague hortatory statement[]" regarding Canada's intentions. Brazil specifically takes issue with Canada's argument that the Guideline states an intention to meet the criteria to qualify for an exception under the second paragraph of item (k) of the Illustrative List of export subsidies through conformity with the "interest rates provisions" of the *OECD Arrangement*. Brazil argues that the Guideline does *not* say this, and that even if it did, Canada does not define the interest rate provisions with which it intends to comply, or how it will apply those provisions. Without such precision, it is not evident to Brazil that Canadian practices would qualify for the specific "safe haven" in the second paragraph of item (k). In particular, Brazil points to the fact that, whereas the second paragraph of item (k) refers specifically to conformity with "the interest rates provisions" of the *OECD Arrangement*, the Policy Guideline refers to compl[iance] with "the OECD Arrangement" more generally. In Brazil's view, this difference in terminology, along with the absence of any detail in the Policy Guideline as to what Canada means by compliance with "the OECD Arrangement" and the basis on which eligibility of Canada Account transactions for the safe haven in the second paragraph of item (k) will be judged, means that the Policy Guideline is insufficient to implement the DSB's recommendation.

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

5.71 Concerning the question of substantive compliance with the *OECD Arrangement*, Canada agrees with Brazil that the burden would be on Canada, as the one making use of the "exception" to

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

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

the SCM Agreement set forth in the second paragraph of item (k) of the Illustrative List, to prove that it is entitled to that exception. Canada appears to differ with Brazil concerning the timing, however. Whereas Brazil believes that this burden exists now, Canada argues that it would need to be satisfied only at such future point as Canada invoked the second paragraph of item (k) and were challenged with respect to that defense.

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

3. Evaluation by the Panel

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

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

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

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

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

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

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

⁶⁷ We recall that the *EC - Bananas III* panel found it necessary to interpret certain provisions of the *Lomé Convention*, since it was referred to in the WTO General Council’s *Lomé waiver* (WT/DS27/R/USA, para. 7.97). We likewise consider it necessary to interpret certain provisions of the *OECD Arrangement*, since it is referred to in the second paragraph of item (k) of Annex I of the SCM Agreement.

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

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

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

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

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

⁶⁹ We take note of the reference to "a successor undertaking" in the second paragraph of item (k). In this regard, first, it is clear from this reference that to the extent that the *Arrangement* today is the only undertaking of the kind referred to in the second paragraph of item (k), if in the future a "successor undertaking" were to take effect, export credit practices conforming with the interest rate provisions of that undertaking also would be eligible for the safe haven in that paragraph. Thus, our detailed analysis of the *Arrangement* in its present form is not in any way intended to exclude this possibility. Second, for purposes of our analysis of the *Arrangement*, we assume that the *Sector Understandings* on Export Credits for Ships, for Nuclear Power Plant, and for Civil Aircraft, contained in Annexes I-III of the *Arrangement*, form an integral part of the *Arrangement* itself. Even if in the strict sense this were not the case (an issue that we do not here decide), in our view these *Sector Understandings* at a minimum would constitute "successor undertakings" in the sense of the second paragraph of item (k), as the *Arrangement* as originally implemented in 1979 did not contain these Annexes. Rather, its very brief sector-specific provisions (which at the time pertained to conventional power plants, to ground satellite communications stations, and to ships) were contained in paragraph 4 of its main text. The *Sector Understandings* were negotiated and implemented later, and incorporate by reference provisions of the *Arrangement*. Thus, if they are not formally integral to the *Arrangement*, there is no doubt that these *Understandings* at a minimum constitute successor undertakings, and thus, conformity with the "interest rates provisions" of the *Understandings* would qualify an export credit practice for the safe haven in the second paragraph of item (k).

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

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

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

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

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

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

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

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

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

5.84 Among these provisions, Article 15 appears to contain the basic interest rate provisions of the *Arrangement*, as the other provisions identified that specifically address interest rates seem to be dependent on and thus subordinate to it. Specifically, Article 15 establishes the basic rule that "minimum interest rates" are to be applied, i.e., respected, by all Participants when providing "official financing support". After establishing as a general principle the application of "minimum interest rates", Article 15 goes on to specify that the Commercial Interest Reference Rates ("CIRRs"), "shall" be applied. Specifically in respect of regional aircraft, Articles 22 and 28(b) of Annex III (the *Sector Understanding* for civil aircraft) provide that the CIRRs "shall" apply.

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

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

5.87 Article 16 puts into concrete technical terms how CIRRs are to be constructed, i.e., on the basis of a fixed margin over government bond yields of varying maturities. More specifically, this

⁷⁴ Annex III of the *OECD Arrangement*.

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

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

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

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

5.89 Finally, Articles 18 and 19 impose limits on “cosmetic interest rates”, which the *Arrangement* describes as rates below the relevant CIRR which benefit from official support, and which may involve a compensatory measure including a corresponding increase in the contract value or other contractual adjustment. These Articles provide, *inter alia* that official financing support by means of direct financing *shall not* be provided at rates below the CIRR, and that other official financing support also shall not be offered at below-CIRR (cosmetic) rates. Thus, these provisions appear to be intended to prevent Participants from offering official financing support for lower-than-CIRR financing, whether or not the below-CIRR rate is achieved directly through the face interest rate or through adjustment of the other terms and conditions of the financing to circumvent the CIRR minimum.

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

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

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

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

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

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

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

5.93 Having identified the "interest rates provisions" of the *OECD Arrangement*, we are next faced with the question of the types of "export credit practices" in respect of which interest rate provisions exist and therefore apply. This is a critical question, because, as noted above, qualification for the safe haven of the second paragraph of item (k) at present is exclusively determined by the conformity of an "export credit practice" with the interest rate provisions of the *Arrangement*. Thus, before we can be in a position to determine the conformity of a given export credit practice with those interest rate provisions, we will need to know whether it is of the type that conceptually could be subject to, and thus in conformity with, those provisions. This means, as a matter of logic, that conformity with the interest rate provisions is a meaningful issue only in respect of types of export credit practices for which such provisions exist.

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

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

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

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

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

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

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

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

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

5.98 On the basis of our identification of the *Arrangement*'s "interest rates provisions" and of the types of "export credit practices" to which those provisions apply, the only logical conclusion that we can draw is that the only *forms* of export credit practices which at present are potentially eligible for the safe haven are those subject to the interest rate provisions of the *Arrangement* in its current form, namely *direct credits/financing, refinancing and interest rate support*⁸⁴. By implication, this means that the other forms of official support for export credits covered by the *Arrangement* (e.g., guarantees and insurance), are simply not eligible for the safe haven, because they are not covered by the existing interest rate rule, and therefore cannot be "in conformity" or out of conformity with it. Thus, for now, there is no safe haven from the prohibition on export subsidies for these forms of official support⁸⁵. Rather, their conformity with the SCM Agreement can only be judged on the basis of Articles 1 and 3 of that Agreement.

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

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

5.101 The conclusion that *only* official financing support is potentially eligible for the safe haven does not necessarily mean, however, that *all* official financing support would be eligible. Rather, continuing the logic of the analysis, it would appear that the safe haven could only be potentially available to those specific kinds of official financing support to which the CIRRs (or if applicable, the

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

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

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

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

special minimum interest rates under the *Sector Understandings*) apply, given that these are the only *existing* systems of minimum interest rates under the *Arrangement*. Thus, in the case of regional aircraft, as the CIRRs are the relevant minimum interest rates, it is only support that is subject to the CIRRs with respect to which “conformity” with minimum interest rates – which are exclusively defined in terms of the CIRRs – even would be relevant and could be judged. Thus, the question of which export credit practices pertaining to regional aircraft are potentially eligible for the safe haven in the second paragraph of item (k) cannot be fully answered without considering the nature of the CIRRs.

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

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

5.104 Article 17(b) reads as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

such as those relating to maximum terms and minimum risk premiums, thereby circumventing the disciplines of the SCM Agreement⁹⁴.

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

5.110 Of course, the *Arrangement* does address and set limits with respect to many such terms and conditions, not limited to the minimum interest rate. Thus, in developing an approach for determining whether a given “official financing support” transaction qualifies for the safe haven of the second paragraph of item (k), it would seem appropriate to adopt an approach to the question of “conformity” with the interest rate provisions that is sufficiently broad to capture *not just* conformity with the CIRR standing alone, but *also* respect for the *Arrangement*’s limits on the generosity of the other financing terms having an effect on the interest rate. That is, recalling⁹⁵ that the stated purpose of the *Arrangement* is, *inter alia*, to “encourage competition among exporters...based on quality and price of goods and services exported rather than on the most favourable officially supported terms”, by placing “limitations on the terms and conditions of export credits that benefit from official support”, it would not make sense from the standpoint of the *Arrangement* to so narrowly interpret the concept of “conformity” with the interest rate provisions as to provide an exemption under the SCM Agreement for transactions that unabashedly circumvent that purpose. Nor would such a narrow interpretation make sense from the standpoint of the SCM Agreement, as doing so would have the effect of exempting from the prohibition on export subsidies practices that respected the CIRRs in name only, even if their other terms were so generous as to remove any limiting effect of the minimum interest rate rule.

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

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

⁹⁴ Id. at paras. 75-77.

⁹⁵ See para. 5.82 *supra*.

⁹⁶ At paras. 5.89-5.92, *supra*.

financing terms and conditions must be treated as a package, and that derogation from one will undercut the others.

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

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

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

5.115 A review of the *Arrangement* in the light of the above discussion suggests that the provisions that would need to be respected in order for official financing support to be in full conformity with the interest rate provisions would include, in addition to the provisions concerning the CIRR, most of the articles of Chapter II of the *Arrangement*, along with (for this dispute) most of the articles of Annex III, Parts 2 and 3 (*Sector Understanding* on Export Credits for Civil Aircraft, All New Aircraft Except Large Aircraft (Part 2) and Used Aircraft, Spare Engines, Spare Parts, Maintenance and Service Contracts (Part 3)). These provisions are discussed in detail in this section.

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

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

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

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

aircraft finance⁹⁹.) Finally, Article 26 establishes the maximum validity period for credit terms and conditions for an individual export credit or line of credit, again limiting the generosity of the financing terms and thus reinforcing the minimum interest rate rule.

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

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

Provisions of the *Arrangement* providing for exceptions and derogations

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

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

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

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

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

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

Arrangement must be *ipso facto* “in conformity” with it, even if it is recognized as a derogation. (This is in fact what Canada argues¹⁰⁴.) On the other hand, if even matched derogations (i.e., *non-conforming* departures from the rules) are considered to be “in conformity”, then the notion of “conformity” cannot be understood to represent a discipline or limitation of any kind.

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

5.122 We turn to the specifics of the Articles in question while bearing in mind all of these general considerations. Article 27 of Chapter 2, entitled the “no derogation engagement for export credits”, in fact envisages certain deviations. That is, as noted, this Article provides that Participants shall not derogate from maximum repayment terms, minimum interest rates, minimum premium benchmarks, the limitation on the validity period for credit terms and conditions, and shall not extend the repayment term by extending the repayment date of the first instalment of principal per Article 13(a).

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

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

5.125 On the other hand, Article 29 further provides that if an initiating offer “*does not comply* with the *Arrangement*”¹⁰⁹, competing Participants are permitted to match those non-complying terms. The *Arrangement* defines “derogation” as terms and conditions that “depart from” the rules of the

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

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

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

¹⁰⁷ Emphasis supplied.

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

¹⁰⁹ Emphasis supplied.

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

Conclusion based on textual analysis

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

5.127 Through the above textual analysis, we have arrived at a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the

¹¹⁰ OECD *Arrangement* Article 47(a).

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

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

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

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

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

other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or matching of derogations.

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

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

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

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

5.131 One implication of the broad approach in this context is that any practice that *is not out of conformity* with the relevant provisions of the *Arrangement*, whether or not even covered by

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

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

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

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

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

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

¹¹⁸ We note that, by contrast, no information is published on the minimum premium benchmarks. Thus, only Participants have access to this information. Given this, it is at present impossible for a non-Participant to have any idea whether a given transaction respects the rules concerning minimum premiums. Thus, until such time as the Participants make this information publicly available, non-Participants should be presumed to be respecting the minimum premium rules in the context of any analysis under the second paragraph of item (k). Canada also has recognized this issue and come to the same conclusion. In particular, Canada states that "it would be unreasonable to expect a non-OECD WTO Member to charge a premium level

forth the limits to most of the permitted exceptions. Thus these as well can be applied by all WTO Members, whether Participants or not¹¹⁹. Financing terms and conditions known only to Participants clearly cannot be universally applied.

5.135 We note further in this context the particular potential for different, indeed *stricter*, rules *de facto* applying to developing than to developed countries, or at a minimum for developed countries to be able *de facto* to enjoy the same less strict rules as are provided *de jure*, through the SCM Agreement's special and differential treatment provisions, to developing countries. Arguably, such situations would be out of keeping with one of the key stated purposes of the WTO Agreement, namely the need for positive efforts on behalf of developing countries (which is the basis for the extensive special and differential treatment provisions of the SCM Agreement)¹²⁰.

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

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

which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the *Arrangement*. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second paragraph of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants" (Canada's reply to the Panel's Canada Account question 3(h)).

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

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

also would qualify for that protection, even where the initiator of the derogation was not a WTO Member. In such circumstances, there would be no real disciplines of any kind on export credits. Such a reading of the *Arrangement* and of item (k) at a minimum would raise the question of why either of these sets of rules was necessary.

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

5.139 Finally, in our view the negotiating history of this provision does not support the broad reading advocated by Canada. In particular, we note that an early (if not the first) Tokyo Round proposal concerning this provision referred to the broad term "substantive guidelines", rather than the narrower term "interest rates provisions". (Proposal of the United States dated 6 December 1978.) The proposal did not identify or define this term, however. The reference to "substantive" provisions was not pursued in the negotiations, as the first version to be included in a Chairman's draft text of the Tokyo Round Subsidies Code of what became the second paragraph of item (k) (dated 15 December, 1978, just two weeks after the US proposal), already referred to the narrower term "interest rates provisions".

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

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

(i) Substance of the Policy Guideline

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

5.142 This being said, however, we recall that in Brazil's view, "the minimum burden accorded to Canada must be to explain with some precision what 'comply with the OECD Arrangement' will mean, so that Members are informed of the terms on which a measure previously judged to be or to provide a prohibited export subsidy will operate in the future". Given that Canada has stated that the Policy Guideline "ensure[s] that any future Canada Account financing transactions will be in

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

conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)”¹²², in our view it is incumbent upon Canada to provide an explanation not only of what in its view constitutes conformity with the interest rate provisions of the *OECD Arrangement*, but also how the Policy Guideline ensures such conformity.

5.143 We note that Canada has in fact provided certain explanations on these points¹²³. As discussed in the previous sections, the approach to this question that we have adopted differs considerably in substance from the approach advocated by Canada, however. Thus, even if the Policy Guideline contained all of the details that Canada has provided in its arguments concerning “conformity” with the “interest rates provisions” of the *Arrangement*, we would find on substantive grounds that it would not ensure that future Canada Account transactions would so conform. We note, however, that in fact the Policy Guideline contains no details at all, but simply indicates that transactions that “do not comply” with “the OECD Arrangement” will not be considered to be in the national interest. Thus, we find that the Policy Guideline is insufficient to accomplish what Canada says it will accomplish, namely to “ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second paragraph of item (k)”.

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

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

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

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

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

¹²⁴ Exhibit CDN-13. Emphasis supplied.

view it would be possible to craft affirmatively-worded language that would leave open this discretion¹²⁵.

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

- (a) That all Canada Account transactions in the regional aircraft sector would take the form of either direct credits/financing, refinancing or interest rate support (i.e., official financing support) with repayment terms of two years or more;
- (b) That such official financing support would be at fixed interest rates;
- (c) That the net interest rates¹²⁶ of all such transactions would be at or above the relevant CIRR;
- (d) That all applicable provisions of Articles 7-10 and 12-26 of the *Arrangement*, and of Articles 18-24¹²⁷ and Articles 27-29(a)-(c) of Annex III would be respected in full;
- (e) That any permitted exceptions would be within the limitations specified in the relevant provisions of the *Arrangement*;
- (f) That no derogations would be made, either at Canada's initiative or via matching.

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

(ii) *Form of the Policy Guideline*

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

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

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

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

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

mandatory under Canadian law, at a minimum mandatory language would need to be used, and provision would need to be made for consequences in the event of non-compliance¹²⁹.

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

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

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

(d) Summary

5.153 In summary, we have established a process for judging the conformity of a specific, individual transaction with the interest rate provisions of the *Arrangement*, and thus qualification for the safe haven in item (k). This process is based on the text of the SCM Agreement and the *OECD Arrangement*, read in the light of the object and purpose of the SCM Agreement. Under this approach, first, it would need to be determined that the transaction was in the form of either direct credits/financing, refinancing or interest rate support with repayment terms of at least two years, at

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

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

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

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

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

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

fixed interest rates, and therefore was subject to the *Arrangement* generally and to the CIRRs (or a sector-specific minimum interest rate, if applicable) specifically. Second, it would need to be determined whether the interest rate was at or above the CIRR (or the applicable sector-specific rate). Third, it would need to be determined which of the other provisions of the *Arrangement* that operate to reinforce the minimum interest rate rule applied to that particular transaction (a determination that would need to be made on a case-by-case, transaction-specific basis). Fourth, the details of the transaction would need to be examined to determine whether or not it respected all such additional provisions, and did not involve any derogations or matching of derogations. We have applied this process to the Policy Guideline, and found that the Policy Guideline is not sufficient to ensure that future Canada Account transactions in the regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and thereby qualify for the safe haven in the second paragraph of item (k) of Annex I of the SCM Agreement.

VI. CONCLUSION

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

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

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

6.4 We note that, by virtue of Article 19.1 of the DSU, the Panel "may suggest ways in which the Member concerned could implement the recommendations". In our view, Article 19.1 envisions suggestions regarding what could be done to a measure to bring it into conformity or, in the case of Article 4.7 of the SCM Agreement, what could be done to "withdraw" a prohibited subsidy. It does

not address the issue of surveillance of those steps. For that reason, we decline to make the suggestion requested by Canada.¹³⁵

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