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The *Dispute Settlement Reports* of the World Trade Organization (the "WTO") include panel and Appellate Body reports, as well as arbitration awards, in disputes concerning the rights and obligations of WTO Members under the provisions of the *Marrakesh Agreement Establishing the World Trade Organization*. The *Dispute Settlement Reports* are available in English, French and Spanish. Starting with 1999, the first volume of each year contains a cumulative index of published disputes.

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UNITED STATES – COUNTERVAILING MEASURES CONCERNING CERTAIN PRODUCTS FROM THE EUROPEAN COMMUNITIES

Report of the Appellate Body
WT/DS212/AB/R

Adopted by the Dispute Settlement Body
on 8 January 2003

United States, *Appellant*	Present:
European Communities, *Appellee*	Lockhart, Presiding Member
Brazil, *Third Participant*	Abi-Saab, Member
India, *Third Participant*	Bacchus, Member
Mexico, *Third Participant*	

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EC – Bananas III	Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591.
US – Countervailing Measures on Certain EC Products	Panel Report, *United States – Countervailing Measures Concerning Certain Products from the European*, WT/DS212/R, 31 July 2002.
US – Lead and Bismuth II	Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, adopted 7 June 2000, DSR 2000:V, 2601. Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R and Corr.2, adopted 7 June 2000, as upheld by the Appellate Body Report, WT/DS138/AB/R, DSR 2000:VI, 2631.
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755.

I. INTRODUCTION

1. The United States appeals certain issues of law and legal interpretations in the Panel Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities* (the "Panel Report").[1] The Panel was established to consider a complaint by the European Communities with respect to countervailing duties imposed or maintained by the United States on certain steel products originating in various Member States of the European Communities.

2. Countervailing duties were imposed or maintained by the United States Department of Commerce ("USDOC") in the course of 12 investigations: six original investigations, two administrative reviews, and four sunset reviews.[2] Certain analyses in these investigations were undertaken pursuant to a United States statute, 19 U.S.C. § 1677(5)(F) ("Section 1677(5)(F)")[3], which reads as follows:

> Change of ownership. A change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's length transaction.

The subject products in the 12 original investigations and reviews in issue were produced by formerly state-owned enterprises that had been privatized at the time of the 12 underlying administrative determinations. The European Communities alleges that the privatizations in all 12 cases took place at arm's

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[1] WT/DS212/R, 31 July 2002.

[2] The Panel adopted the following numbering system, which we will also use, to facilitate identification of the various administrative determinations at issue: *Stainless Sheet and Strip in Coils from France*, 64 Fed. Reg. 30774 (USDOC, 29 June 1999) (Case No. 1); *Certain Cut-to-Length Carbon Quality Steel from France*, 64 Fed. Reg. 73277 (USDOC, 29 Dec. 1999) (Case No. 2); *Certain Stainless Steel Wire Rod from Italy*, 63 Fed. Reg. 40474 (USDOC, 29 July 1998) (Case No. 3); *Stainless Steel Plate in Coils from Italy*, 64 Fed. Reg. 15508 (USDOC, 31 March 1999) (Case No. 4); *Stainless Steel Sheet and Strip in Coils from Italy*, 64 Fed. Reg. 30624 (8 June 1999) (Case No. 5); *Certain Cut-to-Length Carbon-Quality Steel Plate from Italy*, 64 Fed. Reg. 73244 (USDOC, 29 December 1999) (Case No. 6); *Cut-to-Length Carbon Steel Plate from Sweden*, 62 Fed. Reg. 16551 (USDOC, 7 April 1997) (Case No. 7); *Cut-to-Length Carbon Steel Plate from United Kingdom*, 65 Fed. Reg. 18309 (USDOC, 7 April 2000) (Case No. 8); *Certain Corrosion-Resistant Carbon Steel Flat Products from France*, 65 Fed. Reg. 18063 (USDOC, 7 April 2000) (Case No. 9); *Cut-to-Length Carbon Steel Plate from Germany*, 65 Fed. Reg. 47407 (USDOC, 2 August 2000) (Case No. 10); *Cut-to-Length Carbon Steel Plate from Spain*, 65 Fed. Reg. 18307 (USDOC, 7 April 2000) (Case No. 11); and *Grain-Oriented Electrical Steel from Italy*, 66 Fed. Reg. 2885 (USDOC, 12 January 2001) (Case No. 12). Case Nos. 1–6 correspond to original investigations, Case Nos. 7 and 12 to administrative reviews, and Case Nos. 8–11 to sunset reviews.

[3] Section 771(5)(F) of the United States Tariff Act of 1930, as amended, which, for purposes of the United States Code, is codified at 19 U.S.C. § 1677(5)(F), attached as Exhibit EC-4 to the European Communities' first submission to the Panel.

length and for fair market value. The United States did not rebut these allegations.[4] Both participants agree that the changes in ownership relevant to this dispute concern only privatizations, that is, the change in ownership from government to private hands.[5] All the privatizations concerned in this dispute involved a full change in ownership in the sense that in all 12 cases, governments had sold all, or substantially all, their ownership interests and, clearly, no longer had any controlling interests in the privatized producers.[6]

3. The 12 investigations relate to the impact of privatization of the firms under investigation on the existence of a countervailable benefit. The imposition or maintenance of countervailing duties in the 12 determinations was based on the existence of subsidies for the privatized producers, specifically, on the continuing benefit conferred by non-recurring financial contributions bestowed by the governments on the producers prior to privatization.

4. The Panel found that the United States had acted inconsistently with Articles 10, 14, 19.1, 19.4, 21.1, 21.2, 21.3, and 32.5 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and Article XVI:4 of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*")[7], and that it had nullified or impaired benefits accruing to the European Communities under these Agreements.[8] The Panel recommended that the Dispute Settlement Body (the "DSB") request the United States to bring its measures into conformity with its obligations under the *SCM Agreement* and the *WTO Agreement*.[9]

5. The United States notified the DSB on 9 September 2002 of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal[10] with the Appellate Body pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). The Notice of Appeal provides, in relevant part:

> The United States seeks review by the Appellate Body of the conclusions of the Panel set forth in paragraphs 8.1(a)-(d) and 8.2

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[4] The USDOC analyzed the sales conditions of the privatizations in two of the underlying sunset reviews (Case Nos. 8 and 10) and three of the original investigations (Case Nos. 1, 2, and 4), concluding that those five privatizations took place at arm's length and for fair market value. (See Panel Report, paras. 2.2, 2.39, and 2.45; Remand Redetermination in *Acciai Speciali Terni S.p.A. v. United States*, No. 99-06-00364, slip op. 02–10 (Court of International Trade, 1 February 2002), available at *http://www.ia.ita.doc.gov/remands/02-10.htm*; Remand Redetermination in *GTS Indus. S.A. v. United States*, No. 00-03-00118, slip op. 02-02 (Court of International Trade, 4 January 2002), (available at *http://www.ia.ita.doc.gov/remands/02-2.htm*; and Remand Redetermination in *Allegheny Ludlum Corp. v. United States*, No. 99–09–00566, slip op. 02-01 (Court of International Trade, 4 January 2002), available at *http://www.ia.ita.doc.gov/remands/02-1.htm*.)) The USDOC has made no admissions as to the conditions of sale surrounding the other privatizations at issue.

[5] Panel Report, para. 2.3.

[6] Panel Report, para. 2.3.

[7] *Ibid*., para. 8.1.

[8] *Ibid*., para. 8.2.

[9] *Ibid*., para. 8.3.

[10] WT/DS212/7, attached as Annex I to this Report.

of the Panel's report. These conclusions are in error, and are based upon erroneous findings on issues of law and on related legal interpretations.

6. The European Communities filed, on 10 September 2002, a Request for a Preliminary Ruling (the "Request"), pursuant to Rule 16.1 of the *Working Procedures*, to "order" the United States to file particulars "identifying the precise legal findings and legal interpretations that it is challenging."[11] The United States responded to the Request on 12 September 2002, arguing that the Request should be denied because the Notice of Appeal stated the Panel's findings and legal interpretations under appeal with sufficient clarity.[12]

7. On 12 September 2002, after considering the submissions on this issue by the European Communities and the United States, the Appellate Body "invite[d] the United States to identify the precise findings and interpretations of the Panel which are alleged, in the Notice of Appeal filed 9 September 2002, to constitute errors."[13] Responding to the invitation, the United States filed, on 13 September 2002, a document specifying further the errors of law and legal interpretations for which appellate review was requested. This document quoted the "Conclusions and Recommendations" paragraphs from the Panel Report[14], to which it had merely referred in the original Notice of Appeal, and added descriptions of particular errors of the Panel, as claimed by the United States.[15] The issues of the sufficiency of the Notice of Appeal and the request of the European Communities for dismissal of certain grounds of appeal were dealt with by the Participants in their written submissions and submissions at the oral hearing, and are dealt with by us later, under the heading "Procedural Issues".

8. On 19 September 2002, the United States filed its appellant's submission. On 4 October 2002, the European Communities filed its appellee's submission. On the same day, Brazil and India each filed a third participant's submission. Mexico filed a letter that day, pursuant to Rule 24(2) of the *Working Procedures*, stating its intention to participate and make an oral presentation as a third participant at the oral hearing.[16]

9. The Appellate Body also received on 19 September 2002 an *amicus curiae* brief from an industry association.[17] The European Communities, on 27 September 2002, filed a letter contesting the relevance of the *amicus curiae* submission to the Appellate Body's review, contending that the "arguments do

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[11] Request, para. 6.

[12] Letter dated 12 September 2002, from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Presiding Member of the Division hearing this appeal, pp. 2–3.

[13] Letter dated 12 September 2002, from the Director of the Appellate Body Secretariat to the Senior Legal Advisor, Permanent Mission of the United States to the WTO.

[14] Panel Report, paras. 8.1(a)–8.1(d) and 8.2.

[15] See Attachment to letter dated 13 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat.

[16] Letter dated 4 October 2002, from H.E. Mr. Eduardo Pérez Motta, Ambassador, Permanent Mission of Mexico to the WTO, to the Director of the Appellate Body Secretariat.

[17] Submission attached to letter dated 19 September 2002, from Andrew G. Sharkey III, American Iron and Steel Institute President & CEO, to the Presiding Member of the Division hearing this appeal.

not differ in substance from and largely repeat the arguments of the United States Government"[18], and requested the Appellate Body "to inform the parties whether it intends to accept and take account of the brief submitted [by the industry association.]"[19]

10. The Appellate Body responded to the request of the European Communities on 27 September 2002, stating that a decision on the admissibility or relevance of the *amicus* submission would not be made until the written and oral submissions of all the participants had been considered.[20] The Appellate Body therefore invited all the participants "to address the [*amicus curiae*] brief in the further course of this appeal."[21]

11. The oral hearing in the appeal was held on 22 October 2002. The participants and third participants presented oral arguments and responded to questions put to them by Members of the Division hearing the appeal.

II. FACTUAL BACKGROUND

A. The "Gamma" Method

12. The USDOC applied one of two different methods (referred to as the "*gamma*" and "same person" methods)[22] in conducting the 12 determinations to assess the impact of a change in ownership effected through privatization on the continued existence of the benefit of a countervailable subsidy. The *gamma* method was formerly used by the USDOC to determine the extent to which a non-recurring financial contribution provided to a state-owned enterprise should be amortized over time to arrive at a countervailable subsidy rate[23], particularly after sale of the subsidized entity to a private firm.[24] In applying this method, the USDOC employed an "irrebuttable presumption" that the benefits of that financial contribution would remain with the recipient over a standard period of time[25], such that "USDOC does not undertake an inquiry into whether and, if so,

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[18] Letter dated 27 September 2002, from the Minister-Counsellor, Permanent Delegation of the European Communities to the WTO, to the Presiding Member of the Division hearing this appeal, p. 1.

[19] *Ibid.*, p. 2.

[20] Letter dated 27 September 2002, from the Director of the Appellate Body Secretariat to the Minister-Counsellor, Permanent Delegation of the European Communities to the WTO.

[21] *Ibid*.

[22] We note that the Panel refers to the administrative practice challenged in this dispute as the "same person *methodology*". Article 14 of the *SCM Agreement* refers to the procedures used by investigating authorities to calculate the benefit as "method[s]", so we will use the term "method" rather than "methodology".

[23] Both participants agree that "it is a normal and accepted practice … for the importing Member to presume that a non-recurring subsidy will provide a benefit over a period of time, which is normally presumed to be the average useful life of assets in the relevant industry", (Panel Report, para. 7.75) a practice found permissible by the Appellate Body in *US – Lead and Bismuth II*, para. 62, so long as the presumption remained rebuttable.

[24] United States' first submission to the panel, para. 5, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 164.

[25] United States' first submission to the panel, paras. 6 and 44–45, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, pp. 164 and 172.

to what extent the subsidy continues to benefit production at any subsequent point in time. Rather, the USDOC simply will countervail the amount of the subsidy originally allocated to the year" under review.[26] When confronted with a change in ownership of the producer under investigation, the USDOC would devise a ratio so as to allocate the "irrebuttably presumed" benefit between the seller and purchaser.[27] This allocation "can result in the full pass through of benefits from prior subsidies, or absolutely no pass through of benefits, or anything in between, depending on the facts of a particular case."[28]

13. The application by the USDOC of the *gamma* method in previous determinations was reviewed by the panel in *US – Lead and Bismuth II*, whose decision was upheld by the Appellate Body. The Appellate Body determined that, rather than employing the *gamma* method's "irrebuttable" presumption that subsidization continues, the USDOC should have conducted a new determination as to the existence of a "benefit", as "*required*" by the *SCM Agreement*, "given the changes in ownership leading to the creation of" the newly-privatized entities in that case.[29] The Appellate Body further found that the "specific circumstances" of that case did not warrant a finding of the continued existence of a benefit after the privatization of the assets of the state-owned firm at arm's length and for fair market value.[30]

B. The "Same Person" Method

14. The "same person" method was devised as a replacement for the *gamma* method.[31] This method provides for a two-step test. The first step consists of an analysis of whether the post-privatization entity is the same legal person that received the original subsidy before privatization. For this purpose, the USDOC examines the following non-exhaustive criteria: (i) continuity of general business

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[26] United States' first submission to the panel, para. 44, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 172. See also *ibid.*, para. 43, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 171, which states:

> … the US countervailing duty statute contains "the irrebuttable presumption that nonrecurring subsidies benefit merchandise produced by the recipient over time," without requiring any re-evaluation of those subsidies based on the use or effect of those subsidies or subsequent events in the marketplace.

(Quoting *Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37263 (USDOC, 9 July 1993) (General Issues Appendix)).

[27] United States' first submission to the panel, para. 10, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 165.

[28] United States' first submission to the panel, para. 53, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 174.

[29] Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

[30] *Ibid.*, paras. 67–68 and 74.

[31] As noted above, in para. 13, the *gamma* method was found by the Appellate Body to be inconsistent with the United States' obligations under the *SCM Agreement*, because the method does not permit the investigating authority to re-examine its original benefit determination "given the changes in ownership leading to the creation of" the privatized firms. (Appellate Body Report, *US – Lead and Bismuth II*, para. 62) Before the decision of the Appellate Body in *US – Lead and Bismuth II*, the *gamma* method had similarly been rejected by a United States appellate court as inconsistent with the USDOC's governing statute (in particular, with Section 1677(5)(F)). (See *Delverde Srl v. United States*, 202 F.3d 1360 (Fed. Cir. 2000) ("*Delverde III*"))

operations; (ii) continuity of production facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel. If, as a result of the application of these criteria, the USDOC concludes that *no new legal person* was created, the analysis of whether a "benefit" exists stops there, and the USDOC will not assess whether the privatization was at arm's length and for fair market value. The subsidy is automatically found to continue to exist for the post-privatization firm.[32] By contrast, if, as a consequence of the application of these criteria, the USDOC concludes that the post-privatization entity is *a new legal person*, distinct from the entity that received the pre-privatization subsidy, the USDOC will not impose duties on goods produced after privatization on account of the pre-privatization subsidy.[33]

15. In 11 of the 12 determinations at issue in this case, the USDOC applied the *gamma* method. These 11 determinations included six original investigations (Case Nos. 1–6), one administrative review (Case No. 7), and four sunset reviews (Case Nos. 8–11). The United States conceded the inconsistency of seven of these determinations (Case Nos. 1–7) with its WTO obligations, based on its acknowledgement that it must re-examine the continued existence of a benefit in the light of the findings of the panel and Appellate Body in *US – Lead and Bismuth II*.[34] With respect to the remaining four *gamma* determinations (Case Nos. 8–11), all sunset reviews, the United States did not concede inconsistency; rather, the United States argued before the Panel that, where no administrative reviews have taken place, an investigating authority is not required to consider evidence subsequent to the original investigation in evaluating whether the expiry of the countervailing duty would be likely to lead to continuation or recurrence of subsidization causing injury.[35] The Panel found to the contrary.[36] The "same person" method was applied in only one of the determinations at issue on appeal, which was an administrative review (Case No. 12).

16. The Panel concluded, as the United States had conceded, that in the *gamma*-based original investigations and administrative review (Case Nos. 1–7), the USDOC had failed to determine the existence (or continued existence) of a benefit before the imposition or maintenance of countervailing duties.[37] The Panel also concluded, regarding the four sunset reviews applying the *gamma* method (Case Nos. 8–11), that the USDOC had similarly failed to examine the continued existence of a benefit, and therefore, had not properly determined the likelihood of continuing or recurring subsidization.[38] With regard to the "same person" method, the Panel found that it was "itself inconsistent with the SCM

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[32] United States' response to questioning at the oral hearing.

[33] *Ibid*. The USDOC will, however, proceed to examine, in such an event, whether any *new* subsidy had been bestowed upon the post-privatization entity's new owners as a result of the change in ownership (e.g., by assessing whether the sale was for fair market value and at arm's length). (*Ibid.*)

[34] Panel Report, para. 7.84.

[35] Panel Report, paras. 7.104–7.105. Such evidence would include, as in the cases here, changes in ownership occurring after the provision of the relevant financial contribution.

[36] *Ibid*., para. 7.114.

[37] Panel Report, paras. 7.86, 7.98, 8.1(a), and 8.1(b).

[38] *Ibid*., paras. 7.114–7.116 and 8.1(c).

Agreement" [39], and therefore, also found its application in administrative review Case No. 12 to be WTO-inconsistent.[40] In sum, the Panel found all 12 determinations to be WTO-inconsistent.

C. The Consequences of Privatization

17. As regards the consequences of privatization for the purpose of determining the continued existence of a "benefit", the Panel found that privatization at arm's length and for fair market value "must [lead to] the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer".[41] On this premise, the Panel concluded that Section 1677(5)(F) is inconsistent with the United States' WTO obligations because "Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit and the SAA"[42], prevented the USDOC from automatically reaching the conclusion in every case that, following privatization at arm's length and for fair market value, "no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer".[43]

III. ARGUMENTS OF THE PARTICIPANTS AND THIRD PARTICIPANTS

A. Claims of Error by the United States – Appellant

1. Privatizations at Arm's Length and for Fair Market Value

18. The United States claims that the Panel erred in (i) ignoring the distinction between shareholders and firms when interpreting who is the "recipient" of a "benefit", in the light of Articles 1 and 14 of the *SCM Agreement* and Appellate Body jurisprudence, and (ii) consequently determining that, contrary to the text of the *SCM Agreement* and economic reason, an arm's-length privatization for fair market value necessarily extinguishes the benefit received from a previously-bestowed, non-recurring financial contribution.

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[39] Panel Report, para. 7.90.

[40] *Ibid*., paras. 7.81 and 8.1(b).

[41] *Ibid*., para. 8.1(d).

[42] Panel Report, para. 8.1(d). The Statement of Administrative Action ("SAA") was submitted by the President to the United States Congress with the Uruguay Round Agreements Act, the proposed statutory scheme enacting the WTO Agreements into United States domestic law. The SAA "represents an authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round agreements". (H.R. Rep. No. 103-316(I), at 656 (1994)) Congress further adopted the SAA:

> … as an authoritative expression by the United States concerning the interpretation and application of the Uruguay Round Agreements and this Act in any judicial proceeding in which a question arises concerning such interpretation or application.

(19 U.S.C. § 3512(d))

[43] Panel Report, para. 8.1(d).

19. The United States argues that the distinction between shareholders and firms, a "bedrock principle"[44] underlying the corporation laws of most advanced industrial jurisdictions, is recognized by the *SCM Agreement*, and that the Panel therefore impermissibly rejected this distinction when evaluating the determinations of the USDOC. Noting that a "benefit", as used in Article 1.1(b) of the *SCM Agreement*, must be conferred upon a "recipient", as provided for in Article 14 of that Agreement, the United States insists that the plain meaning of the term "recipient" cannot include both the benefiting foreign producer and a shareholder of that producer.[45] The United States finds contextual support for this reading in the forms of financial contribution identified in Article 1.1(a) and in the calculation guidelines of Article 14, arguing that these articles contemplate the recipient of a benefit to be a "firm" rather than, as the Panel found, some amalgamation of a firm and its shareholders.[46]

20. It is therefore "not surprising", in the view of the United States, that the Appellate Body, in *Canada – Aircraft* and in *US – Lead and Bismuth II*, should have expressly identified "legal or natural persons" as the recipients addressed in the *SCM Agreement*.[47] The United States submits that "when the Appellate Body found that benefits are received by legal persons, it necessarily was referring to such legal persons as defined by 'the legal business structure established pursuant to national corporate law'".[48] The United States adduces that the Panel, in finding that "the concept of benefit is independent of the legal business structure established pursuant to national corporate law" [49], unduly ignored this "legal business structure".[50] The United States argues that "[g]overnments subsidize producers, not their shareholders"[51], and to conclude, as the Panel did, that no distinction should be made between a firm and its shareholders for purposes of the *SCM Agreement*, is to ignore the economics of investor behaviour and the "simple logic"[52] underlying the conferring of a benefit upon a foreign producer (not its shareholders) under the *SCM Agreement*.

21. The United States further contests the Panel's finding that privatization at arm's length and for fair market value necessarily extinguishes the benefit the privatized entity received from a non-recurring financial contribution when that entity was owned by the state.

22. The United States argues that the "essence … [of] the Panel's error was to consider the economic effects of a sale from the perspective of *the new shareholders*, rather than from the perspective of *the legal person producing the subject merchandise*, or the parties injured by the subsidized imports in

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44 United States' appellant's submission, para. 60.
45 *Ibid*., para. 56.
46 United States' appellant's submission, paras. 58–59.
47 *Ibid*., para. 65.
48 *Ibid*., para. 66, quoting Panel Report, para. 7.50.
49 United States' appellant's submission, para. 65, quoting Panel Report, para. 7.50.
50 United States' appellant's submission, para. 66.
51 *Ibid*., para. 76.
52 *Ibid*.

question".[53] (original emphasis) Consequently, the Panel ignored the fact that "a change in the shareholders of a subsidy recipient does not remove the new equipment, extract knowledge from the workers, or increase the previously lowered debt load."[54] According to the United States, privatization, even if at arm's length and for fair market value, cannot extinguish the benefit of a financial contribution because of the economic reality that "subsidies shift the recipient's supply curve and, as a result, also change the point at which supply and demand for the products made by the recipient intersect in the marketplace."[55] To the extent that any purchase price paid by new shareholders fails to reduce the "artificially enhanced competitiveness generated by the subsidies" [56] and thereby return the market to its counterfactual position in the absence of previous subsidization, privatization *per se* has no impact on the continued existence of a benefit in the formerly state-owned firm. Accordingly, the United States submits that the Panel erred in finding that, despite the distinctions between the legal personalities of the enterprise (a corporation) and its owners (the shareholders), in an arm's-length privatization, the new owners (that is, the shareholders, *not* the legal person that was the original recipient of the subsidy) could extinguish the non-amortized part of the benefit by paying a fair market price for the state-owned enterprise.

2. The "Same Person" Method

23. The United States additionally challenges the Panel's finding that the "same person" method is inconsistent with the United States' WTO obligations, in particular, with the findings of the Appellate Body in *US – Lead and Bismuth II*. The United States alleges that this erroneous finding stems from the Panel's misunderstanding of the Appellate Body's rationale in *US – Lead and Bismuth II*. According to the United States, "[t]he reason why the Appellate Body concluded in *Lead and Bismuth II (AB)* that the original subsidies at issue did *not* continue to benefit the producer in question was precisely because that producer was not the same legal person that had received those subsidies".[57] (original emphasis) Therefore, in the United States' view, the critical factor weighing in the Appellate Body's decision in *US – Lead and Bismuth II* was the creation of a new legal person subsequent to the privatization transaction. This is the most logical reading of the decision, the United States argues, because the "legal or natural person" receiving the benefit is responsible for repaying the benefit so as to avoid countervailing duty liability.

24. Legal persons such as corporations, the United States reiterates, are separate "persons" from their shareholder-owners. It follows that if a legal person (say, a state-owned enterprise) receives a benefit and, following privatization, that legal person continues to exist, the benefit would also continue to exist (until

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53 United States' appellant's submission, *Ibid.*, para. 46.
54 *Ibid.*, para. 49.
55 United States' appellant's submission, para. 50.
56 *Ibid.*, para. 49.
57 *Ibid.*, para. 4.

fully amortized or repaid), irrespective of the price paid by its new private owners.[58] Because the "same person" method focuses on the "benefit" as received by the "legal person" existing before and after privatization, consistent with the emphasis of the Appellate Body in *Canada – Aircraft* and in *US – Lead and Bismuth II*, the United States urges reversal of the Panel's contrary finding.

3. Consistency of 19 U.S.C. § 1677(5)(F), as such, with WTO Obligations

25. The Panel further erred, according to the United States, in finding a United States statute, Section 1677(5)(F), inconsistent as such with the United States' WTO obligations. The United States contends that, although the Panel acknowledged the proper standard to apply in evaluating the WTO-consistency of Section 1677(5)(F) as such, it erred in the application of that standard to the facts of this case. The United States agrees with the Panel that "[o]nly legislation that 'requires' a violation of GATT/WTO rules can be found to be inconsistent with WTO rules," and that "legislation 'as such' is considered mandatory if it cannot be applied in a manner consistent with the SCM Agreement."[59] According to the United States, this standard is contradicted by the Panel's subsequent characterization that legislation may be WTO-inconsistent if it does not "systematically"[60] produce a WTO-mandated outcome.[61] The United States submits that the *SCM Agreement* does not require Members to enact legislation incorporating *per se* rules guaranteeing a WTO-consistent outcome in every case. For the Panel to conclude otherwise adds to the rights and obligations of Members, contrary to Articles 3.2 and 19.2 of the DSU.[62]

26. The European Communities failed to meet its burden, according to the United States, to show that the United States legislation prevented the USDOC from arriving at WTO-consistent determinations in countervailing duty cases. Section 1677(5)(F) itself provides the USDOC with the discretion to ensure that its countervailing duty investigations and reviews are conducted in a manner consistent with the United States' WTO obligations.[63] In the light of this discretion, the United States argues that the Panel, had it applied the correct standard, could not have concluded that Section 1677(5)(F) "mandates WTO-inconsistent action".[64]

27. The critical error of the Panel in arriving at its conclusion, according to the United States, was its flawed interpretation of Section 1677(5)(F), particularly based on a misreading of United States case law applying this

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[58] United States' appellant's submission, para. 6.
[59] United States' appellant's submission, para. 107, quoting Panel Report, paras. 7.120–7.121.
[60] The Panel uses the term "systematically" to describe a result that would follow "automatically", namely, occurring always as a necessary consequence. (European Communities' response to questioning at the oral hearing)
[61] United States' appellant's submission, para. 108, quoting Panel Report, paras. 7.132, 7.140, and 8.1(d).
[62] United States' appellant's submission, para. 109.
[63] *Ibid.*, para. 110.
[64] *Ibid.*, para. 112.

statute. The United States notes that it repeatedly indicated to the Panel that if it were found that an arm's-length privatization extinguished the benefit from previous non-recurring financial contributions, the USDOC could make countervailing duty determinations consistent with such a finding, without any change in legislation.[65] The Panel, however, found that, as interpreted in a United States court case referred to as *Delverde III* [66], the USDOC would be precluded from conducting countervailing duty investigations and reviews in a WTO-consistent manner, as those cases relate to the calculation of a benefit subsequent to a change in ownership.[67] The United States argues that *Delverde III*, at best, is ambiguous with respect to the specific facts of this case and to the relevance of a privatization at arm's length *and* for fair market value.[68] Although the United States raised this issue before the Panel during the interim review stage, the Panel did not respond to it.[69] Accordingly, the United States submits that the Panel failed to "perform an objective assessment of the matter" before it, as required by Article 11 of the DSU.[70]

B. Arguments of the European Communities – Appellee

1. Privatizations at Arm's Length and for Fair Market Value

28. The European Communities argues that privatization at arm's length and for fair market value necessarily extinguishes any benefit remaining from a previously-bestowed financial contribution by the government when the company was a state-owned enterprise. According to the European Communities, the Panel correctly rejected the distinction between firms and their owners for purposes of determining whether a benefit exists under the *SCM Agreement*. The European Communities submits that, according to Article 1.1(b) of the *SCM Agreement*, a "financial contribution need not be directly provided to its recipient" [71] and "the recipient of a financial contribution need not be the same as the recipient of the benefit conferred thereby, as long as the required causal relationship between the contribution and the benefit is established."[72]

29. The finding in *Canada – Aircraft* that the "recipient" of a "benefit" may include a "group of persons" establishes, in the view of the European Communities, that the "recipient" need not be limited to the single firm exporting subject merchandise, but may also include that firm's owners, that is, its shareholders.[73] The European Communities further submits that the Appellate Body, "by concluding [in paragraph 68 of the Appellate Body Report in *US* –

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65 United States' appellant's submission, paras. 115–117.
66 *Delverde III*, *supra*, footnote 31.
67 United States' appellant's submission, para. 117.
68 *Ibid.*, paras. 118–121.
69 *Ibid*., para. 122.
70 *Ibid*., para. 113.
71 European Communities' appellee's submission, para. 38.
72 *Ibid.*, para. 47.
73 *Ibid*., paras. 23 and 28.

Lead and Bismuth II] that no 'benefit' was conferred [on the privatized enterprise] as a result of the payment of fair market value in an arm's-length transaction limited to the sale of shares … implicitly accepted that the concept of a 'recipient,' as a 'natural or legal person,' is not limited to the company itself, but also includes its owner." [74]

30. The European Communities alleges that the United States does not itself regard the shareholder-firm distinction as absolute. In this regard, the European Communities notes that "the USDOC recognises that subsidies conferred on one part of an economic entity will liberate resources that can be applied to another part of the entity, and hence, for the purpose of countervailing duties, those subsidies are 'attributed' to the production and exports of the entire entity".[75] (footnote omitted) The European Communities also argues that the lack of consistency in the United States' position is further evidenced in the second step of its "same person" method, where "the United States considers that a benefit corresponding to the extent of the difference between the transaction value and fair market value is a benefit to the company as well as its owners." [76]

31. Because a clear line dividing firms from their owners is unsupported by the *SCM Agreement*, the European Communities rejects the United States' position that a benefit, and therefore a countervailable subsidy, can remain after private purchasers have purchased the shares of a state-owned enterprise for fair market value in an arm's length transaction. The European Communities recalls that the Appellate Body recognized in *Canada – Aircraft* that a "benefit" is conferred if "the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[77] This is a "well-established market benchmark standard"[78] that the United States does not appear to respect in focusing its economic analysis on the market distortions caused by previous subsidies. The European Communities consequently regards such distortions as beyond the scope of the "benefit" defined in Article 1.1(b) of the *SCM Agreement*.[79]

32. The European Communities submits that the sale of a state-owned firm at arm's length and for fair market value necessarily satisfies the marketplace comparison contemplated in *Canada – Aircraft* so as to remove any "advantage"[80] that a firm may have held before as a result of a non-recurring financial contribution from the government.[81] According to the European Communities, because "benefit" is defined in relation to the marketplace, as established in *Canada – Aircraft*, a firm privatized at arm's length and for fair market value receives nothing on terms more favourable than what the market itself would have provided. The benefits derived from previous financial

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74 European Communities' appellee's submission, para. 27.
75 *Ibid*., para. 63.
76 *Ibid*., para. 52.
77 *Ibid*., para. 68, quoting Appellate Body Report, *Canada – Aircraft*, para. 157.
78 European Communities' appellee's submission, para. 70.
79 *Ibid*., paras. 76–78.
80 *Ibid*., para. 57, quoting Appellate Body Report, *Canada – Aircraft*, para. 153.
81 European Communities' appellee's submission, paras. 57–59.

contributions are reflected in the firm's balance sheet and accordingly reflected in the price attributed to the firm by the market. In the argument of the European Communities, once the firm is privatized, "[t]he prior subsidies granted to the state-owned producer neither reduce costs nor enhance revenue as far as the privatised producer is concerned."[82] Therefore, the firm's products no longer benefit from previous financial contributions because those products would be competing in the marketplace on the same terms as those of its competitors. In this respect, the European Communities recalls that the USDOC, "[i]n the 'General Issues Appendix' attached to its 1993 determination in *Certain Steel Products from Austria*, … explained [the importance of privatization by stating] that … 'the privatized company now has an obligation to provide to its private owners a market return on the company's full value.'"[83] (footnote omitted)

33. Finally, if the market benchmark standard established by the Appellate Body in *Canada – Aircraft* for calculating the amount of a subsidy is satisfied, the European Communities argues that it is not additionally necessary to establish that subsidies have been repaid to the government, although the fair market value paid for a privatized entity could, as the Panel suggested, "be regarded as 'repayment' of prior subsidies".[84]

2. The "Same Person" Method

34. The European Communities argues that, contrary to the United States' understanding, the Appellate Body, in *US – Lead and Bismuth II*, clearly identified the obligation on the part of investigating authorities to re-examine the existence of a subsidy once they are notified of a privatization resulting in a change of control of the firm at issue.[85] In the view of the European Communities, the interpretation urged by the United States impermissibly inserts an intermediate step before the investigating authority would be required to determine whether a benefit continues to exist, that is, investigating authorities notified of a privatization would undertake a re-examination only if the privatized producer is not the "same person" as the pre-privatized producer.[86] According to the European Communities, no such intermediate step was contemplated by the Appellate Body in *US – Lead and Bismuth II*, as the obligation on the investigating authority flowed directly from the change in ownership.

35. The European Communities argues that the *SCM Agreement* does not permit imposition or maintenance of countervailing duties without a re-examination by the investigating authority of the elements of a subsidy. Accordingly, the European Communities submits that the "same person" method is inconsistent with the United States' WTO obligations because it expressly

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[82] European Communities' appellee's submission, para. 69.
[83] *Ibid*., para. 65, quoting *Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37262 (USDOC, 9 July 1993) (General Issues Appendix).
[84] European Communities' appellee's submission, para. 72.
[85] *Ibid*., para. 32.
[86] *Ibid*.

requires the countervailing of benefits presumed to continue to exist after such a privatization. In such an instance, the United States would effectively be imposing countervailing duties in excess of or in the absence of subsidization. Moreover, the European Communities submits that the "same person" method, "[b]y maintaining a focus on the continuity of the productive operations of the producer … is premised on the same assumption that underlay the 'gamma' methodology, [in respect of which] [t]he Appellate Body has already determined that bind[ing] the benefits of previous subsidies to the productive operations of a producer is inconsistent with the *SCM Agreement*." [87] (footnote omitted)

36. Consequently, according to the European Communities, the "same person" method prevents the USDOC from undertaking the task imposed by the *SCM Agreement* and the Appellate Body's decision in *US – Lead and Bismuth II*, namely, the re-evaluation of the existence of a benefit upon notice of a change in ownership. As a result, the European Communities requests the Appellate Body to uphold the Panel's conclusions in paragraphs 8.1(a), 8.1(b), and 8.1(c), as "the 'same-person' methodology leads to the imposition of countervailing duties in the absence of, or in excess of, subsidies, in violation of Articles 10, 14, 19.1, 19.4, 21.1, 21.2, and 21.3 of the *SCM Agreement*."[88]

3. Consistency of 19 U.S.C. § 1677(5)(F), as such, with WTO Obligations

37. The European Communities argues that the Panel correctly found that Section 1677(5)(F), as such, is inconsistent with the United States' WTO obligations under the *SCM Agreement*. As an initial matter, the European Communities argues that a measure is "mandatory" where "a Member's legislation prohibits the administrative authorities from doing something that is WTO-consistent, without leaving effective options".[89] The European Communities, disagreeing with the Panel in this regard, insists that the plain language of Section 1677(5)(F) sufficiently denotes the "mandatory" nature of the measure.[90] According to the European Communities, the Appellate Body, in *US – Lead and Bismuth II*, established that once a firm is privatized for fair market value, benefits from previously-bestowed financial contributions can no longer exist for the privatized firm.[91] Because Section 1677(5)(F) prevents the USDOC from arriving at such a WTO-mandated conclusion, the measure, which is mandatory, is, as such, inconsistent with the United States' obligations under the *SCM Agreement*.

38. The European Communities also alleges that the "mandatory" nature of this statute is reinforced by the fact that the statute, about which guidance is

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[87] European Communities' appellee's submission, para. 7, referring to Appellate Body Report, *US – Lead and Bismuth II*, paras. 56–58.
[88] European Communities' appellee's submission, para. 86.
[89] *Ibid*., para. 106.
[90] *Ibid*., para. 108.
[91] European Communities' appellee's submission, para. 109.

found in the SAA[92] and as interpreted by United States courts, denies the USDOC the authority to act as required under the *SCM Agreement*, namely, to conclude that no benefit exists as a direct result of an arm's-length privatization.[93] Because the Panel thoroughly investigated the application of Section 1677(5)(F) by reviewing its application in the light of other domestic legal tools, and because the Panel provided the United States sufficient opportunity to present alternative interpretations before the Panel, the European Communities argues that the Panel acted in accordance with DSU Article 11.[94]

39. Even if the measure were found to be discretionary, the European Communities submits that such discretion is incompatible with the nature of the WTO obligations at issue. The European Communities notes that the *SCM Agreement* prohibits absolutely the imposition or maintenance of countervailing duties in the absence of a subsidy. Section 1677(5)(F) expressly preserves the USDOC's discretion to levy countervailing duties notwithstanding the fact that a benefit (and hence, a subsidy) cannot exist for a firm privatized at arm's length and for fair market value. Such discretion to do what is so clearly prohibited by the *SCM Agreement* "is nothing more than a license for nuisance."[95] In this regard, given the centrality of security and predictability to the multilateral trading system, the European Communities argues that the maintenance of the discretion to act in a manner prohibited by WTO obligations undermines such predictability and renders even the discretionary elements of Section 1677(5)(F) WTO-inconsistent, as such.[96]

40. The European Communities observes, however, that the Appellate Body may be able to resolve this issue without reviewing the Panel's decision. The European Communities submits that the Panel's finding in paragraph 8.1(d) of the Panel Report may be regarded as "moot" if the United States is correct and can confirm that Section 1677(5)(F) contains discretion to ensure compliance with WTO obligations regarding the extinguishing of a benefit after an arm's-length privatization.[97] In the view of the European Communities, such confirmation could be presented in the form of:

> … good faith assurances from the United States that the USDOC would determine, systematically, that no benefit passes through to the privatised producer wherever the facts establish that a change of ownership transaction has taken place at arm's length and for fair market value …[98]

The European Communities submits that, although the United States failed to offer such assurances to the Panel, the United States' willingness to do so before the Appellate Body would be sufficient to render Section 1677(5)(F), as such,

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92 See *supra*, footnote 42.
93 European Communities' appellee's submission, paras. 111–119.
94 *Ibid*., paras. 110–111, 118, and 120.
95 *Ibid*., para. 125.
96 *Ibid*., paras. 126–127.
97 European Communities' appellee's submission, paras. 102–104.
98 *Ibid*., para. 102.

not inconsistent with the obligations of the *SCM Agreement*, as understood by the Appellate Body in *US – Lead and Bismuth II*.[99]

C. Arguments of the Third Participants[100]

1. Brazil

a) Privatizations at Arm's Length and for Fair Market Value

41. Brazil observes that "[t]he relevant question … is whether [the] benefit survived privatization"[101] (footnote omitted) and contends that the United States, without foundation, "believes that once equity is provided on terms inconsistent with normal considerations of private investors, it remains on such terms regardless of whether that equity is subsequently sold on terms that are consistent with normal considerations of private investors."[102] Brazil argues that the United States, in emphasizing the shift in the firm's supply curve caused by subsidization, and requiring a readjustment of the supply curve before finding no remaining benefit from a financial contribution, confuses the existence of a countervailable subsidy with the effects of such a subsidy. Brazil submits that, whereas such market distortion may result from a subsidy, it is irrelevant for purposes of identifying a subsidy under Article 1.1 of the *SCM Agreement*.

42. Brazil contends that the obligation to determine a benefit under Article 1.1 of the *SCM Agreement* requires a comparison with the marketplace, as the Appellate Body held in *Canada – Aircraft* and in *US – Lead and Bismuth II*. Such a comparison, in Brazil's view, necessarily entails an examination of the conditions surrounding the sales transaction to assess whether a recipient continued to be advantaged vis-à-vis its competitors, particularly so in the case of equity infusions, as supported by Article 14(a) of the *SCM Agreement*. A fair market purchase price removes the benefit of an equity infusion otherwise in the firm because, when compared with the provision of equity in the marketplace, the shareholders of the new firm will have paid the amount mandated by the market for all the corporation's assets, goodwill, etc. The former beneficiary firm will thus no longer be receiving any advantage because what had previously been a "benefit" (that is, an equity infusion presumably inconsistent with considerations of private investors) has effectively been paid for, and consequently, "[t]he company's costs are in fact altered because they now include the necessity of generating a return to the owners"[103] for the full value of their investment.

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[99] European Communities' appellee's submission, paras. 102–103.
[100] Pursuant to Rule 24(2) of the Working Procedures, Mexico did not file a written submission, but it did make a statement and respond to questioning at the oral hearing.
[101] Brazil's third participant's submission, para. 23.
[102] *Ibid*., para. 29.
[103] Brazil's third participant's submission, para. 52.

b) "Same Person" Method

43. Brazil argues that the United States mischaracterizes the decisions of the panel and the Appellate Body in *US – Lead and Bismuth II*. Contrary to the reading proffered by the United States, Brazil understands that in that case, the panel found that investigating authorities were obliged under the *SCM Agreement* to determine whether a benefit continues to exist upon a change in ownership of the investigated firm, regardless of whether such a transaction resulted in the creation of a new legal entity. This emphasis on the change in ownership was affirmed by the decision of the Appellate Body, which, under Brazil's reading, also accepted the panel's conclusion that a benefit does not remain in a post-privatization entity after an arm's-length, fair market value privatization. Accordingly, Brazil finds no support for the United States' position that the change in legal personality was central to the decisions in *US – Lead and Bismuth II*, thereby justifying the shareholder-firm distinction underlying the "same person" method.

44. Brazil further submits that, pursuant to the obligations under Article 1.1 of the *SCM Agreement*, and the precondition in footnote 36 of Article 10 that countervailing duties are only to offset subsidies, the elements of a subsidy (as identified in Article 1.1) must be established in every investigation. The "same person" method is inconsistent with the obligations in the *SCM Agreement*, according to Brazil, because it irrebuttably presumes that the pre-privatization benefit received by a state-owned firm accrues to the post-privatization entity when the two companies are the same legal person. The "same person" method thus permits the imposition of countervailing duties without requiring the investigating authority initially to establish the existence of a "benefit" upon a change in ownership in every case.

c) Consistency of 19 U.S.C. § 1677(5)(F), as such, with WTO Obligations

45. Brazil argues that the Panel correctly found that Section 1677(5)(F), as interpreted by the United States Court of Appeals for the Federal Circuit and the SAA[104], is inconsistent, as such, with United States' obligations under the *SCM Agreement*. The Panel properly recognized that only legislation compelling a violation of a WTO obligation (that is, "mandatory" legislation) may be found to be inconsistent, as such, with a Member's WTO commitments.[105] As the Panel found the plain text of Section 1677(5)(F) to vest the USDOC with discretion, Brazil submits that the Panel correctly looked to the domestic context of Section 1677(5)(F), including its application in practice and binding legislative history, to determine whether such discretion was "imaginary or ineffective".[106] Brazil argues that, based particularly on a review of the legislative history and case law relating to Section 1677(5)(F), the Panel made numerous findings to substantiate its conclusion that the USDOC is, in effect, prevented from arriving

[104] See *supra*, footnote 42.
[105] Brazil's third participant's submission, para. 34.
[106] *Ibid.*

automatically at the conclusion that, following an arm's-length, fair market value privatization, a benefit from a previously-bestowed financial contribution is necessarily extinguished.[107]

46. Brazil contests the United States' charge that the Panel effectively employed an erroneous standard when evaluating the nature of Section 1677(5)(F) as mandatory or discretionary. Brazil finds the United States' claim of error to be based on "semantics".[108] In the submission of Brazil, the Panel's conclusion that "Section 1677(5)(F) is WTO-inconsistent because it does not 'systematically' allow for a result consistent with *Lead and Bismuth II* … [is] no different than stating that Section 1677(5)(F) requires a WTO-inconsistent result."[109] (footnote omitted)

47. Brazil further argues that the United States' claim that the Panel ignored the ambiguity created by the United States Court of Appeals for the Federal Circuit in the interpretation of Section 1677(5)(F) in *Delverde III* is not persuasive. In this respect, Brazil notes that, in any event, the *Delverde III* court clearly found that Section 1677(5)(F) prevents the USDOC from concluding that a benefit could be extinguished solely through an arm's-length privatization.[110] Brazil says that this reasonable interpretation underlay the Panel's finding of a violation as such because, although the USDOC is empowered to find no benefit after a change in ownership, it would be precluded from making such a finding on the basis of an arm's-length privatization for fair market value "in and of itself"[111], which it is required to do under the *SCM Agreement*.

2. India

48. India argues that, when evaluating whether a benefit continues to exist, no distinction should be made between the benefit conferred as a result of a financial contribution to the shareholders or to their firms.[112] Accordingly, the Panel correctly focused its analysis on the "recipient," determined to be the company and shareholders "together" under the *SCM Agreement*.[113] India notes that the benefit in such evaluations must be measured against the marketplace, as the Appellate Body recognized in *Canada – Aircraft*.[114] India agrees that when a company is sold for fair market value, its purchase price, as determined by the market, necessarily includes the value of the benefit conferred by the previous financial contribution. India says that it therefore considers "fair" the conclusion that privatization at arm's length and for fair market value requires the

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[107] Brazil's third participant's submission, para. 36.
[108] *Ibid*., para. 39.
[109] *Ibid*.
[110] *Ibid*., paras. 41–43.
[111] Brazil's third participant's submission, para. 38.
[112] *Ibid*., p. 5.
[113] *Ibid*., quoting Panel Report, para. 7.54.
[114] Brazil's third participant's submission, p. 5 and footnote 9.

investigating authority to conclude that a benefit from the prior financial contribution no longer remains with the privatized firm.[115]

IV. ISSUES RAISED IN THIS APPEAL

49. The following issues are raised in this appeal:

- One is whether the Panel erred in finding that privatization, at arm's length and for fair market value, "*systematically*"[116] extinguishes the "benefit" from previously-bestowed non-recurring financial contributions.
- Another is whether the Panel erred in finding that the United States failed to comply with its obligations under Articles 10, 14, 19.1, 19.4, 21.1, 21.2, and 21.3 of the *SCM Agreement*, in using a method of calculating the "benefit" to the "recipient" that presumes conclusively that if the state-owned enterprise and the post-privatization firm are the same "legal person", the "benefit" received by the state-owned enterprise *automatically* continues to exist with the newly-privatized firm.
- A third is whether the Panel erred in finding that 19 U.S.C. § 1677(5)(F) is, *per se*, inconsistent with Articles 10, 14, 19, and 21 of the *SCM Agreement*, because it prevents the USDOC from *automatically* concluding that, following privatization at arm's length and for fair market value, the "benefit" of a prior non-recurring financial contribution bestowed on the state-owned enterprise no longer "accrue[s]"[117] to the privatized producers; and, consequently, that the "United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the *WTO Agreement*".[118]

V. PROCEDURAL ISSUES

50. We turn first to the procedural issues raised in this appeal. The first procedural issue is the European Communities' challenge to the sufficiency of the United States' Notice of Appeal. The European Communities requests that we dismiss the United States' appeal with respect to three alleged errors by the Panel on the ground that they were not included in the Notice of Appeal. The second procedural issue relates to the *amicus curiae* brief submitted by an industry association. We will deal with each of these procedural issues in turn.

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[115] Brazil's third participant's submission, p. 5.
[116] As to the term "systematically", see *supra*, footnote 60.
[117] Panel Report, para. 8.1(d).
[118] *Ibid*.

A. Sufficiency of the Notice of Appeal and Request for Dismissal of Certain Aspects of the Appeal

51. The United States filed a Notice of Appeal on 9 September 2002, which provides:

> Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the Working Procedures for Appellate Review, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the panel report on *United States – Countervailing Measures Concerning Certain Products from the European Communities* (WT/DS212/R) and certain legal interpretations developed by the Panel.
>
> The United States seeks review by the Appellate Body of the conclusions of the Panel set forth in paragraphs 8.1(a)-(d) and 8.2 of the Panel's report. These conclusions are in error, and are based upon erroneous findings on issues of law and on related legal interpretations.[119]

52. On 10 September 2002, the European Communities the filed a Request for a Preliminary Ruling (the "Request"), alleging that the United States' Notice of Appeal "is manifestly not in conformity with Rule 20(2)(d) of the *Working Procedures for Appellate Review*"[120] because it "fails to identify the findings or the legal interpretations that it considers to be erroneous."[121] The European Communities argued that "[a]s a consequence, the European Communities is unable to prepare its response to the appeal."[122] The European Communities asked us to "order the United States, pursuant to Rule 16(1) of the Working Procedures, immediately to file further and better particulars to its notice of appeal identifying the precise legal findings and legal interpretations that it is challenging."[123]

53. By letter of 12 September 2002, the United States responded that the Request of the European Communities was unfounded, arguing that the Notice of Appeal meets the requirements of Rule 20(2)(d) of the *Working Procedures* because "[i]t identifies, by reference to the paragraphs of the Panel Report concerned, the findings and legal interpretations of the Panel that the United States is appealing as erroneous. As interpreted by the Appellate Body, Rule 20(2)(d) requires no more."[124] The United States, relying on our ruling in *US – Shrimp*, asserted that it did not have to include arguments in support of the allegations of error in the Notice of Appeal, as those arguments need only be set out in the appellant's submission.

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[119] WT/DS212/7, attached as Annex I to this Report.
[120] Request, para. 1.
[121] *Ibid.*, para. 4.
[122] *Ibid.*, para. 5.
[123] *Ibid.*, para. 6.
[124] Letter dated 12 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Presiding Member of the Division hearing this appeal, p. 2.

54. The United States rejected the European Communities' argument that a Notice of Appeal serves to inform the appellee and third parties of the issues to be raised on appeal. The United States argued that providing notice of the subject-matter of the appeal cannot be the objective of a Notice of Appeal, because there is no requirement to file a Notice of Appeal with respect to a cross-appeal. The United States concluded that "it is clear that the notice of appeal serves a limited purpose: rather than providing a preview of argumentation (of which the cross-appellee (the initial appellant) receives none at all), the notice of appeal is simply a formal trigger for initiating the appeal."[125] The United States found support for its position in Articles 16.4[126] and 17.5[127] of the DSU. Both refer to notifying a decision to appeal; and neither refers to requirements to notify the grounds of appeal.

55. On 12 September 2002, we invited the United States "to identify the precise findings and interpretations of the Panel which are alleged, in the Notice of Appeal filed on 9 September 2002, to constitute errors."[128] The United States responded by letter dated 13 September 2002.[129] In an attachment to that letter, the United States quoted in full the paragraphs of the Panel Report to which it had merely referred by number in the Notice of Appeal. The United States also provided information as to legal errors allegedly committed by the Panel.[130]

56. In its appellee's submission, the European Communities alleges that certain issues argued in the United States' appellant's submission were not included in the United States' Notice of Appeal (or in the attachment to the letter of 13 September 2002). In particular, the European Communities identifies the following issues as those on which the United States failed to claim error by the Panel in the Notice of Appeal:

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[125] Letter dated 12 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Presiding Member of the Division hearing this appeal, p. 2.

[126] Article 16.4 of the DSU provides as follows:

> Within 60 days after the date of circulation of a panel report to the Members, the report shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report. If a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB until after completion of the appeal. This adoption procedure is without prejudice to the right of Members to express their views on a panel report. (footnote omitted)

[127] Article 17.5 of the DSU provides as follows:

> As a general rule, the proceedings shall not exceed 60 days from the date a party to the dispute formally notifies its decision to appeal to the date the Appellate Body circulates its report. In fixing its timetable the Appellate Body shall take into account the provisions of para. 9 of Article 4, if relevant. When the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days.

[128] Letter dated 12 September 2002 from the Director of the Appellate Body Secretariat, to the Senior Legal Advisor, Permanent Mission of the United States to the WTO.

[129] Letter dated 13 September 2002, from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat.

[130] Attachment to letter dated 13 September 2002, from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat.

– "The United States did not allege error in the Panel's finding that administering authorities are required, following notification of a privatisation, to re-examine whether any 'benefit' accrues to the privatised producer";

– "the United States [did not] allege any error in the interpretation of the 'mandatory-discretionary' standard adopted by the Panel to find that Section 1677(5)(F) is inconsistent as such with the *SCM Agreement*"; and

– "the United States [did not] raise any claim of error in the application of Article 11 of the [DSU]."[131] (footnotes omitted)

The European Communities alleges that these issues are therefore not properly before the Appellate Body and should be dismissed.[132]

57. The United States responded to these contentions at the oral hearing, arguing that it is sufficient in a Notice of Appeal to identify the findings of a panel that are being appealed, and that there is no requirement to identify in it why a particular finding is in error. Nor is there any requirement, according to the United States, to include arguments in the Notice of Appeal, such as an argument that a panel failed to act consistently with Article 11 of the DSU. The United States submits that arguments are to be elaborated in the appellant's submission. The United States consequently rejects the contention that the three issues identified by the European Communities are outside the scope of the appeal.

58. On this first procedural issue, we begin our analysis by recalling Rule 20 of the *Working Procedures*, which, as its title attests, establishes guidelines for the commencement of an appeal. Paragraph 1 of Rule 20 states that:

Commencement of Appeal

20. (1) An appeal shall be commenced by notification in writing to the DSB in accordance with paragraph 4 of Article 16 of the DSU and simultaneous filing of a Notice of Appeal with the Secretariat.

Paragraph 2 of Rule 20 prescribes the "information" that must be included in the Notice of Appeal. In addition to the title of the panel report being appealed, the name of the appellant, and the service address and contact coordinates, subparagraph 20(2)(d) states that the Notice of Appeal "shall include" the following information:

[131] European Communities' appellee's submission, para. 17.

[132] *Ibid.*, para. 19. India concurs with the European Communities that the United States' Notice of Appeal is inadequate, arguing that it is "too brief that the [appellee] and the third parties could not make out as to what legal issues were in appeal." (India's third participant's submission, p. 2.) India, however, does not expressly seek the dismissal of certain issues argued by the United States in its appellant's submission.

> d) a brief statement of the nature of the appeal, including the allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel.

59. The requirements in Rule 20(2)(d) for the Notice of Appeal should be contrasted with those in Rule 21(2)(b) of the *Working Procedures*, where we have stated what "shall [be] set out" in the appellant's submission. Those requirements are:

> i) a precise statement of the grounds for the appeal, including the specific allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel, and the legal arguments in support thereof;
>
> ii) a precise statement of the provisions of the covered agreements and other legal sources relied on; and
>
> iii) the nature of the decision or ruling sought.

Thus, both the Notice of Appeal and the appellant's submission must set out the allegations of errors; but, the appellant's submission must be more specific in this regard. The appellant's submission must be precise as to the grounds of appeal, the legal arguments which support it, and the provisions of the covered agreements and other legal sources upon which the appellant relies.

60. As we have said previously, "the right of a party to appeal from legal findings and legal interpretations reached by a panel in a dispute settlement proceeding is an important new right established in the DSU".[133] Furthermore, we have affirmed that "the provisions of Rule 20(2) and other Rules of the *Working Procedures for Appellate Review* are most appropriately read as to give full meaning and effect to the right of appeal".[134] In *US – Shrimp*, where the Joint Appellees sought dismissal of the entire appeal on the ground of insufficiency of the Notice of Appeal, we discussed the elements required for a Notice of Appeal. We said there:

> The *Working Procedures for Appellate Review* enjoin the appellant to be *brief* in its notice of appeal in setting out "the nature of the appeal, including the allegations of errors". We believe that, in principle, the "nature of the appeal" and "the allegations of errors" are sufficiently set out where the notice of appeal *adequately identifies the findings or legal interpretations of the Panel which are being appealed as erroneous*. The notice of appeal is not expected to contain the reasons why the appellant regards those findings or interpretations as erroneous. The notice of appeal is not designed to be a summary or outline of the arguments to be made by the appellant. The legal arguments in support of the allegations

[133] Appellate Body Report, *US – Shrimp*, para. 97.
[134] *Ibid*.

> of error are, of course, to be set out and developed in the appellant's submission.[135] (underlining added)

In that appeal, we upheld the Notice of Appeal against claims that it was "vague and cursory"[136], finding that, although it did not cite the numbered paragraphs of the Panel Report containing the findings that were the subject of that complaint, and although the references in it to the panel's findings were "terse, … there [was] no mistaking which findings or interpretations of the Panel the Appellate Body [was] asked to review."[137] (footnote omitted)

61. At the same time, we confirmed in *US – Shrimp* that "an appellee is, of course, always entitled to its full measure of due process."[138] In another appeal, *EC – Bananas III*, we explained that the Notice of Appeal serves to give notice to the appellee of the findings being appealed.[139] In that appeal, we excluded from the scope of appeal a finding that had not been "covered" in the allegations of error set out in the Notice of Appeal because the appellee "had no notice that the European Communities was appealing this finding."[140]

62. In sum, our previous rulings have underscored the important balance that must be maintained between the right of Members to exercise the right of appeal meaningfully and effectively, and the right of appellees to receive notice through the Notice of Appeal of the findings under appeal, so that they may exercise their right of defence effectively. Hence, we disagree with the contention of the United States here that the Notice of Appeal "serves a limited purpose" as "simply a formal trigger for initiating the appeal."[141] Indeed, if this were the only objective of the notice, our *Working Procedures* would have included only the first paragraph of Rule 20, which refers to commencement of an appeal through written notification to the Dispute Settlement Body and Appellate Body Secretariat. However, Rule 20 also prescribes additional requirements for commencing an appeal; it provides that the Notice of Appeal must include "a brief statement of the nature of the appeal, including the allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel." [142] The notification under Rule 20(1) serves as the "trigger" to which the United States refers. The additional requirements under Rule 20(2) serve to ensure that the appellee also receives notice, albeit brief, of the "nature of the appeal" and the "allegations of errors" by the panel.

63. We turn now to the question whether the United States' Notice of Appeal in this case met the requirements for a Notice of Appeal set out in Rule 20(2)(d).

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[135] Appellate Body Report, *US – Shrimp*, para. 95.
[136] *Ibid.*, para. 92.
[137] *Ibid.*, para. 96.
[138] *Ibid.*, para. 97.
[139] Appellate Body Report, *EC – Bananas III*, para. 152.
[140] *Ibid*.
[141] Letter dated 12 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Presiding Member of the Division hearing this appeal, p. 2.
[142] The United States' comparison to the lack of notice provided to a cross-appellee is not appropriate because the *Working Procedures* do not impose any notification requirements under such circumstances.

We must determine whether the Notice of Appeal was sufficient to give notice to the European Communities that the three alleged claims of error by the Panel, which the European Communities argues were not included in the Notice, were in fact being appealed.

64. In conducting our analysis, we will examine both the Notice of Appeal and the letter of 13 September 2002 supplementing the Notice of Appeal. Although the *Working Procedures* do not expressly provide for the filing of clarifications or further particulars or supplementary or amended Notices of Appeal, we consider it appropriate, in the particular circumstances of this case, to examine both documents with a view to giving "full meaning and effect to the right of appeal."[143] We note in particular that the additional document was filed by the United States in response to our invitation to do so, based in part on a request for additional particulars filed by the European Communities. Moreover, the additional document was filed shortly after the filing of the Notice of Appeal (three days). Finally, we note that the European Communities referred to both the Notice of Appeal and the letter of 13 September 2002 in its arguments on this issue.[144]

65. The Notice of Appeal referred only to the paragraph numbers of the Panel Report where the Panel set out its "Conclusions and Recommendations" (namely paragraphs 8.1(a)-8.1(d) and 8.2). The attachment to the letter of 13 September 2002 quotes the cited paragraphs of the Panel Report in full, and provides the following additional information about the appeal:

> In particular, the Panel erred in finding that:
>
> – subsidies are received by hybrid entities consisting of the company producing subject merchandise and its shareholders (*see, e.g.*, para. 7.54 of the Panel Report), so that a sale of the company to the new shareholders automatically creates a "new" producer for which a new determination of the existence of a benefit is required;
>
> – the payment of fair market value for a company's shares negates previous subsidies provided to that company (*see, e.g.*, para. 7.72 of the Panel Report);
>
> – the so-called "same person methodology" is inconsistent with the SCM Agreement.

66. The first issue identified by the European Communities as not being included in the Notice of Appeal or in the letter of 13 September 2002 is the finding by the Panel that "administering authorities are required, following notification of a privatisation, to re-examine whether any 'benefit' accrues to the privatised producer." A plain reading of the "Conclusions and Recommendations" from the Panel Report, referred to in the Notice of Appeal and quoted in full in the attachment to the letter of 13 September 2002, makes

[143] Appellate Body Report, *US – Shrimp*, para. 97.

[144] European Communities' appellee's submission, paras. 13 and 16; European Communities' statement at the oral hearing as well as responses to questioning at the hearing.

clear that the obligation to conduct a new determination of whether a benefit continues to exist, following notice of a firm's privatization, was a critical component of the appeal. Paragraphs 8.1(a), 8.1(b) and 8.1(c) of the "Conclusions and Recommendations" state:

> (a) The six determinations in the original investigations, based on the gamma methodology, are inconsistent with the SCM Agreement, since the US Department of Commerce did not examine whether the privatizations were at arm's-length and for fair market value; thus *the United States failed to determine whether the new privatized producer received any benefit from prior financial contributions previously bestowed to state-owned producers*.
>
> …
>
> (b) The two determinations made in the context of administrative reviews and based on the gamma methodology (Case No. 7) and on the same person methodology (Case No. 12), are inconsistent with the SCM Agreement since the US Department of Commerce did not examine whether the privatization that occurred after the original imposition of countervailing duties, was at arm's-length and for fair market value; thus *the United States failed to determine whether the privatized producers received any benefit from the financial contributions previously bestowed to the state-owned producers*.
>
> …
>
> (c) The four determinations made in the context of sunset reviews and based on the gamma methodology are inconsistent with the SCM Agreement, since the US Department of Commerce did not examine whether the privatizations, that occurred after the original imposition of countervailing duties, were at arm's-length and for fair market value. Thus *the United States failed to determine whether the privatized producers received any benefit from the financial contributions previously bestowed to the state-owned producers* ...[145] (emphasis added)

67. Each of these paragraphs refers explicitly to the failure of the USDOC to determine if the privatized producer received a benefit as a result of the financial contribution bestowed prior to the privatization. Inherent in these findings is the Panel's view that authorities are required, upon being notified of a privatization, to determine if a privatized producer continues to receive a benefit from a financial contribution bestowed prior to the privatization. Moreover, the attachment to the letter of 13 September 2002 refers to the Panel having erred in finding that "a sale of the company to the new shareholders automatically creates a '*new*' *producer for which a new determination of the existence of a benefit is required*." (emphasis added) In the light of these explicit references to the

[145] Panel Report, paras. 8.1(a)–8.1(c).

obligation to determine whether a "benefit" continues to exist after being informed of a privatization, we find that the United States provided adequate notice to the European Communities that the United States was appealing the Panel's finding that the United States acted inconsistently with its WTO obligations because it did not conduct such a determination following notice of a privatization. Thus, with respect to the first issue identified by the European Communities, we consider that the Notice of Appeal meets the requirements of Rule 20(2)(d) and that the first issue is properly before us in this appeal.

68. The second deficiency claimed by the European Communities is that "[T]he United States [did not] allege any error in the interpretation of the 'mandatory-discretionary' standard adopted by the Panel to find that Section 1677(5)(F) is inconsistent as such with the *SCM Agreement*".[146] In this regard, we note that paragraph 8.1(d) of the "Conclusions and Recommendations" section of the Panel Report, to which the United States referred in the Notice of Appeal, and quoted in full in the attachment to the letter of 13 September 2002, states:

> Once an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer. To the extent that Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit and the SAA, *requires* the US Department of Commerce to apply a methodology where the benefit from a prior financial contribution is not systematically found to no longer accrue to the privatized producer solely by virtue of an arm's-length for fair market value privatization, *is preventing the United States from exercising a WTO-compatible discretion*. Therefore, Section 1677(5)(F) is inconsistent with Articles 10, 14, 19 and 21 of the SCM, as interpreted by the Panel and the Appellate Body Reports in *US – Lead and Bismuth II* and this Panel. As Section 1677(5)(F) is found to be inconsistent with the *SCM Agreement*, the United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the WTO Agreement respectively. (original emphasis; underlining added)

69. In our view, the reference in this paragraph to the Panel's interpretation of Section 1677(5)(F) as *preventing USDOC from exercising discretion* in a WTO-compatible manner was sufficient to alert the European Communities to the fact that the United States was appealing the Panel's characterization and application of the mandatory-discretionary standard in interpreting Section 1677(5)(F) as being, as such, inconsistent with the United States' WTO obligations. Therefore, with respect to the second issue identified by the European Communities, we consider that the Notice of Appeal meets the requirements of Rule 20(2)(d) and that the second issue is properly before us in this appeal.

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[146] European Communities' appellee's submission, para. 17.

70. We observe that, in coming to these conclusions, we have before us a rather unusual example of the "Conclusions and Recommendations" section of a panel report. In most panel reports, the "Conclusions and Recommendations" section is relatively brief, setting out findings in summary fashion. Detailed legal interpretations and reasoning upon which panels rely are usually found only in the "Findings" sections of panel reports. In this case, however, the Panel's "Conclusions and Recommendations" are more detailed than usual. Paragraphs 8.1(a)–8.1(d) of the Panel Report include, not only the Panel's findings, but also certain of the reasons leading to those findings. Hence, in this case, it is possible, by reading the "Conclusions and Recommendations" section from the Panel Report, to discern alleged errors of law appealed by the United States. We emphasize, however, that generally, a Notice of Appeal that refers simply to the paragraph numbers found in the "Conclusions and Recommendations" section of a panel report, or that quotes them in full, will be insufficient to provide adequate notice of the allegations of error on appeal, and, hence, will fall short of the requirements set out in Rule 20(2)(d) of the *Working Procedures*.

71. The third issue that the European Communities alleges was not properly notified is that "[T]he United States [did not] raise any claim of error in the application of Article 11 of the [DSU]"[147], which provides:

> *Function of Panels*
>
> The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an *objective assessment* of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. (emphasis added)

72. We do not find any explicit reference to Article 11 of the DSU, or to the language of Article 11 in the Notice of Appeal, or in the attachment to the letter of 13 September 2002. Nor can we discern in either of them any suggestion that the United States was alleging that the Panel failed to make an objective assessment of the matter before it, or an objective assessment of the facts of the case.

73. The United States acknowledged during the oral hearing that it is not possible to discern from the Notice of Appeal and attachment to the letter of 13 September 2002 that the United States was alleging a *claim* of error under Article 11 of the DSU.[148] However, as mentioned earlier[149], the United States contended that it was not necessary to refer to this in the Notice of Appeal

[147] European Communities' appellee's submission, para. 17.
[148] United States' response to questioning at the oral hearing.
[149] See *supra*, para. 57.

because this was merely an *argument* in support of its allegations of error, and *arguments* need not be included in a Notice of Appeal. In addition, the United States posited that it was not appropriate to refer to "claims" in the context of a Notice of Appeal, as claims are more appropriately referred to in the context of requests for establishment of a panel. [150]

74. We disagree with the United States. A *claim* of error by a panel under Article 11 of the DSU is possible only in the context of an appeal. By definition, this *claim* will not be found in requests for establishment of a panel, and panels therefore will not have referred to it in panel reports. Accordingly, if appellants intend to argue that issue on appeal, they must refer to it in Notices of Appeal in a way that will enable appellees to discern it and know the case they have to meet.

75. Accordingly, we do not believe that the European Communities can be said to have been notified that the United States intended to argue on appeal that the Panel failed to act consistently with Article 11 of the DSU, and, consequently, we consider that the issue of the Panel's compliance with Article 11 of the DSU is not properly before us in this appeal.

B. The Amicus Curiae Brief

76. We turn next to the issue of the *amicus curiae* brief that we received from an industry association[151] in the course of this appeal. Both the United States and the European Communities agreed that we have the authority to accept the brief.[152] The United States confirmed that the brief was not a part of the official submission of the United States, but that the United States agreed with much, although not all, of the brief.[153] The European Communities said that it disagreed with a number of aspects of the brief, and argued that there was no reason for the Appellate Body to take the brief into account in this appeal.[154] We have considered the arguments of the participants and the third participants. The brief has not been taken into account by us as we do not find it to be of assistance in this appeal.

VI. INTRODUCTION TO THE SUBSTANTIVE ISSUES

77. Having dealt with the procedural issues, we turn now to the substantive issues in this appeal. Before doing so, it is useful to recall briefly the relevant law, the particular facts and circumstances[155], and the precise measures relevant to the appeal.

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[150] United States' response to questioning at the oral hearing.
[151] American Iron and Steel Institute.
[152] United States' and European Communities' responses to questioning at the oral hearing. The third participants disagreed.
[153] United States' responses to questioning at the oral hearing.
[154] European Communities' responses to questioning at the oral hearing.
[155] These are set out in more detail in paras. 1–17 of this Report and in paras. 2.1–2.61 of the Panel Report.

78. Article VI:3 of GATT 1994 permits Members of the WTO to impose a "countervailing duty" on products imported from other Members of the WTO "for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise."[156] Article 10 of the *SCM Agreement* provides that "Members shall take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement."[157] (footnote omitted)

79. Article 1 of the *SCM Agreement* sets out when a "subsidy" that may be "offset[]"[158] by "countervailing dut[ies]"[159] "shall be deemed *to exist*" for the purpose of the *SCM Agreement*.[160] (emphasis added) To satisfy the definition of a "subsidy", a "benefit"[161] must be "conferred"[162] on a "recipient".[163] Only a "subsidy" that "exist[s]" and that "confer[s]" a "benefit" on a "recipient" may be "offset" by "countervailing duties".

80. Article 19 of the *SCM Agreement* deals with the "Imposition and Collection of Countervailing Duties". Article 19.1 provides that, after, *inter alia*, "a final determination of the *existence* and *amount* of the subsidy", a Member may impose a countervailing duty "in accordance with the provisions" of that Article.[164] (emphasis added) Among those provisions is Article 19.4, which provides that "[n]o countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to *exist*, calculated in terms of subsidization per unit of the subsidized and exported product."[165] (emphasis added, footnote omitted)

81. Article 21 of the *SCM Agreement* deals with the "Duration and Review of Countervailing Duties and Undertakings". Article 21.1 provides, "A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury."[166] Article 21.2 imposes certain obligations relating to "reviews" of countervailing duties, including the administrative reviews before us on appeal, and Article 21.3 imposes certain obligations relating to "sunset reviews" of countervailing duties.

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156 Article VI:3 of the GATT 1994.
157 Article 10 of the *SCM Agreement.*
158 Article VI of the GATT 1994.
159 Article VI:3 of the GATT 1994.
160 Article 1.1 of the *SCM Agreement*.
161 Article 1.1(b) of the *SCM Agreement*.
162 *Ibid*.
163 Article 14 of the *SCM Agreement.* Although the term "recipient" appears in Article 14 and not in Article 1 of the *SCM Agreement*, we recognized in *Canada – Aircraft* that the ordinary meaning of Article 1.1(b), in conjunction with the structure of Article 1.1 and the context provided by the reference to "benefit to the recipient" in Article 14, reveal that "the word 'benefit', *as used in Article 1.1*, is concerned with the 'benefit *to the recipient*'". (Appellate Body Report, *Canada – Aircraft*, para. 155 (original emphasis))
164 Article 19.1 of the *SCM Agreement.*
165 Article 19.4 of the *SCM Agreement.*
166 Article 21.1 of the *SCM Agreement.*

82. Article 14 of the *SCM Agreement* requires that "any method used by the investigating authority" of a WTO Member "to calculate the benefit to the recipient … shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained."[167]

83. Article 32.5 of the *SCM Agreement* provides, "Each Member shall take all necessary steps, of a general or particular character, to ensure … the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement".[168] Similarly, Article XVI:4 of the *WTO Agreement* provides, "Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements", which include the *SCM Agreement*.[169]

84. Having set out the provisions of the covered agreements relevant to this dispute, we now clarify which issues *are* before us, and which issues *are not* before us. The issues that *are* before us on appeal arise from the determinations of the USDOC in 12 countervailing duty cases involving imports of steel products from the European Communities. The firms under investigation in those cases were all formerly state-owned enterprises that had been privatized at the time of the United States administrative determinations. The European Communities acknowledges that non-recurring financial contributions were provided to these formerly state-owned enterprises.[170] Therefore, that is not in dispute in this appeal. The United States does not contest that, in all 12 cases, the relevant governments privatized the state-owned enterprises by selling "all, or substantially all, [their] ownership interest and clearly no longer [retained] any controlling interest in the privatized producer"[171], and that the sales were at arm's length and for fair market value.[172] Consequently, that, too, is not in dispute. Both parties also concur that "it is a normal and accepted practice … for the importing Member to presume that a non-recurring subsidy will provide a benefit over a period of time, which is normally presumed to be the average useful life of assets in the relevant industry."[173] In *US – Lead and Bismuth II*, we found this practice permissible under the *SCM Agreement*, so long as the presumption was not irrebuttable.[174] Hence, that issue, likewise, is not before us in this appeal.

85. The issues in this appeal relate solely to the impact of the privatization of the firms under investigation in these 12 countervailing duty cases on the continued existence of the benefit derived from a financial contribution. As the Panel stated[175], the "core legal question" before it was to determine whether a "benefit" within the meaning of the *SCM Agreement*, which benefit is derived

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[167] Article 14 of the *SCM Agreement.*
[168] Article 32.5 of the *SCM Agreement.*
[169] Article XVI:4 of the *WTO Agreement.*
[170] Panel Report, footnote 313 to para. 7.40.
[171] *Ibid*., para. 7.62.
[172] See *supra*, para. 2 and footnote 4.
[173] Panel Report, para. 7.75.
[174] Appellate Body Report, *US – Lead and Bismuth II*, para. 62.
[175] Panel Report, para. 7.40.

from a non-recurring financial contribution, continues to exist following a transfer of ownership of a state-owned enterprise to a new private owner at arm's length and for fair market value, where the government retains no "controlling interest in the privatized producer"[176] and transfers all or substantially all the property.[177]

86. The European Communities challenges the administrative practice followed by the USDOC when examining whether a "benefit" continues to exist following a change in ownership. This administrative practice is called the "same person" method.[178] Before the Panel, the European Communities challenged this practice *as such* and *as applied* in the administrative review entitled *Grain-Oriented Electrical Steel from Italy* (Case No. 12).[179] In addition, before the Panel, the European Communities challenged the consistency with the WTO obligations of the United States, of Section 1677(5)(F) of Title 19 of the United States Code, as such. The Panel found in favour of the European Communities, and concluded that the United States had acted inconsistently with its obligations under Articles 10, 14, 19.1, 19.4, 21.1, 21.2, 21.3, and 32.5 of the *SCM Agreement*, and Article XVI:4 of the *WTO Agreement*. The United States appeals these findings.

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[176] Panel Report, para. 7.62.

[177] We observe, in particular, that the Panel has not examined whether a "benefit", within the meaning of the *SCM Agreement*, would be extinguished following a change in ownership under circumstances different from those in the 12 cases under consideration. (*Ibid.*) Hence, our analysis will be circumscribed to determine whether, in the light of the circumstances of this case, the findings and conclusions of the Panel are in conformity with the *SCM Agreement*.

[178] For an explanation of the "same person" method, see para. 14 of this Report. At the oral hearing, the United States argued that the "same person" method, as such, was not at issue before the Panel. The European Communities recalled that "the practice" of the USDOC was included in its request for the establishment of the Panel (WT/DS212/4) and noted that the Panel accordingly found, in para. 7.90 of the Panel Report, that "the same person methodology is itself inconsistent with the SCM Agreement". We note that the United States has not claimed before us that the Panel, in so finding, exceeded its mandate. We also note that the United States claimed, in clarifying its Notice of Appeal, that "the Panel erred in finding that … the so-called 'same person methodology' is inconsistent with the SCM Agreement." (Attachment to letter dated 13 September 2002, from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat, p.2)

[179] The 12 cases are listed in footnote 2 to this Report. Case No. 12, *Grain-Oriented Electrical Steel from Italy*, 66 Fed. Reg. 2885 (USDOC, 12 January 2001) ("*GOES from Italy*"), attached as Exhibit EC–7 to the European Communities' first submission to the Panel, is an administrative review and the only underlying administrative determination in which the USDOC applied the "same person" method in the first instance. The method has been applied by the USDOC in certain other countervailing duty determinations upon remand from the United States Court of International Trade (that is, where the Court has ordered the USDOC to reconduct those determinations). The United States claimed before the Panel, however, with apparently no rebuttal from the European Communities, that the determinations upon remand, which had applied the "same person" method, were not challenged by the European Communities. (Panel Report, footnote 81 to para. 2.55 (quoting United States' first submission to the Panel, para. 85)) Thus, in the course of making the twelve *initial* determinations (that is, not subsequent to a United States court appeal) in dispute, USDOC applied the "same person" method only once, namely, during the administrative review identified as Case No. 12.

VII. PRIVATIZATIONS AT ARM'S LENGTH AND FOR FAIR MARKET VALUE

A. The Panel's Finding

87. Critical to each of the Panel's conclusions is the Panel's central finding that:

> [o]nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer.[180] (emphasis added)

88. The United States submits that the Panel erred in making this fundamental finding because the Panel considered the economic effects of privatization from the perspective of the new owner, and not from that of the "*legal person producing the subject merchandise*".[181] (original emphasis) The United States alleges that, in doing so, the Panel ignored the distinction between firms and their shareholders. According to the United States, as legal persons are distinct from their shareholders, a "benefit" received by a legal person cannot be redeemed by its shareholders. The United States argues that, regardless of the price paid by the new private owner for the privatized firm[182], "[a] subsequent privatization does not move the [privatized enterprise's] supply curve back to where it had been" [183] before the government's provision of the previous financial contribution. The United States concludes that the economic analysis made by the Panel is therefore flawed.

89. According to the United States, the term "recipient" cannot include both a legal person and a shareholder of that legal person.[184] The United States contends that we acknowledged this distinction in *Canada – Aircraft* and in *US – Lead and Bismuth II* by expressly identifying "legal or natural persons" as the recipients addressed in the *SCM Agreement*.[185] Further, the United States argues that, if a state-owned enterprise (a legal person) receives a benefit and that same legal person continues to exist following privatization, then the benefit also continues to exist (until fully amortized or repaid), irrespective of the price paid by its new private owners.[186] The United States concludes, consequently, that such privatization, even if at arm's length and for fair market value, cannot extinguish the benefit of a financial contribution previously made to the recipient (that is, to the state-owned firm) because the recipient is the same legal person.

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[180] Panel Report, para. 8.1(d). This finding is also at the core of the Panel's conclusions in para. 8.1(a)–8.1(c).
[181] United States' appellant's submission, para. 46.
[182] "[F]or fair market value (or otherwise)". *Ibid*., paras. 2 and 6. See also United States' second submission to the Panel, para. 10; United States' response to questioning at the oral hearing.
[183] United States' appellant's submission, para. 50.
[184] *Ibid.*, para. 56.
[185] *Ibid.*, para. 65.
[186] United States' appellant's submission, para. 6.

90. In reply, the European Communities argues that, because a "benefit", as we established in *Canada – Aircraft*, is defined under the *SCM Agreement* in relation to the marketplace, a firm privatized at arm's length and for fair market value receives nothing on terms more favourable than what the market itself would have provided. Consequently, according to the European Communities, the sale of a firm at arm's length and for fair market value necessarily satisfies the marketplace comparison contemplated in *Canada – Aircraft*, so as to remove any "advantage"[187] that a firm may have held previously as a result of a non-recurring financial contribution from the government.[188]

91. The European Communities argues that the Panel correctly rejected the distinction between owners and firms for purposes of determining whether a "benefit" exists under the *SCM Agreement*. The European Communities points to our finding in *Canada – Aircraft*, that the "recipient" of a "benefit" could include a "group of persons". The European Communities maintains that this finding establishes that the "recipient" need not be limited to the firm exporting subject merchandise, but may also include that firm's owners.[189]

92. The European Communities also submits that, under Article 1.1(b) of the *SCM Agreement*, a "financial contribution need not be directly provided to its recipient"[190], and, further, that "the recipient of a financial contribution need not be the same as the recipient of the benefit conferred thereby, as long as the required causal relationship between the contribution and the benefit is established."[191] Moreover, the European Communities contends that, in practice, the United States does not regard the shareholder-firm distinction as absolute because the "the USDOC recognises that subsidies conferred on one part of an economic entity will liberate resources that can be applied to another part of the entity, and hence, for the purpose of countervailing duties, those subsidies are 'attributed' to the production and exports of the entire entity."[192] (footnote omitted)

93. In considering these arguments, we begin by noting the similarities of the issues in this case to the issues we examined in *US – Lead and Bismuth II*. In that case, the United States, as appellant, contended that the panel there had "'exceeded its authority' by, *in effect*, dictating a methodology that a privatization at fair market value *automatically* precludes any benefit from pre-privatization subsidies from being attributed to the successor, privatized company."[193] (emphasis added) In that appeal, we found that the panel had acted within the scope of its mandate, and we upheld the panel's conclusions.[194] However,

[187] Appellate Body Report, *Canada – Aircraft*, para. 153.
[188] European Communities' appellee's submission, paras. 57–59.
[189] *Ibid.*, paras. 23 and 28.
[190] *Ibid.*, para. 38.
[191] *Ibid.*, para. 47.
[192] *Ibid.*, para. 63.
[193] Appellate Body Report, *US – Lead and Bismuth II*, para. 18.
[194] *Ibid.*, para. 73.

contrary to that panel, we restricted our ruling to "the particular circumstances of [that] case" and to "the facts of [that] case".[195]

94. In the present case, the Panel made explicit what had merely been implicit in the report of the panel in *US – Lead and Bismuth II:*

> Privatizations at arm's-length and for fair market value *must* lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer. While Members may maintain a rebuttable presumption that the benefit from prior financial contributions (or subsidization) continues to accrue to the privatized producer, privatization[] at arm's-length and for fair market value is sufficient to rebut such a presumption.[196] (emphasis added)

95. Thus, the Panel found that privatization at arm's length and for fair market value will *always* necessarily extinguish the remaining part of a benefit previously existing with the state-owned enterprise. By contrast, the United States argues, on appeal, that a change in ownership, irrespective of the price paid for the transaction, will *never* extinguish the benefit when the state-owned enterprise and the new privatized firm are the *same* legal person. The United States supports this position by submitting legal and economic arguments seeking to demonstrate that a change in ownership, where the state-owned enterprise and the new firm remain the *same* legal person, *cannot* remove the benefit[197], irrespective of the price paid for acquiring the state-owned enterprise.[198] The United States does state, however, that if the two firms are *different* legal persons, the "USDOC would conclude that the new producer never received [the previous] subsidy and could not be subject to [countervailing duties] on its account."[199]

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[195] Appellate Body Report, *US – Lead and Bismuth II*, para. 74.

[196] Panel Report, para. 7.82. Compare Panel Report, *US – Lead and Bismuth II*, para. 6.81:

> Assuming "financial contributions" bestowed directly on BSC could be deemed to have been bestowed indirectly on UES and BSplc/BSES, this fact alone would not mean that pre-1985/86, untied, non-recurring "financial contributions" bestowed on BSC necessarily confer any "benefit" on UES or BSplc/BSES. This would only be the case if those "financial contributions" were found to have been bestowed indirectly (*i.e.*, through the relevant change-in-ownership transactions) on UES and BSplc/BSES respectively on terms more favourable than UES and BSplc/BSES respectively could have obtained in the market. We consider that such a finding would *only be possible if fair market value was not paid* for all productive assets etc. acquired by UES and BSplc/BSES respectively from BSC. *Since fair market value was paid for all such productive assets etc., we do not consider that any untied, non-recurring "financial contribution" bestowed indirectly on UES and BSplc/BSES could be deemed to confer a "benefit" on those entities*. (footnote omitted; underlining added)

[197] "[A] change in the shareholders of a subsidy recipient does not remove the new equipment, extract knowledge from the workers, or increase the previously lowered debt load." United States' appellant's submission, para. 49.

[198] See *supra*, footnote 182.

[199] United States' appellant's submission, para. 18. If the two enterprises are found to be *different* legal persons, the USDOC will continue to examine the terms of the sale to determine whether the

B. Interpretation of "Benefit"

96. We turn first to the interpretation of the term "benefit" under the *SCM Agreement*. The Panel reasoned that where privatization occurs following a financial contribution that provides a "benefit", "since the fair market value paid to the state-owned producer is deemed to include (*de facto*) the value of the advantage or benefit already received, … the privatization transaction for fair market value includes the repayment to the government of the subsidy *as valued by the market* at the time of privatization."[200] (emphasis added, footnote omitted) As a consequence, the Panel found that, in such a case, the "benefit" is "extinguish[ed]"[201], and, therefore, it no longer "accrue[s] to the privatized producer."[202]

97. The term "benefit" is not defined in the *SCM Agreement*. However, it is referred to explicitly in the definition of "subsidy" set out in Article 1.1, which provides:

> *Definition of a Subsidy*
>
> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member …
>
> and
>
> (b) a *benefit* is thereby conferred. (emphasis added)

98. In *Canada – Aircraft*, we found that:

> … the word 'benefit', as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution. In our view, *the marketplace provides an appropriate basis for comparison* in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market.[203] (emphasis added)

99. The United States argues, on appeal, that the Panel's finding that the benefit must always necessarily be extinguished upon privatization suffers from

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purchaser(s) of the privatized entity received a *new* subsidy as a result. (United States' responses to questioning at the oral hearing)

[200] Panel Report, para. 7.72.

[201] *Ibid.*, para. 7.77.

[202] *Ibid.*, para. 7.81.

[203] Appellate Body Report, *Canada – Aircraft*, para. 157.

a "basic economic misconception"[204] because "subsidies shift the recipient's supply curve and … subsequent privatization does not move the supply curve back to where it had been, and thus, … does not affect the continued existence of the subsidy."[205] The United States contends that the fact that the private owner pays full market price for the enterprise indicates only that the private *owner* is not receiving a *new* subsidy. It does not indicate, in the view of the United States, that "from the perspective of *the legal person producing the subject merchandise*"[206] (original emphasis), the effect of the subsidy has been eliminated. The United States supports this argument by noting that a change in ownership[207] "of a subsidy recipient does not *remove* the new equipment, extract knowledge from the workers, or increase the previously lowered debt load."[208] (emphasis added)

100. The United States advanced similar arguments before the Panel.[209] In considering these arguments, the Panel found that "[t]he United States seems to be 'attaching' the benefit to the production activity"[210], and noted that "countervailing duties are *not* designed to counteract all market distortions or resource misallocations which might have been caused by subsidization."[211] (underlining in original)

101. In contesting this finding before us, the United States argues that the Panel erred in characterizing the United States' position as suggesting that countervailing duties are "designed to counteract all market distortions".[212] The United States informs us that it has, in the light of our decision in *US – Lead and Bismuth II*[213], abandoned the position it held in that case, and that it no longer insists that benefits are conferred upon "production activity".[214] Furthermore, in response to questioning at the oral hearing, the United States confirmed[215] that it continues to stand by the following principle articulated by the USDOC in the context of an earlier domestic countervailing duty case:

> The [countervailing duty] law is designed to provide remedial relief as a result of subsidies; *it is not intended to recreate the* ex

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[204] United States' appellant's submission, para. 44.
[205] *Ibid.*, para. 50.
[206] *Ibid.*, para. 46.
[207] The United States assumes that ownership is held by means of shares.
[208] United States' appellant's submission, para. 49.
[209] See United States' first submission to the Panel, paras. 56–61.
[210] Panel Report, para. 7.80.
[211] *Ibid*.
[212] *Ibid.*
[213] In US – Lead and Bismuth II, para. 56, we stated:

> It is true, as the United States emphasizes, that footnote 36 to Article 10 of the SCM Agreement and Article VI:3 of the GATT 1994 both refer to subsidies bestowed or granted directly or indirectly "upon the manufacture, production or export of any merchandise". In our view, however, it does not necessarily follow from this wording that the "benefit" referred to in Article 1.1(b) of the SCM Agreement is a benefit to productive operations. (original emphasis)

[214] United States' appellant's submission, para. 41.
[215] United States' response to questioning at the oral hearing, discussing *Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37264 (USDOC, 9 July 1993) (General Issues Appendix).

> ante *conditions that existed prior to the bestowal of such subsidies* ... [T]he CVD law is concerned with the identification, measurement, and allocation of subsidies *at the time of receipt*.[216] (emphasis added)

102. We agree with the United States that, irrespective of the price paid by the new private owner[217], privatization does not *remove* the equipment that a state-owned enterprise may have acquired (or received) with a financial contribution and that, consequently, the same firm may "continue[] to make the same products on the same equipment".[218] However, this observation serves only to illustrate that, following privatization, the *utility value* of equipment acquired as a result of a financial contribution is not extinguished, because it is transferred to the newly-privatized firm. But, the *utility value* of such equipment to the newly-privatized firm is legally irrelevant for purposes of determining the continued existence of a "benefit" under the *SCM Agreement*. As we found in *Canada – Aircraft*, the value of the "benefit" under the *SCM Agreement* is to be assessed using the *marketplace* as the basis for comparison.[219] It follows, therefore, that once a fair market price is paid for the equipment, its *market value* is redeemed, regardless of the utility the firm may derive from the equipment. Accordingly, it is the *market value* of the equipment that is the focal point of analysis, and not the equipment's *utility value* to the privatized firm.

103. The United States also argues that, irrespective of the price at which the new owners acquire the state-owned enterprise, "the artificially enhanced competitiveness generated by the subsidies" will not be eliminated, as the firm will continue to produce "at the same costs and in the same volumes".[220] We fail to see the basis for the assumption by the United States that, regardless of the sale price of the firm[221], its costs and volume of production will remain the same, since these costs include, as a necessary component, the cost of capital. Indeed, the Panel noted that private investors are "profit-maximizers"[222], who will seek to "recoup[] through the privatized company … a market return on the full amount of their investment."[223] For example, if a government makes a "financial contribution" that "benefit[s]" a state-owned enterprise, and then sells that enterprise for *less* than its fair market price, would this not normally result in a "better off"[224] return for the private capital newly invested in that enterprise? Would that not suggest, as a consequence, that the under-priced enterprise may then attract more investment than it would have attracted otherwise, if the government had sold it for fair market price? Why would this government-

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[216] *Certain Steel Products from Austria*, 58 Fed. Reg. 37217, 37264 (USDOC, 9 July 1993) (General Issues Appendix).
[217] See *supra*, footnote 182.
[218] *Ibid.*, para. 49.
[219] Appellate Body Report, *Canada – Aircraft*, para. 157.
[220] United States' appellant's submission, para 49.
[221] See *supra*, footnote 182.
[222] Panel Report, para. 7.60. The Panel noted that the USDOC agrees with this characterization of private investors. (*Ibid.*, para. 7.61)
[223] *Ibid.*, para. 7.60.
[224] Appellate Body Report, *Canada – Aircraft*, para. 157.

induced additional investment not then reduce the enterprise's cost of raising capital (either by borrowing it from the bank or from, say, shareholders) and, ultimately, reduce the firm's overall costs of production? The United States' argument fails to address such questions and advances no additional reasons why we should disturb the Panel's finding on this point. Hence, we fail to see why *a firm's* cost and volume of production will necessarily remain the same "[o]n the day before and the day after the sale of some or all of a steel producer's shares", irrespective of the price paid for the property and of whether it adequately reflects "fair market value" or not.[225]

104. Although they are not phrased in terms of productive operations or activities, these arguments by the United States here are not unlike those advanced by the United States before the panel in *US – Lead and Bismuth II*.[226] We therefore do not agree that the Panel has mischaracterized the United States' position by stating that "[t]he United States seems to be 'attaching' the benefit to the production activity"[227], and by suggesting that the United States unduly views countervailing duties as "designed to counteract all market distortions".[228]

105. In sum, we do not agree with the United States' interpretation of "benefit" as used in the *SCM Agreement*.

C. Interpretation of the "Recipient" of the Financial Contribution

106. We turn now to the term "recipient" as used in the *SCM Agreement*. The term "recipient" is found in Article 14 of the *SCM Agreement*, which, as we have noted[229], concerns the methods used by investigating authorities of WTO Members "to calculate the benefit to the recipient" for the purposes of imposing countervailing duties. As we held in *Canada – Aircraft*, the "benefit" of a "financial contribution" is "thereby conferred" on a "recipient". With respect to the identity of a "recipient" of a "benefit", the Panel found that:

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[225] United States' appellant's submission, para. 49.

[226] "The basic principle underlying USDOC's methodology is that … a subsidy benefits the production of merchandise and [USDOC] does not envision ever re-visiting the original determination of the existence of a subsidy benefit". (United States' first submission to the panel, para. 9, attached to the Panel Report in *US – Lead and Bismuth II*, Attachment 2.1, p. 165) This similarity is seen also in the examples used by the United States in its appellant's submission. In one instance (United States' appellant's submission, paras. 47–48), an "uncle" forms for his "nephew" a company ("Nephew, Inc.") and provides that company with a "subsidy" in the form of a newly-constructed apartment building. The consequence of this new building is the depressing of rents in the local real estate market. The United States argues that the new apartment building continues to depress rents in the town even after the transfer of "Nephew, Inc." for fair market value. The "only" way to negate the effects of "uncle's subsidy", according to the United States, would be to return rents in town to their previous levels. From the United States' perspective, therefore, the "benefit" persists so long as the distortions of the financial contribution are detectable in the market, and a transfer in ownership, at fair market price or otherwise, would be immaterial to the determination of whether a "benefit" continues to exist.

[227] Panel Report, para. 7.80.

[228] *Ibid.*

[229] See *supra*, para. 82.

> … for the purpose of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders, as together they constitute a producer, a natural or legal person that may be the "recipient" of the benefit to be assessed. Any artificial distinction between owners (shareholders) and company ignores the relationship between a company and its owners, and it is this relationship that changes upon privatization. When the SCM Agreement refers to the recipient of a benefit it means the company and its shareholders together, being the producer of the exported goods subject to the countervailing investigation (order).[230]

107. The United States challenges this finding on various grounds. First, the United States contends that "the SCM Agreement regards subsidies as bestowed upon legal *or* natural persons"[231] (emphasis added), and argues that this finding of the Panel contradicts our findings in *Canada – Aircraft* and in *US – Lead and Bismuth II*. The United States contends that, in those two appeals, we established that the recipient of the subsidy cannot be "both [the legal person] *and also* its shareholder (or shareholders)".[232] (original emphasis) According to the interpretation by the United States of our rulings in those two appeals, when the recipient of the benefit is the "legal person who is the producer and [the] subsidy recipient"[233] (that is, the state-owned enterprise), the benefit cannot be extinguished by the recipient's sale, irrespective of the price paid by the new owner[234], because the producer and the owner are *two different persons*. The United States argues that a subsidy can be received only by one recipient at a time, namely the legal person, and that, consequently, a subsidy can be repaid only by the recipient, and not by its owners, regardless of the price the owners paid for the property. In sum, the United States argues that, in *Canada – Aircraft* and in *US – Lead and Bismuth II*, we drew a clear line separating a legal person (a firm) from its owners (shareholders).

108. The United States has misconstrued our findings in those two appeals. In *Canada – Aircraft*, we were asked whether the "cost to government" was relevant to the interpretation of "benefit" within the meaning of Article 1.1(b) of the *SCM Agreement.* In finding the "cost to government" not to be the relevant benchmark for identifying the "benefit", we said that Article 14 of the *SCM Agreement* prescribes the guidelines required to "calculate the benefit *to the recipient* conferred pursuant to paragraph 1 of Article 1". (emphasis added) We concluded that this phrase in Article 14 necessarily provides relevant context for interpreting Article 1.1, and we found that:

> [a] "benefit" does not exist in the abstract, but must be *received and enjoyed* by a beneficiary or a recipient. Logically, a "benefit"

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230 Panel Report, para. 7.54.
231 United States' appellant's submission, para. 55.
232 *Ibid.*, paras. 56, 65–67.
233 *Ibid.*, para. 58.
234 See *supra*, footnote 182.

> can be said to arise only if a person, natural or legal, or *a group of persons*, has in fact received something. The term "benefit", therefore, implies that there must be a recipient. [235] (emphasis added)

Contrary to what has been argued here by the United States, when referring to "a recipient" in *Canada – Aircraft*, we did not exclude the possibility that "a recipient" could include both a firm[236] and its owner.[237] A "group of persons" could include a group of "natural persons", or a group of "natural and legal persons", or a group exclusively of "legal persons".

109. In *US – Lead and Bismuth II*, we affirmed our interpretation of the term "recipient" in *Canada – Aircraft* in the following terms:

> The United States argues … that the relevant "benefit" is a benefit to a company's *productive operations*, rather than, as the Panel held, a benefit to *legal or natural persons*.
>
> We … agree with the Panel's findings that benefit as used in Article 1.1(b) is concerned with the "benefit to the recipient", that such recipient must be a natural or legal person, and that in the present case:
>
> > … in order to determine whether any subsidy was bestowed on the production by UES and BSplc/BSES respectively of leaded bars imported into the United States in 1994, 1995 and 1996, it is necessary to determine whether there was any "benefit" to UES and BSplc respectively (*i.e.*, the producers of the imported leaded bars at issue). (original emphasis, footnotes omitted)[238]

110. Contrary to the reading that has been suggested by the United States, when we referred, in *US – Lead and Bismuth II*, to "legal or natural persons", we were *not* seeking to distinguish between a firm and its owners. We were only responding to the arguments by the United States there about linking a benefit to "productive operations". In our reasoning, we simply explained that the focus of any analysis of whether a "benefit" exists should be on "legal or natural persons" *instead of* on productive operations; we did not rely in our reasoning on what the United States describes as "normal corporate law principles".[239] Moreover, there is nothing in these findings indicating that the "benefit" of a financial contribution, as contemplated in Article 1.1(b) of the *SCM Agreement*, should necessarily be "received and enjoyed"[240] by the *same* person or, put differently,

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[235] Appellate Body Report, *Canada – Aircraft*, para. 154.
[236] We use the term "firm" in this Report to include corporate associations, partnerships, limited liability partnerships, unincorporated entities, and other forms of business organization.
[237] We use the term "owner" in this Report to include shareholders, members, proprietors, partners, and all other holders of an equity interest in the relevant business organization.
[238] Appellate Body Report, *US –Lead and Bismuth II*, paras. 56 and 58.
[239] United States' appellant's submission, para. 64.
[240] Appellate Body Report, *Canada – Aircraft*, para. 154.

there is nothing indicating that the "benefit" cannot be "received and enjoyed" by two or more distinct persons.

111. The United States also submits that the Panel improperly rejected "the normal distinction between shareholders and companies"[241] in finding that, "[f]or the purpose of benefit determination based on market criteria … there should be no distinction between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company."[242] The United States finds support for this argument in the list of "financial contributions" included in Article 1.1(a)(1) of the *SCM Agreement*[243], as "[e]ach of these listed items indicates a contribution from a government to a legal person who is the producer and subsidy recipient."[244]

112. The *SCM Agreement* does not include a specific definition of the "recipient" of a "benefit". However, several terms are used to refer to the "recipient" of a "benefit" in the Agreement. Article 2 refers to "an enterprise or industry or group of enterprises or industries"; Article 6.1(b) refers to "an industry"; footnote 36 to Article 10 refers to subsidies "bestowed directly or indirectly upon the manufacture, production or export of any merchandise"; Article 14 refers to "the firm"; Article 11.2(ii) refers to "exporter or foreign producer"; Article 19.3 refers to "sources found to be subsidized"; Annex I refers to "a firm or an industry"; and Annex IV refers to the "recipient firm". This is not an exhaustive list, but it certainly indicates that the *SCM Agreement* does not identify the "recipient" of a "benefit" by using any particular legal term of art. Rather, the *SCM Agreement* uses several terms to describe the economic entity that receives a "benefit". Thus, the reliance by the United States on the list of financial contributions in Article 1.1(a)(1) is not persuasive, because, when viewed in the context of the *SCM Agreement* as a whole, that list cannot be read to imply that the "recipient" is necessarily defined as a "legal person".

113. In addition, we observe that a transfer of funds could be provided directly from the government to the legal person that is the producer of the subsidized

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[241] United States' appellant's submission, para. 60.

[242] Panel Report, para. 7.51.

[243] Article 1.1(a)(1) of the *SCM Agreement* provides:

> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
>
> (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
>
> (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
>
> (iii) a government provides goods or services other than general infrastructure, or purchases goods;
>
> (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; … (footnote omitted)

[244] United States' appellant's submission, para. 58.

product, or it could be provided indirectly, say, through an income tax concession to the natural persons that own the firm (inasmuch as they invest in the legal person's productive activities). In both cases, the cost of raising capital for the legal person that is the producer would be reduced. Hence, contrary to the contention of the United States, it is possible to confer a "benefit" on a firm by providing a financial contribution to its owners, whether natural or legal persons, possibly holding property by means of shares. Moreover, we note that Article VI:3 of the GATT 1994[245] and footnote 36 of Article 10 of the *SCM Agreement*[246] contemplate this possibility by providing that a subsidy may be bestowed "*indirectly*" upon the manufacture, production or export of merchandise. (emphasis added)

114. Moreover, despite insisting on the distinction between firms and their owners, the United States recognized, in its appellant's submission, that a "benefit" can trespass the frontier between the firm and its owners. According to the United States, a financial contribution bestowed by a government on the *owners* of a firm can be attributed to the firm in "some instances"[247]; for example, the United States asserts that if the financial contribution were provided to a "holding company", the consequent benefit could be attributed to the "subsidiary that is actually engaged in production", provided that it is "wholly-owned" by the holding company.[248]

115. For these reasons, the United States is mistaken in its interpretation of our findings in *Canada – Aircraft* and *US – Lead and Bismuth II*. Furthermore, the approach advocated by the United States could potentially undermine the *SCM Agreement* by opening wide a door enabling subsidizing governments to circumvent that Agreement's provisions by bestowing benefits directly on the firm's owners rather than on the firms themselves. In sum, the legal distinction between firms and their owners that may be recognized in a domestic legal context is not necessarily relevant, and certainly not conclusive, for the purpose of determining whether a "benefit" exists under the *SCM Agreement*, because a financial contribution bestowed on those investing in a firm may confer a benefit

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[245] Article VI:3 of the GATT 1994 provides:

> No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, *directly or indirectly*, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise. (emphasis added, footnote omitted)

[246] Footnote 36 to Article 10 of the *SCM Agreement* provides:

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

[247] United States' appellant's submission, footnote 77 to para. 76.

[248] *Ibid*.

"upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994."[249]

116. However, while we disagree with the United States' construction of our findings in *Canada – Aircraft* and in *US – Lead and Bismuth II* as establishing a clear dividing line between a firm and its owners, we are of the view that the Panel went too far in stating, in paragraph 7.54 of the Panel Report, that, "for the purpose of the benefit determination under the SCM Agreement, *no distinction* should be made [because] … [w]hen the SCM Agreement refers to the recipient of a benefit it means the company and its shareholders together".[250] (emphasis added) In so finding, the Panel adopted too sweeping an interpretation of the *SCM Agreement*.

117. As we explained[251], the "core legal question"[252] before the Panel was to determine whether a "benefit", within the meaning of the *SCM Agreement*, continues to exist following privatization at arm's length and for fair market value. In considering this core legal question, the Panel examined a very precise set of facts and circumstances, namely, a benefit resulting from a prior non-recurring financial contribution bestowed on a state-owned enterprise where, following a privatization at arm's length and for fair market value, the government transfers all or substantially all the property and retains no "controlling interest in the privatized producer."[253] The Panel did not examine other situations[254], for instance, situations where a "benefit" is conferred through recurring financial contributions, or where the seller retains a controlling interest in the firm following its change in ownership. The Panel had to consider only one kind of change in ownership (that is, a privatization at arm's length and for fair market value where the government transfers all or substantially all the property and retains no controlling interest in the firm) and only one kind of benefit (that is, a benefit originating from a non-recurring financial contribution bestowed to the state-owned enterprise before privatization). The Panel should have confined its findings to those specific circumstances.

118. Moreover, we note that the Panel's overly broad finding that a firm and its owners are, for *all* purposes of the *SCM Agreement*, virtually the same, could be interpreted as entitling investigating authorities to assume, in *all* cases, that, for the purpose of calculating the benefit, and irrespective of the means and conditions imposed by a government for the provision of a financial contribution to owners of the firm, that firm will receive a benefit equivalent to the full financial contribution. This may or may not be so in all cases. We do not express an opinion on this question, but we caution that this finding of the Panel must not be interpreted as entitling authorities to overlook the possibility that some of the financial contribution provided to owners may not flow into the firm. In sum, it does not seem to us that the very narrow set of facts and circumstances analyzed

[249] Footnote 36 to Article 10 of the *SCM Agreement*.
[250] Panel Report, para. 7.54.
[251] See *supra*, paras. 84–85.
[252] Panel Report, para. 7.40.
[253] *Ibid*., para. 7.62.
[254] *Ibid*.

by the Panel provides sufficient support to conclude that, in *all* cases, "for the purpose of the benefit determination under the SCM Agreement, no distinction should be made [because] … [w]hen the SCM Agreement refers to the recipient of a benefit it means the company and its shareholders together".[255]

119. Therefore, although we agree with the Panel's conclusion in paragraph 7.54 as it relates to the facts of this case, we disagree with the Panel's overreaching conclusion that "for the purpose of the benefit determination under the SCM Agreement, [investigating authorities should make] no distinction … between a company and its shareholders [because] … [w]hen the SCM Agreement refers to the recipient of a benefit it means the company and its shareholders", because, in so concluding, the Panel went beyond the factual circumstances examined in this case.[256]

D. Privatizations at Arm's Length and for Fair Market Value: Can the "Benefit" Continue to Exist?

120. Having examined the term "benefit" as used in the *SCM Agreement*, and having examined also the term "recipient" as used in that Agreement, we examine next whether, under the *SCM Agreement*, a "benefit" conferred on a "recipient" is necessarily extinguished following privatization at arm's length and for fair market value. The Panel found that:

> [p]rivatizations at arm's-length and for fair market value *must* lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer. [257] (emphasis added)

Further, in its "Conclusions and Recommendations", the Panel said:

> [o]nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer.[258] (emphasis added)

121. In effect, the Panel interpreted the *SCM Agreement* as containing an *irrebuttable presumption* that would compel investigating authorities to conclude that the remaining part of a benefit resulting from a prior financial contribution necessarily has been extinguished in all cases where there is privatization at arm's length and for fair market value. In other words, according to the Panel, a benefit can *never* continue to exist for the new owner after privatization at arm's length and for fair market value. We do not agree.

122. Markets are mechanisms for exchange. Under certain conditions (e.g., unfettered interplay of supply and demand, broad-based access to information on

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[255] Panel Report, para. 7.54.
[256] *Ibid*.
[257] Panel Report, para. 7.82.
[258] *Ibid*., para. 8.1(d).

equal terms, decentralization of economic power, an effective legal system guaranteeing the existence of private property and the enforcement of contracts), prices will reflect the relative scarcity of goods and services in the market. Hence, the actual exchange value of the continuing benefit of past non-recurring financial contributions bestowed on the state-owned enterprise will be fairly reflected in the market price. However, such market conditions are not necessarily always present and they are often dependent on government action.

123. Of course, every process of privatizing public-owned productive assets takes place within the concrete circumstances prevailing in the market in which the sale occurs. Consequently, the outcome of such a privatization process, namely the price that the market establishes for the state-owned enterprise, will reflect those circumstances. However, governments may choose to impose economic or other policies that, albeit respectful of the market's inherent functioning, are intended to induce certain results from the market. In such circumstances, the market's valuation of the state-owned property may ultimately be severely affected by those government policies, as well as by the conditions in which buyers will subsequently be allowed to enjoy property.

124. The Panel's absolute rule of "no benefit" may be defensible in the context of transactions between two private parties taking place in reasonably competitive markets; however, it overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate. Privatizations involve complex and long-term investments in which the seller—namely the government—is not necessarily always a passive price taker and, consequently, the "fair market price" of a state-owned enterprise is not necessarily always unrelated to government action. In privatizations, governments have the ability, by designing economic and other policies, to influence the circumstances and the conditions of the sale so as to obtain a certain market valuation of the enterprise.

125. In this respect, we note that, before arriving at its conclusion that privatization at arm's length and for fair market value "must" necessarily extinguish a benefit bestowed by a prior financial contribution, the Panel found, in apparent contradiction to its ultimate conclusion, that the investigating authority was *not* obliged to discontinue its investigation after determining that the privatization was made at arm's length and for fair market value.[259] The Panel acknowledged that the investigating authority could find reasons to continue scrutinizing the circumstances of the privatization with a view to determining whether a benefit still existed. The Panel found also that if, following a privatization at arm's length and for fair market value, "[the investigating authority] wants (to continue) to apply countervailing duties, the importing Member must demonstrate, based on its examination of the conditions of the privatization, that the privatized producer (still) benefits from the prior financial contribution (subsidization)."[260]

[259] Panel Report, para. 7.76.
[260] *Ibid.*

126. We understand the Panel to be stating that privatization at arm's length and for fair market value privatization *presumptively* extinguishes any benefit received from the non-recurring financial contribution bestowed upon a state-owned firm. The effect of such a privatization is to shift to the investigating authority the burden of identifying evidence which establishes that the benefit from the previous financial contribution does indeed continue beyond privatization. In the absence of such proof, the fact of the arm's-length, fair market value privatization is sufficient to compel a conclusion that the "benefit" no longer exists for the privatized firm, and, therefore, that countervailing duties should not be levied. This is an accurate characterization of a Member's obligations under the *SCM Agreement*.

127. Therefore, we find that the Panel erred in concluding that "[p]rivatizations at arm's length and for fair market value *must* lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer."[261] (emphasis added) Privatization at arm's length and for fair market value *may* result in extinguishing the benefit. Indeed, we find that there is a rebuttable presumption that a benefit ceases to exist after such a privatization. Nevertheless, it does not *necessarily* do so. There is no inflexible rule *requiring* that investigating authorities, in future cases, *automatically* determine that a "benefit" derived from pre-privatization financial contributions expires following privatization at arm's length and for fair market value. It depends on the facts of each case. Therefore, we reverse the Panel's conclusion that:

> [o]nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it *must* reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer.[262] (emphasis added)

VIII. THE "SAME PERSON" METHOD

128. With all this in mind, we now turn to the administrative practice of the USDOC that is the source and subject of this dispute. The Members of the WTO have anticipated in Article 14 of the *SCM Agreement* that the investigating authorities of WTO Members will use different "method[s]" to "calculate the benefit to the recipient" when determining the amount of countervailing duties that are imposed on an imported product to offset a subsidy. One such method used by the USDOC for the purpose of determining whether a "benefit" continues to exist following a change in ownership—the *gamma* method—was the subject of a previous dispute and a previous appeal.[263] Another method is the "same person" method, which gives rise to this dispute and this appeal.

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[261] Panel Report, para. 7.82.
[262] *Ibid*., para. 8.1(d).
[263] See Appellate Body Report, *US – Lead and Bismuth II*.

129. The United States stated during the hearing that the "same person" method is prescribed neither by United States statute nor by USDOC regulations.[264] Rather, the USDOC developed this method as an administrative practice in the course of responding to orders of the United States Court of International Trade in the appeals of certain countervailing duty cases.[265] This administrative practice was applied for the first time in an initial countervailing duty determination[266] in *GOES from Italy*, an administrative review determination that is before us on appeal and has been identified as Case No. 12. Generally, the USDOC applies the "same person" method to countervailing duty determinations following a change in ownership.[267]

130. In evaluating the continued existence of a "benefit", the "same person" method provides for a two-step test. The first step consists of an analysis of whether the post-privatization entity is the same legal person that received the original subsidy before privatization. For this purpose, the USDOC examines the following non-exhaustive criteria: (i) continuity of general business operations; (ii) continuity of production facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel. If, as a result of the application of these criteria, the USDOC concludes that *no new legal person* was created, the analysis of whether a "benefit" exists stops there, and the USDOC will not assess whether the privatization was at arm's length and for fair market value. The subsidy is automatically found to continue to exist for the post-privatization firm.[268] By contrast, if, as a consequence of the application of these criteria, the USDOC concludes that the post-privatization entity is a *new legal person*, distinct from the entity that received the prior subsidy, the USDOC will not impose duties on goods produced after privatization on account of the pre-privatization subsidy.[269] The USDOC will, however, proceed to examine, in such an event, whether any *new* subsidy had been bestowed upon the post-privatization entity's new owners as a result of the change in ownership (for example, by assessing whether the sale was for fair market value and at arm's length).[270]

131. The question before us is whether the "same person" method—as such, and also as applied by the United States—is inconsistent with the *SCM Agreement*. In the underlying determinations in these 12 countervailing duty cases, the USDOC used both the *gamma* method and the "same person" method to determine whether a benefit continued to exist following privatization. Of the 12 determinations at issue in this dispute, 11 were based on the application of the *gamma* method (Case Nos. 1–11), and one was based on the application of the "same person" method (Case No. 12).

132. The Panel found that the countervailing duty analyses undertaken by the USDOC in determinations that used the *gamma* method—Case Nos. 1–7—are

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[264] United States' response to questioning at oral hearing.
[265] *Ibid*. See also *supra*, footnote 179.
[266] See *supra*, footnote 179.
[267] United States' response to questioning at the oral hearing.
[268] *Ibid*.
[269] *Ibid*.
[270] *Ibid*.

inconsistent with the obligations of the United States under the *SCM Agreement*.[271] On the basis of our finding in *US – Lead and Bismuth II* that the "irrebuttable"[272] presumption established by the *gamma* method prevented the USDOC from undertaking the necessary determination of whether a "benefit" continues to exist, the United States conceded before the Panel that the determinations in Case Nos. 1–7, which employed the *gamma* method, are inconsistent with the *SCM Agreement*.[273]

133. The Panel also found that the determinations by the USDOC that employed the *gamma* method in sunset reviews—Case Nos. 8–11—are likewise inconsistent with the obligations of the United States under the *SCM Agreement*.[274] Specifically, the Panel found that, despite having been informed that the privatizations took place at arm's length and for fair market value, the USDOC, in using the *gamma* method, "failed to examine the conditions of such privatizations and to determine whether the privatized producers received any benefit from the prior subsidization to the state-owned producers".[275] The United States has not conceded that the use of the *gamma* method in these sunset reviews (Case Nos. 8–11) is inconsistent with the *SCM Agreement*.

134. As the United States explains, because "[t]he [first] eleven determinations involved applications of the now discarded '*gamma*' methodology"[276], "the proceedings before the Panel necessarily centered on *GOES from Italy* [Case No. 12], the only one of the twelve determinations before the Panel in which USDOC had applied its new ["same person"] methodology."[277] In reviewing the application of the "same person" method to Case No. 12—an administrative review—the Panel found that "privatization calls for a (re)determination of the existence of a benefit to the privatized producer".[278] Based on this finding, the Panel concluded that the "same person" method, "is itself inconsistent with [the United States' obligations under] the *SCM Agreement*"[279] because it "prohibits the examination of the conditions of the privatization-transaction when the privatized producer is not a distinct legal person based on criteria relating mainly to the industrial activities of the producers concerned."[280] On appeal, the United

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[271] Panel Report, paras. 8.1(a) and 8.1(b). In this respect, we note that the United States proposes to reconduct the determinations made in the course of original investigations (Case Nos. 1–6) and the administrative review (Case No. 7) on the basis of the "same person" method. (*Ibid.*, para. 7.90)

[272] Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

[273] Panel Report, paras. 2.29–2.30. For Case Nos. 1-6, the United States acknowledged the WTO-inconsistency "to the extent that they were based on the gamma methodology and that the underlying determinations did not fully examine whether the pre- and post-change in ownership entities involved were the same legal persons." (*Ibid.*, para. 2.29) For Case No. 7, the WTO-inconsistency was admitted by the United States "to the extent that the review was based on the gamma methodology and that, therefore, the underlying determination did not fully examine whether the pre- and post-change in ownership entity was the same legal person." (*Ibid.*, para. 2.30)

[274] *Ibid.*, para. 8.1(c).

[275] *Ibid.*, para. 7.116.

[276] United States' appellant's submission, footnote 28 to para. 26.

[277] *Ibid.*, para. 26.

[278] Panel Report, para. 7.77.

[279] *Ibid.*, para. 7.90.

[280] Panel Report, para. 7.77.

States asks us[281] to reverse the Panel's conclusion that "the so-called 'same person methodology' is inconsistent with the SCM Agreement."[282]

135. Because the 12 determinations challenged in this dispute and on appeal include six original investigations, two administrative reviews and four sunset reviews,[283] we must, in considering whether "the so-called 'same person methodology' [*as such*] is inconsistent with the SCM Agreement"[284], examine this matter in the light of the provisions of the *SCM Agreement* covering each of these three types of countervailing duty determinations. We must also consider whether the *application* of this "same person" method, which occurred only in Case No. 12, was undertaken in a manner consistent with the *SCM Agreement*.

136. The Panel observed that, with the "same person" method, "when the new privatized producer is not a distinct legal person (based on the activities, productive assets, management, staff) from the previous state-owned producer, [the USDOC] considers that the benefit attributed to the state-owned producer can be *automatically* attributed to the privatized producer without any examination of the condition[s] of the transaction."[285] (emphasis added) The Panel reasoned that this method impedes the calculation of a "benefit" to a "recipient" according to Article 14 of the *SCM Agreement*[286] because it prevents the USDOC from focusing its analysis on "the relevant issues … [that is, the determination of] whether subsidization (and in particular benefit) exists for the privatized producer under investigation."[287] Therefore, the Panel concluded that the "same person" method does not permit the examination of the conditions of the privatization, which may reveal that no benefit exists for the privatized producer "above what market conditions dictate". Consequently, the Panel found the "same person" method "is itself inconsistent [with the obligations of the United States under] the *SCM Agreement*".[288] The Panel then considered also the *application* of the "same person" method in *GOES from Italy* (Case No. 12), and concluded that the "same person" method, *as applied* in Case No. 12, is also inconsistent with Articles 10, 14, 19.4, 21.1, and 21.2 of the *SCM Agreement*.[289]

137. The United States challenges the Panel's finding that the "same person" method is inconsistent with the obligations of the United States under the *SCM Agreement* – both as such and as applied in Case No. 12. In particular, the United States claims that the method cannot be inconsistent with the *SCM Agreement*

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[281] See *supra*, footnote 178.

[282] Attachment to letter dated 13 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat, p. 2.

[283] See *supra*, para. 15.

[284] Attachment to letter dated 13 September 2002 from the Senior Legal Advisor, Permanent Mission of the United States to the WTO, to the Director of the Appellate Body Secretariat, p. 2.

[285] Panel Report, para. 7.78.

[286] Article 14 of the *SCM Agreement*, in relevant part, provides that:

> any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to para. 1 of Article 1 shall be … transparent and adequately explained.

[287] Panel Report, para. 7.78.

[288] *Ibid*., para. 7.90.

[289] Panel Report, para. 8.1(b).

because of the way the United States interprets our decision in *US – Lead and Bismuth II*. The United States reads our ruling in *US – Lead and Bismuth II* as saying that an investigating authority is required to re-examine a determination as to the existence of a "benefit" *only* when a *new legal person*—distinct from the entity that received the original benefit—is created.[290]

138. The European Communities argues that the United States relies on an erroneous interpretation of our decision in *US – Lead and Bismuth II* to justify the "same person" method. Our decision in *US – Lead and Bismuth II*, according to the European Communities, *compels* a finding that the "same person" method *as such* is inconsistent with the obligation of the *SCM Agreement* that an investigating authority conduct a new determination of whether a benefit exists when notified of a privatization that results in a change in control. The European Communities argues that, because the "same person" method, like the *gamma* method, establishes an irrebuttable presumption that the benefit of a previously-bestowed financial contribution remains in the post-privatization enterprise *unless a new legal person is created*, the "same person" method is inconsistent with the obligations of the United States under the *SCM Agreement*, as those obligations have been interpreted in *US – Lead and Bismuth II*.[291]

139. In considering these arguments, we begin by recalling that, under Article 1.1 of the *SCM Agreement*, a "subsidy" is "deemed to exist" only if a "financial contribution" confers a "benefit". Also, under Article VI:3 of the GATT 1994[292], investigating authorities, before imposing countervailing duties, must ascertain the precise amount of a subsidy attributed to the imported products under investigation. In furtherance of this obligation, Article 10 of the *SCM Agreement*[293] provides that Members must "ensure" that duties levied for the purpose of offsetting a subsidy are imposed only "in accordance with" the provisions of Article VI:3 of the GATT 1994 and the *SCM Agreement.* Moreover, Article 19.4 of the *SCM Agreement*, consistent with the language of Article VI:3 of the GATT 1994, requires that "[*n*]*o countervailing duty* shall be levied on any imported product in excess of the amount of the *subsidy found to exist*". (emphasis added) Finally, Article 21.1 of the *SCM Agreement* provides

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[290] United States' appellant's submission, paras. 86–90.

[291] European Communities' appellee's submission, paras. 2 and 7.

[292] Article VI:3 of the GATT 1994 provides as follows:

> *No countervailing duty* shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party *in excess of an amount equal to the estimated bounty or subsidy* determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. (emphasis added)

[293] Article 10 of the *SCM Agreement* provides as follows:

> Members shall take all necessary steps to *ensure* that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture. (emphasis added, footnotes omitted)

that "[a] countervailing duty shall remain in force *only as long as and to the extent necessary* to counteract subsidization which is causing injury." (emphasis added) In sum, these provisions set out the obligation of Members to limit countervailing duties to the amount and duration of the subsidy found to exist by the investigating authority. These obligations apply to original investigations as well as to administrative and sunset reviews covered under Article 21 of the *SCM Agreement*.

140. As we have mentioned, of the 12 USDOC determinations that are relevant in this dispute, the "same person" method was *applied* only in the *GOES from Italy* case (Case No. 12), an administrative review conducted under Article 21.2 of the *SCM Agreement*, which provides:

> *Article 21*
>
> *Duration and Review of Countervailing Duties and Undertakings*
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> …
>
> 21.2 The authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party which submits positive information substantiating the need for a review. Interested parties shall have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. If, as a result of the review under this paragraph, the authorities determine that the countervailing duty is no longer warranted, it shall be terminated immediately.

141. We considered Article 21.2 for the first time in *US – Lead and Bismuth II*, where we found that:

> [i]n an administrative review pursuant to Article 21.2, the investigating authority may be presented with "positive information" that the "financial contribution" has been repaid or withdrawn and/or that the "benefit" no longer accrues. *On the basis of its assessment of the information presented to it* by interested parties, as well as of other evidence before it relating to the period of review, the investigating authority *must determine whether there is a continuing need for the application of countervailing duties. The investigating authority is not free to ignore such information*. If it were free to ignore this information, the review mechanism under Article 21.2 would have no purpose.[294] (emphasis added)

[294] Appellate Body Report, *US – Lead and Bismuth II*, para. 61.

This finding makes it clear that an investigating authority undertaking an administrative review has an obligation under Article 21.2 of the *SCM Agreement* to determine whether a "benefit" continues to exist when information suggesting that a benefit no longer exists is presented to that authority. According to the United States, our finding in *US – Lead and Bismuth II* was limited to the specific circumstances of that case, which, in the interpretation of the United States, were that the state-owned enterprise and the newly privatized enterprise were two different legal persons. The United States seeks justification for this view in the references in our Report in *US – Lead and Bismuth II* to the "circumstances" of that case[295], and also in our reasoning in paragraph 62 of that Report, in which, according to the United States, "[t]he Appellate Body … accepted the panel's conclusion that UES was a distinct new legal person that could not be held accountable for subsidies bestowed upon BSC [the privatized state-owned enterprise]."[296] (footnote omitted)

142. With respect to the references we made in *US – Lead and Bismuth II* to the "circumstances" of that case[297], we observe that, in those references, we were simply limiting the scope of our findings in that appeal to the particular circumstances of that dispute. We were addressing the conditions under which that particular privatization took place (that is, "fair market value paid for all productive assets, goodwill, etc." [298]); we were not referring at all to a distinction between legal personalities. This is clear when the phrase "in the specific circumstances of this case" is viewed in its context:

> The question whether a "financial contribution" confers a "benefit" depends, therefore, on whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market. In the present case, the Panel made factual findings that UES and BSplc/BSES *paid fair market value for all the productive assets, goodwill, etc.*, they acquired from BSC and subsequently used in the production of leaded bars imported into the United States in 1994, 1995 and 1996. We, *therefore*, see no error in the Panel's conclusion that, *in the specific circumstances of this case*, the "financial contributions" bestowed on BSC between 1977 and 1986 could not be deemed to confer a "benefit" on UES and BSplc/BSES.[299] (emphasis added)

Moreover, in this dispute, the United States explicitly acknowledged this reading of our Report in *US – Lead and Bismuth II* in its first submission to the Panel. The United States asserted that "*because UES's owners had paid fair market value* for UES, the Appellate Body found no error in the panel's conclusion that the financial contributions bestowed upon BSC [that is, the state-owned

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[295] Appellate Body Report, *US – Lead and Bismuth II*, paras. 68 and 74.
[296] United States' appellant's submission, para. 16.
[297] Appellate Body Report, *US – Lead and Bismuth II*, paras. 68 and 74.
[298] *Ibid.*, para. 68.
[299] Appellate Body Report, *US – Lead and Bismuth I*, para. 68..

enterprise] could not be deemed to confer a benefit upon UES."[300] (emphasis added)

143. The interpretation of paragraph 62 that is suggested by the United States in this appeal is equally unfounded. Paragraph 62 of our Report in *US – Lead and Bismuth II* reads as follows:

> Therefore, we agree with the Panel that while an investigating authority may presume, in the context of an administrative review under Article 21.2, that a "benefit" continues to flow from an untied, non-recurring "financial contribution", this presumption can never be "irrebuttable". In this case, given the *changes in ownership* leading to the creation of UES and BSplc/BSES, the USDOC was *required* under Article 21.2 to examine, on the basis of the information before it relating to these changes, whether a "benefit" accrued to UES and BSplc/BSES. We thus agree with the Panel's finding that:
>
> > … the *changes in ownership* leading to the creation of UES and BSplc/BSES should have caused the USDOC to examine whether the production of leaded bars by UES and BSplc/BSES respectively, and not BSC, was subsidized. In particular, the USDOC should have examined the continued existence of "benefit" already deemed to have been conferred by the pre-1985/86 "financial contributions" to BSC, and it should have done so from the perspective of UES and BSplc/BSES respectively, and not BSC. (emphasis added, footnote omitted)

Contrary to the assertions of the United States, there is nothing in this finding to indicate that, in this paragraph of our Report in *US – Lead and Bismuth II*, we "accepted the panel's conclusion that UES was a distinct new legal person that could not be held accountable for subsidies bestowed upon BSC [the state-owned enterprise]."[301] (footnote omitted)

144. In sum, we reject the characterization made by the United States of our rationale in *US – Lead and Bismuth II*, and we reaffirm our finding in that case[302] that an investigating authority, in an administrative review, when presented with

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[300] United States' first submission to the Panel, para. 37.

[301] United States' appellant's submission, para. 16. We also note, as does the European Communities (in the European Communities' appellee's submission, paras. 24–27 and footnote 23 to para. 26; and also in the European Communities' response to questioning at the oral hearing), that the creation of a new legal person could not have been the basis for our requirement of a new benefit determination to be conducted by USDOC because the other privatized company at issue in *US – Lead and Bismuth II*, British Steel plc, became a separate legal entity *before* the privatization took place, rather than establishing a new legal identity as a result of the privatization transaction. (See Appellate Body Report, *US – Lead and Bismuth II*, para. 2) In finding that a benefit could have been extinguished under such circumstances and that the USDOC accordingly should have conducted a new benefit determination, we thus focused necessarily on the change in ownership of the companies at issue, and not on their legal personalities.

[302] Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

information directed at proving that a "benefit" no longer exists following a privatization, *must* determine whether the continued imposition of countervailing duties is warranted in the light of that information. This obligation is premised, *not* on the creation of a new legal person, as the United States insists, but on the possibility that such a change in ownership has affected the continued existence of a benefit.

145. The Panel stated, and the United States agreed before the Panel and on appeal, that the "same person" method *requires* the USDOC to "consider[] that the benefit attributed to the state-owned producer can be automatically attributed to the privatized producer without any examination of the condition of the transaction" when the agency determines the post-privatization entity is not a new legal person.[303] It is only if the USDOC finds that a new legal person has been created that the agency will make a determination of whether a benefit exists, and, in such cases, the inquiry will be limited to the subject of whether a *new* subsidy has been provided to the new owners.[304]

146. Thus, under the "same person" method, when the USDOC determines that no new legal person is created as a result of privatization, the USDOC will conclude from this determination, *without any further analysis*, and irrespective of the price paid by the new owners for the newly-privatized enterprise[305], that the newly-privatized enterprise continues to receive the benefit of a previous financial contribution. This approach is contrary to the obligation in Article 21.2 of the *SCM Agreement* that the investigating authority must take into account in an administrative review "positive information substantiating the need for a review." Such information could relate to developments with respect to the subsidy, privatization at arm's length and for fair market value, or some other information. The "same person" method impedes the USDOC from complying with its obligation to examine whether a countervailable "benefit" continues to exist in a firm subsequent to that firm's change in ownership. Therefore, we find that the "same person" method, *as such*, is inconsistent with the obligations relating to administrative reviews under Article 21.2 of the *SCM Agreement*.

147. In our view, this finding, relating to administrative reviews, leads inevitably to the conclusion that the "same person" method, as such, is also inconsistent with the obligations of the *SCM Agreement* relating to original investigations. In an original investigation, an investigating authority must establish all conditions set out in the *SCM Agreement* for the imposition of

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[303] Panel Report, para. 7.78. See also *ibid.*, para. 7.77:

> In the Panel's view, the United States' same person methodology, as such, prohibits the examination of the conditions of the privatization-transaction when the privatized producer is not a distinct legal person based on criteria relating mainly to the industrial activities of the producers concerned. In applying its methodology the US Department of Commerce does not assess whether the privatized producer has received any benefit from prior financial contributions.

This requirement of the "same person" method was confirmed by the United States in its responses to questioning at the oral hearing.

[304] United States' responses to questioning at oral hearing.

[305] See *supra*, footnote 182.

countervailing duties.[306] Those obligations, identified in Article 19.1 of the *SCM Agreement*, read in conjunction with Article 1, include a determination of the existence of a "benefit".[307] As in the administrative reviews, the "same person" method necessarily precludes a proper determination as to the existence of a "benefit" in original investigations where the pre- and post-privatization entity are the same legal person. Instead, in such cases, the "same person" method establishes an irrebuttable presumption that the pre-privatization "benefit" continues to exist after the change in ownership. Because it does not permit the investigating authority to satisfy all the prerequisites stated in the *SCM Agreement* before the imposition of countervailing duties, particularly the identification of a "benefit", we find that the "same person" method, as such, is inconsistent with the WTO obligations that apply to the conduct of original investigations.

148. This brings us to the third kind of determination at issue, namely sunset reviews. The Panel found that, under Article 21.3 of the *SCM Agreement* [308], and regardless of whether administrative reviews under Article 21.2 had been requested since the original investigation, the importing Member is obliged to consider evidence before it relating to subsidization, and to *determine* whether a "benefit" continues to exist following privatization of the investigated firm, before concluding "whether subsidization exists and is likely to continue or recur".[309] This finding is inherent in the Panel's conclusion that "[t]he four determinations made in the context of sunset reviews and based on the gamma methodology are inconsistent with the SCM Agreement, since the US Department of Commerce did not examine whether the privatizations, that

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[306] Appellate Body Report, *US – Lead and Bismuth II*, para. 63.

[307] Article 19.1 permits the imposition of a countervailing duty only after the investigating authority has found a subsidy (as defined in Article 1), injury, and a causal link between the two.

[308] Article 21.3 of the *SCM Agreement* provides that:

> Notwithstanding the provisions of para.s 1 and 2, any definitive countervailing duty shall be terminated on a date not later than five years from its imposition (or from the date of the most recent review under para. 2 if that review has covered both subsidization and injury, or under this para.), unless the authorities determine, in a review initiated before that date on their own initiative or upon a duly substantiated request made by or on behalf of the domestic industry within a reasonable period of time prior to that date, that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury. The duty may remain in force pending the outcome of such a review. (footnote omitted)

[309] Panel Report, paras. 7.114–7.116. The Panel found this conclusion consistent with that reached by the United States Court of International Trade when it found that the USDOC's practices in sunset reviews are inconsistent with the United States legislation, as "[b]y its nature, then, a sunset review is designed to account for changes in law that have a bearing on whether countervailable subsidies will continue or recur." (Panel Report, footnote 359 to para. 7.114, quoting *AG der Dillinger Hüttenwerke v. United States*, Court No. 00–09–00437, slip op. 02–25, at 32 (Court of International Trade, 28 February 2002)) Furthermore, the Panel also noted "that the [United States] Court rejected the [USDOC's] arguments that it was not appropriate to reach the privatization issue in a sunset review or that an interested party participating in a sunset review must have first requested and completed an administrative review." (*Ibid*.)

occurred after the original imposition of countervailing duties, were at arm's-length and for fair market value."[310]

149. The United States appealed this finding[311], but did not advance any supporting arguments. We have already determined, in *US – Lead and Bismuth II*, that the *gamma* method is inconsistent with the obligation under Article 21.2 of the *SCM Agreement*. That obligation requires an investigating authority in an *administrative* review, upon receiving information of a privatization resulting in a change in ownership, to determine whether a "benefit" continues to exist. In our view, the *SCM Agreement*, by virtue of Articles 10, 19.4, and 21.1, also imposes an obligation to conduct such a determination on an investigating authority conducting a *sunset* review. As we observed earlier[312], the interplay of GATT Article VI:3 and Articles 10, 19.4 and 21.1 of the *SCM Agreement* prescribes an obligation applicable to original investigations as well as to reviews covered under Article 21 of the *SCM Agreement* to limit countervailing duties to the amount and duration of the subsidy found to exist by the investigating authority. Consequently, we see no error in the Panel's finding that, in sunset reviews, the investigating authority, before deciding to continue to countervail pre-privatization, non-recurring subsidies, is obliged to "examine the conditions of such privatizations and to determine whether the privatized producers received any benefit from the prior subsidization to the state-owned producers".[313] Therefore, we agree with the Panel that the "four determinations made in the context of sunset reviews and based on the *gamma* methodology are inconsistent with the SCM Agreement [because] the United States failed to determine whether the privatized producers received any benefit from the financial contributions previously bestowed to the state-owned producers."[314]

150. We now turn to the question whether the "same person" method is inconsistent with Article 21.3 of the *SCM Agreement*, which applies to sunset reviews. We have already found that the "same person" method fails to ensure that a determination of whether a "benefit" continues to exist occurs when the USDOC concludes that no new legal person has been created as a result of privatization. We have found also that investigating authorities have an obligation to make such a determination when conducting a sunset review. Therefore, we also find that the "same person" method, as such, is inconsistent with Article 21.3 of the *SCM Agreement*.

151. In the light of these reasons, as they apply to original investigations, administrative reviews, and sunset reviews, we uphold the Panel's conclusion that "the same person methodology *is itself* inconsistent with the SCM Agreement".[315] (emphasis added) We find that the same person method *as such* is inconsistent with the *SCM Agreement*.

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[310] Panel Report, para. 8.1(c).
[311] As we observed earlier, *supra*, paras. 65–66, the United States quoted para. 8.1(c) in full in the document filed subsequent to its Notice of Appeal. That para. includes this finding.
[312] See *supra*, para. 139.
[313] Panel Report, para. 7.116.
[314] *Ibid.*, para. 8.1(c).
[315] *Ibid*., para. 7.90.

152. We have also been asked to review the consistency with the *SCM Agreement* of the *application* of the "same person" method in only one instance, the administrative review entitled *GOES from Italy* (Case No. 12). As we have already concluded that the "same person" method, *as such*, is inconsistent with the obligation that the USDOC determine whether a "benefit" exists when informed of a change in ownership during an administrative review, it follows that the application of the method by the USDOC in *GOES from Italy*[316] was also inconsistent with the *SCM Agreement*. Consequently, we also uphold the Panel's conclusion, in paragraph 8.1(b) of the Panel Report, that the *application* of the "same person" method in Case No. 12 is inconsistent with the *SCM Agreement*.

153. Finally, we recall that, before the Panel, the United States conceded[317] that, as the investigations and review in Case Nos. 1-7 were carried out using the *gamma* method, the determinations in those cases were inconsistent with the *SCM Agreement*. Accordingly, the Panel found that the countervailing duty determinations in Cases Nos. 1–7 are inconsistent with the obligations of the United States under the *SCM Agreement*.[318] The Panel also found, and we have upheld the finding that, in the sunset reviews (Cases Nos. 8–11), the United States was obliged to "examine whether the privatizations, that occurred after the original imposition of countervailing duties, were at arm's-length and for fair market value" and, accordingly, in using the *gamma* method, it had failed to satisfy this obligation in accordance with the *SCM Agreement*. [319] In *US – Lead and Bismuth II*, we found that the *gamma* method's "irrebuttable"[320] presumption prevented the USDOC from undertaking the requisite determination as to the continued existence of a "benefit". And, in the previous section of this Report, we found that, following privatization at arm's length and for fair market value, a "benefit" no longer exists for the private firm unless the investigating authority finds other evidence to the contrary. Consistent with these findings, we therefore uphold the Panel's conclusions in paragraphs 8.1(a), 8.1(b) and 8.1(c) of the Panel Report.

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316 In *GOES from Italy*, the USDOC found the pre- and post-privatization firms to be the same legal person. Accordingly, the USDOC, as required under the "same person" method, irrebuttably presumed that the "benefit" from the financial contribution received by the firm when owned by the state, continued to exist. See Issues & Decision Memorandum to *GOES from Italy*, 66 Fed. Reg. 2885 (USDOC, 12 January 2001), at comment 1, attached as Exhibit EC–7 to the European Communities' first submission to the Panel:

> [The USDOC] seeks to determine whether the privatized [respondent] is the same person that received the pre-privatization financial contributions and benefits at issue in this review … [W]e would *only* reach [the respondent's] fair-market-value claim in the event that we first find the privatized [respondent] to be a *different* person from the original recipient … [W]e find that the privatized [respondent] is for all intents and purposes the same person that existed prior to the privatization, *and accordingly*, it received the pre-privatization financial contributions and benefits at issue in this review. (emphasis added)

317 See *supra*, footnote 273.

318 Panel Report, paras. 8.1(a)–8.1(b).

319 *Ibid*., para. 8.1(c).

320 Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

IX. CONSISTENCY OF 19 U.S.C. § 1677(5)(F), AS SUCH, WITH WTO OBLIGATIONS

154. Having upheld the Panel's conclusions in paragraphs 8.1(a) through (c) of the Panel Report, we now turn to evaluate the Panel's conclusion, in paragraph 8.1(d), regarding the relevant United States statute.

155. The Panel concluded, in paragraph 8.1(d) of the Panel Report, that:

> To the extent that Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit and the SAA, requires the US Department of Commerce to apply a methodology where the benefit from a prior financial contribution is not systematically found to no longer accrue to the privatized producer solely by virtue of an arm's-length for fair market value privatization, is preventing the United States from exercising a WTO-compatible discretion. Therefore, Section 1677(5)(F) is inconsistent with Articles 10, 14, 19 and 21 of the SCM, as interpreted by the Panel and the Appellate Body Reports in *US – Lead and Bismuth II* and this Panel. As Section 1677(5)(F) is found to be inconsistent with the *SCM Agreement*, the United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the WTO Agreement respectively.[321]

156. Section 1677(5)(F), the so-called "change in ownership" provision, provides:

> [a] change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's-length transaction.[322]

The Panel acknowledged that this "statutory language alone indicates that the competent authority could have the discretion to implement Section 1677(5)(F) consistently with WTO law."[323] However, in looking at the statute in the light of "other domestic interpretive tools such as the legislative history, the SAA, and relevant judicial interpretations"[324], the Panel found that it "prohibit[ed] the United States from exercising its executive discretion so that it can systematically conclude that in cases of [a]rm's-length privatization for fair market value, no benefit accrues to the privatized producer from [a] prior financial contribution bestowed to the state-owned producers".[325]

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[321] Panel Report, para. 8.1(d).

[322] 19 U.S.C. § 1677(5)(F), attached as Exhibit EC–4 to the European Communities' first submission to the Panel.

[323] Panel Report, para. 7.138.

[324] *Ibid*., para. 7.139.

[325] Panel Report, para. 7.140. We note that the United States contests this interpretation, particularly the Panel's reading of "judicial interpretation" (namely of *Delverde III*), in its argument under Article

157. In short, the Panel found that Section 1677(5)(F) prevents the USDOC from determining automatically and in every case that, pursuant to a "*per se*" rule[326], upon privatization at arm's length and for fair market value, the remaining part of a benefit conferred by a prior financial contribution on the formerly state-owned enterprise does not "accrue"[327] to the private owner. In the Panel's view, Section 1677(5)(F), as described in the SAA[328] and as interpreted by the United States Court of Appeals for the Federal Circuit, "bound [the USDOC] to a non-compliant application of Section 1677(5)(F)."[329] The Panel reached this conclusion because it saw the statute as *compelling* the USDOC to make its determinations in a way that prevents it from applying the irrebuttable presumption that the Panel erroneously saw as required by the *SCM Agreement*. On this basis, the Panel found that Section 1677(5)(F) mandates the United States to act inconsistently with the *SCM Agreement* and with Article XVI:4 of the *WTO Agreement*[330], and, *as such*, is inconsistent with United States' WTO obligations.

158. As stated earlier, we agree with the Panel that privatization at arm's length and at fair market price will *usually* extinguish the remaining part of a benefit bestowed by a prior, non-recurring financial contribution.[331] However, we disagree with the Panel that this result will *necessarily* and *always* follow from every privatization at arm's length and for fair market value.[332] For this reason, we reversed the Panel's conclusion that, under the *SCM Agreement*, investigating *authorities* "must" determine, *automatically*, that the remaining part of a benefit bestowed by a prior financial contribution does not continue to exist for a privatized firm following a transaction at arm's length and for fair market value. Accordingly, we have also found that, contrary to the Panel's understanding, the *SCM Agreement* permits an investigating authority to evaluate evidence directed at proving that, regardless of privatization at arm's length and for fair market

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11 of the DSU. However, we found earlier that this issue was not properly raised in the United States' Notice of Appeal and is not before us. (See *supra*, paras. 71–75)

[326] In the words of the United States Court of Appeals for the Federal Circuit:

> [Section 1677(5)(F)] clearly states that a subsidy cannot be concluded to have been extinguished solely by an arm's length change of ownership. However, it is also clear that Congress did not intend the opposite, that a change in ownership always requires a determination that a past countervailable subsidy continues to be countervailable, regardless whether the change of ownership is accomplished through an arm's length transaction or not. If that had been Congress's intent, the statute would have so stated. Rather, the Change of Ownership provision simply prohibits a *per se* rule either way.

Delverde III, *supra*, footnote 31, at 1366.

The Panel interpreted a "*per se*" rule as a "systematic" rule. (Panel Report, para. 7.147)

[327] Panel Report, para. 8.1(d).

[328] See *supra*, footnote 42.

[329] Panel Report, para. 7.156.

[330] Article XVI:4 of the *WTO Agreement* provides:

> Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.

[331] See *supra*, paras. 126–127.

[332] See *supra*, paras. 121–124.

value, the new private owner may nevertheless enjoy a benefit from a prior financial contribution bestowed on the state-owned enterprise.[333] In the light of these earlier conclusions, we disagree with the Panel that Section 1677(5)(F) is inconsistent *per se* with the WTO obligations of the United States. The Panel's basis for this finding is incorrect.

159. There remains the question whether Section 1677(5)(F) is inconsistent *per se* with the WTO obligations of the United States because it mandates[334] a particular method of determining the existence of a "benefit" that is contrary to the *SCM Agreement*. We agree with both the appellant and appellee that "Section 1677(5)(F) does not … prescribe any specific methodology", and, consequently, does not mandate the USDOC to apply the "same person" method.[335] Hence, Section 1677(5)(F), as such, does not prevent the USDOC from determining whether a "benefit" continues to exist, as required by the *SCM Agreement*. Moreover, we also see nothing in the interpretation of Section 1677(5)(F) made by the United States Court of Appeals for the Federal Circuit[336] that would prevent the USDOC from complying with its obligations under the *SCM Agreement*.

160. For all these reasons, we reverse the Panel's conclusion that:

> To the extent that Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit and the SAA, requires the US Department of Commerce to apply a methodology where the benefit from a prior financial contribution is not systematically found to no longer accrue to the privatized producer solely by virtue of an arm's-length for fair market value privatization, is preventing the United States from exercising a WTO-compatible discretion. Therefore, Section 1677(5)(F) is inconsistent with

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[333] See *supra*, para. 126.

[334] We are not, by implication, precluding the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation. We make no finding in this respect.

[335] Panel Report, para. 7.134; United States' and European Communities' responses to questioning at the oral hearing.

The fact that the "same person" method is not mandated by Section 1677(5)(F) appears also to be the view of the United States Court of International Trade. In several recent decisions the Court has held the "same person" method inconsistent with Section 1677(5)(F), as interpreted in *Delverde III*. See *Ilva Lamiere E Tubi S.r.L. v. United States*, 196 F. Supp. 2d 1347 (Court of International Trade, 29 March 2002); *Acciai Speciali Terni S.p.A. v. United States*, No. 99–06–00364, slip op. 02-10 (Court of International Trade, 1 February 2002); *GTS Indus. v. United States*, 182 F. Supp. 2d 1369 (Court of International Trade, 4 January 2002); *Allegheny Ludlum Corp. v. United States*, 182 F. Supp. 2d 1357 (Court of International Trade, 4 January 2002).

We also note one decision of the United States Court of International Trade that has upheld the "same person" method as consistent with *Delverde III* and therefore a permissible exercise of the USDOC's discretion under the statute. *Acciai Speciali Terni S.p.A. v. United States*, 206 F. Supp. 2d 1344 (Court of International Trade, 4 June 2002). This decision, however, explicitly recognizes that Section 1677(5)(F) does not prevent the USDOC from devising any methodology to determine the post-privatization subsidization of a foreign firm under investigation, provided that a *per se* rule is not applied. (*Ibid*., at 1349–50, 1354–55) These cases were brought to our attention by the participants and third participants.

[336] See *supra*, footnote 326.

Articles 10, 14, 19 and 21 of the SCM, as interpreted by the Panel and the Appellate Body Reports in *US – Lead and Bismuth II* and this Panel. As Section 1677(5)(F) is found to be inconsistent with the *SCM Agreement*, the United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the WTO Agreement respectively.[337]

X. FINDINGS AND CONCLUSIONS

161. For the reasons set out in this Report, the Appellate Body:

a) *upholds* the Panel's findings, in paragraphs 8.1 (a), (b) and (c) of the Panel Report, that the United States has acted inconsistently with Articles 10, 14, 19.1, 19.4, 21.1, 21.2 and 21.3 of the *SCM Agreement*, by imposing and maintaining countervailing duties without determining whether a "benefit" continues to exist in the following countervailing duty determinations:

- Stainless Sheet and Strip in Coils from France (C–427–815) (Case No. 1);
- Certain Cut-to-Length Carbon Quality Steel from France (C–427–817) (Case No. 2);
- Certain Stainless Steel Wire Rod from Italy (C–475–821) (Case No. 3);
- Stainless Steel Plate in Coils from Italy (C–475–823) (Case No. 4);
- Stainless Steel Sheet and Strip in Coils from Italy (C–475–825) (Case No. 5);
- Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475–827) (Case No.6);
- Cut-to-Length Carbon Steel Plate from Sweden (C-401–804) (Case No. 7);
- Cut-to-Length Carbon Steel Plate from United Kingdom (C–412–815) (Case No. 8);
- Certain Corrosion-Resistant Carbon Steel Flat Products from France (C-427-810) (Case No. 9);
- Cut-to-Length Carbon Steel Plate from Germany (C-428–817) (Case No. 10);
- Cut-to-Length Carbon Steel Plate from Spain (C–469–804) (Case No. 11); and
- Grain-Oriented Electrical Steel from Italy (C–475–812) (Case No. 12).

[337] Panel Report, para. 8.1(d).

b) *reverses* the Panel's finding, in paragraph 8.1(d), first sentence, of the Panel Report, that "[o]nce an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it must reach the conclusion that no "benefit" resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer"; and

c) *reverses* the Panel's conclusion, in paragraph 8.1(d), second sentence, of the Panel Report, that Section 771(5)(F) of the Tariff Act 1930, as amended, 19 U.S.C. § 1677(5)(F), is inconsistent with the *SCM Agreement* and that, therefore, "the United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the *WTO Agreement* respectively."

d) *upholds* the Panel's conclusion, in paragraph 8.2 of the Panel Report, that, insofar as the United States has infringed its obligations under the *SCM Agreement*, as set out in paragraphs 8.1(a), (b), and (c) of the Panel Report, these actions of the United States constitute *prima facie* nullification or impairment of benefits accruing to the European Communities, pursuant to Article 3.8 of the DSU; and, because the United States has failed to rebut this presumption, the United States has in fact nullified or impaired benefits accruing to the European Communities under the *SCM Agreement*.

162. The Appellate Body recommends that the Dispute Settlement Body request the United States to bring its measures and administrative practice (the "same person" method), as found in this Report and in the Panel Report as modified by this Report, to be inconsistent with the *SCM Agreement*, into conformity with its obligations under that Agreement.

ANNEX I

NOTIFICATION OF AN APPEAL BY THE UNITED STATES UNDER PARAGRAPH 4 OF ARTICLE 16 OF THE UNDERSTANDING ON RULES AND PROCEDURES GOVERNING THE SETTLEMENT OF DISPUTES (DSU)

WORLD TRADE ORGANIZATION

WT/DS212/7
11 September 2002

(02-4760)

Original: English

UNITED STATES – COUNTERVAILING MEASURES CONCERNING CERTAIN PRODUCTS FROM THE EUROPEAN COMMUNITIES

Notification of an Appeal by the United States under paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)

The following notification, dated 9 September 2002, sent by the United States to the Dispute Settlement Body (DSB), is circulated to Members. This notification also constitutes the Notice of Appeal, filed on the same day with the Appellate Body, pursuant to the *Working Procedures for Appellate Review*.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the Working Procedures for Appellate Review, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the panel report on *United States – Countervailing Measures Concerning Certain Products from the European Communities* (WT/DS212/R) and certain legal interpretations developed by the Panel.

The United States seeks review by the Appellate Body of the conclusions of the Panel set forth in paragraphs 8.1(a)-(d) and 8.2 of the Panel's report. These conclusions are in error, and are based upon erroneous findings on issues of law and on related legal interpretations.

UNITED STATES – COUNTERVAILING MEASURES CONCERNING CERTAIN PRODUCTS FROM THE EUROPEAN COMMUNITIES

Report of the Panel
WT/DS212/R

Adopted by the Dispute Settlement Body
on 8 January 2003
as Modified by the Appellate Body Report

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I. INTRODUCTION

1.1 On 10 November 2000, the European Communities requested consultations with the United States under Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU"), Article XXII of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994") and Article 30 of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement"). The European Communities' request was related to the continued application by the US Department of Commerce of countervailing duties based on its "*change in ownership*" methodology which consisted of a presumption that non-recurring subsidies granted to a former producer of goods, prior to a change in ownership, "pass through" to the current producer of the goods following the change in ownership.[1]

1.2 Consultations took place in Geneva on 7-8 December 2000, but the parties failed to reach a mutually satisfactory solution. On 1 February 2001, the European Communities requested further consultations with the United States.[2] Further consultations took place in Geneva on 3 April 2001, but the parties did not reach a mutually satisfactory solution.

[1] WT/DS212/1.
[2] WT/DS212/1/Add.1.

1.3 On 8 August 2001, the European Communities requested the Dispute Settlement Body (the "DSB") to establish a panel, pursuant to Articles 4 and 6 of the DSU, Article 30 of the SCM Agreement and Article XXII of the GATT 1994 with respect to the practice by the United States of imposing countervailing duties on certain products exported from the European Communities "without establishing the existence of a financial contribution or a benefit to the producers under investigation and hence the existence of a countervailable subsidy as defined in the SCM Agreement." These duties had been imposed or maintained notwithstanding privatizations or changes of ownership in reliance, *inter alia*, on Section 771(5)(F) of the Tariff Act 1930, as amended, (19 USC Section 1677(5)(F)) and according to the European Communities were not based on an analysis of the existence of a countervailable subsidy benefiting the producer concerned during the period of investigation or review.[3]

1.4 At its meeting on 10 September 2001, the DSB established a panel in accordance with Article 6 of the DSU. At that meeting, the parties agreed that the Panel should have standard terms of reference. The terms of reference of the panel were, therefore, the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS212/4, the matter referred to the DSB by the European Communities 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."[4]

1.5 On 25 October 2001, the European Communities requested the Director-General to determine the composition of the panel, pursuant to paragraph 7 of Article 8 of the DSU. This paragraph provides:

> "If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request."

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[3] Since the request for consultations, which included 14 countervailing duty determinations, one order was terminated (Cold-Rolled Carbon Steel Flat Products from Sweden C-401-401) and another order was limited to recurring subsidies, pursuant to an agreement between the exporter concerned and the US Department of Commerce (Certain Pasta from Italy C-475-819). Therefore, the European Communities decided not to include these two determinations in its request for the establishment of a Panel. WT/DS212/4, footnote 1.

[4] WT/DS212/5.

1.6 On 5 November 2001, the Director-General accordingly composed the Panel as follows:

Chairman: Mr. Gilles Gauthier

Members: Ms. Marie-Gabrielle Ineichen-Fleisch

Mr. Michael Mulgrew

1.7 Brazil, India and Mexico reserved their rights to participate in the panel proceedings as third parties.

1.8 The Panel met with the parties on 19-21 February 2002 and 20-21 March 2002. It met the third parties on 20 February 2002. The Panel sent questions to the parties on 25 February 2002 and provided additional questions to the parties during the second substantive meeting.

1.9 The Panel submitted its Interim Report to the parties on 13 May 2002. The Panel submitted its Final Report to the parties on 19 June 2002.

II. FACTUAL ASPECTS

A. United States' Countervailing Duty Determinations Covered by this Dispute

2.1 The European Communities has requested the Panel to rule on the WTO-consistency of 12 countervailing duty determinations against imports of certain steel products originating in the European Communities. The imposition of countervailing duties in these 12 determinations were based on the application by the US Department of Commerce of two different methodologies (the so-called "gamma" and "same person" methodologies) used to assess the impact of a change in ownership, (in all 12 cases before the Panel) via privatization, in the determination of the existence of subsidization in respect of the privatized producer; specifically whether non-recurring subsidies bestowed prior to the change in ownership (privatization) remained countervailable against imports from the privatized producer. From these 12 determinations, six are original investigations Stainless Sheet and Strip in Coils from France (C-427-815) (Case No. 1); Certain Cut-to-Length Carbon Quality Steel from France (C-427-817) (Case No. 2); Certain Stainless Steel Wire Rod from Italy (C-475-821) (Case No. 3); Stainless Steel Plate in Coils from Italy (C-475-823) (Case No. 4); Stainless Steel Sheet and Strip in Coils from Italy (C-475-825) (Case No. 5); Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475-827) (Case No. 6); two are administrative reviews Cut-to-Length Carbon Steel Plate from Sweden (C-401-804) (Case No. 7); Grain-oriented Electrical Steel from Italy (C-475-812) (Case No. 12) and four are sunset reviews Cut-to-Length Carbon Steel Plate from United Kingdom (C-412-815) (Case No. 8); Certain Corrosion-Resistant Carbon Steel Flat Products from France (C-427-810) (Case No. 9); Cut-to-Length Carbon Steel Plate from Germany (C-428-817) (Case No. 10); and Cut-

to-Length Carbon Steel Plate from Spain (C-469-804) (Case No. 11).[5] A table describing these determinations is included in Annex A.

2.2 In two out of these 12 cases, the Court of International Trade (CIT), in prior court appeals, expressly requested that the US Department of Commerce determine if the privatization at issue was at arm's length and for fair market value. The companies involved were British Steel (Case No. 8, Cut-to-Length Carbon Steel Plate from United Kingdom (C-412-815)) and Dillinger AG (Case No. 10, Cut-to-Length Carbon Steel Plate from Germany (C-428-817)). In 1995, in the context of a court remand, the US Department of Commerce determined that the British Steel privatization was at arm's length, for fair market value and consistent with commercial considerations because British Steel shares were offered to private investors world-wide (a) the offering price was based on valuations by independent consultants; (b) private investors purchased nearly the entire share offering; (c) similar findings were made for Dillinger.[6]

2.3 Both parties agree that the changes in ownership relevant to this dispute only concern the privatization of state-owned companies, i.e. the change in ownership from government to private hands. All the privatizations concerned by this dispute involved a full change in ownership in the sense that in all these 12 cases, governments had sold all, or substantially all, their ownership interests and, clearly, had no longer any controlling interests over the privatized producers.[7]

2.4 The following factual information regarding these 12 countervailing duty determinations and the relevant privatizations is based on evidence submitted by the European Communities commented by the United States, including references from the twelve determinations submitted as exhibits by the European Communities.

1. Original Investigations

(a) Original Investigations Covered by this Dispute

(i) United States Countervailing Duties on Imports of Stainless Steel Sheet and Strip in Coils from France (Case No. 1)

2.5 This case concerns the imposition of countervailing duties on imports of stainless steel sheet and strip in coils from France, produced and exported by Usinor -Sacilor S.A. (Usinor). The US case number is C-427-815; (64 Fed. Reg. 30774 of 29 June 1999). On 8 June 1999, the US Department of Commerce published its final determination imposing a countervailing duty rate of

[5] The numbering of the cases from 1 to 12 was presented by the European Communities and seconded by the United States.

[6] *See* EC's and US' responses to question No. 16 posed by the Panel.

[7] *See* EC's response to question No. 11 posed by the Panel.

5.38 per cent *ad valorem* on imports produced by Ugine S.A., a wholly owned subsidiary of Usinor.[8]

2.6 In July 1995 the privatization of Usinor began. Pursuant to the French privatization law, Usinor Sacilor (and shares thereof) was valued for privatization purposes by the French Privatization Commission (the "FPC"), an independent body charged with valuing companies designated for privatization. The FPC's valuation analysis used three methods: (i) comparison to the stock market values of other European steel producers; (ii) evaluation of net liquidity flows; and (iii) estimated value of the company's net re-evaluated assets. Based on the FPC's valuation opinion, the French Minister of Economy and Finance established share prices for the various Usinor share offerings. The Commission's valuation of the company was consistent with the range of values for the company established in a report prepared by Banque S.G. Warburg and Crédit Lyonnais.[9] At the same time, Usinor Sacilor offered additional shares for sale in the form of a capital increase. All shares were sold through a public offering of shares which consisted of a French public offering, an international public offering, and an employee offering. In accordance with the French privatization law, a certain portion of the shares were also sold to a group of so-called "stable shareholders", some of which were government-owned banks and other entities.[10] After the July 1995 public offering, the French Government held 9.8 per cent of Usinor's shares while Crédit Lyonnais retained approximately 3 per cent.[11]

2.7 The privatization continued throughout the years 1996 and 1997. At the end of the privatization, the stable shareholders held approximately 14 percent of Usinor's total shares, 10 per cent of which were held by government- owned or controlled entities.[12] During 1997 and 1998 the French Government divested itself of the remaining shares which it held.[13]

2.8 The margins found by the US Department of Commerce in its final determination were attributable to non-recurring subsidies found to have been received by the state-owned Usinor Sacilor (as Usinor was then known) in the 1980s. The US Department of Commerce found, on the basis of its gamma methodology[14], that these subsidies continued to benefit the company during the 1997 period of investigation. Usinor claimed that it had been privatized in 1995 by means of an arm's length, fair market value sale of shares.[15] Usinor further

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8 *See Stainless Steel Sheet and Strip in Coils from France* 64 Fed. Reg. 30774 (Dep't Commerce 8 June 1999) (final countervailing duty determination), Exhibit EC–10 to the EC's first written submission.

9 *See* Annex to EC's responses to questions posed by the Panel (4 March 2002).

10 *Stainless Steel Sheet and Strip in Coils from France, supra,* footnote 8, at 30776.

11 *See* Annex to the EC's responses to questions posed by the Panel (4 March 2002).

12 *Stainless Steel Sheet and Strip in Coils from France, supra,* footnote 8, at 30776

13 *See* Annex to EC's replies to questions posed by the Panel (4 March 2002). For details of the GOF divestiture *see Stainless Steel Sheet and Strip in Coils from France, supra,* footnote 8, at 30776-30777.

14 *See infra,* Section B.1 for a description of this methodology.

15 *Stainless Steel Sheet and Strip in Coils from France, supra,* footnote 8, at 30776-30778.

claimed that pre-privatization subsidies accounted for all but 0.10 per cent of the subsidy margin.

2.9 On 1 October 2000 Usinor challenged aspects of the US Department of Commerce's final determination, including its treatment of Usinor's privatization, in the CIT. During the litigation, the US Department of Commerce requested, and was granted, a remand to reconsider the effect of the US Court of Appeals for the Federal Circuit's decision in *Delverde Srl v. United States* (*Delverde III*) [16] on the US Department of Commerce's treatment of the effect of Usinor's privatization on prior non-recurring subsidies. On 20 December 2000, the US Department of Commerce reported its final remand redetermination to the CIT, which Usinor challenged. In its remand determination in the ongoing appeal before the CIT, the US Department of Commerce applied the same person methodology and focused on whether the change in ownership of Usinor resulted in a new legal person.[17] The US Department of Commerce found that Usinor had received a financial contribution and a benefit notwithstanding the change in ownership because Usinor was the same person before and after the privatization. On 4 January 2002, the CIT issued a remand order in which it found the same person methodology inconsistent with the US statute.[18]

(ii) United States Countervailing Duties on Imports of Certain Cut-to-Length Carbon Quality Steel Plate from France (Case No. 2)

2.10 This case concerns the imposition of countervailing duties on imports of certain cut-to-length carbon quality steel plate from France, produced and exported by Usinor Sollac S.A. (Usinor) and GTS Industries S.A. (GTS). The US case number is C-427-817; (64 Fed. Reg. 73277 of 29 December 1999). On 29 December 1999, the US Department of Commerce published its final determination imposing countervailing duties to Usinor and GTS of 5.56 per cent and 6.86 per cent *ad valorem* respectively.[19]

2.11 As regards the margins found by the US Department of Commerce for Usinor in its determination, these were mainly attributable to non-recurring subsidies found to have been received by Usinor during State-ownership in the 1980s. Usinor claimed that it was privatized in 1995 by means of an arm's length, fair market value sale of shares. The US Department of Commerce found,

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[16] *Delverde Srl. v. United States* ("*Delverde III")* 202 F.3rd 1360 (Fed Cir. Feb 2, 2000) rehg denied (20 June 2000). Exhibit EC-5 to the EC's first written submission.

[17] *See, Final Results of Redetermination pursuant to Court Remand, Allegheny Ludlum Corp.* et al. v United States Court No. 99-09-00566, (Ct. Int'l Trade 13 December 2000) (unpublished) *("Allegheny Ludlum I").*

[18] See, *Allegheny Ludlum Corp. et al. v United States* Court No. 99-09-00566 (Ct. Int'l Trade 4 January 2002). Exhibit EC–29 to the EC's second written submission. ("*Allegheny Ludlum II").*

[19] *See Certain Cut-to-Length Carbon-Quality Steel Plate from France* 64 Fed. Reg. 73277 (Dep't Commerce 29 December 1999) (final countervailing duty determination). Exhibit EC–11 to the EC's first written submission.

on the basis of its gamma methodology[20], that these subsidies continued to benefit the company during the 1998 period of investigation. Usinor claimed that these pre-privatization subsidies accounted for all but 0.10 per cent of the subsidy margin.

2.12 In the same determination the US Department of Commerce imposed a countervailing duty rate of 6.86 per cent on products exported by GTS Industries (GTS). The US Department of Commerce assigned a countervailing duty rate of 6.86 per cent allocated *pro rata* to GTS based on financial contributions that were given to the Usinor group of which GTS was a member. The US Department of Commerce concluded that the conversion of the group's consolidated debts owed to the French Government, denominated as "Loans with Special Characteristics" and of "Steel Intervention Fund" bonds into shares of common stock constituted countervailable equity infusions, which were treated as non-recurring grants.[21] The US Department of Commerce applied its gamma change in ownership methodology.[22] GTS, Usinor, the Government of France, and the European Communities provided evidence that Usinor had been privatized in 1995 at arm's length and for fair market value, but the US Department of Commerce never made any finding on whether the privatization was for fair market value.

2.13 At the time of Usinor's privatization, GTS was owned 100 per cent by AG der Dillinger Hüttenwerke (Dillinger), and Usinor held 70 per cent of Dillinger's parent company DHS – Dillinger Hutte Saarstahl (DHS). In July 1995, the French Government sold 90.2 per cent of Usinor's shares in a public offering on the French and International Stock Exchanges (described in Case No. 1 above). In April 1996, Usinor reduced its interest in DHS to 48.75 per cent. As a result of this reduction, the US Department of Commerce found in its final determination that GTS was no longer under the control of Usinor but it continued to benefit from the subsidies previously granted to Usinorand thus GTS' products were subject to countervailing duties.

2.14 On 7 April 2000, GTS filed a complaint with the US CIT On 24 August 2000, the CIT remanded the case to the US Department of Commerce to determine whether the *Delverde III* decision had any applicability on the GTS proceeding. In its remand determination in the ongoing appeal before the CIT, the US Department of Commerce did not investigate further whether any of the privatization transactions were at arm's length and for fair market value but focused exclusively on whether the change in ownership of Usinor resulted in a new legal person. In this respect the US Department of Commerce concluded that whether the owners of the newly privatized Usinor paid fair market value for the company in an arm's-length transaction based upon commercial considerations was not relevant to its analysis of previously-bestowed

[20] *Ibid*., at 73279-73280.
[21] *Certain Cut-to-Length Carbon-Quality Steel Plate from France, supra,* footnote 19, at 73281-73282
[22] *Ibid*.

subsidies.[23] The US Department of Commerce found that Usinor had received a financial contribution and a benefit notwithstanding the change in ownership because Usinor was the same person before and after the privatization. On 4 January 2002, the CIT issued its judgment on the remand redetermination in which it found the same person methodology inconsistent with US statute[24].

(iii) United States Countervailing Duties on Imports of Certain Stainless Steel Wire Rod from Italy (Case No. 3)

2.15 This case concerns the imposition of countervailing duties on imports of Certain Stainless Steel Wire Rod from Italy, produced and exported by Cogne Acciai Speciali S.r.l. (CAS) The US case number is C-475-821; (63 Fed. Reg. 40474 of 29 July 1998). On 7 January 1998, the US Department of Commerce published its final determination imposing a countervailing duty of 22.22 per cent *ad valorem* on imports of the product concerned from CAS.[25]

2.16 Until the early 1990s, the company was owned by the Italian State, at first directly by a Government-owned holding company, Istituto per la Ricostruzione Industriale (IRI) and thereafter by IRI subholding companies, Finsider S.p.A., Deltasider S.p.A. or ILVA S.p.A. On 31 December 1992 (CAS) came into being. All shares in CAS were owned by Cogne S.p.A., also a state-owned company. From this date, CAS assumed the ongoing operations of the Cogne facility. As a part of the privatization, a public offer for the sale of CAS was prepared. Notices were published in Italian and foreign newspapers soliciting purchase offers. The result of this process was that expressions of interest were received from ten private industrial or financial bidders. On 27 December 1993, an agreement was signed between Cogne S.p.A. and GE.VAL. S.p.A. for the purchase of all shares of CAS. The total price paid by GE.VAL. for CAS was higher than the amount that had been independently determined as Cogne's value by an independent expert in 1992. Since the public sale of the company, the Italian State has held no ownership interest of any kind in CAS.

2.17 The US Department of Commerce assigned a rate of 22.22 per cent *ad valorem* to CAS based almost exclusively on pre-privatization financial contributions to the ILVA group that were conferred before the creation of CAS. The US Department of Commerce applied its gamma change in ownership methodology.[26] According to the US Department of Commerce's calculations provided to CAS, at least 21.74 per cent of the total 22.22 per cent margin was composed of CAS' pro-rata share of subsidies granted to the state-owned ILVA group.

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[23] *Allegheny Ludlum I*, Court No. 99-09-00566, at 17.

[24] See *GTS Industries v. United States* Court No. 00-03-00118 (Ct. Int'l Trade 4 January 2002). Exhibit EC–30 to the EC's second written submission.

[25] *See: Certain Stainless Steel Wire Rod from Italy* 63 Fed. Reg. 809 (Dep't Commerce 7 January 1998) (prelim. determination and alignment of countervailing duty and anti-dumping duty final determinations). Exhibit EC–12 to the EC's first written submission.

[26] *Ibid.*, at 811-12.

(iv) United States Countervailing Duties on Imports of Stainless Steel Plate in Coils from Italy (Case No. 4)

2.18 This case concerns the imposition of countervailing duties on imports of Stainless Steel Plate in Coils from Italy, produced and exported by Acciai Speciali Terni S.p.A. (AST).[27] The US case number is C-475-823; (64 Fed. Reg. 15508 of 31 March 1999). On 31 March 1999, the US Department of Commerce published its final determination imposing a countervailing duty rate of 15.16 per cent *ad valorem* on products exported by AST.[28]

2.19 In September 1993, Istituto per la Ricostruzione Industriale (IRI) endorsed a plan for the market privatization of ILVA's core businesses, and the ILVA's specialty steels division was separately incorporated, first as a limited liability company (S.r.l.) and then as a stock company (S.p.A.), with all shares in this stock company – AST S.p.A. – initially owned by IRI. IRI's privatization plans were issued under the legal control of the European Commission, which set important conditions for the sale in a binding decision of April 1994. IRI prepared a public offering for the sale of AST. Notices were published in Italian and foreign newspapers soliciting purchase offers. IRI appointed the international investment firm Barclays de Zoete Wedd (BZW) as its financial adviser in the privatization process. It is reported that two other independent financial advisers were retained to conduct financial appraisals of the likely fair market value of AST. The result of this process was that expressions of interest were received from 19 private industrial or financial bidders.

2.20 A binding offer of purchase was accepted by IRI on 30 June 1994. On 14 July 1994, a purchase agreement was signed between IRI and KAI Italia S.r.l. (a holding company created by a German-Italian consortium for this purpose) for the purchase of all shares of AST S.p.A. The total price paid by KAI for AST was significantly greater than the amounts that had been independently determined as AST's value by each of IRI's independent valuation experts and financial advisers to the privatization.

2.21 The above duty is reported to be the result of the pro-rata allocation to AST of the pre-privatization financial contributions to the state-owned ILVA group, of which AST was a member. The determination was made on the basis of the gamma methodology.[29] The US Department of Commerce found irrelevant the evidence placed on the administrative record by AST, the Government of Italy, and the European Communities that the company had been privatized in 1994 at arm's length for fair market value when sold at public auction by the Government of Italy to the highest bidder, a private consortium led by German steelmaker Krupp AG Hoesch-Krupp. According to the US

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[27] ILVA S.p.A. (old, state-owned) was dissolved on 31 October 1993. Two new companies were created: ILVA Laminati Piani S.r.l. (ILP) and Acciai Speciali Terni S.r.l. (AST). In December 1994, AST was sold to KAI Italia S.r.l. A more detailed corporate history can be found in Annex A *infra*.

[28] *See Stainless Steel Plate in Coils from Italy* 64 Fed. Reg. 15508 (Dep't Commerce 31 March 1999) (final countervailing duty determination). Exhibit EC–13 to the EC's first written submission.

[29] *See Stainless Steel Plate in Coils from Italy*, *supra*, footnote 28, at 15509-15510.

Department of Commerce's calculations provided to AST, at least 13.42 per cent of the total 15.16 per cent margin was composed of AST's pro-rata share of the subsidies granted to the state-owned ILVA group, of which AST was a member.

2.22 The US Department of Commerce's final determination in this investigation was challenged by AST in the CIT on 10 June 1999.[30] On 14 August 2000, the CIT remanded AST's appeal back to the US Department of Commerce in light of the *Delverde III* ruling. The US Department of Commerce applied its new same person test in the remand proceeding and did not consider any evidence regarding the arm's length and fair market value of the privatization of AST.[31] The application of the new methodology resulted in an increase of the countervailing duty applicable to AST from 15.16 per cent to 17.25 per cent *ad valorem*. AST disputed this remand redetermination before the CIT. On 1 February 2002, the CIT rendered its opinion where it rejected the US Department of Commerce's findings.

(v) United States Countervailing Duties on Imports of Stainless Steel Sheet and Strip in Coils from Italy (Case No. 5)

2.23 This case concerns the imposition of countervailing duties on stainless steel sheet and strip in coils from Italy, produced and exported by Acciai Speciali Terni S.p.A. (AST).[32] The US case number is C-475-825; (64 Fed. Reg. 30624 of 8 June 1999). The US Department of Commerce published its final determination imposing a countervailing duty of 12.22 per cent on exports of AST *ad valorem*.[33]

2.24 As in stainless steel plate in coils from Italy the countervailing duty is based in part on pre-privatization financial contributions to the ILVA group, in part on pre-privatization financial contributions to TAS/Terni, and in part on debt relief provided to AST itself during the process of privatization.[34] The pre-privatization subsidies were analysed under the gamma methodology by US Department of Commerce.[35]

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[30] *Final Results of Redetermination pursuant to Court Remand, Acciai Speciali Terni ("AST") v. United States* Court No. 99-06-00364, (Ct. Int'l Trade 19 December 2000) (unpublished) (Stainless Steel Plate in Coils from Italy) Exhibit EC–6 to the EC's first written submission.

[31] *Ibid.*

[32] *Stainless Steel Sheet and Strip in Coils from Italy* 64 Fed. Reg. 30624 (Dep't Commerce 8 June 1999) (final countervailing duty determination), Exhibits EC–14 and EC–15 to the EC's first written submission.

[33] *See Stainless Steel Sheet and Strip in Coils from the Republic of Korea* 64 Fed. Reg. 42943 (Dep't Commerce 6 August 1999) (final determination)*; and Stainless Steel Sheet and Strip in Coils from France, Italy, and the Republic of Korea* 64 Fed. Reg. 42943 (Dep't Commerce 6 August 1999) (notice of countervailing duty orders); and *Stainless Steel Sheet and Strip in Coils from Italy*, *supra*, footnote 32.

[34] *Stainless Steel Sheet and Strip in Coils from Italy* (C-475-825) *supra,* footnote 32, at 30626, which refers to the examination of the AST change in ownership by the Department of Commerce in *Stainless Steel Plate in Coils From Italy*, *supra,* footnote 28 (Case No. 4 *supra*).

[35] *Stainless Steel Plate in Coils from Italy*, *supra,* footnote 28,. at 15509-15510.

2.25 The US Department of Commerce's final determination in this investigation was timely challenged in the US courts by AST and is now before the CIT.[36] This appeal has been temporarily stayed pending resolution of the parallel appeal of the US Department of Commerce determination concerning Stainless Steel Plate in Coils from Italy (see paragraph 2.21 above.)

(vi) United States Countervailing Duties on Imports of Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (Case No. 6)

2.26 This case concerns the imposition of countervailing duties on certain cut-to-length carbon-quality steel plate from Italy, produced and exported by ILVA S.p.A.[37] The US case number is C-475-827; (64 Fed. Reg. 73244 of 29 December 1999). On 29 December 1999, the US Department of Commerce published its final determination imposing a countervailing duty of 26.12 per cent on exports of ILVA (ILP).[38] The US Department of Commerce assigned that duty of 26.12 per cent to ILP. This was also based on the gamma methodology.[39] According to the US Department of Commerce calculations provided to ILP, at least 22.68 per cent of the total 26.12 per cent margin was composed of subsidies granted to ILVA during that company's period of State ownership.

2.27 As regards the privatization process, in September 1993, the IRI endorsed a plan for the market privatization of ILVA's core businesses, and ILVA's carbon steel flat products division was separately incorporated as a stock company (S.p.A.), with all shares in this stock company – ILP S.p.A. – initially owned by IRI. IRI's privatization plans were issued under the legal auspices of the European Commission. The IRI prepared a public offering for the sale of ILP. Notices were published in Italian and foreign newspapers soliciting purchase offers. IRI appointed the Italian Bank IMI S.p.A. as its financial adviser in the privatization process. It was reported that two other independent financial advisers (Pasfin Servizi Finanziari S.p.A. and Samuel Montagu Ltd.) were retained to conduct financial appraisals of the likely fair market value of ILP. Expressions of interest were received from 11 private industrial or financial bidders. On 16 March 1995, a purchase agreement was signed between IRI and Riva Acciaio S.p.A.

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[36] *See* EC's first written submission, para. 99.

[37] ILVA S.p.A. (old, state-owned) was dissolved on 31 October 1993. Two new companies were created: ILVA Laminati Piani S.r.l. (ILP) and Acciai Speciali Terni S.r.l. (AST). On 16 March 1995, ILP was sold to a consortium of investors led by Riva Acciaio S.p.A. On 1 January 1997, ILP was renamed ILVA S.p.A. (new). For practical reasons, the only name mentioned in this request for consultations is ILVA S.p.A., even when we make reference to the (old) ILVA or to ILP. A more detailed corporate history can be found in Annex A, *infra*.

[38] See *Certain Cut-to-Length Carbon-Quality Steel Plate from Italy* 64 Fed. Reg. 73324 (Dep't Commerce 29 December 1999) (final countervailing duty determination). Exhibit EC–16 to the EC's first written submission.

[39] *Ibid.*, at 73246.

2.28 The US Department of Commerce's final determination in this investigation was challenged in the US courts by ILP and is now before the CIT.[40] The US Department of Commerce has conducted a remand redetermination in which it has applied the same person methodology.[41]

(b) The US Department of Commerce's practice in original investigations

2.29 The United States does not dispute that the original investigations before the Panel are WTO-inconsistent to the extent that they were based on the gamma methodology and that the underlying determinations did not fully examine whether the pre- and post-change in ownership entities involved were the same legal persons.[42]

2. Administrative Reviews

(a) Administrative Reviews Covered by this Dispute

(i) United States Countervailing Duties on Imports of Certain Cut-to-length Carbon Steel Plate from Sweden (Case No. 7)

2.30 This case concerns the definitive results of an administrative review which led to the imposition of countervailing duties on certain carbon steel products from Sweden, produced and exported by SSAB Svenskt Stal AB (SSAB), on 7 April 1997. The US case number is C-401-804; (62 Fed. Reg. 16551 of 7 April 1997). On 7 April 1997, the US Department of Commerce published its final determination which led to the imposition of the countervailing measures of 1.91 per cent *ad valorem*.[43] This duty was imposed on the basis of [alleged] subsidies which derived from financial contributions made by the Government of Sweden to the State-owned Swedish steel industry prior to the privatization of SSAB, which began in 1987 and was completed on 15 February 1994. In making this determination, the US Department of Commerce based its findings on the gamma methodology.[44] The US Department of Commerce admits that the administrative review was WTO-inconsistent to the extent that the review was based on the gamma methodology and that, therefore,

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[40] *Final Results of Redetermination pursuant to Court Remand, ILVA Lamiere e Tubi S.p.A. v. United States* Court No. 00-03-00127, (Ct. Int'l Trade 28 December 2000) (unpublished) (Certain Cut-to-Length Carbon-Quality Steel Plate from Italy), Remand Order (Ct. Int'l Trade August 30, 2000).

[41] *Ibid*.

[42] US' first written submission, para. 85. For a detailed description of US practice in original investigations *see Countervailing Duties; Final Rule* 19 C.F.R. § 351(1998). (Selected pages contained in Exhibit EC–32 to the EC's second written submission).

[43] *See Certain Cut-to-Length Carbon Steel Plate from Sweden* 62 Fed. Reg. 16551 (Dep't Commerce 7 April 1997) (final admin. review) (hereinafter *Sweden Admin. Review*). Exhibit EC–17 to the EC's first written submission.

[44] *Sweden Admin. Review, supra*, footnote 43, at 16552.

the underlying determination did not fully examine whether the pre- and post-change in ownership entity was the same legal person.[45]

2.31 SSAB was privatized in three stages, in 1987, 1989 and 1992. The first stage took place in 1987 when the Government of Sweden which by then was the sole owner of SSAB sold one-third of its shares to a consortium of six institutional investors. The second step took place in 1989, when the Government of Sweden and the international investors sold part of their shares in a public offer. After this offer, the Government of Sweden held 47.8 per cent of the company's shares. Shortly afterwards, SSAB's shares were introduced on the stock exchange. In 1992, in the framework of a general privatization programme, the Government of Sweden floated bonds to which were attached warrants to purchase the remaining shares retained by the Swedish Government. All warrants were exercised by 16 February 1994, thereby completing the SSAB privatization. As a result of the SSAB privatization, the company's shares were distributed to more than 30,000 small shareholders. The sale price of the company was determined in 1987 through negotiations with private institutional investors; share prices were based on estimated average profit levels before tax, at a level considered normal on the Swedish stock market at that time for companies with similar profiles. In 1989, the price of shares was determined by two reportedly independent investment banks appointed by the Government. In 1992, the sale price of the remaining shares was determined with reference to the stock market and resulted in a price slightly higher than the six previous months average price. In the administrative review the United States determined that during the review period, SSAB was completely privatized.[46]

(ii) Grain-Oriented Electrical Steel from Italy (Case No. 12)

2.32 This case concerns the preliminary results of an administrative review which led to the continued imposition of countervailing duties on grain-oriented electrical steel from Italy, produced and exported by Acciai Speciali Terni S.p.A. (AST). The US case number is C-475-812; (65 Fed. Reg. 41950 of 7 July 2000). On 12 January 2001, the US Department of Commerce published the final results of the administrative review imposing a countervailing duty rate of 14.25 per cent *ad valorem* on exports of Acciai Speciali Terni S.p.A. (AST)[47]. This duty is reported to have been based in part on pre-privatization financial contributions to the state-owned ILVA group (allocated pro-rata to a group of producers, including AST), in part on pre-privatization contributions to TAS/Terni, and in part on debt relief provided to AST itself during the process of privatization.

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[45] US' first written submission, para. 86

[46] *Sweden Admin. Review*, *supra*, footnote 43 at 1655116552.

[47] *Grain-Oriented Electrical Steel from Italy* 66 Fed. Reg. 2885 (Dep't Commerce 12 January 2001) (final admin. review) (hereinafter *GOES Admin. Review*) Exhibit EC–7 to the EC's first written submission. The original final countervailing duty determination was published in *Grain Oriented Electrical Steel from Italy* 59 Fed. Reg. 183357 (Dep't Commerce 18 April 1994) (final countervailing duty determination) (hereinafter *GOES* Final Determination).

2.33 The US Department of Commerce applied its same person change in ownership methodology[48]. In this regard, the US Department of Commerce indeed concluded that AST was the same person because the specialty steel factories in Terni still sold specialty steels, still employed the same workers, still had the same or similar suppliers, and still marketed their products to the same or similar consumers. The US Department of Commerce's final determination in the administrative review of Grain-Oriented Electrical Steel from Italy was challenged in court by AST. [49]

(b) The US Department of Commerce's Practice in Administrative Reviews

2.34 Under United States law[50], the US Department of Commerce may initiate an administrative review on its own initiative or further to the written request of a domestic interested party, a foreign government, an exporter or producer covered by an order or an importer of the merchandise.[51] The US Department of Commerce may rescind an administrative review, in whole or only with respect to a particular exporter or producer, if it concludes that during the period covered by the review, there were no entries, exports, or sales of the subject merchandise, as the case may be. [52]

2.35 Pursuant to US Department of Commerce's practice, the appropriate venue for introducing evidence of a privatization as a basis for a change in the countervailable duty is in an administrative review.[53]

3. Sunset Reviews

(a) Sunset Reviews Covered by this Dispute

(i) United States Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from the United Kingdom (Case No. 8)

2.36 This case concerns the definitive results of a sunset review which led to the continuation of the countervailing measures imposed on cut-to-length carbon steel plate from the United Kingdom, produced and exported by British Steel plc.

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[48] *GOES Admin. Review*, *supra*, footnote 47, at 2886, which refers to the *Issues and Decision Memorandum for the Administrative Review of the Countervailing Duty Order in Grain Oriented Electrical Steel from Italy for the period January 1, 1998 to December 31, 1998* (unpublished) attached as Exhibit EC-7 to the EC's first written submission , where the relevant discussion can be found on pages 3, 4, and 16-27.

[49] The original 1994 countervailing duty order on grain-oriented electrical steel from Italy was the subject of US sunset review, which was initiated on 1 December 1999. *Grain-Oriented Electrical Steel from Italy* 65 Fed. Reg. 65295 (Dep't Commerce 1 November 2000) (full sunset review).

[50] Detailed procedures for administrative reviews can be found in *Countervailing Duties; Final Rule*, 19 C.F.R. § 351.213 (1998).

[51] *Countervailing Duties; Final Rule*, 19 C.F.R. § 351.213 (1998), p. 203.

[52] *Countervailing Duties; Final Rule*, 19 C.F.R. § 351.213 (1998), p. 204.

[53] See US first written submission, para. 77.

The US case number is C-412-815; (65 Fed. Reg. 18309 of 7 April 2000). On 7 April 2000, the US Department of Commerce published its final determination which led to the continuation of the countervailing measures at a rate of 12.00 per cent, the applicable rate of duty at the time and the same as that found in the original investigation.[54] This countervailing duty was originally imposed in 1993, on the basis of subsidies which derived from financial contributions made by the Government of the United Kingdom to the State-owned British Steel Corporation.[55] This was prior to the transformation of British Steel Corporation into British Steel plc (BS plc) and its privatization in 1988. In making the above sunset determination, the US Department of Commerce determined on the basis of its gamma methodology that these subsidies continued to benefit British Steel after its privatization.[56] The subsidies originally received by British Steel Corporation in this case are the same as those involved in the *US – Lead and Bismuth II* WTO dispute. However, the *US – Lead and Bismuth II* WTO dispute covered countervailing duties on imports by UES whereas this dispute involves imports from British Steel plc., a different sucessor to British Steel Corporation.

2.37 Prior to 1988, British Steel Corporation (BSC) was a Crown corporation without shares which was wholly-owned by the United Kingdom Government. On 26 July 1988, it was reincorporated as a public limited company named British Steel plc (BS plc). All the shares were owned by the United Kingdom Government.

2.38 The second step in the privatization was the actual public offering of the shares of BS plc. Following a competitive process, the Secretary of State for Trade and Industry appointed a number of independent firms to provide advice on the sale. Two billion ordinary shares of BS plc were offered at a fixed price on 23 November 1988. The final price of £1.25, was determined based upon a recommendation by the main financial adviser for the transaction and produced a total sale price to the United Kingdom Government of 2.5 billion pounds sterling. In determining the sale price, the main financial adviser took into account the forecast dividend yield, the company's forecasted profits, the market conditions and the anticipated level of demand in the UK and overseas.

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[54] *See, Cut-to-Length Carbon Steel Plate from the United Kingdom* 65 Fed. Reg. 18309 (Dep't Commerce 7 April 2000) (exp. sunset review). *See also Issues and Decision Memorandum for the Expedited Sunset Review of the Countervailing Duty Order on Cut-to-Length Carbon Steel Plate from the United Kingdom; Final Results* 29 March 2000 (unpublished) Exhibit EC–18 to the EC's first written submission.

Note that while the Government of the United Kingdom and the European Communities did provide information to the US Department of Commerce to the effect that the order should be terminated because pre-privatization subsidies to BSC did not continue to benefit the production of BS plc after the fair market value privatization in 1988, Corus itself did not cooperate with the US Department of Commerce's investigation.

[55] *See Cut-to-Length Carbon Steel Plate from the United Kingdom* 58 Fed. Reg. 37393 (Dep't Commerce 9 July 1993) (final countervailing duty determination).

[56] *See Issues and Decision Memorandum for the Expedited Sunset Review of the Countervailing Duty Order on Cut-to-Length Carbon Steel Plate from the United Kingdom; Final Results, supra,* footnote 54, at 7.

2.39 In this case, the US Department of Commerce was expressly requested by a US domestic court to determine if the privatization of British Steel was at arm's length and for fair market value. In 1995, in the context of this court remand, the US Department of Commerce confirmed that the British Steel privatization was at arm's length, for fair market value and consistent with commercial considerations because British Steel shares were offered to private investors world-wide, the offering price was based on valuations by independent consultants, and private investors purchased nearly the entire share offering[57].

(ii) United States Countervailing Duties on Imports of Certain Corrosion-Resistant Carbon Steel Flat Products from France (Case No. 9)

2.40 This case concerns the definitive determination of a sunset review which led to the continuation of the countervailing measures imposed on certain corrosion-resistant carbon steel flat products from France, produced and exported by Usinor SA (Usinor). The US case number is C-427-810; (65 Fed. Reg. 18307 of 7 April 2000). On 7 April 2000, the US Department of Commerce published its final determination which led to the continuation of the countervailing measures imposed on corrosion-resistant carbon steel flat products from France, produced and exported by Usinor S.A.[58] The rate of countervailing duty for Usinor was 15.13 per cent *ad valorem*; the same as that found in the original investigation, because Usinor had never sought an administrative review.

2.41 The above countervailing duty was originally imposed in 1993, on the basis of the subsidies which derived from financial contributions made by the French Government to the State owned Usinor SA.[59] This was prior to the privatization of Usinor in 1995.[60] In making this sunset determination, the US Department of Commerce concluded that these subsidies continued to benefit Usinor after privatization.[61]

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[57] *See Final results of redetermination pursuant to Court remand on general issues on privatization* (*British Steel plc v United States*) Consol. Court No. 93-09-00550 (Ct. Int'l Trade 17 July 1995), at 18-20. Exhibit EC–19 to the EC's first written submission.

[58] See *Corrosion-Resistant Carbon Steel Flat Products from France* 65 Fed. Reg. 18063 (Dep't Commerce 7 April 2000) (exp. sunset review) See also *Issues and Decision Memorandum for the Sunset Review of the Countervailing Duty Order on Certain Corrosion-Resistant Carbon Steel Flat Products from France; Final Results* 29 March 2000 (unpublished). Exhibit EC–20 to the EC's first written submission. Note, that while the Government of France and the European Communities did communicate to the US Department of Commerce that Usinor had been privatized for fair market value, the company itself did not cooperate with US Department of Commerce's investigation.

[59] *Certain Steel Products from France*, 58 Fed. Reg. 37304 (Dep't Commerce 9 July 1993) (final countervailing duty determination, as amended).

[60] For details on Usinor's privatization, see Case No. 1 *supra*.

[61] *See Issues and Decision Memorandum for the Sunset Review of the Countervailing Duty Order on Certain Corrosion-Resistant Carbon Steel Flat Products from France; Final Results, supra,* footnote 58.

(iii) United States Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from Germany (Case No. 10)

2.42 This case concerns the final determination of a sunset review which led to the continuation of the countervailing measures imposed on cut-to-length carbon steel plate from Germany, produced and exported by AG Dillinger Hüttenwerke Saarstahl (Dillinger). The US case number is C-428-817; (65 Fed. Reg. 47407 of 2 August 2000). On 2 August 2000, the US Department of Commerce published its final determination leading to the continuation of the countervailing measures imposed on Cut-to-Length Carbon Steel Plate from Germany, produced and exported by Dillinger.[62] The rate of countervailing duty for these products exported by Dillinger is 14.84 per cent *ad valorem*. This countervailing duty was originally imposed in 1993, on the basis of the subsidies which derived from financial contributions made by the German Government and the Regional Government of Saarland to Dillinger Hütte Saarstahl and attributed in part to Dillinger.[63]

2.43 At the beginning of April 1989, Saarstahl Völkingen GmbH was owned 76 per cent by the Government of Saarland (a German land) and 24 per cent by Arbed Luxembourg though its subsidiary, Arbed-Finanz Deutschland GmbH. On 20 April 1989, Saarland and Arbed reached an agreement with Usinor Sacilor to combine Saarstahl Völkingen GmbH with Dillinger, another Saarland steel producer owned by Usinor Sacilor, under a holding company (DHS). The parties engaged two independent accounting firms (Treuarbeit and KPMG) to appraise the relative values each party would contribute to the combined entity, in order to calculate each party's per centage ownership. On 15 June 1989, after the change in ownership transaction, Usinor Sacilor owned 70 per cent of DHS's shares, Saarland owned 27.5 per cent of DHS's shares and the remaining 2.5 per cent was owned by Arbed. The main subsidy came in the form of debt relief provided to DHS in connection with its creation in 1989.

2.44 On 30 June 1989, DHS transferred the assets and liabilities of the former Saarstahl Völkingen GmbH into the newly created subsidiary, Saarstahl. Thus DHS became a holding company with two operating subsidiaries, Saarstahl and Dillinger.

2.45 In the court remand mentioned in Case No. 8, the US Department of Commerce was requested to analyse the change in ownership of certain companies including Dillinger. As a result of this exercise, the US Department of

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[62] *Certain Corrosion-Resistant Carbon Steel Flat Products; Cold-Rolled Carbon Steel Flat Products; and Cut-to-Length Carbon Steel Plate Products from Germany*. 65 Fed. Reg. 47407 (Dep't Commerce 2 August 2000) (full sunset reviews). See also *Issues and Decision Memorandum for the Sunset Reviews of the Countervailing Duty Orders on Certain Corrosion-Resistant Carbon Steel Flat Products; Cold-Rolled Carbon Steel Flat Products; and Cut-to-Length Carbon Steel Plate Products from Germany; Final Results* 27 July 2000 (unpublished). Exhibit EC–21 to the EC's first written submission.

[63] *Certain Corrosion-Resistant Carbon Steel Flat Products; Cold-Rolled Carbon Steel Flat Products; and Cut to- Length Carbon Steel Plate Products from Germany* 58 Fed. Reg. 37315 (Dep't Commerce 9 July 1993) (final countervailing duty determination).

Commerce confirmed that the Dillinger transaction was at arm's length, for fair market value, and consistent with commercial considerations because it occurred between two unrelated parties and each party's percentage shareholding in DHS/Dillinger was based on appraisals performed by two independent accounting firms which took into account the forgiveness of the debt.[64]

2.46 The US Department of Commerce determined that it was "not appropriate" to address the privatization issue in the sunset review, the focus of which is on whether subsidization is likely to continue or recur.[65] The US Department of Commerce cited the "complexity and fact-intensive nature" of this issue in support of its finding that the sunset review schedule did not allow time for it to analyze the privatization and other changes in law. When this determination was challenged before the CIT, it was pointed out that the statute allows the US Department of Commerce to extend the period for issuing final results by up to 90 days. For this and other reasons, the CIT later remanded the sunset review to the US Department of Commerce for redetermination, taking into account all the evidence submitted by the parties, including that on privatization.[66]

(iv) United States Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from Spain (Case No. 11)

2.47 This case concerns the definitive results of a sunset review which led to the continuation of the countervailing measures imposed on cut-to-length carbon steel plate from Spain, produced and exported by Aceralia SA. The US case number is C-469-804; (65 Fed. Reg. 18307 of 7 April 2000). On 7 April 2000, the US Department of Commerce published its final determination continuing the countervailing measures imposed on cut-to-length carbon steel plate from Spain, produced and exported by Aceralia S.A.[67] The rate of countervailing duty was set at 36.86 per cent *ad valorem*, the same rate of duty as found in the original investigation. The above countervailing duty was originally imposed in 1993, on the basis of the alleged subsidies which derived from financial

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[64] See *Final results of redetermination pursuant to Court remand on general issues on privatization* (*British Steel plc v United States)* Consol. Court No. 93-09-00550, at 22-34.

[65] *AG Dillinger Huttenwerke et al v United States* ("*Dillinger*"); Court No. 00-09-00437 (Ct. Int'l Trade 28 February 2002), at 62. Exhibit EC-34 to the EC's second written submission.

[66] *Ibid.* at 67.

[67] *Cut-to-Length Carbon Steel Plate from Spain* (C-469-804) 65 Fed. Reg. 18307 (Dep't Commerce 7 April 2000) (exp. sunset review). See also *Issues and Decision Memorandum for the Expedited Sunset Review of the Countervailing Duty Order on Cut-to-Length Carbon Steel Plate from Spain; Final Results* 29 March 2000 (unpublished). Exhibit EC–22 to the EC's first written submission.

While the Government of Spain and the European Communities did communicate to US Department of Commerce that CSI had been privatized to create Aceralia, Aceralia itself, did not cooperate with the US Department of Commerce's investigation. According to the US Department of Commerce's practice, Aceralia was not entitled to request any administrative review since it had stopped exporting to the United States when the order became effective in 1993.

contributions made by the Spanish Government to CSI Corporación Siderúrgica.[68] This was prior to the privatization of CSI in 1997.

2.48 CSI was privatized through a three-step process by its State-controlled owner AIE (Agencia Industrial del Estado). Phase one involved the selection of a "*technological partner*" to purchase a 35 per cent share of the company. Phase two involved the selection of a "*supporting partner*" to purchase between 10 per cent and 25 per cent of the company's shares. In phase three, the remaining shares were sold by an international subscription open to private investors. Prior to its privatization, CSI was valued by experts from the University of Oviedo and Carlos III of Madrid and from the international audit firm of Ernst & Young. Furthermore, a Spanish bank, Banco Central Hispano-Americano, was requested to monitor the privatization in order to ensure that every step was properly carried out. During the process other independent auditors such as Coopers & Lybrand were required to certify the correctness of the privatization. After a fully transparent evaluation process, on 1 August 1997 the Luxembourg company Arbed was finally chosen as the technological partner of CSI. The supporting partner was also selected through an open bid. The only two companies which expressed an interest were Corporacion J.M. Aristrain and Gestamp SL which respectively purchased shares amounting to 11 per cent and 1 per cent of the company's capital (17 October 1997). The privatization was completed by the sale through a public subscription of the remaining shares owned by the Spanish State (March 1998).

2.49 In its sunset review, the US Department of Commerce determined that the above financial contributions continued to benefit Aceralia.[69]

(b) The US Department of Commerce's Practice in Sunset Reviews

2.50 Under United States law, the US Department of Commerce automatically initiates a sunset review on its own initiative within five years of the date of publication of a countervailing duty order.[70] The US Department of Commerce conducts these reviews pursuant to published regulations.[71] In the sunset review, the US Department of Commerce has the responsibility of determining whether revocation of a countervailing duty order would be likely to lead to continuation or recurrence of subsidization. If the US Department of Commerce's determination is negative, it must revoke the order. However, if the US Department of Commerce's determination is affirmative, it transmits its

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[68] *Cut-to-Length Carbon Steel Plate from Spain* 58 Fed. Reg. 37374 (Dep't Commerce 9 July 1993) (final countervailing duty determination). Exhibit EC-22 to the EC's first written submission.

[69] *See also Issues and Decision Memorandum for the Expedited Sunset Review of the Countervailing Duty Order on Cut-to-Length Carbon Steel Plate from Spain; Final Results, supra,* footnote 67.

[70] Sections 751(c)(1) and (2) of the Tariff Act of 1930, as amended, *see also Countervailing Duties; Final Rule,* 19 C.F.R. § 351.218(c)(1) (1998).

[71] For a detailed description of procedures, the United States refers to *Procedures for Conducting Five-year ("Sunset") Reviews of Antidumping and Countervailing Duty Orders ("Sunset Regulations")* 19 C.F.R. § 351(1998).

determination to the U.S. International Trade Commission ("USITC"), along with a determination regarding the magnitude of the net countervailable subsidy that is likely to prevail if the order is revoked. The USITC has the option of considering the magnitude of the net countervailable subsidy when it analyses the likelihood of continuation or recurrence of injury. [72]

2.51 The US Department of Commerce informs exporting Members and firms of the initiation of a sunset review in at least four ways. The US Department of Commerce publishes in the *Federal Register* a sunset review initiation schedule to provide for monthly initiations of so-called "transition orders." In addition, in the month preceding the scheduled initiation date of a sunset review, the US Department of Commerce notifies representatives of the foreign government, the foreign producers, and the domestic producers, by mail, that the sunset review of a particular countervailing duty order will be initiated on or about the first of the following month. The US Department of Commerce subsequently publishes the notice of initiation of the sunset review in the *Federal Register*. Finally, information concerning, *inter alia*, the initiation of a sunset review, including the scheduled initiation date, the parties on the service list, and the merchandise covered by the scope of the order is available on the US Department of Commerce's website.[73]

2.52 When the US Department of Commerce initiates sunset reviews it requests that any interested parties who wish to participate in the review submit such a request and comments on the likelihood of continuation or recurrence of subsidization.[74] The *Sunset Regulations* set forth, *inter alia*, the information to be provided by parties participating in a sunset review and the deadlines for required submissions.[75] When the exporting producers subject to the countervailing duties do not submit comments, the US Department of Commerce conducts an expedited sunset review. The evidence used in sunset reviews is that already on the record at the US Department of Commerce. The US Department of Commerce position is that unless during the five-year period of the countervailing duty the US Department of Commerce has conducted an administrative review, the only evidence in a sunset review on the likelihood of continuation or recurrence of subsidization will be that coming from the original investigation.[76] The United States maintains that the US Department of Commerce is under no obligation, pursuant to Article 21.3 of the SCM Agreement, to convert sunset reviews into full-blown administrative reviews of the respective countervailing duties.

2.53 While the European Communities does not dispute the accuracy of the US Department of Commerce's description of its practices, the European Communities maintains that the practice is incompatible with Article 21.3 of the SCM Agreement. The European Communities argues that the US Department of

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[72] US' response to question No. 20 posed by the Panel, para 2.
[73] *Ibid*, para 1.
[74] *See* US' first written submission, para 89.
[75] The US refers to *Procedures for Conducting Five-year ("Sunset") Reviews of Antidumping and Countervailing Duty Orders ("Sunset Regulations")*, 19 C.F.R. § 351(1998).
[76] See footnote 53.

Commerce's practice of conducting an expedited review and not taking into account comments submitted by interested parties if the exporting producer does not submit comments is inconsistent with Article 21 of the SCM Agreement.

2.54 The European Communities notes a distinction between the United States and the European Communities as to the facts. The US Department of Commerce maintains that "in three of the four sunset reviews, the US Department of Commerce received no comments from the European steel companies involved. Accordingly, in those cases and pursuant to its procedures, the US Department of Commerce conducted expedited reviews."[77] Both the United States and the European Communities agree that in Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from Germany (Case No. 10) the exporting company did participate and a full review was conducted. However, the European Communities asserts that in Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from the United Kingdom (Case No. 8), Countervailing Duties on Imports of Certain Corrosion-Resistant Carbon Steel Flat Products from France (Case No. 9) and Countervailing Duties on Imports of Cut-to-Length Carbon Steel Plate from Spain (Case No. 11), the US Department of Commerce deliberately ignored comments submitted by the Governments of the United Kingdom, France and Spain as well as by the European Communities.[78]

B. United States' Change in Ownership Methodologies Covered by this Dispute

2.55 This dispute covers two methodologies used by the US Department of Commerce in order to assess the impact of a change in ownership in the determination of subsidization in respect of privatized companies. These methodologies are the so-called gamma methodology and the same person methodology. In this regard, of the 12 determinations challenged by the European Communities, 11 were initially based on the gamma methodology. In Case No. 12 (*Grain-Oriented Electrical Steel from Italy "GOES"*) the US Department of Commerce used the same person methodology. The same person methodology was first applied in the Final Results of the Administrative Review in this case which was published on 12 January 2001.[79] This methodology had earlier also been applied in various remand determinations ordered by CIT within appeal proceedings in four of the above 11 determinations.[80] The same

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[77] *See* US' first written submission, para. 89.

[78] *See* EC's first written submission, para. 109 and footnote 102 to para. 115; *and Issues and Decision Memorandum for the Sunset Review of the Countervailing Duty Order on Certain Corrosion-Resistant Carbon Steel Flat Products from France; Final Results, supra*, footnote 58, at 5.

[79] *See* EC's first written submission, para. 124.

[80] Stainless Sheet and Strip in Coils from France (C-427-815) (Case No. 1); Certain Cut-to-Length Carbon Quality Steel from France (C-427-817) (Case No. 2) (with respect to GTS); Stainless Steel Plate in Coils from Italy (C-475-823) (Case No. 4) and Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475-827) (Case No. 6).

person methodology has been challenged before the CIT in all of these remand redeterminations[81], and also in the GOES determination.[82]

2.56 The United States has admitted that seven (Case Nos. 1 to 7) of these 12 determinations are inconsistent with its WTO obligations to the extent that the US Department of Commerce did not fully examine whether the pre- and post-change in ownership entities were the same legal persons change in ownership.[83] These were based on the gamma methodology.

1. The Gamma Methodology

2.57 In July 1993, the US Department of Commerce introduced the gamma methodology.[84] According to this methodology, after assessing the existence of pre-privatization subsidies, the US Department of Commerce determines to what extent (if any) the privatization transaction price repaid unamortized subsidies, and countervails the remainder (if any). Unlike the pass-through methodology where the totality of prior subsidies passed through, the application of the gamma methodology could, depending on the facts, result in a finding that all, some, or none of the unamortized portion of the pre-privatization subsidies remains countervailable after privatization.

2.58 The gamma methodology was the methodology applied in the three administrative reviews of countervailing duty determinations covered by the *United States – Imposition of Countervailing Duties on Certain Hot Rolled Lead an Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*") dispute and which the Panel and Appellate Body found to be inconsistent with the SCM Agreement.[85]

2. The Same Person Methodology

2.59 In *Grain-Oriented Electrical Steel from Italy*, the US Department of Commerce applied for the first time the same person methodology which it had developed on remand after the *Delverde III* judgment. This methodology had

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[81] The United States claims that since "the EC has not challenged the four remand determinations in this forum ... the Panel's review is limited to the six original determinations in which US Department of Commerce applied its old methodology." US' first written submission, para. 85.

[82] *See* EC's first written submission, para. 124.

[83] *See* US' first written submission, para. 85.

[84] The methodology was set out in a "General Issues Appendix" annexed to *Certain Steel Products from Austria*, 58 Fed. Reg. 37217 (Dep't Commerce 9 July 1993) (final countervailing duty determination) (hereinafter, *General Issues Appendix*). The relevant discussion of privatization is found at 37259-65. Exhibit EC–2 to the EC's first written submission.

[85] *See* Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/AB/R, adopted 7 June 2000, DSR 2000:V, 2595. As further discussed, the United States in its first written submission stated "the panel and the Appellate Body rejected the gamma methodology as inconsistent with the SCM Agreement." US' first written submission, para. 12.

first been set out in the draft and then final results of a redetermination pursuant to a court remand in *Acciai Speciali Terni v United States.*[86]

2.60 The same person methodology provides for a two-step test. The first step consists in an analysis of whether the post-privatization entity is the same legal person that received the original subsidies before privatization. For this purpose, the US Department of Commerce examines the following non-exhaustive criteria: (i) continuity of general business operations; (ii) continuity of production facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel.[87] If, as a consequence of the application of these criteria, the US Department of Commerce concludes that the post-privatization entity is a new legal person, distinct from the entity that received the prior subsidies, the US Department of Commerce would not impose duties on goods produced after privatization on account of the pre-privatization subsidies. The US Department of Commerce would, however, proceed to examine in such an event, whether any subsidy had been bestowed upon the post-privatization entity as a result of the change in ownership (by assessing whether the sale was for fair market value and at arm's-length). If as the result of the application of the above criteria the US Department of Commerce concludes that no new or distinct legal person was created, all the subsidy is found to continue to reside in the post-privatization producer and the US Department of Commerce will not assess whether the privatization was at arm's-length and for fair market value.[88]

C. Section 771(5)(F) of the US Tariff Act of 1930, As Amended, (19 U.S.C. Section 1677(5)(F))

2.61 Section 771(5)(F) of the US Tariff Act of 1930, as amended, (19 U.S.C. Section 1677(5)(F)), hereinafter "Section 1677(5)(F)", reads as follows:

> "a change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's-length transaction."[89]

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1 The **European Communities** claims that the old change in ownership methodology applied by the United States in the 12 countervailing duty orders listed in Section IIabove, and the new change in ownership methodology applied,

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[86] *Acciai Speciali Terni ("AST")* Court No. 99-06-00364.
[87] *Acciai Speciali Terni ("AST")* Court No. 99-06-00364, at 13.
[88] *Ibid.*, at 7.
[89] Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994); 19 U.S.C. § 1677(5)(F). Exhibit EC–4 to the EC's first written submission.

inter alia, in the administrative review in Grain Oriented Electrical Steel from Italy, and more generally the refusal of the United States to correctly apply the SCM Agreement, as interpreted by the Panel and Appellate Body in *US – Lead and Bismuth II*, are inconsistent with the United States' obligations under the WTO Agreement. In particular, but not necessarily exclusively, the European Communities requests the Panel to examine the consistency of these measures with the following provisions:

- Articles 1.1, 10, 14(d) of the SCM Agreement insofar as these Articles require an authority to establish the existence of a financial contribution and benefit (and hence a countervailable subsidy);
- Footnote 36 to Article 10 of the SCM Agreement which provides that countervailing duties may only be imposed in order to offset a subsidy bestowed upon the manufacture, production or export of any merchandise, as provided for in Article VI:3 of GATT 1994;
- Article 19.1 of the SCM Agreement which in particular provides that a countervailing duty may only be imposed if the existence of a subsidy has first been determined ;
- Article 19.3 of the SCM Agreement which in particular requires investigating authorities promptly to establish an individual countervailing duty rate for new exporters who were not subject to the original investigation;[90]
- Article 19.4 of the SCM Agreement, which provides that no countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist calculated in terms of subsidization per unit of the subsidized and exported product;
- Article 21.1 of the SCM Agreement, which provides that a countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization;
- Article 21.2 of the SCM Agreement, which in particular requires investigating authorities to determine whether there is a continuing need for the application of countervailing duties in the light of the information before it;
- Article 21.3 of the SCM Agreement, which in particular provides that countervailing duties are to expire after five years unless it is determined that the expiry of the duty would lead to continuation or recurrence of subsidization and injury;
- Article 32.5 of the SCM Agreement which requires Members to ensure the conformity of their laws, regulations and administrative procedures with the provisions of the SCM Agreement; and

[90] The Panel notes that although this claim was initially raised by the European Communities, it did not present arguments on this issue during the proceedings.

– Article XVI.4 of the WTO Agreement, which requires Members to ensure the conformity of their laws, regulations and administrative procedures with their obligations as provided in the annexed Agreements. [91].

3.2 In addition, the **European Communities** believes that Section 1677(5)(F) is inconsistent with the SCM Agreement and the WTO Agreement to the extent that it prevents the United States from implementing its WTO obligations such that where a privatization takes place for fair market value and at arm's length, no benefit passes through to the post-privatization entity.[92]

3.3 In its first written submission[93], and with reference to the Panel's competence under Article 19.1 of the DSU, the **European Communities** requests the Panel to suggest possible means of implementation on the grounds that the United States has demonstrated a lack of good faith with respect to the previous WTO dispute settlement proceeding. In this regard, the European Communities would like that the Panel suggests the following implementation actions:

– The United States should bring Section 1677(5)(F) into conformity with its WTO obligations;

– The United States should immediately revoke the sunset determinations in Cut-to-Length Carbon Steel Plate from United Kingdom (C-412-815) (Case No. 8) and Cut-to-Length Carbon Steel Plate from Germany (C-428-817) (Case No.10); and,

– The United States should immediately review or amend the remaining determinations brought before the Panel in the present dispute. In doing so, it should apply in good faith the findings of the Panel. If the privatization transactions which are the subject of this dispute have taken place for fair market value and at arm's length, then no more countervailing duties should be levied. In the event that the United States should find that the privatization transactions are not at fair market value and arm's length, the United States should determine that the subsidy amount is the difference between the price actually paid and the fair market value.[94]

3.4 In its first oral statement[95], the **European Communities** indicates that, in order to prevent further dispute over this issue, the Panel should issue a clear and unambiguous explanation of the correct interpretation of the relevant provisions of the SCM Agreement. The European Communities also asks the Panel to consider making a suggestion on implementation to assist in resolving this dispute and suggests that one possibility could be:

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91 *See* EC's first written submission, para. 160.
92 *See* EC's first written submission, para. 16.
93 *See* EC's first written submission, para. 161.
94 *See* EC's first written submission, para. 57.
95 *See* EC's statement at the first substantive meeting, para. 64.

"The Panel suggests that the US abandon its "same-person methodology" and replace it with another that involves (1) an examination of whether an exporter is in fact benefiting from a financial contribution and (2) provides that a sale of a state-owned company for fair market value and at arm's length means that the privatized company cannot be considered to benefit from any prior financial contribution to the State-owned company."

3.5 In its second written submission[96], the **European Communities** respectfully requests that the Panel to reach the findings contained in the European Communities first written submission, and to adopt the suggestions on implementation which the European Communities suggested in its first written submission and in its opening statement to the Panel at the first substantive meeting. In its second oral statement[97], the European Communities asks the Panel to make the findings requested in its first written submission, and to issue suggestions for implementation of its Report set out in the conclusion to the oral statement of the European Communities to the first meeting of the Panel.

3.6 The **United States** requests that the Panel make the following findings:

– by not self-initiating reviews to reconsider change in ownership situations in light of the Appellate Body's report in *US – Lead and Bismuth II*, the United States has not acted inconsistently with its obligations under the SCM Agreement;

– the seven US Department of Commerce determinations (six investigations and one administrative review (Case Nos. 1-7) are inconsistent with the United States' obligations under the SCM Agreement only to the extent that US Department of Commerce did not fully examine whether the pre- and post-change in ownership entities involved were the same legal persons;

– the four US Department of Commerce sunset determinations (Case Nos. 8-11) are not inconsistent with the United States' obligations under the SCM Agreement;

– the *GOES from Italy* administrative review (Case No. 12) is not inconsistent with the United States' obligations under the SCM Agreement;

– the US change in ownership provision, Section 1677(5)(F) is not inconsistent with the United States' obligations under the SCM Agreement and the WTO Agreement; and

– the European Communities' claims regarding the expedited sunset review of the countervailing duty order on cut-to-length steel plate from Sweden are not within the Panel's terms of reference.[98]

[96] *See* EC's second written submission, para. 83.
[97] *See* EC's statement at the second substantive meeting, para. 20.
[98] *See* US' first written submission, para. 99.

IV. ARGUMENTS OF THE PARTIES

4.1 This Section includes a summary of the main arguments of the parties which are of relevance to the findings of the Panel.

A. WTO-Compatibility of the United States' Same Person Methodology

4.2 The **European Communities** submits that the same person methodology is inconsistent with the requirement under Article 1.1(b) of the SCM Agreement to determine the existence of a benefit to the post-transaction entity before countervailing duties can be imposed. For that reason, any countervailing duties imposed on the basis of this methodology will be inconsistent with Articles 1, 10, 14, 19.4 and either 19.1 or 21.1, 21.2 or 21.3 (depending whether a review or original investigation is at issue).[99]

4.3 The **European Communities** claims that, in applying the methodology, the US Department of Commerce disregards the instructions set down in Article 14 of the SCM Agreement that any benefit must be calculated with respect to the advantage obtained over what was available in the market. It argues that the factors examined by the US Department of Commerce in determining whether the firm under investigation is the same person as the pre-transaction subsidy recipient bear no relation to the benefit analysis required under the SCM Agreement. The "same person methodology", in not taking into account the price paid by the purchaser of the privatized company and thus failing to analyse the existence of a benefit to the post-transaction entity, is inconsistent with Articles 1.1(b), 10, 14, 19.4 and either 19.1 or 21.1 (depending on the circumstances) of the SCM Agreement. Thus, it concludes, Case 12, *Grain-Oriented Electrical Steel from Italy* (C-475-812)[100], based on the same person methodology involves the imposition of countervailing duties inconsistently with Articles 1.1(b), 10, 14, 19.4, 21.1 and 21.2 of the SCM Agreement.[101]

1. Whether Privatization Triggers the Need for a Re-Examination of the Existence of Benefit

4.4 The **European Communities** submits that privatization is a fundamental change in ownership that *a fortiori* requires a new benefit analysis. It explains that since the government – or a government body – is the owner of any state-owned company, all financial contributions of the State towards a state-owned company must be assessed on the basis of the equity investor standard of Article 14 of the SCM Agreement. This is because in terms of analysis, the European Communities believes there is no meaningful distinction between an equity investment and other forms of financial contribution, such as, for example a cash grant. Whether the government had provided money for the purchase of a

[99] *See* EC's first written submission, para. 126.
[100] *GOES Admin. Review*, *supra*, footnote 47.
[101] *See* EC's first written submission, para. 132.

factory, or had injected capital, the result is the same; there is an increase in the value of the equity held by the government. Thus, it argues, all subsidies granted by the government to a state-owned company can be analysed on the basis of the private equity investor standard of Article 14(a). The European Communities further argues that this is not the case for subsidies to private companies, because the government may not have the choice as to the form its subsidization might take; i.e. it may not have the option to purchase equity in the company. It explains that when this equity is sold the basis for the original benefit analysis changes, because the government's equity interest will be re-valued on market terms and in fact repaid.[102]

4.5 In its second written submission, the **United States** indicates that there has never been any dispute before this Panel concerning the fact that a change in ownership triggers an obligation to re-examine the existence of a subsidy.[103] In the view of the United States however, their examination (with regard to previously bestowed subsidies) is complete once an authority concludes that the current producer is the same legal entity that received the earlier financial contribution and benefit. The United States, in the second substantive meeting, also disputed the European Communities' belief that all subsidies granted by the government to a state-owned company can be analysed on the basis of the private equity investor standard..

2. Who is the Recipient of the Benefit in Case of Privatization?

(a) Concept of Benefit under the SCM Agreement

4.6 The **European Communities** points out that Article 1.1 of the SCM Agreement provides that a subsidy will only exist if there is a financial contribution which confers a benefit. The European Communities asserts that the findings by the Appellate Body in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*") clearly state that the focus of the enquiry under Article 1.1(b) is on the recipient, not the government granting the subsidy.[104] The European Communities also refers to the Appellate Body decision in *Canada – Aircraft* to support its contention that a benefit can only "be said to arise if a person, natural or legal, or a group of persons, has in fact received something."[105] The European Communities argues that the Appellate Body's interpretation of Article 1.1 of the SCM Agreement in *Canada – Aircraft* makes it clear that the analysis of the existence of a benefit should be on the value to the recipient, not on the cost to the granting authority.

4.7 The **United States** contends that the nature of countervailable benefits is made plain by Articles 1 and 14 of the SCM Agreement. It explains that a

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[102] *See* EC's second written submission, para.26.
[103] *See* US' second written submission, para. 11.
[104] *See* EC's first written submission, para. 42.
[105] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377, at para. 154, *cited in* EC's first written submission, para. 42.

countervailable benefit is that part of a financial contribution that is obtained on terms more generous than those the recipient could have obtained commercially. In its view, there is no requirement to analyse the competitive advantage derived by the recipient from the benefit, or the extent to which the recipient succeeds in enjoying the benefit since these concepts are not found in the SCM Agreement. Countervailable benefits are, in essence, simply *fixed sums of money*, which (in the case of non-recurring benefits) are amortized over time.[106]

4.8 The **European Communities** agrees with the United States that the benchmark for making a calculation of the value of the benefit to the recipient is through comparison to the marketplace. The European Communities refers to the text of the various provisions of Article 14 of the SCM Agreement, which refer to "comparable commercial" practices.[107]

4.9 Where the **European Communities** differs with the United States is in the evaluation of the effect of a change in ownership on the existence of a countervailable benefit. The European Communities argues that any benefit, and hence any benefit stream from non-recurring subsidies, must be viewed from the perspective of a natural or legal person. The benefit does not "attach" to the productive assets. Thus, when the exported product is no longer produced by the same natural or legal person as received the financial contribution and benefit, one must ask whether the current producer also enjoys the same benefit stream.[108] This new benefit analysis must be made on the basis of a comparison with a market benchmark in accordance with Article 14 of the SCM Agreement. In *US – Lead and Bismuth II* the Appellate Body concluded that because UES and BS plc/BSES had paid:

> "fair market value for all the productive assets, goodwill, etc., they acquired from BSC and subsequently used in the production of leaded bars imported into the United States in 1994, 1995, and 1996. We, therefore see no error in the panel's conclusion that, in the specific circumstances of this case, the "financial contribution" bestowed on BSC between 1977 and 1986 could not be deemed to confer a "benefit" on UES and BS plc/BSES."[109]

4.10 The **United States** maintains that, because countervailable benefits, once identified and valued, are, essentially, amounts of money, the method by which they may be terminated is straightforward — that amount of money is amortized

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[106] *See* US' second written submission, para. 4.

[107] *See* EC's first written submission, para. 44. The European Communities specifically refers to Article 14(d) of the *SCM Agreement* as a useful analogy for the present case. Article 14(d) states:

> "the provision of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of the remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale)."

[108] *See* EC's first written submission, para. 49.

[109] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 68, *supra*, footnote85, *cited in* EC's first written submission, para. 52.

over time, unless the recipient pays back the remaining unamortized amount. The United States agrees that such a repayment could occur in conjunction with a change in ownership and, under its new methodology, investigates any claim that such a repayment has occurred (or that the subject merchandise is being produced by a different person than the recipient). However, it adds, the SCM Agreement provides no basis for concluding that a change in the ownership of a subsidy recipient, for fair market value or otherwise, automatically eliminates the benefit conferred on the company. The United States argues that if a corporation has received a subsidy — a financial contribution that confers a benefit — the simple transfer of that corporation from one owner to another does not mean that the corporation no longer has the subsidy. Neither the financial contribution nor the benefit has changed, and the corporation is still the same person.[110]

4.11 The **European Communities** argues that since benefits do not reside in the assets themselves a benefit does not continue to flow from untied, non-recurring financial contributions even after changes of ownership. The European Communities believes that the only way to support a finding that the benefit passes through to the new owners would be "if fair market value was not paid for all such productive assets."[111]

4.12 The **United States** submits that the European Communities has not sufficiently explained how "fair market value extinguishes subsidies" nor has it shown where there is any basis for this conclusion in the SCM Agreement.[112] The United States maintains that the European Communities has not sufficiently explained how and why the payment of fair market value by the *new owner* of the subsidy recipient extracts the benefit from *the subsidy recipient itself*.[113]

4.13 The **United States'** reasoning is based on its interpretation of the Appellate Body's finding in *US – Lead and Bismuth II* that subsidies are bestowed on legal persons. The United States believes that this means that subsidies continue to reside in the recipient legal person unless they are taken out of that person, or the person is dissolved.[114]

4.14 The **European Communities** disputes the United States notion that subsidies must be "taken out" or "extracted" from a legal person. To the European Communities, it appears that the United States is talking about the extraction of subsidization from productive operations – whether they be workers with enhanced skills, or steel mills which have been built with the help of subsidies. The United States points out that the workers remain the same after privatization, that the steel mills do not change. The Appellate Body in *United States – Lead and Bismuth II* clearly found that subsidies do not accrue to productive operations, but rather to legal persons. The European Communities

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110 *See* US second written submission, para. 5.

111 Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/R and Corr. 2, adopted 7 June 2000, DSR 2000:VI, 2623, as upheld by the Appellate Body Report, at para. 6.81, *cited in* EC's first written submission, para. 53.

112 *See* US' second written submission, para. 7.

113 *See* US' second written submission, para. 8.

114 *See* US' second written submission, para. 16.

relies on the Appellate Body where it rejected the United States' view that benefit should be considered as accruing to productive operations.[115]:

4.15 The **United States** does not dispute that a change in ownership triggers an obligation to re-examine the existence of a subsidy.[116] However, it maintains that its current methodology is consistent with the SCM Agreement. Based on its understanding of the fact that subsidies reside in the recipient legal person, the United States believes that what must be considered after a change in ownership has occurred, is whether prior subsidies have been wholly or partly paid back, and whether the change in ownership has created a new producer of the subject merchandise to which no portion of any previously bestowed subsidies can be said to accrue.[117] Thus, the US Department of Commerce, following a change in ownership, examines whether the current producer has a financial contribution and a benefit, or whether in conjunction with the change in ownership the contribution or benefit has been repaid or cut off.[118]

(b) United States' "distinct legal person" Concept

4.16 The **United States** maintains that the US Department of Commerce's revised change in ownership methodology, i.e. the same person methodology, is consistent with the SCM Agreement, particularly as interpreted by the Appellate Body in *United States – Lead and Bismuth II*. In this regard, the United States explains that, in its report, the Appellate Body agreed with the Panel (based upon the Appellate Body's own findings in *Canada – Aircraft*) that a subsidy must be received by the natural or legal person that produced or exported the subject merchandise. The United States alleges that the Appellate Body also accepted the Panel's finding that the privatized company concerned, UES, was a distinct new legal person entitled to an independent subsidy determination (which it had not received from the US Department of Commerce). In addition, it argues, because UES' new owners had paid fair market value for UES, the Appellate Body found no error in the Panel's conclusion that the financial contributions bestowed upon BSC could not be deemed to confer a benefit upon UES. In its view, although the Appellate Body accepted the Panel's conclusion that BSC and UES were distinct legal persons, it did not adopt the Panel's reason for reaching this conclusion. The United States explains that, whereas the Panel found that BSC and UES were distinct legal persons purely because of the change in ownership, the Appellate Body simply stated that, given the changes in ownership leading to the creation of UES, the US Department of Commerce was required to determine whether UES, had itself received a financial contribution and benefit. [119] The United States further contends that the Appellate Body did not identify the specific factors dictating that UES must be treated as a distinct legal person, and

[115] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 58, *supra* footnote 85.
[116] *See* US' second written submission, para. 11.
[117] *See* US' second written submission, paras. 15-16.
[118] *See* US' second written submission, para. 11.
[119] *See* US' first written submission, paras. 39-40.

twice stated that its determination was based on "the particular circumstances of this case."[120]

4.17 The **United States** points out that where the Panel emphasized that the changes in ownership leading to the creation of new legal persons had involved the payment of consideration, the Appellate Body simply stated that, given the creation of these new legal persons (who were, in fact the producers of the subject merchandise) the US Department of Commerce was required to determine whether these new legal persons had received a benefit. In its view, the notion that the Appellate Body simply forgot to cite the payment of fair market value as the reason that the prior subsidies did not transfer to the newly-created companies is further contradicted by the fact that the payment of fair market value was no minor issue – it was one of the EC's central arguments in the proceeding. The United States considers that the Appellate Body did not address this issue explicitly because it understood that the issue had not been fully explored or explained. The United States contends the Appellate Body, having a narrower basis upon which to dispose of the appeal, therefore, did the sensible thing – it decided the case on the narrower basis, without touching upon the more difficult and ill-defined issue.[121]

4.18 The **European Communities** contended that the principle whereby it is the change in ownership which reverses the presumption that a benefit stream continues over the average life of the assets, has been explicitly endorsed by the panel and Appellate Body in *US – Lead and Bismuth II*.[122] For the European Communities, it is quite clear that the Appellate Body considers the change in ownership the crucial factor bringing about the need to reconsider the continuing existence of the benefit stream. The Appellate Body in the same paragraph also quotes approvingly the Panel's statement that:

> *"the changes in ownership* leading to the creation of UES and BS plc/BSES should have caused the US Department of Commerce to examine whether the production of leaded bars by UES and BS plc/BSES respectively, and not BSC, was subsidized."[123] (emphasis added)

4.19 The **European Communities** considers, therefore, that it was the change in ownership which triggered the need to examine benefit from the perspective of the post-transaction entity. It considers that this conclusion is reinforced by the fact that the Appellate Body repeated the factual findings of the Panel that British Steel Corporation ceased to exist and British Steel plc was created before the actual privatization transaction.[124] In other words, at that point, before the privatization had taken place, the legal person exporting the product under investigation was different from the legal person which had received a

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[120] *See* US' first written submission, para. 40 *citing* Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 58.
[121] *See* US' response to question No. 4 posed by the Panel.
[122] *See* EC's second written submission, paras. 23 to 25.
[123] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 62.
[124] *Ibid.*, at para. 2.

subsidy.[125] It argues that, if the United States were correct in its assertion, this simple change in legal person would have been enough to trigger the need to revisit the subsidy determination. Quite apart from the fact that such an assertion would leave the door wide open for circumvention, this fact was clearly not considered dispositive by either the panel or Appellate Body. The European Communities concludes that what was considered dispositive was the change in ownership, as is evidenced by the clear references to this factual element in the findings of the Panel and the Appellate Body.

4.20 The **United States** argues that the European Communities portrays the US Department of Commerce as drawing its new privatization methodology on a blank slate following *US – Lead and Bismuth II* (and *Delverde III*). In its view, however, the inquiry into whether the producer in question is the same person that received the subsidy follows directly from the Appellate Body's conclusion that the producer of the subject merchandise in that case (UES) was not the same person that received the subsidy (BSC). The United States notes that the European Communities itself has accepted that, "the Appellate Body agreed that where the change in ownership had lead to *the creation of a different legal person* from the subsidy recipient any benefit must be assessed from the perspective of the post-transaction entity."[126] The United States argues that the US Department of Commerce's new approach simply inquires into the acknowledged premise of the Appellate Body report in *US – Lead and Bismuth II* – whether the change in ownership has led to "the creation of a different legal person." It contends that, where that basic premise is missing – that is, where a change in ownership has *not* led to "the creation of a different legal person" – the Appellate Body's reasoning in *US – Lead and Bismuth II* does not require US Department of Commerce to find that the subsidies were eliminated.[127]

4.21 The **United States** submits that a change in the ownership of a company does not automatically create a distinct new legal person. It argues that the European Communities in GOES from Italy claims that the subsidy determination, which originally was conducted for the subsidy recipient itself (AST), must, purely as a result of the change in ownership, now be conducted anew, not for the subsidy recipient (still AST) but for the new owners of that recipient (KAI). It is as if, suddenly, KAI, rather than AST, were the respondent company in the countervailing duty investigation and the producer of the Italian steel products subject to investigation. The United States notes that the European Communities itself has acknowledged that a subsidy "resides with the natural or

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[125] *See* EC's second written submission, para. 54 where the European Communities notes that during the first substantive meeting with the Panel, the United States stated that BSC and BS plc would probably be regarded as the same person under the "same person methodology". The European Communities refers to US' response to question No. 7 posed by the European Communities during the Panel proceedings, where the United States refuses to explain whether BSC and BS plc could be regarded as the same person under its new methodology. The European Communities believes that applying its new methodology US Department of Commerce would find that BSC and BS plc were the same person and thus that subsidization passed through the privatization.

[126] *See* US' first written submission, para. 41 (quoting EC's first written submission, para. 51 (emphasis added)).

[127] *See* US' first written submission, para. 42.

legal person which originally received the subsidy", not the owner of that person.[128]

4.22 The **United States** also submits that in *US – Lead and Bismuth II*, the Appellate Body found that the presumption that benefits are allocated over time could never be irrebuttable, so that administering authorities were required to demonstrate that the current producer received a benefit under the SCM Agreement.[129] The United States believes that its new same person methodology is entirely consistent with this finding. Under this new methodology, it explains that following a change in ownership, the United States examines whether the current producer benefits from a subsidy, or whether that change in ownership has either terminated the subsidy or created a new legal person entitled to its own subsidy analysis.[130] To make this determination, the United States considers evidence put forward by respondents that the financial contribution has been repaid or withdrawn and/or that the benefit no longer accrues.

4.23 The **European Communities** alleges that the United States intertwines its misinterpretation of the SCM Agreement with a manipulation and distortion of various legal concepts under municipal law. It considers that the assimilation of "ownership changes" to the entirely different concept of the creation of "a new legal entity" is the basis for the United States' misunderstanding of the Appellate Body Report in *US – Lead and Bismuth II*, which the United States claims is based on a finding of "distinct legal persons". The European Communities maintains that the Appellate Body did not equate the natural or legal person which receives a benefit with the exporting producer subject to investigation.[131] Neither the *US – Lead and Bismuth II* nor the *Canada – Aircraft* Appellate Body reports addressed the issue of what is meant by "person". The European Communities explains that in *Canada – Aircraft* the Appellate Body was asked what was the standard for the calculation of benefit – was it cost to the government or benefit to the recipient[132]; in *US – Lead and Bismuth II*, the Panel and Appellate Body were examining the question of whether benefit could accrue to productive assets. Thus, in the European Communities' view, neither report supports the United States' assertion that the only natural or legal person relevant to an examination of subsidization is the exporting producer. Thus, it concludes, the United States equation of "natural or legal person" and the exporting producer under investigation is unwarranted. [133]

[128] The United States refers to EC's first written submission, para. 12.
[129] The United States refers to Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 62, *supra* footnote 85.
[130] *See* US' second written submission, para. 16.
[131] *See* EC's second written submission, paras. 31-35.
[132] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, at para. 154.
[133] *See* EC's second written submission, paras.36-38.

(c) Corporate Law Principles in the Interpretation and Application of the SCM Agreement

(i) The Relevance of the Distinction Between a Company and its Owners for the Purposes of Assessing the Benefit

4.24 The **United States** invokes corporate law principles to provide logical support for its use of a "distinct legal person" test for its determination of the continuation of a countervailable benefit. The United States contends that the distinction between owners and companies is real and may not be ignored. The United States further submits that it has demonstrated (and the European Communities does not dispute) that the distinction between companies and owners is fundamental in most jurisdictions, including the European Communities. In its view, given this fact, it is not possible to interpret the SCM Agreement as if this distinction did not exist, or as if the WTO Members disavowed it in drafting the SCM Agreement, without giving the slightest indication that they were doing so. The United States contends that not only is the distinction between owners and companies unavoidable, the Appellate Body has confirmed that subsidies are received by legal persons[134], not the owners of those persons or "economic entities." It further submits that the European Communities itself has acknowledged that subsidies "reside" in the legal persons that receive them, not in their owners or some all-encompassing "economic entity".[135]

4.25 The **United States** interprets the Appellate Body findings in *US – Lead and Bismuth II* that subsidies are bestowed on legal persons as meaning that subsidies continue to reside in that person unless they are taken out of that person, or the person is dissolved. The United States asserts that a change in ownership, *per se*, does neither.[136] The United States argues that the only obligation under the SCM Agreement created by a change in ownership is that the investigating authorities should inquire whether, in conjunction with the change in ownership, the subsidies have been paid back or not transferred to the new producer of the subject merchandise (if one has been created). The United States maintains that this position is entirely consistent with the Appellate Body Report in *US – Lead and Bismuth II*.[137]

4.26 The **European Communities** argues that the United States' suggestion to the effect that a distinction be drawn between the company producing the exported goods and its ownership is contrary to the Panel findings in *United States – Lead and Bismuth II*. It recalls that the Panel found that such a distinction "elevate[d] form over substance", and had been rejected itself by the

[134] The United States refers to Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 58, *supra* footnote 85.
[135] The United States refers to the EC's first written submission, para. 12; *See* US' second written submission, paras. 13-14.
[136] *Ibid.*, para. 15.
[137] US' second written submission, para. 16.

US Department of Commerce.[138] Moreover, the European Communities does not consider, for the purpose of analysing the existence of subsidization, that a distinction between the company and its owners is appropriate.[139] The European Communities goes on to note[140] that the distinction which the United States attempts to make between the company and its owners, for the purposes of the application of countervailing duties, is the cornerstone of the United States' argument. While the European Communities accepts that a distinction can be drawn for general purposes of corporate or commercial law, the distinction between owners and the company is not relevant for the imposition of countervailing duties. It is the economic entity which is the subject of the benefit analysis, not simply the exporting producer subject to investigation. This is the analysis used by the United States in general. This analysis flows from the principle, one of the central principles of countervailing duty law, that money is fungible.

4.27 The **United States** submits that the European Communities' assertion that no distinction can be made between companies and their owners flouts the corporation laws of both the United States and the European Communities, laws which have as their very cornerstone the concept that companies are legal persons distinct from their owners. It further submits that, although the *United States – Lead and Bismuth II* Panel arguably endorsed this position, the Appellate Body did not say that no distinction could be drawn between companies and their owners.[141] The United States affirms that, even if one were to accept, *arguendo*, that a privatized company and its new owner must be considered together, it is easy to see why, as a matter of economics, privatization does not extinguish previously bestowed subsidies. What goes into the company initially (say a $3 billion subsidy) yields an artificial competitive advantage. When the company is later sold (say, for $2 billion) what the new owner/company parts with ($2 billion cash) is precisely balanced by something worth $2 billion coming in (stock – an expected earning stream with a net present value of $2 billion). It is no more defensible to find extinguishment of the $3 billion subsidy here than if the owner/company, after receiving the $3 billion, pays the government $2 billion in exchange for $2 billion worth of coal. The coal purchase, a fair market value transaction, obviously does not

[138] *See* EC's first written submission, para. 62.
[139] EC's response to question No. 9 posed by the Panel.
[140] EC's second written submission, paras. 39 to 43.
[141] The United States compares the Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, DSR 2000:VI, 2623 at para. 6.82 with Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at paras. 62-64. The United States contends that, at the same time, the Appellate Body did, in this context, confirm that: (1) an authority may allocate subsidy benefits to particular post-bestowal years and countervail those benefits without analysing whether the recipient continues to enjoy a demonstrable competitive advantage; and (2) the burden rests upon a respondent in a countervailing duty proceeding to demonstrate in the context of a review, that such a subsidy has been rescinded if it wishes to have its countervailing duties lifted or adjusted. Had any mere change in ownership been adequate to satisfy this requirement, this entire discussion by the Appellate Body would have been surplusage.

"repay" $2 billion of prior government aid. Like the stock transaction, it is an exchange of value for equal value.[142]

4.28 The **European Communities** submits that the United States has attempted to suggest that WTO Members did not decide silently to reject the company/owner distinction in the SCM Agreement given that it is a central concept of corporate law. The European Communities, however, believes that the truth is the opposite. In that regard, it explains that it has been well known for many years, and broadly accepted by WTO Members, that subsidies granted to an owner may be attributed to a subsidiary. It explains that the fact that a parent and wholly owned subsidiary may be considered together was accepted by the Appellate Body when it assimilated BS plc and its subsidiary BSES in the statement in its Report in *US – Lead and Bismuth II*. The European Communities further explains that it has been the practice of the United States to treat parent and wholly-owned subsidiary as one for countervailing duty purposes for a long period of time. In fact, it adds, the United States concluded, when adopting the previous gamma methodology, that the distinction between owners and the company was irrelevant for countervailing duties purposes.[143]

4.29 The **European Communities** contends that, while methodologies might have changed, the basic principles of countervailing duty laws under the SCM Agreement have not. It therefore concludes that the United States has invented the centrality of its company/owner distinction only for the purposes of its same person methodology since it did not apply to its previous change in ownership methodology, nor does the United States currently apply this distinction when it is attributing subsidies.[144]

4.30 The **United States** submits that, because the European Communities cannot explain how the payment of fair market value by the new owner of a subsidized company extracts subsidies from that company, it now asserts that the admitted distinction between owners and companies[145] should be disregarded for the purpose of analysing the existence of subsidies because subsidies are received by "economic entities."[146] It argues that, although the European Communities has not explained just what it means by "economic entity," the concept presumably is broad enough to encompass both owners and companies — investors and producers. The United States submits that the European Communities wants the Panel to embrace this new concept so that the Panel will treat money taken out of an owner's pocket as having been taken out of the company, potentially eliminating subsidies that reside in the company. If the subsidy is received by an "economic entity"(company/owner unit) instead of the company, it may be repaid by that same "economic entity" (company/owner unit), instead of the owner.[147]

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[142] *See* US' first written submission, para. 68.
[143] *See* EC's statement at the second substantive meeting, paras. 11-13.
[144] *See* EC's statement at the second substantive meeting, paras. 14-16.
[145] The United States refers to EC's response to question No. 11 posed by the United States during the Panel proceedings.
[146] The United States refers to EC's response to question No. 9 posed by the Panel, para. 13.
[147] *See* US' second written submission, para. 12.

4.31 The **European Communities** considers that countervailing duties are applied without reference to the corporate law distinction between owners and the company; this follows both from the SCM Agreement and US practice. In support of this view, the European Communities quotes the US Department of Commerce's statement in proceedings before the US Court of Appeals for the Federal Circuit; in the case *British Steel plc v United States* as follows:

> "The flaw in the lower court's analysis, plainly stated, is that the CVD law is not based upon principles of corporate law or property law. [T]he CVD law imposes two requirements before Commerce may countervail subsidies: (1) provision of a subsidy with respect to the manufacture, production, or exportation of a class or kind of merchandise; and (2) injury to the relevant US industry by imports of that class or kind of merchandise".[148]

(ii) Whether Countervailing Duties are Comparable to Liabilities for Regulatory or Tortious (delictual) Acts

4.32 The **United States** claims that its "same person methodology" is based on the principles of corporate successorship.[149] It argues that its same person methodology is the only approach consistent with the principles of corporate successorship – principles of such long standing and so widely accepted that the drafters of the SCM Agreement would never have abrogated them without clearly so indicating. According to the United States there is nothing in the SCM Agreement which requires an authority to treat potential countervailing duty liability differently from other potential regulatory liabilities and tort liabilities. It also argues that there is no legal or economic distinction between potential countervailing duty liability and other potential burdens on the earnings of a company whose outstanding stock changes hands.

4.33 The **European Communities** disputes the relevance of the above concepts to countervailing duty determinations. According to the European Communities, whereas regulatory and tortious liability may vest at the time of the act, and liability for environmental damage arises as of the date the action causing the damage was taken, liability for countervailing duties does not arise on the day that the subsidy was granted, but only at the time of importation. Thus, it concludes, a company may choose whether or not to export and thereby incur liability for countervailing duties.[150]

4.34 The **United States** considers that the above argument reveals a thorough misunderstanding of the nature of potential liabilities, i.e. potential burdens on a company's earnings stream. In its view, once a company pollutes, the potential for environmental liability exists and may materialize if someone sues. Alternatively, it explains, the company can take steps to cure the harm by

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[148] *See*, Brief for Defendant-Appellant, United States Court of Appeals for the Federal Circuit; *British Steel plc v United States*, 23 October 1996, pages 21 and 22.
[149] *See* US' first written submission, paras. 15-17, 72.
[150] *See* EC's statement at the first substantive meeting, paras. 76-77.

voluntarily undertaking a clean-up. Likewise, once a company receives an amortizable subsidy, the potential for countervailing duties exists. The United States contends that that potential liability may materialize if someone (an injured industry in an importing country) files a countervailing duty petition. Alternatively, it adds, the company can take steps to cure the harm by voluntarily repaying the subsidy or stopping its injurious exports. The United States submits that there is simply no basis for the European Communities' extraordinary suggestion that the normal rules of corporate law and successorship cease to apply when the liability in question involves exposure to countervailing duties. It adds that the European Communities' argument is particularly vacuous with regard to Usinor, which was actually subject to countervailing duty orders at the time of its privatization.[151]

4.35 In response to the Panel's question No. 6 on whether there are any international standards or rules regarding the creation of a new legal entity further to a change in ownership, the **United States** stated that corporate laws on successor liability (and on what kinds of ownership changes create a new legal entity) are applied in a generally consistent manner although they have not been harmonized internationally.[152]

4.36 The **European Communities** considered, in its response to question No. 6, that the determination of a change in ownership is largely a question of fact, to be determined in accordance with applicable domestic law. It argues that is not aware of any relevant international rules on change in ownership although it pointed out that Article XXVIII (n) of the General Agreement on Trade in Services defines "ownership" and "control" for the purposes of determining which obligations are owed under GATS.[153]

4.37 The **European Communities** agrees that potential countervailing duties do act as a restriction on an exporting producer. It explains that, if an exporting producer is aware that its products might be subject to countervailing duties, an exporting producer might think twice about exporting to a country imposing countervailing duties (such as the United States). However, it adds, as is beyond dispute, simple subsidization is not enough to bring about the imposition of countervailing duties. Moreover, it argues and as distinct from liability for damages caused by pollution, an exporting producer has a choice whether to subject its products to countervailing duties since it can decide whether or not to export. The European Communities explains that a countervailing duty is equivalent to customs duties and submits that it is patently ridiculous to say that liability for customs duties is akin to liability for environmental pollution, and that a corporate successorship test is applicable.[154]

4.38 The **United States** claims that the European Communities argues that, because countervailing duty liabilities do not operate in exactly the same manner

[151] *See* US' response to question No. 6 posed by the Panel.
[152] *Ibid.*, para. 21.
[153] *See* EC's response to question No. 6 posed by the Panel.
[154] *See* EC's second written submission, paras. 45-46.

as potential tort liabilities, they are not potential liabilities at all.[155] The United States contends that the truth is that countervailing duty exposure is very much like potential tort liabilities – they are both potential burdens upon the earnings of the company that a prospective purchaser would take into account just as surely as it would take account of potential tort liabilities. In any event, it argues, the European Communities' attempt to distinguish potential countervailing duty liabilities is not persuasive since both liabilities will become actual only if injured parties in the affected country bring some kind of legal action. Moreover, the United States affirms, just as a subsidized steel producer could avoid countervailing duties by disgorging the subsidies or by ceasing to export to countries with countervailing duty orders, a producer that has caused environmental damage in another country could well escape that potential liability by repairing that damage or by ceasing certain operations in that country. Finally, it argues, countervailing duties are very specific to the subsidized producer, i.e. the amount of the duty is calculated by dividing the subsidy to that producer for the year in which the merchandise is produced by that producer's total production during that year.[156]

4.39 The **European Communities** considers the United States' example of environmental pollution to be erroneous.[157] In the example of tortious or delictual liability, liability attaches as of the act causing the damage. The "potentiality" of the liability lies entirely in the hands of the person suffering damages – they have the choice whether to sue. For countervailing duties, the potentiality is entirely in the hands of the exporting producer; it has the choice whether to export, pay back the subsidies or to request that an investigating authority properly examine whether it is receiving a benefit.

(d) "Same person" versus "same activity"

4.40 The **European Communities** maintains that the designation given to the United States' new change in ownership methodology, i.e. same person methodology is misleading. It states this because it considers that the term "same person" is a disguise for "same activity". Thus, it argues, this methodology, like the gamma methodology, treats as irrelevant the terms of the sale. In its view, this methodology perpetuates the United States incorrect conception that benefit somehow resides in the assets by examining, not whether the current producer has received any benefit, and hence a countervailable subsidy, but rather whether the assets and business operations of the company can be regarded as the same both before, and after, the transaction. The European Communities considers that this presumption, which could only be rebutted if the post-transaction entity disposed of all of its assets, and started production on another site, with another workforce, and under another brand name, does not involve any examination of the existence of a countervailable benefit. It therefore concludes that the same person methodology is, consequently, as WTO-inconsistent a presumption, as

[155] The United States refers to EC's second written submission, paras. 44-46.
[156] *See* US' statement at the second substantive meeting, paras. 31-33.
[157] *See* EC's second written submission, para. 46.

the presumption the United States adopted in the gamma methodology. The European Communities points out that, in determining the existence of a benefit, the US Department of Commerce treats as irrelevant the nature of the transaction. US Department of Commerce is, in order to avoid such a benefit examination, equating the word "person" with the notion of "productive assets". The European Communities considers that the panel and Appellate Body[158] have already rejected the notion that two entities might be the same person simply by virtue of their operations remaining the same.[159]

4.41 In reference to the statement by the European Communities to the effect that the US Department of Commerce's same person test is a "same activity" test, which can only be satisfied if "the post-transaction entity disposed of all of its assets, and started production on another site, with another workforce, and under another brand name,"[160] the **United States** considers that this is a distortion of the US Department of Commerce's actual methodology, which is firmly grounded in sound economics and in the principles of corporate successorship that apply in both the United States and the European Communities. Under that test, it explains, one corporate entity may be considered to be the successor of another if, in substance, it is the same person. As the US Department of Commerce explained, the various factors that go into the determination of whether a nominally different company should be treated, in substance, as the same person are just that – factors. The United States claims that there is no basis for asserting that all of the factors must weigh in favour of finding that a new corporate entity was created before such a finding may be made. The United States contends that in *US – Lead and Bismuth II*, neither the Panel nor the Appellate Body said that two different companies cannot be treated as the same person "simply by virtue of their operations remaining the same"[161], as claimed by the European Communities. The United States submits that, faced with the very particular and complex facts of that case, the Panel simply stated (without explanation) that it "had no doubt" that BSC and UES were different companies and the Appellate Body merely stated that "given the changes of ownership leading to the creation of UES, the [US Department of Commerce] was required …. to examine, on the basis of the information before it relating to these changes, whether a "benefit" accrued to UES ... ." It concludes that there is no indication that the Appellate Body would have required a new subsidy determination had it been confronted with a determination involving the very same corporate entity accompanied by a fully-developed record demonstrating the continuity of that legal person.[162]

4.42 The **European Communities** submits that there can be no doubt that it was the change in ownership which the Appellate Body considered in *US – Lead*

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[158] The European Communities refers to, Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, DSR 2000:VI, 2623 at para. 6.70 and Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 62.

[159] *See* EC's first written submission, para. 125.

[160] *See* US' first written submission, para. 74 (*quoting* EC's first written submission, para. 130).

[161] The United States refers to EC's first written submission, para. 125.

[162] *See* US' first written submission , para. 74.

and Bismuth II, triggered the need to examine anew the benefit analysis and that, by ignoring the change in ownership transaction, and focusing on the existence of "same persons", the United States fails to make the benefit determination which is required by Article 1 of the SCM Agreement. It simply assumes that the benefit passes through the transaction, despite the fact that there has been a change in ownership recasting the economic entity, and consideration has been paid for advantages previously received for free. The European Communities considers that the factors examined, which focus on continuity of business activities, do not involve an examination, in any form, of the existence of benefit to the post-privatization entity, they ignore the change in ownership, and the payment of consideration. The European Communities points out that the United States admits that it has never found a pre-privatization and post-privatization entity to be different persons.[163] The European Communities believes that the same person methodology focuses on continuity of business activities, including maintenance of assets and liabilities, workforce etc, and is therefore no more than an extended and enlarged focus on continuity of assets, which formed the core of the gamma methodology discredited by the Appellate Body in *US – Lead and Bismuth II* and by the US Court of Appeals for the Federal Circuit in *Delverde III*.[164]

4.43 The **United States** asserts that it has not said that subsidies reside in assets. In fact, it argues, it has repeatedly stressed quite the opposite, i.e. that subsidies reside in legal persons. The United States explains that if a subsidy recipient simply transfers its productive assets to a different legal person, the subsidies do not transfer to the person that buys the assets. The United States considers that the European Communities' assertion is astonishing in light of the United States' answer to the European Communities' question 10 that "a sale of bare assets is treated differently from a stock sale. Assuming that the assets are sold to a different person than the person that originally received subsidies, the DOC will not find that the producer that operates the purchased assets is subject to countervailing duties".[165]

4.44 The **European Communities** argues that the use of the same person methodology shows that the United States remains convinced that subsidies reside in productive assets. It considers that the United States finds the methodology economically rational only because of its belief that a company "pumped up" with subsidies cannot be "deflated". The European Communities submits that, even accepting, for the sake of argument, the United States' contention that the Appellate Body based its finding on the fact that the subsidy recipient and the exporting producer were distinct legal persons, the same person methodology is still WTO-inconsistent. In this regard, it argues that there can be little doubt that an application of the "same person methodology" to the British Steel privatization would indeed find that the companies involved are the same

[163] The European Communities refers to the US' response to question No. 13 posed by the Panel.
[164] The European Communities refers to the US' response to question No. 11 posed by the European Communities during the Panel proceedings, para. 21.
[165] *See* US' statement at the second substantive meeting, para. 22.

person since all the factors which the United States examines in its same person methodology are present. Thus, it concludes, even on the United States' interpretation of the Panel and Appellate Body's reports, the same person methodology would not be consistent with the WTO because it is not a methodology which can properly distinguish between distinct legal persons.[166]

(e) European Communities' "economic entity" Concept

4.45 In its second written submission, the **European Communities** refined its arguments by developing the concept of an "economic entity" as the recipient of the benefit. In this regard, the European Communities argues that the essential issue in this dispute is whether a change in ownership at arm's length and for fair market value, such as a privatization, can bring into question the continued relevance of a "benefit stream" presumed to exist as a result of a non-recurring subsidy. In the European Communities' view, the concept of "benefit stream" is simply an expression of the presumption that a non-recurring financial contribution provides a benefit over an extended period of time. The European Communities considers that a total change in ownership (i.e. where control passes from one entity to another)[167] must bring any benefit analysis based on the old group into question for two reasons: first, the benefit must be examined from the perspective of the new economic entity, and, second, what had been received for free has now been paid for.[168]

4.46 The **European Communities** maintains that the appropriate object of a benefit analysis is the economic entity of which the producer of the goods in question forms a part. It explains that this may be a large corporation with a very complex structure or be simply a single company and its controlling owner. According to the European Communities, the economic entity is the object of analysis because subsidies from throughout the economic entity may be attributed to the producer under investigation, and because a subsidy provided to one part of the entity permits resources to be used for other purposes in the economic entity; i.e. money is fungible.[169] The European Communities alleges that this is explicitly permitted by the SCM Agreement and is the practice of investigating authorities, specifically the United States, but also the European Communities and others. The European Communities explains that, in the event of a change in ownership, this economic entity changes and thus the "benefit stream" may no longer be presumed to continue.[170]

4.47 According to the **European Communities**, the benefit must "accrue" to the exporting producer. The European Communities explains that this follows from the principle that money is fungible, i.e. that money granted to one part of an economic entity will free up resources for another part of the economic entity.

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166 *See* EC's second written submission, paras. 54-55.
167 *Ibid.*, para. 3.
168 *Ibid.*, para. 12.
169 *See* EC's second written submission, para. 29.
170 *See* EC's second written submission para. 12.

The European Communities further explains that no investigating authority is required to impose countervailing duties on subsidies bestowed on parts of an economic entity which are not responsible for the production of the products under investigation. However, the European Communities adds, GATT Article VI.3 clearly envisages that it would be possible to countervail such subsidies. It contends that this is also clear from the references in Article VI.3 to subsidies which may be bestowed in both the country of origin or of exportation, and also the possibility that a countervailable subsidy could be granted for the "transportation of a particular product". The European Communities claims that this has also been recognized by the Appellate Body in *Canada – Aircraft* where it stated: "*Logically, a 'benefit' can only be said to arise if a person, natural or legal, or a group of persons, has in fact received something*."[171]

4.48 The **United States**, in response to the above argument of the European Communities to the effect that the distinction between owners and companies should be disregarded because money is fungible within "economic entities,"[172] concedes that, generally speaking, money is fungible. However, it argues, fungibility operates only within groups of entities that may be collapsed and treated as one. It submits that this does not include investors and producers. In its view, to treat money as being fungible between investors and producers, for example, would imply that, if one of the Panel members were to buy shares of IBM, IBM's creditors could attach that Panel member's assets to satisfy a debt of IBM. The fungibility of money does not extend this far.[173]

4.49 The **United States** maintains that the European Communities' new "economic entity" approach suffers from two fundamental defects. First, as the Appellate Body has stated**,** the recipient of a subsidy "must be a natural or legal person".[174] The United States argues that, while the European Communities has not explained what an "economic entity" is, it is clearly intended to be broader than the legal person that received the subsidy. Second, the "economic entity" approach leads to one logical absurdity after another. According to the United States, the European Communities' new economic entity approach results in a situation where: (i) a government gives a subsidy to an "economic entity," consisting of both itself and the legal person to whom the subsidy was given; (ii) the government then sells a portion of the "economic entity" (formerly known as the company) to a new owner. This creates a new "economic entity" consisting of a portion of the pre-privatization entity and the new owner[175]; and (iii) when the new owner writes the check, it is distinct from the legal person that received the subsidy (otherwise, the subsidy recipient would be buying itself from itself). The instant the transaction is complete, however, the subsidy

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[171] *See* Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, *supra* footnote 105, cited *in* EC's second written submission, para. 15.
[172] The United States refers to EC's second written submission, para. 13.
[173] *See* US statement at the second substantive meeting, para. 30.
[174] *See* US statement at the second substantive meeting, para. 13 (*quoting* the Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 58).
[175] *See* US' statement at the second substantive meeting, para. 15 citing Exhibit US – 13 to the US' statement at the second substantive meeting.

recipient is merged with the new owner into a new post-transaction "economic entity," which has never received a subsidy.[176]

4.50 The **European Communities** argues that the existence of a subsidy is not, as the United States claims, something that can be irrebutably presumed until it is demonstrably "extracted" from the assets of the "legal person" in which the US Department of Commerce has deemed it to "reside". It is something that has to be *determined* to exist in the light of all the circumstances. Since the actual ownership of a company and the fact that it is government-owned are circumstances that influence the existence of a subsidy, the European Communities argues, this needs to be re-assessed when these circumstances change.

4.51 The **United States** considers that the European Communities has coined the new term "economic entity" to obscure the simple fact that a privatization consists of a sale by a government of a subsidy recipient to a new owner. It argues that the fact that the sale is not a sale of some other entity is demonstrated by the price paid – the fair market value of the legal person that received the subsidy; it is not the fair market value of some other, larger "economic entity." The United States submits that calling the subsidy recipient different "economic entities" before and after the sale, cannot change this simple fact: the legal person that received the subsidy does not necessarily change simply as the result of the sale.[177]

4.52 The **European Communities** submits that the United States itself explicitly uses the economic entity approach. In this regard, they refer to § 351.525(b)(6) of the US Department of Commerce's *Countervailing Duties; Final Rule* which sets out a number of methods for allocating subsidies granted to one part of a group to other parts of the group.[178] The European Communities contends that this allocation of subsidies depends on relationships of control; i.e. can one company control the use of assets of the other. The European Communities argues that these principles become entirely irrelevant where the United States insists on the need to analyse whether the "legal person" before the privatization is the same as the "legal person" after the privatization. The European Communities considers that, when ownership changes, the economic entity of which the exporting producer formed a part cannot continue to be subject to countervailing measures on the same basis and that it must be determined, in an investigation, whether benefits which accrued to or were attributed to the exporting producer under investigation, can still be attributed in the same manner. The European Communities further notes that in its response to part (e) of its question 12, the United States explains that if the parent company then acquired a new company, the United States could impose countervailing duties on imports from that company as well, on the same basis as it had attributed them, to pre-existing subsidiaries. Thus, the European

[176] *See* US' statement at the second substantive meeting, paras. 13-15.
[177] *Ibid.*, para. 16.
[178] The European Communities refers to *Countervailing Duties; Final rule*, 19 C.F.R. § 351 (1998). Selected pages contained in Exhibit EC–32 to the EC's second written submission.

Communities concludes that, for the United States, the existence of ownership is relevant when it may wish to increase the possibilities of imposing countervailing duties, but is not relevant when it might require a renewed examination of the existence of subsidization.[179] In its view, the US Department of Commerce ignores the distinction between companies and owners, so that, in effect, it applies an "economic entity" approach itself.[180]

4.53 The **United States** contends that the above statement by the European Communities is a gross misstatement.[181] It submits that an accurate description of the US Department of Commerce's practice is that, as a general rule, the US Department of Commerce treats companies and owners as completely distinct, but that it sometimes allocates subsidies to different producers within the same corporate group. As regards the general rule, the US Department of Commerce does not allocate to producers, subsidies that are given to investors; nor does it allocate to investors, subsidies that are given to producers. It adds that the US Department of Commerce also necessarily distinguishes between owners and companies each time it finds that a government has provided a subsidy to a government-owned company – not to do so would be to imply that the government subsidized itself. As regards the exceptions, the United States points out that the very existence of carefully crafted exceptions to the rule that legal persons are treated as distinct entities itself demonstrates the existence of the general rule. It explains that the most obvious exception is where subsidies are nominally granted to a holding company that simply acts as a conduit for subsidies to one or more of its producing subsidiaries.[182] If the subsidies were allocated strictly within the holding company, they would never apply to the production in question, negating the remedy that countervailing duty regimes are intended to provide. In spite of this, the United States indicates, the allocation of subsidies to the members of the group does not imply that there is no distinction between the various legal persons – it implies that, in giving the subsidy to the holding company, the government was making an indirect grant to the various operating units.[183] The United States explains that where the US Department of Commerce does allocate subsidies across the combined production of a closely related corporate group, it is because the various members of that group are all engaged in production of similar merchandise and essentially, function as one entity[184], or, if the firm that received an untied financial contribution is a holding company, including a parent corporation with its own production, then the US Department of Commerce would attribute the subsidy to the consolidated sales of the holding company and its subsidiaries.[185] The United States clarifies that when there is an insufficient identity of interests between the parent and the subsidiary to warrant treating the entities as one, the US Department of

[179] *See* EC's second written submission, paras. 16-20.
[180] *Ibid*.
[181] The United States refers to the EC's second written submission, paras. 16-20.
[182] *Countervailing Duties; Final rule*, 19 C.F.R. § 351.525(b)(6)(iii)
[183] *Countervailing Duties; Final rule*, 19 C.F.R. § 351.525(b)(4).
[184] *Countervailing Duties; Final rule*, 19 C.F.R. § 351.525(b)(6)(ii).
[185] *Countervailing Duties; Final rule*, 19 C.F.R. § 351.525(b)(6)(iii).

Commerce follows its general rule and does not allocate subsidies to the entire group.[186]

3. Whether the Benefit Passes through when the Privatization Transaction Takes Place for Fair Market Value and at Arm's Length

4.54 The **European Communities** maintains that where the change in ownership has taken place for fair market value and at arm's length, the entity will not have any benefit and hence any subsidy. Consequently, it argues, it is only if the company has received subsidies after the transaction (by virtue of attribution), either through membership of a different economic entity or through a privatization taking place at an undervalue that the exports of the post-transaction entity can be subject to countervailing duties.[187]

4.55 The **European Communities** considers that these two concepts are also facets of the economic entity analysis. In its view, a change in ownership transaction will not involve two different economic entities, if the parties to the change in ownership transaction are not at arm's length. In a similar sense, it adds, one would intuitively expect two different economic entities to negotiate, in order to arrive at the fair market value of the object of sale. If a transaction did not take place at fair market value then there must be a supposition that the two parties are related or are not at arm's length.[188]

4.56 The **European Communities** argues that the concept of the economic entity is also relevant for establishing whether value has been paid for that which had previously been received for free. The European Communities argues that a subsidy offered to a company also has an effect on the owner of the company. In its view, rather than invest in the company, the owners' financial resources are free for other investments. This is because money is fungible. The European Communities explains that when a company is sold, the value which the subsidies have brought is incorporated in the value of the company. A new owner buying at fair market value will not have received a benefit, because it has received nothing for free. That is, the economic entity which produces the goods after the change in ownership has not received anything for free; rather all assets which it is in a position to control have been fully paid for.[189] The European Communities claims that its understanding that it is the change in ownership which reverses the presumption that a benefit stream continues over the average life of the assets, has been explicitly endorsed by the panel and Appellate Body in *US – Lead and Bismuth II*.[190] The European Communities claims that this

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[186] *See* US' statement at the second substantive meeting, para. 29 *citing Ferrosilicon From Venezuela*, 58 Fed. Reg. 27539, 27542 (Dep't Commerce 10 May 1993) (final countervailing duty determination).

[187] *See* EC's second written submission, para. 27.

[188] *Ibid.*, para. 28.

[189] *See* EC's second written submission, paras. 21-22.

[190] The European Communities refers to Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 62.

conclusion is reinforced by the fact that the Appellate Body repeated the factual findings of the panel that British Steel Corporation ceased to exist and British Steel plc. was created before the actual privatization transaction.[191] In other words, the European Communities argues, at that point, before the privatization had taken place, the legal person exporting the product under investigation was different from the legal person which had received a subsidy.[192] Were the United States correct in its assertion, this simple change in legal person would have been enough to trigger the need to revisit the subsidy determination. The European Communities contends that this fact was clearly not considered dispositive by either the Panel or Appellate Body. It submits that what was considered dispositive was the change in ownership, as is evidenced by the clear references to this factual element in the findings of the Panel and the Appellate Body.[193]

4.57 The **European Communities** explains that it has referred to the "pass through" of a benefit rather than whether that benefit is "extinguished" or "survives" the privatization. It clarifies that this is because a benefit does not necessarily simply "disappear"; it resides with the natural or legal person which originally received the subsidy. In its view, a privatization transaction will only lead to the "extinction" of a countervailable subsidy where the pre-transaction subsidy beneficiary no longer exists.[194]

4.58 The **United States** maintains that the European Communities fails to explain how the payment of fair market value *for* a company extracts a subsidy *from* that company. It submits that the European Communities should admit that it has not made out even a prima facie case that a payment for fair market value extracts subsidies from a company, and it should admit that the only consequence of such a payment is that the purchasers themselves have not obtained a separate, new benefit.[195] In reference to the European Communities' argument that the purchaser for fair market value and at arm's length of previously subsidized production does not personally obtain any benefit, the United States submits that there is no dispute about this proposition since all parties agree that new owners who pay fair market value (for anything, including a subsidized company) personally obtain no benefit. The new owners give equal value for what they obtain, and so do not personally receive any benefit – their financial circumstances are unchanged. It further submits that there is no new subsidy in such a case, since the purchasers simply become the owners of the entity or "person" in which the subsidy has always resided, and continues to reside. The United States considers that what the European Communities is really suggesting with this argument is that, somehow, when the new owners pay fair market value for a company, not only they do not personally obtain a benefit, but the benefit from any previous subsidies is somehow extracted from the

[191] *Ibid.*, at para. 2.
[192] *See* EC's second written submission, para. 54 where the European Communities notes that during the first substantive meeting with the Panel the United States stated that BSC and BS plc would probably be regarded as the same person under the "same person methodology".
[193] *See* EC's second written submission, paras.23-25.
[194] *See* EC's first written submission, para. 12.
[195] *See* US' statement at the second substantive meeting, paras. 18-19.

company. The United States considers that there are two problems with this approach: First, it is inconsistent with the European Communities' main explanation that the "post privatization entity" is a new and distinct person from the recipient of the subsidy. If that is so, then the original subsidy is not there to be extracted from the "post-transaction" entity by its owners. Second, it argues, the European Communities' theory is based on pure speculation since there is no basis whatsoever on either the record before the US Department of Commerce or before this Panel, for assuming that AST's new owners will extract some extra margin of profit from the company. The United States argues that prices are set by supply and demand and, therefore, the new owners cannot simply increase the price of the goods; nor can they simply increase production without further pushing prices downward. Put simply, no matter how profit-minded they are, they can extract no more from the company than could the prior owners. It mentions that this is particularly true in the steel industry, which is plagued with chronic overcapacity that frustrates the efforts of even the most ravenous investor to realize a reasonable profit.[196]

4.59 The **United States** claims that, since the Appellate Body found in *US – Lead and Bismuth II* that subsidies are bestowed on legal persons (i.e., the company producing subject merchandise), these continue to reside in that person unless they are taken out of that person, or the person is dissolved. It submits that a change in ownership, *per se*, does neither. Accordingly, the United States requests that the Panel find that changes in ownership of subsidized companies do not automatically extract the subsidies from those companies, but that investigating authorities should simply inquire whether, in conjunction with the change in ownership, the subsidies have been paid back or not transferred to the new producer of the subject merchandise.[197]

4.60 The **European Communities** argues that when the United States uses the word "extract", it appears to be talking about the extraction of subsidization from productive operations – whether they be workers with enhanced skills, or steel mills which have been built with the help of subsidies. In the European Communities' view, the Appellate Body in *US – Lead and Bismuth II* clearly found that subsidies do not accrue to productive operations, but rather to legal persons.[198] The European Communities submits that the United States misrepresents and manipulates the Appellate Body findings with its new same person methodology since an analysis of the factors used in this same person methodology, shows that it is in reality an examination of continuation of productive operations.[199] The European Communities therefore considers that the focus on continuity of business activities, including maintenance of assets and liabilities, workforce etc, is no more than an extended and enlarged focus on continuity of assets, in which, it seems, the United States is convinced

[196] *See* US' first written submission, paras. 53-56.
[197] *See* US' second written submission para. 15.
[198] Appellate Body Report, *US – Lead and Bismuth II*, *supra* footnote 85, 138/AB/R, at para. 58 (footnotes omitted).
[199] *See* EC's statement at the second substantive meeting, paras. 8-9.

subsidization resides[200]. It argues that this is clearly contrary to the Appellate Body's findings firstly, that a benefit is calculated with respect to a natural or legal person, and secondly, that a change in ownership accomplished at fair market value and arm's length means no subsidization passes through.[201]

B. US Department of Commerce's Practice in Administrative Reviews

4.61 The **European Communities** does not challenge the procedures in administrative reviews in Countervailing Duties on Imports of Certain Carbon Steel Products from Sweden (Case No. 7) or Grain-Oriented Electrical Steel from Italy (Case No. 12), but rather the methodology applied. However, the European Communities points out a problem of circular logic in the US Department of Commerce's practice whereby the appropriate venue for introducing evidence of a privatization as a basis for a change in the countervailing duty is in an administrative review. The European Communities contends that exporting companies often do not participate in the US Department of Commerce's investigations because of the "prohibitive costs of co-operating and [the] awareness that US Department of Commerce's applicable change in ownership methodology would mean that the privatization would not be taken into account."[202] It also submits that in both Cut-to-Length Carbon Steel Plate from Germany (Case No. 10) and Cut-to-Length Carbon Steel Plate from Spain (Case No. 11) the exporting producers were "precluded from asking it because the US Department of Commerce prohibits the review of an order if a foreign manufacturer has made no shipments to the United States during the relevant period of review."[203]

4.62 The **United States** maintains that, with respect to each of the 12 measures the European Communities has challenged, it has given each responding steel company, for each of the countries and products involved, every opportunity to request an administrative review of the pertinent countervailing duty order, where the jurisdictional grounds to do so exist as a matter of domestic law.[204] The United States disputes the assertion by the European Communities that companies do not participate because the process is lengthy and expensive. The United States points out that three European steel companies have requested reviews, one of which is completed and two of which are ongoing. The United States feels that the European Communities' assertion is "pure speculation, unsupported by evidence on any administrative record."[205]

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[200] Although the United States does not explain why the same logic does not apply in the case of bankruptcy, where the assets, workforce etc also remain essentially the same. *See* the US' response to question No. 11 posed by the European Communities during the Panel proceedings, para. 21.

[201] *See* EC's second written submission, para. 51.

[202] *See* EC's first written submission, footnote 102 to para. 116.

[203] *See* EC's first written submission, footnote 101 to para. 115.

[204] *See* US' first written submission, para. 77.

[205] *See* US' first written submission, footnote 84 to para. 77.

C. Obligations of the Members in Sunset Review Investigations

4.63 The **European Communities** claims that the US Department of Commerce's practice as regards sunset reviews is inconsistent with the SCM Agreement to the extent that the US Department of Commerce fails to examine the existence of a benefit after a change in ownership on the basis that it is not required to take into account evidence before it, other than from the original investigation, where there have been no administrative reviews since the original investigation.[206]

1. Scope of the Obligations of Members under Article 21.3 of the SCM Agreement

4.64 The **European Communities** argues that Articles 21.1 and 21.3 of the SCM Agreement read together clearly create a presumption that countervailing duties should be terminated five years after the imposition of the original duty unless the investigating authority first initiates a review and second, determines, in that review, that there is a likelihood of continuation or recurrence of subsidization and injury. In its view, the general rule embodied in Article 21.1 is given concrete expression in Article 21.3.[207] The European Communities contends that, because Article 21.1 of the SCM Agreement requires a countervailing duty to be levied only for as long as, and to the extent which injurious subsidization exists, Article 21.3 of the SCM Agreement must be interpreted as requiring an investigating authority to examine the existence of subsidization, as part of its determination of the likelihood of continuation or recurrence of subsidization.

4.65 The **European Communities** submits that an investigating authority cannot determine whether there is a likelihood of continuation or recurrence of subsidization without considering whether, and the extent to which, a benefit continues to accrue and that this requires it to carry out a new, detailed investigation, in which it determines, on the basis of positive evidence, the likelihood of continuation or recurrence.[208] The European Communities explains that in all four of the sunset reviews included in this dispute, the US Department of Commerce based its decision to continue the countervailing duty orders just on information from the original investigation.[209] In its view, the investigating

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[206] While the European Communities considers that the automatic self-initiation of sunset reviews by the US Department of Commerce is inconsistent with the SCM Agreement, its arguments in the present dispute are founded on the basis that the United States is levying countervailing duties without having determined the existence of subsidization (and in particular benefit). This is so because the scope of the investigating authority's duties under a sunset review procedure is the subject of parallel panel proceedings also initiated at the request of the European Communities (WT/DS213 – *United States – Corrosion-Resistant Carbon Steel Flat Products from Germany*). *See* EC's second written submission, paras. 62 and 66.

[207] *See* EC's second written submission, paras. 63-65.

[208] *See* EC's second written submission, paras. 71-72.

[209] *Ibid.*, para. 76.

authority cannot simply presume such a likelihood just because certain interested parties have not responded to a notice of initiation.[210]

4.66 The **United States** considers that an investigating authority need not revisit *ex officio* its subsidy determination, in a sunset review under Article 21.3 of the SCM Agreement. In its view, the determination in a sunset review under Article 21.3 concerns future behaviour, i.e. the likelihood of continuation or recurrence of subsidization _ not whether, or to what extent subsidization currently exists. In its final results of the sunset review in Case No. 10, the US Department of Commerce stated that:

> "a sunset review is not the appropriate proceeding in which to examine a complicated privatization transaction and to consider new privatization methodology. In light of the complexity and fact-intensive nature of this issue, it is imperative that the issues be fully developed on the record."[211]

4.67 The **United States** points out that nothing in the SCM Agreement requires consideration of the magnitude of subsidization in determining the likelihood of continuation or recurrence.[212] Furthermore, the United States considers that where there have been no administrative reviews of a countervailing duty order, the only evidence which an investigating authority can take into account is evidence from the original investigation. The United States submits that in the four sunset reviews covered by this dispute, the US Department of Commerce was under no obligation, pursuant to Article 21.3, to convert its sunset reviews into full-blown administrative reviews of the respective countervailing duty orders.[213]

4.68 The **European Communities** disagrees with the United States' position. It contends that administrative reviews, under Article 21.2 of the SCM Agreement are facultative; interested parties may, or may not, choose to request reviews, and investigating authorities may, or may not, consider it justified to initiate an investigation. Under Article 21.2, it is for the interested party to provide substantiated information, which the investigating authority is, according to the Appellate Body, obliged to fully examine. The European Communities argues that, under Article 21.3, it is for the investigating authority to make a determination of continuing injurious subsidization. In this regard, it indicates that to premise examination of evidence in a determination under Article 21.3 on the evidence having been examined in a review under Article 21.2 is a pure invention, not founded on any provision of the SCM Agreement. The European Communities points out that the CIT reached the same conclusion in the *Dillinger* case when it found that the US Department of Commerce is not entitled to base its findings in sunset reviews only on evidence gathered in the initial

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[210] *Ibid.*, paras. 71-72.

[211] See, *Issues and Decision Memorandum for the Sunset Reviews of the Countervailing Duty Orders on Certain Corrosion-Resistant Carbon Steel Flat Products; Cold-Rolled Carbon Steel Flat Products; and Cut-to-Length Carbon Steel Plate Products from Germany; Final Results*, *supra*, footnote 62.

[212] *See* US' response to question No. 19 posed by the Panel.

[213] *See* US' first written submission, para. 89.

investigation.[214] The CIT also pointed out to the US Department of Commerce that in the case of "extraordinarily complicated" sunset reviews the Secretary of Commerce may extend the period for issuing final results by up to 90 days.[215]

2. Obligation of Examination

4.69 For the **European Communities**, it is for the importing Member to re-examine whether countervailing duties are still justified and considers this requires it to carry out a new, detailed investigation, in which it determines, on the basis of positive evidence, the likelihood of continuation or recurrence.[216] The European Communities contends that, if no existing subsidization can be identified, an investigating authority must be under an obligation to adduce positive evidence supporting its determination of the likelihood of recurring subsidization. It further indicates that, in a sunset review under Article 21.3, it is for the authorities to determine, and not for the respondent to disprove, that there is a likelihood of continuation or recurrence.[217] The European Communities submits that the fact that in three of the reviews the exporting producers did not respond to the notice of initiation, cannot be used by the United States as an excuse for reversing the burden of proof in a sunset review. The investigating authority cannot just simply presume that there is a likelihood of continuation or recurrence of injurious subsidization because certain interested parties have not responded to a notice of initiation. According to the European Communities, this reversal of the burden of proof is inconsistent with Article 21.3 of the SCM Agreement.[218]

4.70 The **United States** contests the nature of the sunset review obligation. The United States feels, that absent an administrative review, the only evidence it is required to evaluate in order to determine the likelihood of continuation or recurrence of the countervailable subsidies is that contained in the original

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[214] *Dillinger* Court No. 00-09-00437, at.12–14, 18, 19. The CIT in *Dillinger* held that:

> "even in an "expedited review based on the facts available," Commerce is to rely on information from prior determinations as well as from submissions by the parties in the sunset proceedings. . . It stands to reason, that, than in a "full review," Commerce must engage in analysis that is at least somewhat more searching than simply continuing to apply the countervailing duty rate determined in the original investigation for particular subsidies without considering evidence proffered by the parties that would support making adjustments thereto."

Dillinger, Court No. 00-09-00437, at 20-22. (Note that in the version attached as Exhibit EC–34 the quoted material appears on page 14). *See also* EC's second written submission, para. 72.

[215] The CIT also stated:

> "If Commerce deemed the issues raised by the Plaintiffs to warrant a more thorough analysis or more extensive fact gathering, it could have sought additional time, but did not do so. Commerce cannot justify its decision not to address the issues raised by the parties simply on the basis that the issues arise in the context of a sunset review and the stringent time limits involved, especially when Commerce does not avail itself of the mechanisms provided for by its own regulations."

Dillinger, Court No. 00-09-00437, at 63 (Note that in the version attached as Exhibit EC–34 the quoted material appears on page 38).

[216] *See* EC's second written submission, para. 76.

[217] *See* EC's second written submission, paras. 70 and 72.

[218] *See* EC's second written submission, para. 76.

investigation. The United States maintains, insofar as benefits streams from amortizable subsidies addressed in the original investigation are concerned, that sunset reviews are not the appropriate place to evaluate new evidence.

4.71 The **European Communities** points to the CIT ruling in *Dillinger* where the Court held that:

> "The statute, however, does not charge any interested party with the ultimate burden of persuasion, or otherwise create a presumption that a countervailable subsidy is or is not likely to continue or recur if the order is revoked. …. Because there is no presumption as to the likelihood of continuation or recurrence it follows that there is no presumption that the countervailable subsidies will continue at the specific rate determined in the original investigation."[219]

4.72 The **European Communities** submits that the United States, through its practice of limiting evidence in sunset reviews, absent an administrative review, to the evidence in the original investigation, has created an irrebuttable presumption of continuation or recurrence at the specific rate determined in the original investigation.

D. Arguments Relating to the WTO Compatibility of Section 771(5)(F) of the US Tariff Act of 1930, As Amended, (19 U.S.C. 1677(5)(F))

4.73 The **European Communities** maintains that Section 1677(5)(F) prevents the US Department of Commerce from adopting the principle laid down in the SCM Agreement, and confirmed by the Panel and Appellate Body in *US – Lead and Bismuth II*, that a benefit must be assessed with respect to the market benchmark and that consequently a fair market value, arm's-length transaction means that any pre-transaction benefit stream is not enjoyed by the post-transaction entity. The European Communities considers that Section 1677(5)(F) is thus inconsistent with Articles 1.1(b), 10, 14 and 32.5 of the SCM Agreement in addition to Article XVI.4 of the WTO Agreement.[220]

4.74 For the **European Communities**, Section 771(5)(F) of the Tariff Act 1930, as amended, (19 U.S.C. Section 1677(5)(F)) (hereinafter Section 1677(5)(F)), as interpreted by the US Court of Appeals for the Federal Circuit, prevents the United States recognizzing the principle that an arm's length, fair market value transaction does not pass through any benefits from pre-transaction financial contributions to the post-transaction entity. The European Communities is of the view that, Section 1677(5)(F) was specifically designed to prevent the US Department of Commerce applying a "rule" that a benefit stream does not survive a fair market value, arm's-length transaction. The European Communities argues that the wording and legislative history of Section 1677(5)(F) and the

[219] *Dillinger*, Court No. 00-09-00437, at 16 (Note that in the version attached as Exhibit EC–34 the quoted material appears on pages 11 and 12).
[220] *See* EC's first written submission, para. 139.

intent to overrule the identical principle as developed by the CIT in the *Saarstahl I* decision, prove that it was designed so as to ensure that in situations of fair market value change in ownership, benefits of the subsidies are never considered not to have been passed to the new owner.[221] It quotes the US Department of Commerce in its findings in the Court remand redetermination in the *Delverde* case:

> "Section 771(5)(F) only acts to preserve the ability of the Department to exercise its discretion, and it accomplishes this goal by overturning the approach ordered in Saarstahl I, which had mandated that the Department find that an arm's-length transaction, in and of itself, precludes any pass-through to the purchaser."[222]

4.75 The **United States** contends that Section 1677(5)(F) does not mandate an either/or approach to the question of whether pre-privatization subsidies benefit a post-privatization entity.[223] On the contrary, it argues, the plain language of Section 1677(5)(F) demonstrates its discretionary nature. In this regard, the United States contends that the text of Section 1677(5)(F) clearly provides that a change in ownership does not by itself means that a past countervailable subsidy is no longer countervailable, nor does it mean that it is countervailable. The United States argues that the statute leaves the investigating authority discretion to make its decision. It further argues that the Statement of Administrative Action ("SAA") also supports the view that Section 1677(5)(F) is discretionary and not mandatory. In this regard, the SAA states that the purpose of Section 1677(5)(F) is to clarify that "the sale of a firm at arm's length does not automatically, and in all cases, extinguish any prior subsidies conferred", and that it is the Administration's intent that "Commerce retains the discretion to determine whether, and to what extent ... previously conferred countervailable subsidies" are eliminated,[224]

4.76 The **European Communities** alleges that it is unable to determine whether the US Department of Commerce requires this discretion as a finder of fact – to determine whether a transaction has taken place at fair market value and arm's length, or whether the US Department of Commerce requires this discretion to allow it to determine that, even after a fair market value, arm's-length transaction, the "benefit stream" from pre-transaction non-recurring subsidization might continue to flow. The European Communities indicate that it can accept that a privatization transaction is often very complex and might require detailed examination. However, the European Communities cannot accept that an investigating authority might require discretion to determine that benefit from pre-transaction subsidization passes through an arm's length, fair

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[221] *See* EC's first written submission, para. 157.

[222] Final Results of Redetermination pursuant to Court Remand, *Delverde Srl. v United States* Consol. Ct. No. 96-08-01997 (Ct. Int'l Trade 2 December 1997), at 33. Exhibit EC–28 to the EC's first written submission (Note that in the version of this Remand Redetermination supplied to the Panel, the quoted text can be found on page 16.)

[223] *See* US' first written submission, para. 91.

[224] *See* US' first written submission, paras. 94-96.

market value transaction. In the view of the European Communities, such discretion would clearly be inconsistent with Article 1.1 of the SCM Agreement which requires the existence of benefit for subsidization to be found and countervailing duties imposed, and permits no exception.[225]

4.77 In its response to question No. 18 from the European Communities, the **United States** indicates that if an evaluation of all the facts and circumstances of a particular privatization or a change in ownership warrants a finding that as a result of an arm's length, fair market value privatization, the post-sale company does not enjoy a benefit from past subsidies, then such a finding can be made. In the United States' view, there is nothing in the language of the change in ownership provision, or in the legislative history of that provision which would prevent the US Department of Commerce from making such a finding.

4.78 The **European Communities** interprets the above statement as meaning that the United States is saying that, even if the "legal person" after the transaction is not a different "legal person" from the subsidy recipient under its "same person methodology", Section 1677(5)(F) would allow the US Department of Commerce to find that where it had determined, as a matter of fact, that the change in ownership had taken place at arm's length and for fair market value, it could conclude that no benefit passes through. The European Communities however claims that the United States has not explained whether the US Department of Commerce could apply the logic of this statement to every change in ownership transaction with which it is faced, issue methodology setting out this intention, and still act consistently with Section 1677(5)(F).[226]

V. ARGUMENTS OF THE THIRD PARTIES

5.1 From the three third-parties to this proceeding, i.e. Brazil, India and Mexico, only Brazil filed its comments within the 28 January 2002 deadline. Brazil and Mexico presented oral statements during the third-party session. India reserved its rights to participate as a third-party in eventual appeal proceedings.

A. Brazil

1. Arguments Relating to the United States Change in Ownership Methodology

(a) The Existence of a Benefit in the Post-Privatization Entity

5.2 **Brazil** argues that the existence and value of countervailable benefits can change as a result of events that occur after the initial financial contribution. Brazil also notes that in *US – Lead and Bismuth II* the Appellate Body determined that a change in ownership necessarily triggers an examination of whether a benefit received prior to the change in ownership continues to benefit

[225] *See* EC's second written submission, para. 79.
[226] *See* EC's second written submission, para. 81.

the new owners. The Appellate Body also concluded in *US – Lead and Bismuth II* that whether a financial contribution confers a benefit depends on "whether the recipient has received a financial contribution on terms more favourable than those available to the recipient in the market."[227] Brazil contends that under the United States' same person methodology, the price paid by the new post-privatization owners is irrelevant to the determination of whether the post-privatization entity continues to enjoy the benefits of the pre-privatization subsidies. Brazil contends that this is contrary to the finding in *US – Lead and Bismuth II*, which made clear that the essential determination of whether a post-privatization entity continues to enjoy the benefits of the pre-privatization entity is whether or not the new owners paid fair market value in the transaction transferring ownership. Brazil maintains that theUnited States' same person methodology does not address the issue of whether the transaction transferring ownership was at fair market value, but rather only inquires whether the pre-privatization and post-privatization entities are the same. While Brazil concedes that the Panel and the Appellate Body in *US – Lead and Bismuth II* found there must be a "recipient" of a subsidy benefit and, therefore, that subsidy benefits can only reside in natural or legal persons, it argues that this finding "does not mean either that subsidy benefits cannot be transferred from one legal entity to another or that the entity originally receiving the subsidy retains the benefit for as long as it remains the same legal entity." [228] Rather, Brazil interprets *US – Lead and Bismuth II* to mean that the relevant question is not whether the entity originally receiving the subsidy is the same legal person as the post-privatization entity, but whether the "benefit" has been transferred in the sale to new owners. Thus, Brazil argues that the central issue to be examined according to *US – Lead and Bismuth II* is the nature of the transaction transferring ownership.

(b) Determination of Countervailability under Article 14 of the SCM Agreement

5.3 **Brazil** argues that a financial contribution can only confer a countervailable "benefit" if the financial contribution received is "on terms that are more favorable to the recipient than the terms available in the market."[229] Brazil also contends that such contributions only remain countervailable so long as they are provided on terms more favorable than those available in the market. Brazil maintains that Article 14 of the SCM Agreement makes clear that the "existence and magnitude of countervailable subsidies are always determined by reference to "commercial" or "market" criteria"[230] and that the same criteria apply in determining the existence of "benefits" from the provision of capital.

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[227] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 67, *citing* Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R.

[228] Brazil's statement at the first substantive meeting, para. 11.

[229] Brazil refers to the citation of the Panel Report in *Canada – Aircraft* by the Appellate Body in *US – Lead and Bismuth II*, *supra* footnote 85, 138/AB/R, at para. 67.

[230] Brazil's statement at the first substantive meeting, para. 12.

5.4 **Brazil** argues that "countervailable subsidies can change over time, both in terms of their existence and their magnitude."[231] Brazil holds that market factors are the criteria for determining whether provisions of capital, such as loans and equity are financial contributions that confer a subsidy benefit. For a loan, Brazil contends that the measure is whether the interest charged for the loan capital is consistent with the interest charged in the market; for equity, the measure is whether the equity is valued properly based on the expectations that the recipient entity will generate adequate returns. Brazil argues that the existence of a benefit is based on the terms on which the capital is provided and will change if those terms change.

5.5 Citing Article 14(a) of the SCM Agreement, **Brazil** states that equity capital can be a financial contribution which confers a benefit only if the provision of that equity capital is on terms "inconsistent with the usual investment practice of private investors." Brazil argues that in a financial contribution to an non equity-worthy recipient on terms inconsistent with usual investment practices of private investors ceases to be a countervailable benefit when the capital is no longer available on terms inconsistent with usual investment practices of private investors. Therefore, Brazil concludes that in the case of equity, the transaction governing the sale of equity is the key event which must be analysed to determine whether or not the equity, continues to be provided on terms inconsistent with market terms. Brazil contends that the United States' methodology ignores the question of whether there are changes to the terms of capital provision resulting from a sale of the equity. Brazil maintains that once the equity has been transferred to a private party in an arm's-length transaction at market value, the expectation (and, therefore, the terms of its provision) is that the equity will maintain or increase in value and earn a return for the investors or the company will no longer be able to raise equity capital.

(c) Resource Misallocation and Countervailing Duties

5.6 **Brazil** believes that the true objective of the United States' same person methodology is to ensure that events which take place after the initial financial contribution are not allowed to affect the ability of the United States to impose countervailing duties on the original financial contribution and the benefits conferred by that original financial contribution. Brazil notes that the United States argues that even if an arm's-length transaction does not confer a benefit to the new owners and the new company, a market distortion remains and must be redressed. Brazil argues that the logic of the United States' argument is that any methodology that does not allow Members to address the supposed macroeconomic effects of a subsidy, is not consistent with the object and purpose of the SCM Agreement. However, Brazil notes that the SCM Agreement does not provide Members with a broad-based authorization to redress all actions that the Member feels distort the market. Brazil contends that the SCM

[231] Brazil's statement at the first substantive meeting, at para. 14.

Agreement requires a financial contribution which confers a benefit as a condition for imposing countervailing duties, nothing more, nothing less.

2. Arguments Relating to Section 1677(5)(F)

5.7 **Brazil** contends that the United States law prevents the adoption of a methodology to determine the existence of post-privatization benefits which would be consistent with the Panel and Appellate Body reports in *US – Lead and Bismuth II*. Brazil argues that Section 1677(5)(F) renders the consideration of whether the transfer in ownership was an arm's-length transaction at fair market value irrelevant to the determination of whether the new owners continued to enjoy the subsidy benefit. As an illustration, Brazil claims that not a single factor in the "totality of circumstances" test applied in the United States' same person methodology looks at whether the transaction is an arm's-length transaction for fair market value. While Brazil recognizes that under the new methodology, the benefits are no longer determined to adhere only to the physical assets of the privatized entity, one of the rationales for the gamma methodology which led to the Panel and Appellate Body rejection of that methodology in *US – Lead and Bismuth II*, they now adhere, in effect, to a more broadly defined set of assets which include the name, the personnel, the customers, the management, and the business relationships of the entity. Thus, the new same person methodology is only a variation of the rejected gamma methodology and still fails to consider the effects of a change in ownership as required by *US – Lead and Bismuth II*.

5.8 **Brazil** believes that, in light of the United States' failure to implement the *US – Lead and Bismuth II* determinations, the Panel should, in addition to finding that the United States actions inconsistent with its WTO obligations, suggest how the substantive standard addressing privatization should be implemented and that the United States should initiate and conduct reviews of all existing countervailing measures.

B. Mexico

1. Arguments Relating to the United States Change in Ownership Methodology

5.9 **Mexico** submits that the revised US Department of Commerce same person methodology is used by the United States in its latest attempt to continue applying countervailing duties on goods produced by privatized firms, while avoiding the determination of whether a previously bestowed subsidy continues to confer a benefit. Mexico claims that the SCM Agreement and the GATT 1994 require two essential prerequisites to be fulfilled for the imposition of countervailing duties, as was made clear in *US – Lead and Bismuth II*, which is a direct precedent for this dispute. First, demonstration of the existence of a subsidy is required. In accordance with Articles 19.1, 19.4 and 21 of the SCM Agreement and Article VI:3 of the GATT 1994, an investigating authority may not impose or maintain countervailing duties on an imported product without determining the existence of a subsidy bestowed, directly or indirectly, upon the

manufacture, production or export of any merchandise. Second, determination of the existence of a "benefit" by reference to a market benchmark. As shown by the Panels and the Appellate Body in *Canada – Aircraft*[232] and *US – Lead and Bismuth II* [233], a "benefit" is determined by reference to the terms on which a "financial contribution" would have been made available to the recipient *in the marketplace.* In addition, in accordance with Article 1.1 (and Article 21) of the SCM Agreement, "the investigating authority must establish the existence of a 'financial contribution' and 'benefit' during the relevant period of investigation or review".

5.10 **Mexico** submits that the US Department of Commerce same person methodology is inconsistent with the United States' obligations as a WTO Member. Under the new US Department of Commerce methodology, if the privatized company has been determined as remaining the same person as the firm on which the subsidy was originally bestowed, it is unduly *assumed* that the benefit conferred by that subsidy has passed through to that company. Mexico contends that such an assumption, without a concrete determination on the continued existence of a benefit, cannot be regarded as valid under the SCM Agreement as interpreted in *US – Lead and Bismuth II*. Moreover, the same person methodology, like US Department of Commerce preceding methodologies, is entirely unrelated to the market benchmarks referred to by the panels and the Appellate Body, since according to the US Department of Commerce criteria, practically any privatized company would be found to be the same person. Mexico argues that under no economic logic would it be reasonable to expect that a private investor who buys a public enterprise (*e.g.* a steel company), to have to change its name, facilities, line of production, customers, etc. and to fire hundreds of qualified workers, just to avoid the imposition of antidumping duties. In this context, Mexico contends that this US Department of Commerce criteria used to assume the transfer of the subsidies granted prior to the privatization, may respond to the United States' corporate law principles, but not to the United States' obligations as a WTO Member to make an adequate determination of the continued existence of a "benefit" by reference to a market benchmark, and hence, due demonstration that a countervailable subsidy has been bestowed, directly or indirectly, on the production of goods by the privatized company.

5.11 **Mexico** contends that, in the case of a change in ownership involving the payment of consideration, a distinction must be drawn between the pre-privatization company that originally received the subsidy and the post-privatization entity, for the purpose of reviewing continuity of the benefit conferred by a subsidy. Mexico claims that this has also been recognized by the

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[232] *See* Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), WT/DS70/R, adopted 20 August 1999 as upheld by Appellate Body Report, DSR 1999:IV, 1443, *Canada – Aircraft*, WT/DS70/AB/R, at para. 9.112; *and* Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, DSR 1999:III, 1377, at paras. 154, 157.

[233] *See* Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 85, at para. 6.66 (including footnote 78).

Panel in *US – Lead and Bismuth II*.[234] According to Mexico, it is the change in ownership and the ensuing payment of consideration for the productive assets that calls for a new determination of benefit conferred by a subsidy. Thus, Mexico considers that the SCM disciplines do not release the United States from the obligation to determine the continued existence of a benefit to a privatized company, on the sole grounds that it deems the new firm to be "not distinct" from the original firm. Thus, Mexico contends that the same person methodology and the investigations and reviews based on that methodology are not consistent with Article VI:3 of the GATT 1994 and Articles 14, 19.1, 19.4 and 21 of the SCM Agreement.

2. Arguments Relating to Section 1677(5)(F)

5.12 **Mexico** maintains that a concrete determination of the continued existence of a benefit is necessary in all cases involving a change in ownership accomplished through an arm's-length transaction. A change in ownership through an arm's-length transaction is an event of such relevance as to require, by itself, a concrete finding regarding the continuation of the benefit conferred by the subsidy granted to the privatized firm before the privatization. Mexico claims that Section 1677(5)(F) directly contravenes this requirement, since it clearly fails to stipulate the need for such a benefit determination. Therefore, this Section violates the United States' obligations under Articles 1, 10, 19, 21 and 32.5 of the SCM Agreement and Article XVI:4 of the WTO Agreement.

VI. INTERIM REVIEW[235]

6.1 On 8 April 2002, pursuant to Article 15.1 of the DSU, the Panel issued the draft descriptive part of its Report. As agreed, on 18 April 2002 both parties commented on the draft descriptive part. The Panel issued its Interim Report on 13 May 2002. On 27 May 2002, pursuant to Article 15.2 of the DSU, the United States and the European Communities provided comments and requested the revision and clarification of certain aspects of the Interim Report. None of the parties requested that the Panel hold a further meeting with the parties. In the absence of a meeting and further to paragraph 16 of the Panel's Working Procedures[236], the parties were given until 5 June 2002 to submit further written

[234] *See* Panel Report *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 85, at para. 6.70.

[235] Pursuant to Article 15.3 of the DSU, "The findings of the final panel report shall include a discussion of the arguments made at the interim review stage". The following section entitled "interim review" therefore forms part of the findings.

[236] Paragraph 16 of the Panel's Working Procedures reads as follows: "Following issuance of the interim report, the parties shall have no less than 7 days to submit written requests to review precise aspects of the interim report and to request a further meeting with the Panel. The right to request such a meeting must be exercised no later than at that time. Following receipt of any written requests for review, in cases where no further meeting with the Panel is requested, the parties shall have the opportunity within a time-period to be specified by the Panel to submit written comments on the other parties' written requests for review. Such comments shall be strictly limited to referencing the other parties' written requests for review."

comments on the other party's Interim Review's comments. Both parties filed further comments on that date.

6.2 Following the comments of the parties, the Panel has reviewed the claims, arguments and evidence submitted by the parties during the panel process. Where it considered it appropriate to ensure clarity and avoid misunderstandings, the Panel revised its findings, including the correction of typographical and editorial mistakes. The Panel has addressed the following concerns raised by the parties.

6.3 Generally, the United States' allegations concern the factual description of the Panel Report. The United States makes a point of repeating that the Panel did not include several of its 18 April requests to amend the descriptive part of the Panel Report. The United States' comments seem to want to give the impression that the Panel intentionally, or without due diligence, refused to accept or refer to evidence or arguments that the United States submitted to the Panel during the panel process. Before it addresses any specific allegation, the Panel notes that most of the United States' requests and comments made in its 18 April communication were accepted by the Panel and were reflected in the Interim Report. In its 18 April comments, the United States often did not point to submissions or communications where the concerned factual or legal allegations could be located. The Panel notes, however, that the present dispute is generally not concerned with factual matters but rather with the legal consequences of privatizations, which occurred in all 12 cases before it. This is the factual basis upon which the Panel's findings and conclusions are made. Nonetheless, where factual allegations were made by the European Communities, it was for the United States to refute them.[237] On occasion, the Panel has explicitly invited the United States to comment on the European Communities' description of the twelve determinations[238]; the United States did not respond fully to the Panel's questions. However, because it wants to take into account the United States' concerns to the extent permitted by WTO law, the Panel has reviewed the record for the facts that the United States requests be added to the descriptive part of the Panel Report. To the extent possible, and with a view to favour transparency of the circumstances of those cases, the Panel has revised some of the paragraphs of the Panel Report to include references to data contained in the actual 12 determinations submitted by the European Communities as exhibits. As noted later, these additional factual data, are not necessarily relevant to the limited terms of reference of this Panel, including those relating to allocation and attribution of subsidies. In all cases, the Panel has refused to amend the descriptive part of its Report where it would involve the introduction of new evidence or new arguments not submitted during the panel process.

6.4 The United States makes some general remarks regarding what it considers as "errors of particular significance"; namely: (1) "*that the Panel*

[237] The Panel recalls that the Appellate Body has made clear that a *prima facie* case is one which in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the *prima facie* case.

[238] See for instance the US replies to question No. 11 posed by the Panel.

considers that all sizable subsidies at issue in the challenged cases were pre-privatization subsidies (*some were not)*; (2) "*that in all cases disregarding the pre-privatization subsidies would have left only a de minimis benefit (for several cases this is not true)*"; (3) "*that all of the privatizations were full privatizations (some were not)*"; (4) "*that all of them at issue occurred at fair market value (some likely did not and others have not been sufficiently investigated to permit a finding one way or the other)*"; and (5) "*that the EC's factual characterizations reproduced in sections II-IV were "not rebutted" by the United States (many were vigorously rebutted)*".[239]

6.5 As regards the United States' allegations Nos. (1) and (2), the Panel fails to understand why the United States considers that the Panel has ignored that, in some of the determinations affected by this Panel, the US Department of Commerce may have countervailed post-privatization subsidies. We have never, contrary to what the United States has claimed, made such statements or assumptions in our Panel Report. What the Panel has done is to delimit the scope of its ruling according to its mandate; namely to assess the WTO-compatibility of the US change-in-ownership methodologies which allow non-recurring pre-privatization subsidies to be countervailed after privatization has taken place without any prior WTO-compatible determination of benefit *vis-à-vis* the privatized producer, as applied in the 12 countervailing duty determinations before it. In this regard, the Panel recalls its findings in paragraph 7.39 (6.39 of the Interim Report).

6.6 Paragraph 7.39 does not exclude the possibility of post-privatization subsidies or even recurring pre-privatization subsidies. These are not, however, relevant to our analysis. Our analysis only focuses on the treatment of pre-privatization non-recurring subsidies under the SCM Agreement following a change in ownership, more specifically on the effect of such treatment on the privatized producer.

6.7 The Panel understands that its request for the termination of the countervailing duty orders may not have been sufficiently clear and may have led the United States to believe that the Panel had wanted to ignore the possible existence of post-privatization subsidies in some of the 12 determinations which, the Panel believes, is not an issue before it. Accordingly, the Panel has amended paragraphs 7.87, 7.100, 7.116 and 7.117 to improve the clarity of the Panel's recommendations.

6.8 As regards the United States' allegation No. (3) that the 12 determinations did not concern full privatizations, the United States alleges that in the case of Usinor, the subsidy recipient in the three French cases, the Government of France continued to maintain a "substantial level" of government ownership. The Panel notes that the Government of France divested itself of the remaining shares in Usinor in 1997-1998, that is before the countervailing duty order was issued in the three cases.[240] As the US Department of Commerce's own record reflects

[239] *See* US Comments to the Interim Report, paras. 2-3.

[240] These cases are: Case No. 1 (original investigation) where the final determination was published on 8 June 1999; Case No. 2 (original investigation) where the final determination was published on

after privatization, so-called "stable shareholders" held approximately 14 per cent of Usinor's total shares; 10 per cent of these stable shareholders were claimed by the United States to be government-owned or controlled entities.[241] To accommodate the United States, the Panel has added this information from the United States Federal Register into the factual description of the relevant French cases. The Panel uses the term "full privatization" to refer to a change in ownership where the government has divested itself of all, or substantially all, of its ownership interest in the privatized company, and clearly could no longer exert a controlling interest On the basis of the evidence submitted by the parties by the close of the second substantive meeting, the Panel still considers that in the 12 determinations before it, the governments had severed their control over the state-owned producers upon privatization and the privatized producers could no longer rely on government financing for their operations and could no longer receive things for free. For the Panel these are full privatizations. In order to facilitate the understanding, the Panel has expanded its discussion on what it understands as (full) privatization for the purpose of these panel proceedings. To take into account the United States' concern, the Panel has deleted the term "full", as this does not affect the Panel's considerations and reasoning applicable to all 12 determinations before it, as in all the twelve determinations, the governments had, upon privatization, severed all, or substantially all, their ownership interests over the state-owned enterprises in favour of the privatized producers and their shareholders.

6.9 As regards the United States allegation No. (4), the Panel is surprised at this comment since it has never stated that all 12 privatizations have taken place for fair market value. On the contrary, the Panel has specified that only as regards two determinations (Case Nos. 8 and 10) had the US Department of Commerce itself found that the privatizations at issue taken place for fair market value. The Panel would like to refer to paragraph 2.2 of the Report which is very clear on this matter. The Panel's findings do not assume that all privatizations were for fair market value. Although the European Communities has made allegations to this effect, the Panel does not prejudge those privatizations where the US Department of Commerce has not actually found that the privatization was done for fair market value,. The Panel does consider, however, that the US Department of Commerce's practice, not to examine whether a privatization took place for fair market value and at arm's length in its change in ownership methodology , unless the privatized producer is a distinct legal person from the state-owned producer, is contrary to the SCM Agreement. Except for Case Nos. 8 and 10, whether the specific privatizations were for fair market value is of no relevant to this Panel as long as the US Department of Commerce fails to undertake the examination itself.

29 December 1999; and Case No. 9 (sunset review) where the final determination was published on 7 April 2000.

[241] *Stainless Steel Sheet and Strip in Coils from France, supra,* footnote 8, at 30776.

6.10 As regards the United States' allegation (5), the Panel does not agree with the United States' statement to the effect that it has vigorously rebutted the factual characterization by the European Communities reproduced in Sections II to IV of the Panel Report. Up to the interim review stage, the United States has scarcely contested the factual data provided by the European Communities. For example, the United States did not rebut the factual data provided by the European Communities in its Annex to question No. 11 of the Panel where it describes the various privatizations. Only at the review stage of the descriptive part (in its communication of 18 April), has the United States attempted to contest these facts generally, often without pointing to any specific evidence on the record which the Panel may have ignored.

6.11 The United States argues that in paragraph 2.1 of its Report, the Panel had inaccurately described the question before the Panel, by implying that any subsidy existing after a privatization, must arise out of the privatization itself. The Panel recalls that its terms of reference are limited to the issues raised by the European Communities in its request for the establishment of a panel. In particular, the European Communities' claims concern the legal consequences of a change in ownership from wholly-owned state enterprises to privatized producers and whether the imports from the privatized producers in the 12 determinations can continue to be countervailed for subsidies bestowed to state-owned producers prior to the privatizations. In any event, the Panel has clarified the wording of paragraph 2.1 in the hope that it will leave no doubt as to the Panel's mandate and intent.

6.12 The United States considers that paragraph 2.3 inaccurately states that all of the privatizations before the Panel involved a full change in ownership; because, in fact, the French privatization featured in 3 out of the 12 cases involved a 'substantial level of continued government ownership' through GOF-owned "stable shareholders". The European Communities in its 5 June 2002 comments suggests that the Panel change the word "ownership" to "control". The Panel refers to its statement in paragraph 6.8 above. Yet, even if the United States is correct in stating that the French Government maintained a minority indirect ownership interest in Usinor, the Panel is of the view that all the determinations before it, including the three French cases, involved changes in ownership leading to a privatization of the state-owned enterprises, in the sense that the government had divested itself of all, or substantially all its ownership interest and clearly no longer had any controlling interest in the privatized companies. After privatization, the privatized producers could no longer rely on government financing for its operations and could no longer receive things for free. The Panel believes that under its definition, Usinor's privatization qualifies as a full privatization. Nonetheless, the Panel has revised the text of paragraph 2.6 to reflect the findings regarding "stable shareholders" made by the US Department of Commerce in *Final Affirmative Countervailing Duty Determination: Stainless Steel Sheet and Strip in Coils from France*.[242] The

[242] *Ibid*.

Panel believes that this change responds to both the United States' comments of 27 May 2002 and the European Communities' comments of 5 June 2002.

6.13 With regard to paragraph 2.6, in its comments of 18 April, the United States was not able to point to any evidence it had submitted to the Panel during the panel proceedings and which the Panel had ignored, set aside or misinterpreted. Yet the Panel has attempted to clarify further its point.

6.14 In paragraph 2.10, the United States disagrees with the use of the term "judgment" to refer to the remand redetermination from the CIT in the AST case, as no final judgment has been issued. The European Communities, in its 5 June comments, suggests using the word "decision" for judgment. The Panel has replaced substituted the word "judgment" with the word "order".

6.15 The United States claims that paragraph 2.13 still fails to state that the US Department of Commerce's *pro rata* allocation of the Usinor group's subsidies to all group producers, including GTS, has not been challenged (either by the European Communities in the present dispute or by the respondents during the US Department of Commerce investigation). The United States considers that, as written, paragraph 2.11 implies that whether GTS "received" a portion of the original French Government subsidies is a subject of dispute. The Panel has no evidence before it of whether the allocation concerned was challenged or not. The Panel agrees with the European Communities' comments of 5 June 2002 that the issue of attribution is not within the terms of reference of the Panel. In order to accommodate the United States' concerns, the Panel has revised the relevant paragraph to reflect the limited terms of reference of this Panel.

6.16 As regards paragraph 2.14, the United States claims that it does not correctly describe the facts of Usinor's evolving ownership interest in GTS, nor does it correctly describe the US Department of Commerce's analysis of those facts. Further to the United States comments on 18 April, the Panel did change the wording of its old paragraph 2.12 but did not agree with the United States' characterization of its determination and preferred its own language. The Panel recalls that the pro-rata allocation of subsidies and related percentage of countervailing duties is not a matter before this Panel. The United States claims that paragraph 2.13 continues to inaccurately describe the US Department of Commerce's remand investigation and redetermination. The United States alleges that it was at GTS' request that the US Department of Commerce focused its analysis on changes in Usinor's (as opposed to GTS') ownership. The Panel did not accept the United States' comment because it had not been presented with any evidence to support the United States' assertion that GTS requested such an analysis. Moreover the Panel does not see how this is relevant to the present dispute.

6.17 The United States considers that paragraph 2.18 contains errors in the description of the subsidy bestowal, the change in ownership transaction, and the US Department of Commerce's analysis regarding ILVA and CAS and refers to its comments of 18 April. The Panel has reviewed the evidence within the United States Federal Register, submitted by the European Communities. In particular, Federal Register (63 Fed. Reg. 810) indicates that *"[i]n 1989, the Aosta*

operations were transferred to ILVA. In December 1989, Cogne S.r.l. ***was created*** *as a wholly-owned subsidiary of ILVA S.p.A., which held the Aosta operations. Cogne S.r.l. was later named Cogne Acciai Speciali S.p.A. (Cogne S.p.A.).*" (emphasis added). Therefore, the Panel stands by its previous decision not to accept the United States' request. However, the Panel has amended the text of this paragraph to show more fully the evidence in the Federal Register.

6.18 The United States considers that in paragraph 2.20, the statements concerning maximization of revenue in selling AST and the independence of the financial advisers should be deleted since they are not factual findings by the US Department of Commerce. The Panel notes that this evidence submitted by the European Communities was never contested by the United States before the interim review stage. The Panel has reviewed the evidence presented to it and has therefore deleted the phrase on maximizing revenue and maintained the phrase on the reported independence of the financial advisers. The Panel is of the view that these factual allegations are not relevant for its legal analysis.

6.19 The United States maintains that paragraphs 2.22, 2.23, and 2.25 do not accurately describe the subsidies in *Stainless Steel from Italy* and that paragraphs 2.32 and 2.33 do not accurately describe the facts of Case No. 12 regarding *GOES from Italy*, because they do not contain details relating to the pro-rata allocation of subsidies among the relevant corporate groups. The Panel, with a view to clarifying its Report, has decided to adjust the text of paragraph 2.22 according to the relevant Federal Register; adjust the text of paragraph 2.23, and accept the United states comments on paragraph 2.25. The European Communities points out that the allocations made by the US Department of Commerce have been contested in domestic proceedings in the United States and argues that therefore the changes requested by the United States should not be made. The Panel is merely correcting its statement to reflect more accurately what the US Department of Commerce concluded in this case. The Panel does not take any position on the validity of the US Department of Commerce's determinations on such pro-rata allocation and their relevance, if any, as this is for another forum, and constitutes a matter outside the terms of reference of this Panel.

6.20 As regards paragraph 2.31, the United States also claims that the Panel did not accept all its suggestions. The Panel did accept most of the United States suggestions of 18 April and has changed the word "findings" for "review" to respond to any remaining concerns by the United States.

6.21 As regards former paragraphs 2.33, 2.34 and 2.35, the United States would like the Panel to delete them since they do not deal with factual aspects, but instead reflect the arguments of the parties. The Panel has reviewed its previous position and has moved the relevant paragraphs to a new section IV.B ("US Department of Commerce's practice in administrative reviews") in the arguments part. The Panel has substituted the relevant paragraphs in the factual part (now 2.34 and 2.35) with some summarized information regarding the US Department of Commerce's relevant practice available in the "Countervailing Duties; Final Rule" quoted in footnote 50.

6.22 The United States considers that paragraph 2.37 (now 2.36) does not reflect the United States' comments of 18 April. The Panel amended the text to make clear that the Panel is aware that UES was the actual exporter in the *US – Lead and Bismuth II* case, but that the subsidies provided to British Steel are the same ones at issue in the case from the United Kingdom before this Panel. The Panel hopes that this addresses both the United States' concerns of 27 May 2002 and the European Communities' concerns of 5 June 2002.

6.23 The United States claims that paragraph 2.42 (now 2.41) does not reflect the changes proposed by the United States in its 18 April communication. With a view to avoiding including arguments into the factual descriptive part of the Panel Report, the Panel has revised the text to delete any reference to *how* the US Department of Commerce arrived at its conclusion that the non-recurring pre-privatization subsidies continued to benefit Usinor after privatization.

6.24 The United States considers that the assertions by the European Communities as to why exporters did not request administrative reviews should be deleted from paragraph 2.48 (now 2.47), footnote 64 (now 67). The Panel has already responded to the United States' comments of 18 April by amending the text of the footnote in question (now footnote 67) and sees no need to further amend the text; what is stated there is factually correct and was not challenged by any party.

6.25 The United States claims that paragraph 2.59 (now 2.57) contains an inaccurate description of the gamma methodology and its results. The Panel already responded to the United states' comments of 18 April by amending the text of the paragraph in question. To take into account the United States' concern, while noting that the United States had admitted that the gamma methodology was inconsistent with the SCM Agreement, the Panel has revised the text accordingly.

6.26 The United States refers to paragraph 2.60 (now 2.58) and claims that it inaccurately describes the panel and Appellate Body decisions in *US – Lead and Bismuth II*. According to the United States, these decisions found three particular countervailing duty determinations, rather than the gamma methodology itself, to be WTO-inconsistent. The Panel directs the United States to paragraph 12 of its first written submission where it states that, in *US – Lead and Bismuth II* "the panel and the Appellate Body rejected the gamma methodology as inconsistent with the SCM Agreement."[243] The Panel also notes that in other parts of this proceeding, the United States has stated that it accepted that its gamma methodology was inconsistent with the SCM Agreement, because it did not establish that the requirements of the SCM Agreement had been satisfied with respect to the current (privatized) producer.[244] To take into account the United States' concern, the Panel has revised its text.

6.27 The United States claims that paragraph 2.61 (now 2.60) mistakenly states that under the same person methodology, prior subsidies are "presumed" to

[243] *See* US' first written submission, para. 12.
[244] *See* US' first written submission, para. 69.

"pass through" to the post change-in-ownership producer. The Panel has reconsidered the United States' concerns and has changed the text of the relevant paragraph to read "found to continue to reside in".

6.28 The United States claims that in paragraph 4.5, the Report omits its principal rebuttal to the European Communities's arguments on the subject of whether privatization triggers the need for a re-examination of the existence of benefit. The Panel recalls that the United States has admitted that a change in ownership triggers the obligation to review the conditions of application of the SCM Agreement. The Panel has stated on numerous occasions the United States' argument and has added another reference to it following the United States request of 18 April. The United States also requires that we introduce a new argument regarding its belief that no distinction should be made between privatization and any other change in ownership.[245] In the Panel's view, the United States wants to introduce a new argument at this late stage in the panel process which does not add to its main claims and arguments. The United States has not been able to point to any communications during the panel process where it would have argued that privatizations were not distinct from any other change in ownership for the reasons mentioned in its communication of 14 May. The Panel is also well aware of the United States' argument that only a change of legal personality of the producer (not any change in ownership or privatization) extinguishes the benefit *vis-à-vis* the privatized producer or, to put it differently, that unless the privatized producer is a distinct legal person from the state-owned enterprise, a countervailable subsidy continues to reside in the person upon whom it was originally bestowed.

6.29 The United States considers that paragraph 4.22 inaccurately summarizes the United States' position on subsidies and changes in ownership and its interpretation of *US – Lead and Bismuth II*. The Panel has added to its description to take into account the United States' concerns.

6.30 As regards the United States comments on paragraph 4.32, the Panel has considered the United States' proposal and revised the text as suggested by the United States.

6.31 The United States comments on paragraph 6.6 (now 7.6) to the effect that the US Department of Commerce examines the "circumstances of the privatization," including all terms of the transaction, in determining whether the person under investigation or review is the same legal person that received the subsidy. The Panel recognizes the United States' point and has revised the

[245] In its 18 April communication the United states requested the Panel to introduce the following argument which the Panel was not able to identify in any of the US communications to the Panel:

> "For purposes of this analysis, moreover, the United States considers that privatizations do not merit special treatment different from other changes in ownership simply because the purchase price is being paid to a government and government owners are being replaced by private ones. Adopting such a distinction would imply that government ownership per se (rather than non-commercial financial contributions) had constituted the original subsidy, and that the original subsidies were limited to the cost incurred by the subsidizing government rather than the full benefit conferred to the recipient enterprise."

description of the United States' argument. The Panel maintains, however, that the US Department of Commerce does not look to the issue of whether the privatization took place at arm's length and for fair market value, in making its analysis of whether the privatized producer has received a benefit from the subsidy bestowed to the state-owned producer, unless that privatized producer is a distinct legal person from the state-owned producer.

6.32 As regards the United States' claim that paragraph 6.14 (now 7.14) contains an inaccurate description of the US Department of Commerce's test, the Panel has reconsidered the United States' concerns and has changed the text of the relevant paragraph to read "found to continue to reside in".

6.33 The United States points out some errors in the chart attached to the Interim Report as Annex A. The Panel has updated the chart to reflect the United States' comments on the data included for Case Nos. 7 and 10 and the French cases. The Panel has also considered the United States' comments regarding the use of the % symbol rather than the term "percentage points" in the column concerning alleged countervailable subsidies in Annex A. The Panel notes that this was not raised in the United States' 18 April comments on the draft descriptive part, which contained Annex A. The Panel is unclear as to the value of using the term "percentage points" rather than the percentage symbol. The reason the Panel used the % symbol was to reduce the amount of text in Annex A. However, in an effort to respond to the United States' concerns the Panel has amended the text of the column in question to duplicate the text in the corresponding portions of the descriptive part, to which the United States has not raised any objections.

6.34 With regard to paragraph 6.90 (now 7.90), the Panel has adjusted the text to reflect the Panel's terms of reference.

6.35 The United States argues that the Panel's statement that the sunset reviews in question "should be terminated" reflects several errors of law and fact. The Panel does not necessarily agree with the United States' comments. However, to accommodate the United States' concerns, the text of paragraphs 6.117 and 6.118 (now 7.116 and 7.117) have been amended to clarify that the Panel was referring only to the termination or removal of the (share of the) countervailing duty order which derived from non-recurring pre-privatization subsidies, for which no WTO-compatible determination of benefit has taken place *vis-à-vis* the privatized producer. The Panel makes no findings on recurring subsidies or post-privatization subsidies and their countervailability, as these are not within the terms of reference of the Panel.

6.36 The European Communities suggested that paragraph 6.130 (now 7.129) be revised by changing the word "purchaser" in the first line to "producer." The Panel agrees with the United States' comment of 5 June that this change would make the sentence incomprehensible and therefore has maintained the original version.

6.37 The United States notes that in three separate places, the Panel states that the United States took the position that Case No. 7 (the administrative review involving steel from Sweden) was not within the Panel's terms of reference

because it was finalized prior to the Appellate Body Report in *US – Lead and Bismuth II* (paras. 6.5, 6.27, and 6.99 of the Interim Report). The United States claims that it never put forward this argument and that any reference to it should be struck from the report. The Panel points out that in paragraph 99 of its first written submission the United States contents: "[t]he European Communities' claims regarding the expedited sunset review of the CVD order on cut-to-length plate from Sweden are not within the Panel's terms of reference."[246] Since the Panel is now aware that the inclusion of this claim was an error, the Panel will therefore delete the requested passages.

6.38 The United States makes a variety of arguments against the Panel's factual findings regarding Section 1677(5)(F). First, the United States claims that the Panel erred in attempting to establish the meaning of the legislation, as a factual element, by examining the "internal elements" relevant to the construction of the statute – its legislative and judicial history. The Panel repeats its discussion contained in its findings. The Appellate Body Report in *India – Patents* stated that: where the alleged violation at issue is domestic legislation, an examination of the relevant aspects of municipal law is essential to determining whether a Member has complied with its obligations.[247] The panel in *US – Section 301 Trade Act* provided guidance for panels interpreting domestic law when it stated that: "a Panel should not interpret the law "as such", but rather establish the meaning of the disputed legislation as a *factual element* and determine whether the factual element constitutes conduct by the respondent Member contrary to its WTO obligations."[248] The Panel also feels that it was appropriate to use the legislative and judicial history of Section 1677(5)(F) in establishing the meaning of the legislation. The panel – upheld by the Appellate Body – in *US – 1916 Act*, stated that even if the text of the law in question were clear on its face, it was necessary to examine the domestic application of that law, its historical context and legislative history and subsequent declarations of US authorities in order to asses its compatibility with WTO law.[249] Based on the jurisprudence, the Panel maintains that it was correct for it to examine the relevant aspects of the United States' law and to establish the meaning of the legislation as a factual element.

6.39 The United States specifically argues that the Panel made erroneous assumptions about what the US Court of Appeals for the Federal Circuit meant when it discussed the concept of "arm's-length" in its decision in the *Delverde III* case. However, we note that the US Court of Appeals for the Federal Circuit relied specifically on the legislative history to determine the Congressional intent in promulgating the statute. The definition of "arm's-length transaction"

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[246] *See* US' first written submission, para. 99

[247] Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R, DSR 1998:I, 9, at para. 66.

[248] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, DSR 2000:II, 589, at para. 7.18 citing Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R,, at para. 66 (emphasis added)

[249] Panel Report, *US – 1916 Act (EC)*, WT/DS136/R, DSR 2000:X, 4593, at para. 6.48. *See a*lso Panel Report, *United States – Section 337 of the Tariff Act of 1930* ("*US – Section 337*"), adopted 7 November 1989, BISD 36S/345.

contained in the SAA[250], which the Panel relied upon, is identical to the wording in the House of Representatives Report cited by the US Court of Appeals for the Federal Circuit as the basis for its interpretation of the meaning of the statute.[251] The Panel also notes that throughout its discussion of both the *Delverde III* case and the *Saarstahl II* case, the Court seems to use the two terms interchangeably. When we requested that the United States explain the meaning of arm's length in United States law and its difference from fair market value, the representative of the United States said there was a great deal of confusion about those terms in the United States and that he was not in a position to reply.[252] Therefore, based on the definition of arm's length provided by Congress, the interchangeable use of the terms arm's length and fair market value by the US Court of Appeals for the Federal Circuit, and the United States' inability to explain how United States law differentiates between the two, the Panel maintains that its position is not "unsubstantiated and unwarranted." The Panel agrees with the United States that one can reasonably interpret the two concepts as being different, but maintain its position that the United States' legislation and US Court of Appeals for the Federal Court decision seem to have defined arm's length to include fair-market value.[253]

6.40 The United States also contends that the Panel erred in finding that the same person methodology had also been condemned by the US Court of Appeals for the Federal Circuit's reasoning when it condemned the "gamma methodology." The Panel has never claimed that the US Court of Appeals for the Federal Circuit has ruled specifically on the legality of the same person methodology under Section 1677(5)(F); the Panel also feels that this is not relevant. In the context of its examination of the gamma methodology, the US Court of Appeals for the Federal Circuit discussed and analysed Section 1677(5)(F) and found that a *per se* methodology would violate the statute. It is to this discussion and finding to which the Panel is referring. The Panel notes that the US Department of Commerce has itself argued that "the Federal Circuit in *Delverde III* was quite clear that 19 U.S.C. Section1677(5)(F) precludes *per se* rules, including one that would automatically treat the change in ownership as extinguishing prior subsidies."[254] The Panel again maintains its reasoning, that

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[250] "For purposes of section 771(5)(F), the term "arm's-length transaction" means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties." SAA 1994 U.S.C.C.A.N 3773, 4241 Exhibit EC–25 to EC's first written submission.

[251] The Panel recognizes that the House of Representatives Report is not, as such, in the record. However, it is cited by the US Court of Appeals for the Federal Circuit in *Delverde III*. The Panel has decided to look at the full document in order to respond to the United States' comments in the US' Request for Interim Review. The Panel also notes that the Federal Circuit stated that the Senate Report was "nearly identical" to the House Report it cited. *Delverde III* 202 F.3d. 1360, at 1366-67.

[252] *See* US response to question No. 15 posed by the Panel.

[253] *See* US' request for Interim Review, para. 44.

[254] Defendant's Memorandum in Opposition to Plaintiff's Motion for Judgment upon the agency record, *Acciai Speciali Terni et al. v. United States et al.* Court No. 01-00051 (Ct. Int'l Trade 5 October 2001). (Extracts; cover page, table of contents, and pages 9 to 18 attached as Exhibit EC-26) *cited in* EC's first written submission, para. 150.

the effect of the interpretation of the statute by the US Court of Appeals for the Federal Circuit, is to make Section 1677(5)(F) inconsistent with the United States' WTO obligations.

6.41 The United States argues that the fundamental problem with the Panel's analysis is that it ignores the fact that under the United States' legal system, courts develop the law on a case-by-case basis. The Panel understands that law in a common law legal system is continuously evolving. However, the current state of the law in the United States today is that expressed by the US Court of Appeals for the Federal Circuit in *Delverde III*. The United States has provided no evidence of other dispositive decisions by the US Court of Appeals for the Federal Circuit or the United States Supreme Court (the only higher court), that would alter the binding nature of the US Court of Appeals for the Federal Circuit's holding in *Delverde III* or the Panel's understanding of what that decision requires of the United States Department of Commerce.[255] The United States also contends that all that can be fairly said at this time is that the US Court of Appeals for the Federal Circuit has found the gamma methodology to be unlawful, and has yet to opine on whether the type of methodology proposed by the Panel would be permitted under the United States' statute. The Panel would like to point out that in no way is it proposing that any particular methodology be adopted by the United States. The Panel examined *Delverde III*, not to assess or discuss the compatibility of the gamma methodology but to understand the nature and legal effects of Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit, in the context of its examination of the gamma methodology. Since the United States itself has argued that the *Delverde III* ruling clearly precludes *per se* rules, including one that would automatically treat the change in ownership as extinguishing prior subsidies[256], the Panel continues to believe that the current interpretation of Section 1677(5)(F) by the US Court of Appeals for the Federal Circuit, which is binding upon the CIT and the US Department of Commerce, would prevent the United States from applying Section 1677(5)(F) in a manner consistent with the SCM Agreement.

6.42 The United States believes that the Panel should explain more precisely in paragraph 7.1 (now para. 8.1) why the United States' measures in question are inconsistent with, or violate, Articles 1, 10, 14, 19.1, 19.4, 21.1, 21.2, 21.3 and 32.5 of the SCM Agreement and Article XVI:4 of the WTO Agreement. In particular, the Panel agrees with the United States that *stricto sensu*, Article 1 being a definitional provision, cannot be violated as such. The Panel understands the concerns of the United States and has therefore expanded its explanation and conclusion, of the reasoning behind each of the various violations.

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[255] The United States itself has admitted that "many judgments are final as a practical matter at the level of the circuit court of appeals, *inter alia*, because the possibility to appeal before the Supreme Court is not automatically granted." Panel Report, *US – 1916 Act (EC)*, WT/DS136/R, *supra*, footnote 249, at para. 6.139.

[256] *Ibid.*

6.43 In its interim review submission on 27 May 2002, the European Communities submits that it would like that the Panel to explain why it did not consider it necessary to adopt the suggestions or adopt suggestions of its own. Article 19.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), simply states that a panel "may" suggest ways in which the Member concerned could implement the recommendations. This discretion is reserved to the Panel, and the Panel is under no obligation to take up suggestions of the complaining party. The Panel is of the view that its findings and conclusions are sufficiently clear and that the Members have discretion in how to bring a measure found to be WTO-inconsistent into conformity with WTO obligations.

6.44 The Panel notes that, on 4 June 2002, the CIT ruled on AST's challenge to the US Department of Commerce's final determination of the administrative review in *GOES from Italy* (Case No. 12).[257] In its opinion, the Court upheld the same person methodology as being consistent with Section 1677(5)(F), in particular with the US Court of Appeals for the Federal Circuit's decision in *Delverde III*. Since this CIT decision was issued after the interim review stage, the Panel has not taken it into account within the descriptive part or the findings. Nevertheless, the Panel wishes to comment on the paragraphs of this Report on which the decision by the CIT might have some bearing.

6.45 In particular, paragraph 2.33, which indicates that AST has challenged the US Department of Commerce's final determination of the administrative review in *GOES from Italy*[258], could be completed by adding the following text:

> "… On 4 June 2002, the CIT ruled on AST's challenge to the US Department of Commerce's final determination of the administrative review. The Court remanded the case to the US Department of Commerce to 'further explain whether post-sale AST or KAI [the purchaser] become legally responsible for all of pre-sale AST's assets and liabilities.'[259] The Court upheld the same person methodology as being consistent with Section 1677(5)(F), in particular with the US Court of Appeals for the Federal Circuit's decision in *Delverde III*."

6.46 Paragraph 7.79 quotes a 4 January 2002 decision of the CIT[260] which concluded that the same person methodology was inconsistent with Section 1677(5)(F). This paragraph could be expanded to completely cover the current CIT jurisprudence on the same person methodology by noting that in the 4 June 2002 CIT decision[261], the Court concluded that the same person

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[257] *Acciai Speciali Terni v. United States of America* Court No. 01-00051, at p. 29.
[258] The corresponding box of the table included in Annex A would also be affected.
[259] *Ibid*.
[260] *GTS Industries v. United States* Court No. 00-03-00118 (Ct. Int'l Trade 4 January 2002), at 14-18. Exhibit EC–30 to the EC's second written submission. *See* also, *Final Results of Redetermination pursuant to Court Remand, Allegheny Ludlum Corp. et al. v United States* Court No. 99-09-00566, (Ct. Int'l Trade 13 December 2000) (unpublished) ("*Allegheny Ludlum I")*.
[261] *Acciai Speciali Terni v. United States of America* Court No. 01-00051, at p. 29.

methodology is consistent with *Delverde III* and Section 1677(5)(F).[262] While the Panel accepts that, in the 4 June 2002 case, the CIT seems to validate the same person methodology, this does not change the reasoning of this Panel to the measures before us. In our view, the CIT is equating countervailing duty liability to other corporate liabilities, which can be inherited by the new owner. However, a countervailing duty liability can only exist if there is countervailable subsidization under the terms of the SCM Agreement. Therefore, the Panel considers that since, in its view, the subsidy benefit ceases to accrue to the privatized producer through the payment of fair market value for the shares of stock, there is no longer a countervailable subsidy under the SCM Agreement. In the view of this Panel, as there is no subsidy to countervail, there is therefore no outstanding importers' liability in respect of countervailing duties on the imported goods produced by the privatized producer.

6.47 Another paragraph which could benefit from reference to the 4 June 2002 CIT decision is paragraph 7.153. In this paragraph, the Panel indicates that the current interpretation of Section 1677(5)(F) by the US Court of Appeals for the Federal Circuit, which is binding upon the CIT and the US Department of Commerce, prevents the United States from applying Section 1677(5)(F) in a manner consistent with the SCM Agreement. The 4 June 2002 CIT decision supports the conclusion of the Panel that the US authorities are unable to consistently implement the SCM Agreement through Section 1677(5)(F), as interpreted by *Delverde III*. [263] In its decision, the CIT concurred with the argument put forward by the United States, in evidence submitted before this Panel[264], that "the Statute [Section 1677(5)(F)] prohibits a *per se* rule for determining whether a subsidy continues to be countervailable to a new owner following a change in ownership"[265] and thus upheld the same person methodology as being consistent with Section 1677(5)(F), in particular with the US Court of Appeals for the Federal Circuit's decision in *Delverde III*. The CIT concluded that Section 1677(5)(F) does not require the US Department of Commerce to conduct a second benefit determination if the entity that originally received the subsidy is the same person being reviewed after privatization.[266]

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[262] In particular, the CIT considered that:

> "The mere payment of more or less for the purchase of shares of stock would seem to have no impact by itself upon the amount of countervailable duty liability any more than such payment would have on the amount of a mortgage liability that was the responsibility of AST. It would simply mean the purchaser of stock paid more or less for its shares. Such payment by itself would not extinguish liabilities to third parties".
>
> *Ibid*. p. 16.
>
> The Panel is of the view that the CIT, like the United States' arguments before this Panel, is elevating form over substance.

[263] *Acciai Speciali Terni v. United States of America* Court No. 01-00051, at p. 29.

[264] Defendant's Memorandum in Opposition to Plaintiff's Motion for Judgment upon the agency record, *Acciai Speciali Terni et al. v United States et al.* Court No. 01-00051 (Ct. Int'l Trade 5 October 2001). (Extracts; cover page, table of contents, and pages 9 to 18 attached as Exhibit EC-26) *cited in* EC's first written submission, para. 150.

[265] *Acciai Speciali Terni v. United States of America* Court No. 01-00051, at p. 13.

[266] *Ibid* p. 15.

This indicates that, pursuant to Section 1677(5)(F), the US Department of Commerce will not be required, [or even able] to make, an independent benefit assessment *vis-à-vis* the privatized producer nor will it be able to conclude that when the privatization is at arm's length and for fair market value that the benefit no longer accrues to the privatized producer.[267]

VII. FINDINGS

A. Claims of the Parties

7.1 The European Communities has requested the Panel to rule on the WTO-consistency of 12[268] countervailing duty determinations listed in paragraph 2.1 above. Six of these countervailing duty determinations occurred in the context of original investigations[269], two in the context of administrative reviews[270], and four others in the context of sunset reviews[271], as further detailed in that paragraph.

7.2 The European Communities claims generally that the United States has not respected its obligations pursuant to the SCM Agreement in the 12 listed determinations and that the countervailing duties in place are, therefore, inconsistent with the United States' obligations pursuant to the SCM Agreement and the Marrakesh Agreement Establishing the World Trade Organization (the WTO Agreement).[272] According to the European Communities, a change in ownership, such as a privatization, creates a mandatory obligation on the investigating authority to examine the conditions of the change in ownership transaction in order to determine whether any benefit accrues to the new economic entity.[273] The European Communities argues that when a privatization

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[267] For example, in this case, even though the new owner of AST (i.e. KAI) paid more than the originally projected fair market value, this payment by itself was not considered by the CIT enough to extinguish the so-called countervailing duty liability. *Ibid.* p. 16.

[268] There are also allegations on the US Department of Commerce's redeterminations within remand investigations ordered by the CIT in the context of appeals against four of those 12 determinations. See Annex A of this Panel Report.

[269] Stainless Sheet and Strip in Coils from France (C-427-815) (Case No. 1); Certain Cut-to-Length Carbon Quality Steel from France (C-427-817) (Case No. 2); Certain Stainless Steel Wire Rod from Italy (C-475-821) (Case No. 3); Stainless Steel Plate in Coils from Italy (C-475-823) (Case No. 4); Stainless Steel Sheet and Strip in Coils from Italy (C-475-825) (Case No. 5); Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475-827) (Case No. 6).

[270] Cut-to-Length Carbon Steel Plate from Sweden (C-401-804) (Case No. 7); Grain-Oriented Electrical Steel from Italy (C-475-812) (Case No. 12).

[271] Cut-to-Length Carbon Steel Plate from United Kingdom (C-412-815) (Case No. 8); Certain Corrosion-Resistant Carbon Steel Flat Products from France (C-427-810) (Case No. 9); Cut-to-Length Carbon Steel Plate from Germany (C-428-817) (Case No. 10); and Cut-to-Length Carbon Steel Plate from Spain (C-469-804) (Case No. 11).

[272] Marrakesh Agreement Establishing the World Trade Organization (hereinafter WTO Agreement) including Annexes 1, 2, 3, and 4 in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, 15 April 1994, Legal Instruments – Results of the Uruguay Round vol. 1 (1994); 33 I.L.M. 1125 (1994).

[273] In this dispute, parties had to make reference to enterprises before and after privatization. Parties have referred to pre-privatization company, pre-privatization producer, pre-privatization (economic) entity and other similar expressions. With a view to consistency, the Panel, when referring to the

takes place at arm's length and for fair market value[274], the benefit of the subsidy to the previous state-owned producer does not continue to accrue to the post-privatization economic entity. The European Communities asserts that the investigating authority's obligation to examine whether the benefit continues to accrue to the privatized producer exists for all types of countervailing duty proceedings, regardless of whether they are original investigations, administrative reviews, or sunset reviews. The European Communities claims that with both the gamma methodology and the same person methodology, the US Department of Commerce does not examine the conditions of the transaction and thus fails to determine whether a benefit continues to accrue to the current producer contrary to the requirements of Articles 1, 10, 14, 19, and 21 of the SCM Agreement.

7.3 The European Communities also claims that Section 771(5)(F) of the US Tariff Act of 1930, as amended (19 U.S.C. §1677(5)(F)) ("Section1677(5)(F)") "as such" prohibits the US Department of Commerce from systematically assessing benefit in cases of privatizations in a manner consistent with the SCM Agreement and it is, thus, also inconsistent with Article XVI:4 of the WTO Agreement.

7.4 The United States replies that the primary issue to examine when a change in ownership occurs is not whether the transaction was at arm's length and for fair market value, but whether it resulted in a change of the legal personality of the producer, *i.e.* whether the privatized producer is a "distinct legal person" from the pre-privatization state-owned producer. The United States maintains that a change in ownership or privatization does not necessarily result in a change of the legal personality of the producer and as such, should not change any prior determination of benefit assessed when the subsidy was bestowed to the state-owned producer, since the subsidy resides in the same legal person as before the privatization. For the United States, unless the post-privatization producer has become a new distinct legal person after the privatization, the importing Member can attribute the non-amortized part of a non-recurring subsidy provided to the state-owned producer to the privatized producer. Therefore, in its view, exports from the privatized producer can be countervailed or continue to be countervailed after the privatization pursuant to the SCM Agreement.

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wholly-owned state enterprise before the privatization, will use the term "state-owned producer". Parties have also referred to the post-privatization company, post-privatization producer, post-privatization (economic) entity and other similar expressions. With a view to consistency, the Panel, when referring to the privately-owned enterprise after the privatization, will use the term "privatized producer".

[274] Initially, and then sporadically, the European Communities argued that, in case of any change of ownership at fair market value and for arm's-length, the benefit from a subsidy bestowed to the previous producer would not pass through to the new producer. The European Communities referred to concepts of "control" as a criteria to determine which change of ownership calls for such re-examination of the conditions of applications of the SCM Agreement. In its second written submission, and during the second substantive meeting, the European Communities limited its argumentation to privatization, as the 12 challenged determinations involved privatizations.

7.5 The United States admits that in Case Nos. 1 to 7, where the gamma methodology was applied, its determinations are WTO-inconsistent but only to the extent that it did not reconsider them under its new "same person" methodology.

7.6 The United States maintains that its same person methodology, which is a two-step process looking first to whether the post-privatization producer is a new distinct legal person and only making a benefit assessment after a determination that the post-privatization producer is a new legal person, is consistent with its WTO obligations. The United States asserts that if the post-privatization producer is not a new legal person, the benefit attributed to the state-owned producer automatically accrues to the privatized producer. The United States also states that arms length's transactions for fair market value do not necessarily result in no benefit accruing to the post-privatization producer. In addition, the United States argues that sunset reviews are an inappropriate forum for analysing complex privatization transactions. The United States believes that it is not obligated, in a sunset review, to examine any evidence regarding subsidization that is not already on the record. In its view, in the absence of an administrative review, the only evidence of subsidization to be examined in a sunset review, will be that of the original investigation.

7.7 As to the WTO-compatibility of Section 1677(5)(F), the United States argues that Section 1677(5)(F) only maintains the US Department of Commerce's discretion to determine whether or not the benefit continues to reside in the company even after a change in ownership (privatization) at arm's length and for fair market value. The United States maintains that the SCM Agreement provides no basis for concluding that a change in the ownership of a subsidy recipient, for fair market value or otherwise, automatically eliminates the benefit conferred on the company. Therefore Section 1677(5)(F) is WTO-compatible.

B. The Measures at Issue

1. Evolution of Change in Ownership Methodologies Applied by the US Department of Commerce

7.8 It is reported that the issue of the effect of a change in ownership as a consequence of privatization for fair market value and at arm's length was first addressed by the US Department of Commerce in the administrative review of the countervailing duty order on *Lime from Mexico* in 1989.[275] It is also reported that in that review, the US Department of Commerce determined first, whether an actual sale took place, and second, whether subsidies paid to the government-owned company continued to provide benefits to the owners of the privatized company.[276] Having determined that there was an actual sale, the US Department of Commerce came to the conclusion that the price paid for the privatized

[275] *Lime from Mexico*, 54 Fed. Reg. 1753, 1754-55 (Dep't Commerce 17 January 1989) (prelim. admin. review). *See* EC's first written submission, at para. 19.
[276] *Ibid.*, at 1754.

company reflected its market value and that "therefore no benefits to [the government-owned company] passed through to [the privatized company]".[277] In 1992, in a preliminary determination in the *US – Lead and Bismuth II* investigation, the US Department of Commerce followed the approach taken in *Lime from Mexico* finding that a fair market value privatization did not provide any benefit to the post-privatization entity.[278] However, in the Final Determination of 27 January 1993 in that case, the US Department of Commerce used the "pass-through" methodology to conclude that all pre-privatization countervailable subsidies passed through to the privatized company and can continue to be countervailed.[279] This pass-through methodology was replaced first by the so-called "gamma methodology" and then by the so-called "same person methodology", both of which are challenged in this dispute.

2. Change in Ownership Methodologies Challenged in this Dispute

7.9 This dispute covers two methodologies used by the US Department of Commerce in order to assess the impact of privatization in the determination of subsidization *vis-à-vis* the post-privatization companies. These methodologies are the gamma methodology and the same person methodology. In this regard, of the 12 determinations challenged by the European Communities, 11 were initially based on the gamma methodology. In Case No. 12 (*Grain-Oriented Electrical Steel from Italy "GOES"*[280]) the US Department of Commerce used the same person methodology. The same person methodology was first applied in the final results of the administrative review in this case which were published on 12 January 2001.[281] This methodology had been applied earlier in various remand determinations ordered by the CIT within appeal proceedings in four of the above 11 determinations.[282] The same person methodology has been challenged before the CIT in all of these remand redeterminations[283], (and also in the *GOES* determination).[284] The United States has admitted that seven (Case Nos. 1 to 7) of these 12 determinations are inconsistent with its WTO obligations to the extent that the gamma methodology was used in the determination and that

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[277] *Ibid*., at 1755.

[278] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom* 57 Fed. Reg. 42974 (Dep't Commerce 17 September 1992) (prelim. determination).

[279] *Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom*, 58 Fed. Reg. 6237 (Dep't Commerce 27 January 1993). (final countervailing duty determination).

[280] *GOES Admin. Review, supra,* footnote 47. The original final countervailing duty determination was published in *GOES Final Determination, supra,* footnote 47.

[281] *See* EC's first written submission, para. 124, not contested by the United States.

[282] Stainless Sheet and Strip in Coils from France (C-427-815) (Case No. 1); Certain Cut-to-Length Carbon Quality Steel from France (C-427-817) (Case No. 2) (with respect to GTS); Stainless Steel Plate in Coils from Italy (C-475-823) (Case No. 4) and Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475-827) (Case No. 6); see Annex A to this Panel Report.

[283] The United States claims that since "the EC has not challenged the four remand determinations in this forum ... the Panel's review is limited to the six original determinations in which US Department of Commerce applied its old methodology." US' first written submission, para. 85.

[284] *See* EC's first written submission, para. 124.

the US Department of Commerce did not fully examine whether the pre- and post- change in ownership entities were the same legal persons.[285]

(a) The Gamma Methodology

7.10 In July 1993, the US Department of Commerce introduced the gamma methodology.[286] According to this methodology, after assessing the existence of pre-privatization subsidies, the US Department of Commerce determines to what extent (if any) the privatization transaction price repaid unamortized subsidies, and countervails the remainder (if any). Thus, unlike the pass-through methodology where the totality of prior subsidies passed through, in the gamma methodology only a portion of such subsidies may pass through.

7.11 In 2000, the US Court of Appeals for the Federal Circuit found that the gamma methodology was inconsistent with Section 1677(5)(F).[287] The Court found that the gamma methodology, in presuming that some benefit passed through, meant that the US Department of Commerce had adopted a *per se* rule that a pre-privatization subsidy would always pass through despite an arm's-length, fair market value transaction.[288] The Court found that Section 1677(5)(F) prevents the adoption of a *per se* rule either that a subsidy continues to be countervailable despite an arm's-length transaction or that the subsidy is no longer countervailable as a result of a such a transaction.[289]

7.12 The gamma methodology was the methodology applied in the three administrative reviews covered by the *US – Lead and Bismuth II* dispute and which the Panel and Appellate Body found to be inconsistent with the SCM Agreement.[290]

(b) The Same Person Methodology

7.13 In *GOES from Italy*[291], the US Department of Commerce applied for the first time the same person methodology, which it had developed on remand after the *Delverde III* judgment. This methodology had first been set out in the preliminary and then final results of a redetermination pursuant to a court remand in *Acciai Speciali Terni v United States.*[292]

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[285] *See* US' first written submission, para. 85.

[286] The methodology was set out in a *General Issues Appendix, supra,* footnote 84, the relevant discussion of privatization is found at 37259-65.

[287] *Delverde Srl. v. United States* ("*Delverde III")* 202 F.3rd 1360 (Fed Cir. Feb 2, 2000) rehg denied (20 June 2000). Exhibit EC-5 to the EC's first written submission

[288] *Ibid*., at 12.

[289] *Ibid*., at 10.

[290] *See* Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/AB/R, adopted 7 June 2000, *supra* footnote 85.

[291] *GOES Admin. Review*, *supra*, footnote 47.

[292] *Final Results of Redetermination pursuant to Court Remand, Acciai Speciali Terni ("AST") v. United States* Court No. 99-06-00364, (Ct. Int'l Trade 19 December 2000) (unpublished) (Stainless Steel Plate in Coils from Italy) Exhibit EC–6 to the EC's first written submission

7.14 The same person methodology provides for a two-step test. The first step consists of an analysis of whether or not the state-owned producer and privatized producer are distinct legal persons. For this purpose, the US Department of Commerce examines the following non-exhaustive criteria: (i) continuity of general business operations; (ii) continuity of production facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel. If, as a consequence of the application of these criteria, the US Department of Commerce concludes that the post-privatization entity is a new legal person, distinct from the entity that received the prior subsidies, the benefit of a prior subsidy would not be found to continue to reside in the post-privatization producer and the US Department of Commerce would proceed to examine whether any new subsidy has accrued to the privatized producer as a result of this change in ownership (and it would do so by assessing whether the sale was at arm's length and for fair market value). If, as the result of the application of the above criteria, the US Department of Commerce concludes that no new or distinct legal person was created, all the subsidy is found to continue to reside in the post-privatization producer and the US Department of Commerce will not assess whether the privatization was at arm's length and for fair market value.

7.15 In response to Panel question No. 13[293], the United States informed the Panel that, until now, there have been no cases where the application of the same person methodology in the context of a given privatization has resulted in the US Department of Commerce finding that no benefit continued to accrue to the privatized producer.

(c) Section 1677(5)(F)

7.16 The European Communities also requests the Panel to find Section 1677(5)(F) of Title 19 of the US Code inconsistent with the United States' WTO obligations. Section 1677(5)(F) reads as follows:

> "a change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's-length transaction."[294]

7.17 The legislative history of this statute is discussed hereafter in Section F.

[293] "Could the United States provide examples where the application of the same person methodology in the context of a given privatization has resulted in US Department of Commerce finding that there was no benefit to the privatized entity?"

[294] Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994); 19 U.S.C. § 1677(5)(F). Exhibit EC–4 to the EC's first written submission.

C. The Impact of Privatization on the Determination of Subsidization and Related Countervailing Duties

1. Parties' Claims and Arguments

(a) The European Communities' Claims and Arguments

(i) The Gamma Methodology

7.18 The European Communities claims that the gamma methodology applied by the United States in 11 of the countervailing duty determinations before the Panel, and the same person methodology applied, *inter alia*, in the administrative review in *GOES from Italy*, are inconsistent with the SCM Agreement. For the European Communities, the United States refuses to correctly apply the SCM Agreement as interpreted by the Panel and Appellate Body in *US – Lead and Bismuth II*. Since the United States admits that the gamma methodology is WTO-inconsistent, the European Communities focused its argumentation on the WTO-compatibility of the same person methodology.

(ii) The Same Person Methodology

7.19 The European Communities submits that the same person methodology is inconsistent with Article 1.1(b) of the SCM Agreement which requires a determination of the existence of a benefit before countervailing duties can be imposed.[295] The European Communities claims that this methodology disregards criteria set down in Article 14 of the SCM Agreement that any benefit must be calculated with respect to the advantage obtained over what was available in the market.

7.20 For the European Communities, when a change in ownership takes place at arm's length and for fair market value, the benefit attributed to the prior financial contributions (subsidization) does not continue to accrue to the new economic entity. The European Communities submits that privatization is a fundamental change in ownership that *a fortiori* requires a new benefit analysis.[296] The European Communities believes that the standard for determining whether a countervailable benefit continues to accrue after privatization is not whether the new entity is the "same legal person" as before, but rather whether the transaction took place at arm's length and for fair market value. Basing its argument on the reasoning of the Panel and the Appellate Body reports in *US – Lead and Bismuth II*, the European Communities contends that since the benefit does not reside in the assets themselves, a benefit does not continue to flow from untied, non-recurring financial contributions after a change in ownership for fair market value at arm's length. The European Communities submits that the only way to support a finding that the benefit

[295] The European Communities believes that any countervailing duties imposed on the basis of this methodology will be inconsistent with Articles 1.1(b), 10, 14, 19.4, and either 19.1 or 21.1, 21.2, or 21.3 (depending on whether an original or review investigation is at issue). EC's first written submission, para. 126.

[296] *See* EC's first written submission., para. 26.

passes through to the new economic entity would be "if fair market value was *not* paid for all such productive assets."(emphasis added)[297]

"Benefit" under the SCM Agreement

7.21 The European Communities asserts that, contrary to the ruling of the Panel in *US – Lead and Bismuth II*, as upheld by the Appellate Body, the United States, through its methodology, is creating a nearly irrebuttable presumption that the benefit of non-recurring countervailable subsidies resulting from financial contribution to the state-owned enterprise always passes through to the post-privatization economic entity. The European Communities believes that this United States' presumption could only be rebutted if the post-transaction entity disposed of all of its assets, and started production on another site, with another workforce, and under another brand name. The European Communities claims that the same person test does not involve any examination of the existence of a countervailable benefit: therefore it is as WTO-inconsistent as the gamma methodology.[298]

7.22 In response to the United States' argument that a change in ownership or privatization does not "extract" the subsidy or the benefit from the company, the European Communities argues that when the United States uses the word "extract", it appears to be talking about the extraction of subsidization from productive operations – whether they be workers with enhanced skills, or steel mills which have been built with the help of subsidies. In its view, the Appellate Body in *US – Lead and Bismuth II* clearly found that subsidies do not accrue to productive operations, but rather to legal persons.[299]

Distinct Legal Persons

7.23 The European Communities considers that the term same person is a disguise for "same activity". The European Communities argues that this new methodology continues to treat as irrelevant the terms of the sale, just as the gamma methodology did. The European Communities believes that the United States is persisting in applying its misconception that the benefit somehow resides in the assets by examining, not whether the current producer has received any benefit, and hence a countervailable subsidy, but rather whether the assets and business operations of the company can be regarded as the same before and after the transaction.

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[297] Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* ("*US – Lead and Bismuth II*"), WT/DS138/R, *supra* footnote 111 as upheld by Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 6.81, *cited in* EC's first submission, para. 53.

[298] *See* EC's first written submission, para. 125.

[299] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 58 (footnotes omitted).

Corporate Law Principles

7.24 The European Communities rejects the parallels with corporate law and the distinction between owners and company invoked by the United States to maintain its position that only when the subsidy is paid back by the company recipient itself and not by its owners (shareholders) can it consider that the benefit has been extinguished. For the European Communities, countervailing duties are applied without reference to the corporate law distinction between owners and the company; this follows both from the SCM Agreement and the United States' practice. While the European Communities accepts that a distinction between owners and the company can be drawn for general purposes of corporate or commercial law, this distinction is not relevant for the imposition of countervailing duties since it is the economic entity which is the subject of the benefit analysis, not simply the exporting producer subject to investigation.

7.25 In response to the United States's analogy between corporate liability and potential liability for countervailing duties, the European Communities argues that unlike regulatory and tort law where liability may vest at the time of the act and liability for environmental damage which arises as of the date of the action causing the damage, liability for countervailing duties does not arise on the day that the subsidy was granted but only arises at the time of importation. A subsidized producer may decide not to export and avoid countervailing duties, while a company cannot simply avoid liability once the act has been committed. The European Communities explains that a countervailing duty is equivalent to customs duty and submits that it is inappropriate to say that liability for customs duties is akin to liability for environmental pollution, or that a corporate successorship test is applicable.

(b) The United States' Claims and Arguments

7.26 The United States claims that its same person methodology is consistent with the SCM Agreement and the WTO Agreement and that nothing in the SCM Agreement provides that upon a change in ownership at arm's length and for fair market value, the benefit accruing to the state-owned producer when it was provided with a subsidy does not continue to accrue to the new owner(s).

(i) The Gamma Methodology

7.27 The United States admits that, based on the ruling of the Appellate Body in *US – Lead and Bismuth II* and the ruling of the US Court of Appeals for the Federal Circuit in *Delverde III*, the gamma methodology was not consistent with either the SCM Agreement or with the United States' law. Therefore, the United States agrees that the original six investigations and one administrative review (Case Nos. 1-7), to the extent that the underlying determinations did not fully examine whether the pre- and post-change in ownership entities involved were the same legal person, are inconsistent with its WTO obligations. The United States claims to be prepared to bring these determinations into conformity, to the extent that it has not already done so. The United States points out that all six of

the original investigations challenged by the European Communities that were determined under the gamma methodology are currently in litigation before the CIT.[300] The US Department of Commerce adds that although it was not obligated to do so by the Appellate Body in *US –Lead and Bismuth II*, it has, in the context of the domestic litigation, revised its determinations in the four cases (Case Nos 1, 2, 4 and 6) which are proceeding, applying its new same person methodology. Since the United States claims that the European Communities has not challenged the four remand determinations before the WTO Panel, it asserts that the Panel's review is limited to the six original determinations in which the US Department of Commerce applied its old methodology.[301]

(ii) The Same Person Methodology

7.28 The United States submits that its new same person methodology is consistent with the SCM Agreement and was specifically designed to take into account the Panel and Appellate Body rulings in *US – Lead and Bismuth II* and the US Court of Appeals for the Federal Circuit ruling in *Delverde III*. The United States reminds the Panel that the only case before it where the same person methodology was applied by the US Department of Commerce is *G from Italy* (Case No. 12).

7.29 The United States maintains that the same person methodology is firmly grounded in sound economics and in the principles of corporate successorship that apply in both the United States and the European Communities. Pursuant to the methodology, one corporate entity may be considered to be the successor of another if, in substance, it is the same legal person. As the US Department of Commerce explained, the various criteria that go into the determination of whether a nominally different company should be treated, in substance, as the same person, are just "factors" (which include: (i) continuity of general business operations; (ii) continuity of production facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel). The United States claims there is no basis for asserting that all of the criteria must weigh in favour of finding that no new corporate entity was created before such a finding is actually made.

7.30 The United States finds support for its same person methodology in the wording of the SCM Agreement, the Appellate Body ruling in *US – Lead and Bismuth II*, in corporate law principles and draws parallels with corporate liabilities.

"Benefit" in the SCM Agreement

7.31 The United States contends that the nature of countervailable benefits is made plain by Articles 1 and 14 of the SCM Agreement. It explains that a countervailable benefit is that part of a financial contribution that is obtained on

[300] Case Nos. 3 and 5 are stayed; the other four (Case Nos. 1, 2, 4 and 6) have been briefed and are in various stages before the respective judges. *See* EC's first written submission, paras. 84-101.
[301] *See* US' first written submission, para. 85.

terms more generous than those the recipient could have obtained commercially. In its view, countervailable benefits are, in essence, simply *fixed sums of money*, which (in the case of non-recurring benefits) are amortized over time.[302]

7.32 The United States maintains that, because countervailable benefits, once identified, and valued, are essentially, amounts of money, the method by which they may be terminated is straightforward: that amount of money is amortized over time, unless the recipient pays back the remaining non-amortized amount. The United States agrees that such a repayment could occur in conjunction with a change in ownership and, under its new methodology, it would investigate any claim that such a repayment has occurred. However, it adds, the SCM Agreement provides no basis for concluding that an arm's length and fair market value change in the ownership of a subsidy recipient, automatically eliminates or extracts the benefit conferred on the company.

7.33 The United States submits that the European Communities has not sufficiently explained how "fair market value extinguishes subsidies", nor has it shown where there is any basis for this conclusion in the SCM Agreement.[303] The United States' reasoning is based on its interpretation of the Appellate Body's finding in *US – Lead and Bismuth II* that subsidies are bestowed on legal persons. The United States believes that this means that subsidies continue to reside in the recipient legal person unless they are taken out of that person, or the person is dissolved.[304] The United States notes that the European Communities itself has acknowledged that a subsidy "resides with the natural or legal person which originally received the subsidy," not the owner of that person.[305] Based on its understanding of the fact that subsidies reside in the recipient legal person, the United States believes that what must be determined after a change in ownership has occurred is whether the subsidies have been paid back or not transferred to the new producer of the subject merchandise. The United States maintains that its current methodology examines just that; it is therefore consistent with the SCM Agreement.[306]

"Distinct legal person"

7.34 The United States maintains that the US Department of Commerce's revised change in ownership methodology, *i.e.* the same person methodology, is consistent with the SCM Agreement, particularly as interpreted by the Appellate Body in *US – Lead and Bismuth II*. In this regard the United States explains that, in its report, the Appellate Body agreed with the Panel (based on the Appellate Body's own findings in *Canada – Aircraft*) that a subsidy must be received by the natural or legal person that produced or exported the subject merchandise. The United States notes that the European Communities itself has accepted that,

[302] *See* US' second written submission, para. 4.
[303] *See* US' second written submission, para. 7.
[304] *See* US' second written submission, para. 16.
[305] The United States refers to the EC's first written submission, para. 12.
[306] *See* US' second written submission, paras. 11 and 16.

"the Appellate Body agreed that where the change in ownership has lead to *the creation of a different legal person* from the subsidy recipient any benefit must be assessed from the perspective of the post-transaction entity."[307] The United States contends that, where that basic premise is missing – that is, where a change in ownership has *not* led to "the creation of a different legal person" – the Appellate Body's reasoning in *US – Lead and Bismuth II* does not require the US Department of Commerce to find that the subsidies were eliminated.[308] The United States contends, that in reaching the conclusion that the conditions of application of the SCM Agreement had to be re-examined, the Appellate Body has put more emphasis on the fact that the privatized producers were distinct legal persons from the state-owned producer, than on the fact that there was a change in ownership for consideration. In particular, the United States insists on the fact that the Appellate Body, when quoting and upholding the Panel's conclusion, did not make any reference to change in ownership "for consideration". For the United States, this is evidence that the change in ownership for fair market value was not the dispositive criteria for the Appellate Body's reasoning.

Corporate Law Principles

7.35 The United States invokes corporate law principles to provide logical support for its use of a "distinct legal person" test and its consideration that fair market value payment by the shareholders (the owners) of the privatized company for the purchase of the state-owned enterprise does not extinguish a prior benefit attributed to that state-owned enterprise. The United States contends that the distinction between owners and companies is real and cannot be ignored. The United States further submits that it has demonstrated (and the European Communities does not dispute) that the distinction between a company and its owners is fundamental in most jurisdictions, including the European Communities. In its view, given this fact, it is not possible to interpret the SCM Agreement as if this distinction does not exist, or as if the WTO Members disavowed it in drafting the SCM Agreement, without giving the slightest indication that they were doing so.

7.36 For the United States, the distinction between owners and companies is unavoidable, and this is confirmed by the fact that the Appellate Body has established that subsidies are received by legal persons, not by the owners of those persons or "economic entities".[309] The United States submits that the European Communities' assertion that no distinction can be made between companies and their owners flouts the corporation laws of both the United States and the European Communities, which have as their very cornerstone the concept that companies are legal persons distinct from their owners. It further

[307] The United States refers to the EC's first written submission, para. 50 (emphasis added).
[308] *See* US' first written submission, para. 42.
[309] The United States refers to Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 58.

submits that while the Panel in *US – Lead and Bismuth II* may have endorsed the European Communities' position, the Appellate Body did not say that no distinction could ever be drawn between companies and their owners.[310]

7.37 The United States submits that, because the European Communities cannot explain how the payment of fair market value by the new owner of a subsidized company extracts subsidies from that company, it now asserts that the admitted distinction between owners and companies should be disregarded for the purpose of analysing the existence of subsidies, because subsidies are received by "economic entities."[311] The United States submits that the European Communities wants the Panel to embrace this new concept so that the Panel will treat money taken out of an owner's pocket as having been taken out of the company, potentially eliminating subsidies that reside in that company.

7.38 The United States contends that countervailing duty exposure is very much like potential tort liabilities – both are potential burdens upon the earnings of the company that a prospective purchaser would take into account just as surely as it would take account of potential tort liabilities. As with other corporate liabilities, the United States argues that once a company receives a non-recurring subsidy, the potential for countervailing duties exists. The United States contends that that potential liability may materialize if someone (an injured industry in an importing Member) files a countervailing duty petition. Alternatively, it adds, the company can take steps to cure the harm by voluntarily repaying the subsidy or stopping its injurious exports. Moreover, the United States affirms, just as a producer that has caused environmental damage in another country could well escape that potential liability by repairing that damage or by ceasing certain operations in that country, a subsidized steel producer could avoid countervailing duties by disgorging the subsidies or by ceasing to export to countries with countervailing duty orders..[312]

2. Evaluation by the Panel

7.39 The main issue before the Panel is to assess the legal consequences, under the SCM Agreement, of a change in ownership leading to the privatization of state-owned producers. More precisely, the 12 countervailing duty determinations being contested all relate to a change in ownership from wholly-owned state enterprises to private producers – i.e., privatization . In all these cases, a countervailable non-recurring subsidy had been granted prior to the privatization. The non-recurring subsidy had been allocated over time (e.g., 12 years) and the privatization took place before the non-recurring subsidy had been fully amortized. In short, the question before us is whether an arm's-length privatization for fair market value can extinguish an otherwise countervailable subsidy, and if so, what are the implications for the 12 determinations at issue.

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[310] The United States compares the Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 111, at para. 6.82 with the Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at paras. 62-64.

[311] The United States refers to the EC's response to question No. 9 posed by the Panel, para. 13.

[312] US' statement at the second substantive meeting, paras. 31-34.

7.40 We should therefore begin our examination by reviewing the object and purpose of the SCM Agreement, and in particular the conditions of application of countervailing duties. The core legal question before us is the determination of the existence of "benefit" within the meaning of the SCM Agreement following a change in ownership through privatization.[313] In particular, the Panel will have to determine to whom the benefit accrues – more specifically whether a distinction must be made between the "benefit to the owners" of the company and the "benefit to the company itself" – and how the existence of a benefit must be established when privatization has taken place.

(a) Objective and Conditions for Applying Countervailing Duties under the SCM Agreement.

7.41 In the WTO, subsidies are regulated, and so is the use of countervailing duties imposed to offset the impact of subsidization. Article VI of GATT 1994 and footnote 36 of Article 10 of the SCM Agreement[314], specify the purpose of countervailing duties. In particular, Article VI.3 states:

> "The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise."

7.42 We note at the outset that countervailing duties are not designed to counteract all market distortions or resource misallocations which might have been caused by subsidization.

7.43 Article 10 provides that countervailing duties may only be imposed consistently with the SCM Agreement, and, in particular, specifies that a countervailing duty may be imposed to offset any subsidy bestowed. The SCM Agreement provides that countervailing duties may be imposed on imported goods provided that three basic conditions are fulfilled, namely: (i) imported products are subsidized; (ii) there is injury to the domestic industry producing

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[313] Throughout this dispute and in this Panel Report, parties and the Panel have referred to the "pass-though or continuation of benefits" from the state-owned producer to the privatized producer, or the "pass-though or continuation of a benefit from a prior subsidy or subsidization" or the "pass-through or continuation of a prior subsidy or subsidization". As further discussed hereafter, a subsidy or subsidization exists if there is a financial contribution and a benefit. Absent any benefit, there cannot be any subsidy or any subsidization. Hence the benefit resulting from (prior) financial contribution, or benefit from prior subsidy or subsidization refers to the "benefit" component of the subsidy provided to the state-owned producer, In this dispute we deal with original investigations as well as with administrative and sunset review investigations and our reasoning applies to all three types of determination. In the case of original investigations, it may be more accurate to refer to "benefit from prior financial contribution" while in the case of review determinations, it may be more accurate to refer to "benefit from prior subsidies". We note that the European Communities does not contest before this Panel that subsidization was provided to state-owned enterprises. The issue is rather whether the benefit component of this subsidization continues to accrue to the privatized producer.

[314] Footnote 36 to Article 10 of the *SCM Agreement*, which provides: "The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in para. 3 of Article VI GATT 1994."

the like products; and (iii) there is a causal link between the subsidized imports and the injury. The focus of this dispute is mainly concerned with the fulfilment of the first condition, i.e. the determination of subsidization and in particular that of a "benefit".

(b) The Existence of a "benefit"

7.44 Article 1.1 of the SCM Agreement provides that a subsidy will exist only if there is a *financial contribution* by a government which confers a *benefit*.[315] This determination of a benefit (as a component of subsidization) must be made before countervailing duties can be imposed, and permits a calculation of the extent of subsidization, as required under Articles 19.4 and 21.1.

7.45 However, the SCM Agreement does not define "benefit". In its *Canada – Aircraft* Report the Appellate Body held that benefit should be understood as a benefit to a "recipient", i.e. a natural or legal person:

> "A 'benefit' does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a 'benefit' can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term "benefit", therefore, implies that there must be a recipient."[316]

7.46 As the Appellate Body has found, any "benefit", and hence the benefit stream from non-recurring subsidies, must be viewed from the perspective of a natural or legal person. The benefit is not to be determined with reference to "cost to government" [317] and does not reside in or attach to the productive assets:

> "The United States argues, on the basis of footnote 36 to Article 10 of the *SCM Agreement* and Article VI:3 of the GATT 1994, that the relevant "benefit" is a benefit to a company's *productive operations*, rather than, as the Panel held, a benefit to *legal or natural persons*. It is true, as the United States emphasizes, that footnote 36 to Article 10 of the *SCM Agreement* and Article VI:3 of the GATT 1994 both refer to subsidies bestowed or granted directly or indirectly "upon the manufacture, production or export of any merchandise". In our view, however, it does not necessarily follow from this wording that the "benefit" referred to in Article 1.1(b) of the *SCM Agreement* is a benefit to *productive operations*."[318]

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[315] Article 1.1 of the SCM Agreement states: "For the purpose of this Agreement, a subsidy shall be deemed to exist if:

> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as 'government'), … and
> (b) a benefit is thereby conferred."

[316] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), WT/DS70/AB/R, *supra* footnote 105, at para.154.

[317] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, *supra* footnote 105, at para.153.

[318] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 56 (footnote omitted).

7.47 Indeed, in *US - Lead and Bismuth II* the Appellate Body rejected the United States' argument that the subsidy "resides" in the productive operations of the company. The benefit determination is concerned with the advantage[319] to the producer exporting the goods subject to a countervailing duty investigation or order. This provides textual support for the view that the focus of the inquiry under Article 1.1(b) should be on the recipient and not on the granting authority.[320] We believe that the enquiry should be on the benefit to a natural or legal person, and not on the "productive operations or the products".[321]

(i) Who is the Recipient of the Benefit in the Case of a Change in Ownership?

7.48 The "benefit" in Articles 1.1 and 14 of the SCM Agreement is concerned with the "benefit *to the recipient*". In the present dispute which involves a change in ownership, the issue is to identify the relevant entity for the purpose of determining the recipient of a benefit. We agree with the United States that a subsidy is "paid" or "given" to a legal person, to a company and not directly to the owners or the shareholders themselves.

7.49 In terms of identifying the relevant legal or natural person for the purpose of determining the existence of a benefit and its recipient, the United States makes a distinction between the owners (shareholders) and the company itself. It claims that the financial contribution and, the benefit therefrom, "reside" in the legal person or company and continue to accrue to the same legal person, even when the ownership changes. The United States submits that if the company itself is the same legal person as before the privatization, that company may still benefit from the prior financial contributions. For the United States, privatization does not automatically result in a change of the legal personality of the producer. If the state-owned producer and privatized producer are the same legal person, the financial contribution and benefit therefrom, provided to the state-owned producer "resides", *per se*, that legal person or company and continues to accrue to the legal person now owned by the shareholders of the privatized producer. For the United States, the change in ownership itself does not affect the determination of the existence of benefit which remains in the company.[322] That same company, that same legal person, is the recipient of the benefit. The United States argues that the Panel should not treat money taken out of an owner's pocket as having been taken out of the company, potentially eliminating subsidies that reside in the company.

7.50 We are of the view that the distinction between a company and its shareholders as used by the United States is not appropriate in the context of the

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[319] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, *supra* footnote 105, at para.153.
[320] *Ibid.*, at para. 154.
[321] *Ibid.*, at paras. 154–155. *See* also Appellate Body Report, *Brazil – Export Financing Programme for Aircraft ("Brazil – Aircraft"*) WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161, para. 157; *and* Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at paras. 56-58. Note that benefit is also a concept distinct from that of the "costs" to the government granting the subsidy.
[322] *See supra*, para. 4.59.

SCM Agreement. We agree that for the purpose of the national corporate law of the United States and many other WTO Members, a distinction may be drawn between shareholders and the company. However the SCM Agreement does not make any reference or any distinction between shareholders and the company when it discusses the need to establish the benefit. Articles 1, 10 and 14 of the SCM Agreement make references only to "recipient" (or "benefit to recipient") and to "producer". The concept of benefit is independent of the legal business structure established pursuant to national corporate law. This is so because the SCM Agreement is concerned with identified adverse trade effects of subsidization on the domestic industry producing the like product. The production and export of goods is done by a producer for the purpose of generating an economic benefit to its owners. When the existence of a subsidy improves the ability of a producer to produce and export a good, it necessarily impacts on its profitability, and, therefore, on the rate of return to shareholders.

7.51 In fact, in a market-based economy, the value of a company depends on its ability to generate returns for its shareholders. Where this ability has been improved by the subsidization, the value of the benefit conferred by a financial contribution should be reflected in the overall market value of the company which received it. When someone purchases a company for fair market value, the purchase price includes the value of the benefit conferred to that company. For the purpose of benefit determination based on market criteria (an element which we develop further below), there should be no distinction between the advantage or benefit conferred by the financial contribution to the company or to the shareholders, i.e. the owners of the company.

7.52 We note that the Panel in *US – Lead and Bismuth II* reached the same conclusion with regard to UES and BS plc/BSES companies and its owners:

> "In our view, it is irrelevant that the aforementioned fair market value was paid by the (new) owners of UES and BS plc/BSES respectively, rather than those companies themselves. Any approach requiring that fair market value be paid by the company itself, rather than its owners, would elevate form over substance. In the context of privatizations negotiated at arm's-length, for fair market value, and consistent with commercial principles, the distinction between a company and its owners is redundant for the purpose of establishing "benefit". Following privatization at arm's-length, for fair market value, and consistent with commercial principles, the owners of the privatized company will be profit-maximizers, set on obtaining a market return on the entirety of their investment in the privatized company. Ultimately, therefore, the owners' investment in the privatized company will be recouped through the privatized company providing its owners a market return on the full amount of their investment. In such circumstances, it would be misleading in the extreme to suggest

> that the price paid by the owners of the privatized company is not ultimately paid by the privatized company itself."[323]

7.53 The Panel also notes that in 1993 the US Department of Commerce expressed this same view very clearly:

> "Merely because a company has been incorporated to protect its owners from the company's legal liabilities or for beneficial tax and accounting purposes (or both), it does not follow that the financial condition of the owners is irrelevant to the financial position of the firm. The form in which new owners purchase the government company creates no appreciable difference in how that company will be operated overall. The fact that the owners are shareholders and raise capital to purchase the government-owned company through new share issuings, rather than the company itself taking on debt, does not mean that the owners can be indifferent to the profit margin the company generates, as petitioners assert. Rather, in the real-world marketplace, the owner-shareholders' expectations of a return on their investment cannot be separated from the profitability of the newly privatized company. (…) The owners will seek to extract a rate of return from their company at least equal to that of alternative investments of similar risk. There is, then, no appreciable difference, as reflected in the marketplace, between the profit-making ability of the company and the owners' realization of a profitable return on their investment in that firm (…) To adopt the petitioners' rationale that only a full repayment by the new company can extinguish past subsidies would create a test that would elevate form over substance and produce incentives for foreign governments merely to alter the form of the privatization to satisfy this artificial distinction."[324]

7.54 We conclude that, for the purpose of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders, as together they constitute a producer, a natural or legal person that may be the "recipient" of the benefit to be assessed. Any artificial distinction between owners (shareholders) and company ignores the relationship between a company and its owners, and it is this relationship that changes upon privatization. When the SCM Agreement refers to the recipient of a benefit it means the company and its shareholders together, being the producer of the exported goods subject to the countervailing investigation (order).

7.55 We note that the criteria used in the United States' same person methodology: (i) continuity of general business operations; (ii) continuity of productive facilities; (iii) continuity of assets and liabilities; and (iv) retention of personnel, all relate to the production assets of the concerned enterprises. The

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[323] Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 111, at para. 6.82.

[324] The full statement of the US Department of Commerce can be found in *General Issues Appendix*, *supra*, footnote 84, at 37262.

continuous reference by the United States to the fact that privatization would not "extract" subsidization from the company, appears to link the subsidization and the benefit accrued to the productive operations and assets.[325] The United States maintains that, because countervailable benefits, once identified and valued are essentially amounts of money, the only methods by which they may be terminated are: amortization over time or the reimbursement of the non-amortized amount by the recipient company. In doing so, the United States seems to be "attaching" the benefit to the productive operation and neglecting the fundamental purpose of productive operations in a market-based economy which is to generate returns on someone's investment. The Panel recalls that benefit does not accrue to productive operations, but rather to legal persons, as the Appellate Body made clear in *Canada – Aircraft*[326] and in *US – Lead and Bismuth II*.[327]

7.56 The Panel is of the view that in a countervailing duty investigation the focus should be on the producer (company and its owners) exporting the products alleged to be subsidized with a view to assessing whether it is the recipient of a benefit pursuant to the SCM Agreement.

(ii) How the Benefit Should be Assessed: Against the Market

7.57 The term "benefit" effectively represents the "financial advantage" that, by reference to a market benchmark, the recipient gets for "free". This financial advantage is what the recipient has not "paid for". In the case of a "benefit" conferred by untied, non-recurring "financial contributions", the United States seems to presume that such a "benefit" is used to the advantage of future production through investment in productive assets. In this sense, the beneficiary of untied, non-recurring "financial contributions" is deemed to have acquired productive assets for "free".[328]

7.58 We are of the view that the word "benefit", as used in Article 1.1(b), implies a comparison which we believe is market-based. Indeed, in Article 14, all the benchmark comparisons relate to market conditions: "usual investment practice" in 14(a); "comparable commercial loan … on the market" in 14(b); "comparable commercial loan absent the government guarantee" in 14(c); "adequate remuneration … in prevailing market conditions" in 14(d).

7.59 In *Canada – Aircraft* the Appellate Body confirmed this view that the "benefit" analysis implies a comparison, and that the comparison should be made with the marketplace:

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[325] Note that the United States admits that a benefit resides with the natural or legal person which originally received the subsidy. See US' first written submission, para. 50.

[326] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, *supra* footnote 105, at paras. 154-156.

[327] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 56.

[328] Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 111, at footnote 80.

> "This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", in the sense of determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[329]

(c) The Particular Circumstances of Privatization

(i) A particular Change in Ownership

7.60 Privatization is a very particular and complex change in ownership. It involves a fundamental transformation of a government-owned and controlled entity into a privately-owned, market-oriented company. Following privatization and consistent with commercial principles, the owners of the privatized company should be profit-maximizers, set on obtaining a market return on the entirety of their investment in the privatized company. Ultimately, therefore, the owners' investment in the privatized company will be recouped through the privatized company providing its owners a market return on the full amount of their investment.

7.61 We note again that the US Department of Commerce statement in this regard is most relevant:

> "Rather, in the real-world marketplace, the owner-shareholders' expectations of a return on their investment cannot be separated from the profitability of the newly privatized company. Privatized companies (and their assets) are now owned and controlled by private parties who are profit-maximizers. Unlike the former company, which did not need to earn a return on capital when owned and controlled by the government (i.e., when the government is 100 percent owner there is no necessity of paying dividends to itself), the privatized firm now faces the same capital market as its competitors. … Put another way, the privatized company now has an obligation to provide to its private owners a market return on the company's full value."'[330]

7.62 In their arguments before the Panel, both parties referred to the issue of change in ownership *per se*, and developed a distinction between a partial and a complete change in ownership. The European Communities initially argued that any change in ownership would necessitate a re-evaluation of the benefit. The United States argued that since ownership of publicly traded companies and their market value change every day, a re-evaluation at every change in ownership would be impracticable. The European Communities responded that the change in ownership must be of a sufficient magnitude so as to change the control of the

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[329] Appellate Body Report, *Canada – Aircraft*, WT/DS70/AB/R, *supra* footnote 105, at para. 157.
[330] *General Issues Appendix, supra*, footnote 84, at 37262.

enterprise and thus trigger a re-evaluation of the conditions of application of the SCM Agreement. We have not considered it necessary to address all those situations, as we have before us 12 determinations where the relevant government had sold all, or substantially all, its ownership interest and clearly no longer had any controlling interest in the privatized producer. state-owned.

(ii) Whether Privatization Triggers the Obligation to (re-)examine the Conditions of Application of the SCM Agreement

7.63 The European Communities claims, and the United States admits, that in case of a change in ownership (including privatization), the investigating Member is under the obligation to (re)consider the conditions of application of the SCM Agreement.[331] The dispute arises over a difference in what examination fulfils that obligation. The European Communities claims that the investigating authority must determine whether the privatization took place at arm's-length and for fair market value. The United States maintains that the investigating authority need only look into the nature of the privatization transaction if the post-privatization entity is a "distinct legal person" from the original state-owned producer.[332]

7.64 The Panel is of the view that the SCM Agreement requires that when a Member is informed of a privatization of a state-owned producer whose exports are subject to a countervailing duty order or investigation, the importing Member must (re)examine the conditions of application of the SCM Agreement *vis-à-vis* the new privatized producer. There is a fundamental reason for that requirement.

7.65 As we mentioned before, after the privatization, a new privatized producer is exporting the products which are the object of the countervailing duty investigation. In the 12 cases before us the governments had severed their control over the state-owned producers upon privatization. The privatized producers could no longer rely on government financing for their operations and could no longer receive things for free. Indeed, it is reasonable to assume that the act of privatization has involved a payment for the assets and the shares of the state-owned producer. A payment for consideration necessarily implies that the privatized producer may not have received anything for free. In fact, as we explain in greater detail hereafter, if this payment for consideration reflects fair market value in an arm's-length transaction, the privatized producer will not have received any benefit.[333] Therefore, after a privatization, the conditions of the

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[331] *See* EC's second written submission, para. 26; *and* US's second written submission, para. 11.

[332] The United States has admitted that in a situation where a person purchased 100 per cent of the shares of a producer at fair market value, the new owner does not receive any benefit from the transaction. *See* US' first written submission, para. 53; US' second written submission, para. 9; *and* US' statement at the second substantive meeting, para. 19.

[333] The economic reasoning behind this is that the subsidy bestowed to the state-owned producer will necessarily be reflected in the balance sheet of the state-owned producer. Following privatization (where ownership shifts from the public to private sector), the sale price paid for the assets and shares of the state-owned producer will include a valuation of the advantage brought by the financial contribution, i.e. the benefit pursuant to the SCM Agreement. As we will elaborate further below,

SCM Agreement should be (re-)examined *vis-à-vis* the privatized producer, since it is possible that the advantage, the benefit from the prior financial contribution (subsidization), has been extinguished *vis-à-vis* the privatized producer.

7.66 For the United States, in case of a change in ownership, the focus of this benefit determination is only the company/producer, which, the United States claims, may not have changed into a distinct legal person when privatized; since the benefit resides in the company, so long as the company remains the same legal person, the benefit continues to accrue to the privatized producer.

7.67 The Appellate Body in *US – Lead and Bismuth II*[334], has recognized that following the privatization of the state-owned producer BSC, the US Department of Commerce should have re-examined and reconsidered the continuing existence of the benefit stream for the new privatized producers, UES and BS plc/BSES.

> "We agree with the panel that … the changes in ownership leading to the creation of UES and BS plc/BSES should have caused the USUS Department of Commerce to examine whether the production of leaded bars by UES and BS plc/BSES respectively, *and not BSC,* was subsidized."[335] (emphasis added)

7.68 From our reading of the Panel and the Appellate Body reports in *US – Lead and Bismuth II*, the Appellate Body does not seem to have based any of its findings on the premise that BSC and, UES and BS plc/BSES were two distinct legal persons or that UES and BS plc/BSES were engaged in commercial and industrial activities that were distinct from that of BSC, as suggested by the United States. The parties seem to have accepted that the operations of BSC were the same as those of UES and BS plc/BSES.[336] To us, it seems that the privatization of BSC that led to the creation of UES and BS plc/BSES did not appear to have led to distinct legal persons using the criteria applied by the United States in the same person methodology (i.e. continuity of general business operations, continuity of production facilities, continuity of assets and liabilities, and retention of personnel). Still, the Appellate Body concluded that the focus of the benefit determination was to be the privatized producer and not the state-owned producer, the company, or the productive operations.

7.69 The United States also insists on the fact that, in its view, the Appellate Body's conclusion in *US – Lead and Bismuth II* – that the condition of application of the SCM had to be re-examined *vis-à-vis* the privatized producer – was based on the assumption that the privatized producers was a distinct legal person from the state-owned producer, and not on the fact that there had been a

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when this valuation reflects market conditions, the benefit would be extinguished, since it has been fully paid for.

[334] In that case the change of ownership was invoked in the context of an administrative review.

[335] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 62.

[336] See the Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 111, at para. 6.70 referring to the US' responses to that Panel's questions where the United States itself argued that the state-owned producer and the privatized producers were conducting the same operations.

change in ownership for consideration. In particular, the United States insists that the Appellate Body, when quoting and upholding the Panel's conclusion, did not make any reference to change in ownership "for consideration". For the United States, this is evidence that the change in ownership at arm's-length and for a fair market value was not relevant to the Appellate Body's reasoning.

7.70 We disagree with the United States' reading of the Appellate Body Report in *US – Lead and Bismuth II*. In our view, when the Appellate Body wanted to express disagreement with the Panel report, it did so quite explicitly (as it did with regard to the nature of the examination process under administrative review[337]). In addition, since the parties had admitted that the privatization had taken place at fair market value, it would follow that full consideration was paid; therefore the Appellate Body did not have to address the issue of consideration. We note also that the Appellate Body upheld the Panel's conclusion that it was the change in ownership leading to the creation of the privatized producers that triggered the obligation to re-examine the conditions of application of the SCM Agreement.[338] Since the US Department of Commerce's finding of the continuing countervailable "benefit" to the privatized producer was effectively based on the old state-owned company acquiring productive assets etc. for free, a privatization for consideration raises the possibility that the original "benefit" determination in respect of the state-owned producer is no longer valid for the new privatized producer (the company and/or its owners). This is even more so when there is an allegation of a fair market value transaction at arm's-length.

7.71 The Panel concludes, therefore, that when informed of the privatization in each of the 12 determinations at issue, the United States should have examined whether each privatized producer "was subsidized", namely whether it had received any benefit from the prior financial contribution (subsidization) to the state-owned producer.

(iii) Did the Privatized Producer get any "benefit" from the Prior Financial Contribution?

7.72 When a state-owned company/producer receives subsidies from the government, the advantage conferred by the subsidy should be reflected in the fair market value (sale price) of the state-owned enterprise to be privatized. Thus, if upon privatization, fair market value is paid for all productive assets, goodwill, etc. employed by the state-owned producer, the Panel fails to see how the subsidies bestowed to the state-owned producer could subsequently be considered to still confer a "benefit" on the privatized producer (in the sense of the company together with its owners) who has paid fair market value for all the

[337] *See* Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 63.

[338] "In this case, given the changes in ownership leading to the creation of UES and BS plc/BSES, the US Department of Commerce was required under Article 21.2 to examine, on the basis of the information before it relating to these changes, whether a "benefit" accrued to UES and BS plc/BSES." Appellate Body Report *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 62.

shares and assets, reflecting, we must assume, the value of past subsidization. The privatized producer will not have received a benefit or any advantage, because it has received nothing for free: all assets which it has acquired, further to the privatization transaction, have been fully paid for under normal market conditions, and it is those market conditions that serve as a benchmark for assessing the benefit to the privatized producer, as envisaged in Article 14 of the SCM Agreement. Furthermore, since the fair market value paid to the state-owned producer is deemed to include (*de facto*) the value of the advantage or benefit already received, the Panel considers that the privatization transaction for fair market value includes the repayment to the government of the subsidy as valued by the market at the time of privatization.[339]

7.73 The United States admits that the owners of the privatized producer have not received any new benefit from the transaction, since they paid fair market value for what they purchased and have not received anything for free. The United States claims, however, that the benefit from prior financial contributions (subsidization) to the state-owned producer remains in the privatized company/producer, because the United States makes a distinction between the owners and the post-privatization company itself. It claims that privatization does not automatically result in a change of the legal personality of the producer; hence the state-owned producer and privatized producer being the same, the financial contribution and benefit therefrom, provided to the state-owned producer "reside" in the legal person or company and continues to accrue to the legal person now owned by the privatized producer.

7.74 To the argument that the new owners have paid for everything they got upon the privatization, the United States replies that the owners may not have received any new benefit if the transaction was made at arm's-length and for fair market value, but the company itself, the producer – if it is still the same legal person as before the privatization, may still benefit from the prior financial contributions. The United States argues that the Panel should not treat money taken out of an owner's pocket as having been taken out of the company, potentially eliminating subsidies that reside in the company. It adds that if the company (not the owners) producing the goods subject to countervailing duties, *itself* pays back the subsidy, or if the assets of the state-owned producer are sold to a new and distinct legal person producing the same goods, then the benefit (and thus subsidization) may be extinguished. The United States insists that a distinction must be drawn between the shareholders and the company; that the subsidy "resides" in the company and remains there; and that payment of fair market value by the owners of the producer does not extinguish the benefit to that same pre/post privatization producer. Therefore, it considers that it is obliged to examine the conditions of the transaction – and whether the change in ownership took place at arm's-length and for fair market value – only when the

[339] This does not suggest a "cost-to-government" approach to a determination of benefit. The nominal cost of the financial contribution may have little to do with the price sold, which will be dictated by the market, not by the government past financing situation. What this clearly entails is that there has been a market assessment of the value of the benefit bestowed to the state-owned producer and that that benefit has now been fully paid for.

privatized producer is determined to be a distinct legal person from the state-owned producer which received the prior financial contribution.

7.75 In the Panel's view, the United States' methodology does not recognize that privatization by itself can change the benefit determination under the SCM Agreement; the United States attempts to identify the recipient of the benefit determination with reference to the initial recipient of the financial contribution. The Panel understands that it is a normal and accepted practice (including both in the United States and the European Communities), for the importing Member to presume that a non-recurring subsidy will provide a benefit over a period of time, which is normally presumed to be the average useful life of assets in the relevant industry. We note that nothing in Article 1.1 nor Article 14 of the SCM Agreement explicitly provides for such a possibility. This practice is based on the fact that a non-recurring financial contribution will not be treated by a company as attributable solely to the current period but will be considered as providing a lasting benefit over an extended period of time. The investigating authority normally assumes that this extended period of time will be the amortization period used in the relevant sector.[340]

7.76 In our view, a privatization at arm's-length and for fair market value extinguishes the benefit to the privatized producer, which benefit the market has valued when assessing the fair market price which the privatized producer has fully paid for upon the privatization. This is to say that a privatization at arm's-length and for fair-market value reverses the presumption that the benefit of a non-recurring financial contribution which has been allocated within a given period of time will continue to accrue to a recipient during the allocated period. Therefore, if it wants (to continue) to apply countervailing duties, the importing Member must demonstrate, based on its examination of the conditions of the privatization, that the privatized producer (still) benefits from the prior financial contribution (subsidization).

7.77 In the Panel's view, the United States' same person methodology, as such, prohibits the examination of the conditions of the privatization-transaction when the privatized producer is not a distinct legal person based on criteria relating mainly to the industrial activities of the producers concerned. In applying its methodology the US Department of Commerce does not assess whether the privatized producer has received any benefit from prior financial contributions. In fact the United States twice admitted that the new owner(s) of the privatized company do not get any new benefit from the prior financial contribution when it/they paid fair market value for the assets and the shares of the state-owned producer. But the United States argues that the company continues to "carry" the benefit stream allocated over the lifetime of certain productive assets. We disagree. We believe that privatization calls for a (re)determination of the existence of a benefit to the privatized producer, and that fair market value payment by the privatized producer (and its owners) extinguishes the benefit resulting from the prior financial contribution (subsidization) bestowed upon the state-owned producer, because no advantage or benefit accrued to that privatized

[340] *See* US' and EC's responses to question No. 6 posed by the Panel.

producer over and above what market conditions dictate pursuant to Article 14 of the SCM Agreement.

7.78 The United States admitted that when the new privatized producer is not a distinct legal person (based on the activities, productive assets, management, staff) from the previous state-owned producer, it considers that the benefit attributed to the state-owned producer can be automatically attributed to the privatized producer without any examination of the condition of the transaction. We are of the view that with the same person methodology (as it did with the gamma methodology), the US Department of Commerce, in failing to examine the conditions of the privatizations, does not focuss its analysis on the relevant issues: it does not determine whether subsidization (and in particular benefit) exists for the privatized producer under investigation.

7.79 We note that this was one of the base for the reasoning of the CIT[341] when it concluded that the same person methodology was inconsistent with US Section 1677(5)(F):

> "… the new statute required two actions from Commerce: one, that the terms of the sale must be examined, and must include analysis of the entire transaction to determine if the subsidy (not the corporate entity) passed through to a person now under investigation. … In addition, such examination must focus on the new owner. … Commerce … must look at facts and circumstances of the TRANSACTION, to determine whether the PURCHASER, received a subsidy, directly or indirectly, for which it did not PAY ADEQUATE COMPENSATION."

7.80 We would like to address an additional matter. The United States seems to be "attaching" the benefit to the production activity, which may not have changed with privatization, even though the privatized producer must now compete according to market rules and can no longer take advantage of the below-market cost benefits to which the state-owned producer had access. Although the United States declares that the SCM Agreement does not require investigating authorities to investigate whether a subsidy recipient derives any competitive advantage from a subsidy[342], it seems to complain about the fact that prior subsidization may have distorted the market and may have artificially maintained producers that would not otherwise be there. Indeed, the United States developed its arguments using hypothetical examples of companies that would not be in the market, absent subsidization.[343] We understand the concerns of the United States. However, as indicated in paragraph 7.42, countervailing duties are *not* designed to counteract all market distortions or resource misallocations which might have been caused by subsidization. For the purpose

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[341] *GTS Industries v. United States* Court No. 00-03-00118 (Ct. Int'l Trade 4 January 2002), at 14-18. Exhibit EC–30 to the EC's second written submission. *See* also, *Final Results of Redetermination pursuant to Court Remand, Allegheny Ludlum Corp. et al. v United States* Court No. 99-09-00566, (Ct. Int'l Trade 13 December 2000) (unpublished) ("*Allegheny Ludlum I*").

[342] *See* US' response to question No. 14 posed by the Panel.

[343] *See* for instance, US' first written submission, paras 62-63.

of determining the existence of a benefit under the SCM Agreement, it is irrelevant whether or not any potential market distortions resulting from the prior subsidy remain after the privatization at arm's-length and for fair market value.[344] The existence of a benefit should be determined only with reference to the terms on which a financial contribution could be obtained by the recipient on the market.[345]

7.81 For the reasons mentioned above, we conclude that the same person methodology – applied in Case No. 12 – is inconsistent with the SCM Agreement, as interpreted by the Panel and the Appellate Body reports in *US – Lead and Bismuth II* and this Panel, because it does not require that in all cases of privatization, the US Department of Commerce examine the conditions of such privatization with a view to determining whether the benefit resulting from the financial contribution received by the state-owned producer continues to accrue to the privatized producer. The same person methodology is inconsistent with the SCM Agreement because in situations of privatization at arm's-length and for fair market value, the US Department of Commerce is prohibited from reaching the systematic conclusion that the privatized producer has not received any benefit, thus rebutting the presumption, if any, that the benefit from prior financial contributions (or subsidization) continues to accrue to the privatized producer, unless it finds that the privatized producer is a person legally distinct from the state-owned producer based on the criteria used in the same person methodology.

7.82 In our view, in privatization situations, the importing Member must always examine the conditions of the privatization to determine whether the privatized producer has received any benefit from a prior financial contribution bestowed on the state-owned producer, independently of whether the privatized producer is a distinct legal person from the state-owned producer. Privatizations at arm's-length and for fair market value must lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer. While Members may maintain a rebuttable presumption that the benefit from prior financial contributions (or subsidization) continues to accrue to the privatized producer, privatizations at arm's-length and for fair market

[344] Panel Report, *US – Lead and Bismuth II*, WT/DS138/R, *supra* footnote 111, at footnote 95 to para. 6.81. We recall that in dispute settlement and in their recommendations, panels are prohibited from adding or diminishing rights and obligations of Members under the covered agreements, Article 3.2 and 19.2 of the DSU.

[345] It is interesting to note that in *Saarstahl I*, the CIT concluded that the US Department of Commerce's interpretation "[would] impose a heavy burden on commercial transactions as it effectively requires buyers to value the potential liability of purchasing productive units which previously received a subsidy. A purchaser could no longer value a business based on market considerations; he would have to investigate whether there had been previous subsidies that were being, or possibly might be, countervailed in the future. The burden would be especially onerous where a productive unit which had received subsidies and never exported to the US under prior ownership begins such exportation." *Saarstahl AG v. United States* 858 F. Supp. 187 (Ct. Int'l Trade 1994) (hereinafter *Saarstahl I)*, at para. 9. Note that this decision was overturned by the US Court of Appeals for the Federal Circuit based on the interpretation of US legislation prior to the pre–URAA implementing Act.

value is sufficient to rebut such a presumption. Furthermore, since the fair market value paid for the state-owned producer is deemed to include the market value of the benefit received, the Panel considers that the privatization transaction for fair market value includes the repayment to the government, as the shareholder of the state-owned producer, of the subsidy as valued by the market at the time of privatization.

7.83 As mentioned before, the United States' same person methodology was applied in Case No. 12, in the context of an administrative review. Members' specific obligations in administrative reviews are discussed in the following section of this report and we shall complete our examination of the application of the same person methodology in the administrative review of Case No. 12 in Section D below.

7.84 In all the other cases before us, the determinations were performed using the gamma methodology which has already been condemned by the Panel and Appellate Body reports in *US – Lead and Bismuth II*. The United States admits that in the original investigation of Case Nos. 1 to 6 and in the administrative review in Case No. 7, it must re-examine its benefit determinations since they were based on the gamma methodology; the United States notes that pursuant to domestic court orders, these six cases have been remanded for redetermination.

7.85 We do not need to examine fully all the aspects of the gamma methodology, as it has already been condemned by the Panel and Appellate Body in *US – Lead and Bismuth II*.[346] We recall the Appellate Body's findings that when it applied the gamma methodology in the determination against UES and BS plc/BSES, it found that the United States had violated the SCM Agreement:

> "On the basis of the above reasoning, we uphold the Panel's finding that, in the particular circumstances of this case, the USUS Department of Commerce should have examined in its 1995, 1996 and 1997 administrative reviews whether a 'benefit' accrued to UES and BS plc/BSES following the changes in ownership; as well as the Panel's finding that, on the facts of this case, no 'benefit' was conferred on UES or BS plc/BSES as a result of the 'financial contributions' made to BSC."[347]

7.86 In light of the European Communities' claims and our terms of reference, the Panel concludes that the original investigations' determinations in Case Nos. 1, 2, 3, 4, 5 and 6, based on the gamma methodology, are inconsistent with Articles 10, 14 and 19.1 and 19.4 of the SCM Agreement. In failing to examine the conditions of the concerned privatizations, namely whether they occurred at arm's-length and for fair market value, the United States had not first determined

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[346] The Appellate Body made clear in *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia* ("*US – Shrimp (Article 21.5 – Malaysia)*"), (WT/DS58/AB/RW, adopted 21 November 2001, that the interpretations and findings by the Appellate Body create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute; DSR:XIII, 6481, at paras. 108-109.

[347] Appellate Body Report, *US – Lead and Bismuth II*, *supra* footnote 85, 138/AB/R, at para. 74.

whether the privatized producers had received any benefit, pursuant to the SCM Agreement, from the prior financial contribution (subsidization).

7.87 The SCM Agreement only allows countervailing duties to be imposed when an importing Member has determined that the producer under examination – that is the company and its owners – have received an unfair benefit. Thus, in Case Nos. 1, 2, 3, 4, 5 and 6, the United States was not entitled to impose duties to countervail pre-privatization non-recurring subsidies as it did. Since these countervailing duties were imposed without legal basis pursuant to the SCM Agreement they should be removed accordingly.

7.88 The gamma methodology was also used in the context of the administrative review in Case No. 7. We examine further the determination in Case No. 7 in Section D hereafter.

7.89 The gamma methodology was used as well in the four sunset reviews (Case Nos. 8, 9, 10 and 11). The United States raises specific arguments and defences regarding its sunset review obligations, which we examine in Section E hereafter, where we complete our examination of those determinations.

7.90 The United States proposes to reconduct these determinations on the basis of the same person methodology and argues that these remand redeterminations, which have not been concluded, are not part of the terms of reference of the Panel. The Panel agrees with the United States that these remand redeterminations are not part of the terms of reference of the Panel, *stricto sensu*. The Panel notes, however, that the same person methodology is itself inconsistent with the SCM Agreement for the reasons mentioned above.

7.91 We now proceed to examine the application of the above findings on the consequence of privatization pursuant to the SCM Agreement, when the issue is raised in administrative reviews and sunset reviews.

D. Examination of Privatizations in Administrative Reviews

1. Claims and Arguments of the Parties

7.92 The European Communities claims that in the context of the administrative review of Case No. 7[348], the US Department of Commerce has applied the gamma methodology in a manner inconsistent with Articles 21.1 and 21.2 of the SCM Agreement. The United States has admitted that its determination in Case No. 7 is inconsistent with its WTO obligations to the extent that it was not made using the same person methodology. The United States does not make such a similar admission for Case No. 12[349], whose administrative review determination was based on the same person methodology and which is also challenged by the European Communities as being inconsistent with Articles 21.1 and 21.2 of the SCM Agreement.

[348] *Sweden Admin. Review*, *supra*, footnote 43.
[349] *GOES Admin. Review*, *supra*, footnote 47.

2. Evaluation by the Panel

7.93 We must determine whether and how the United States is obliged to examine and take into account privatizations when so requested under the administrative review procedure.

7.94 Article 21.1 of the SCM Agreement provides that a countervailing duty shall remain in force only as long as, and to the extent necessary, to counteract subsidization. Article 21.2 states that the authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party which submits positive information substantiating the need for a review.

7.95 In *US – Lead and Bismuth II*, the Appellate Body made clear that the importing Member cannot simply ignore facts that may reveal that no benefit, and thus no subsidization, exist *vis-à-vis* the privatized producer. The Appellate Body stated

> "on the basis of its assessment of the information presented to it by interested parties, as well as of other evidence before it relating to the period of review, the investigating authority must determine whether there is a continuing need for the application of countervailing duties. *The investigating authority is not free to ignore such information*. If it were free to ignore this information, the review mechanism under Article 21.2 would have no purpose."[350] (emphasis added)

7.96 The Appellate Body added that it was of the view that the privatization of BSC – the change in ownership leading to the creation of UES and BS plc/BSES – was such as to require the United States to re-examine, in the context of that administrative review, whether the privatization had occurred at fair market value so that if there was no benefit to the new privatized producer, it should terminate its countervailing duties orders.

> "*In this case, given the changes in ownership leading to the creation of UES and BS plc/BSES, the USDOC was required under Article 21.2 to examine, on the basis of the information before it relating to these changes, whether a 'benefit' accrued to UES and BS plc/BSES*." (emphasis added)[351]

7.97 We recall also that "in order to establish the continued need for countervailing duties, an investigating authority will have to make a finding on *subsidization*, i.e., whether or not the subsidy continues to exist. If there is no longer a subsidy, there would no longer be any need for a countervailing duty."[352] As discussed in Part C above, in order to conclude that subsidization existed in these Case Nos. 7 and 12, the US Department of Commerce was

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[350] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 61.
[351] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 62.
[352] Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 54.

obliged to examine the conditions of the privatization with a view to assessing whether benefit to the prior state-owned producer continued to accrue to the privatized producer. Without such prior determination of benefit (and therefore subsidization) no countervailing duty orders could be maintained.

7.98 Although the investigation performed under an administrative review differs from that under an original investigation[353], we are of the view that in the context of the administrative review of Case Nos. 7 and 12, the United States, which had been informed of the privatizations by the interested producers and by the European Communities (and its member States concerned), was obligated to re-examine the conditions of application of the SCM Agreement *vis-à-vis* the privatized producer. In particular, being informed of the privatization of a state-owned producer, the United States was obliged to determine whether the privatized producer continued to receive any benefit from the prior subsidization, before it could reach any conclusion that countervailing duties should be continued. If such privatization was at arm's-length and for fair market value, the United States was obliged to conclude that the privatized producer no longer obtained any benefit from the prior subsidization to the state-owned producer. In refusing to examine the conditions of such privatizations, the United States acted inconsistently with Article 21.1 and 21.2 of the SCM Agreement.

7.99 The Panel is rather of the view, that while the United States is correct in stating that *US – Lead and Bismuth II* did not require the US Department of Commerce to retroactively change closed countervailing duty orders and that WTO remedies are generally prospective, it did not preclude the European Communities from challenging other orders determined under the gamma methodology simply because they occurred prior to the Appellate Body ruling in *US –Lead and Bismuth II*. The Panel and Appellate Body rulings in *US – Lead and Bismuth II* were that, in the case of BSC privatization, countervailing duty orders against BSC should be terminated because benefit to UES and BS plc/BSES pursuant to the SCM Agreement had not been established. The European Communities, and other WTO Members, remain free to request that the United States bring any other allegedly WTO-inconsistent (ongoing) countervailing duty measures into conformity with the WTO Agreement, even if the implementation of the present Panel report will be prospective.

7.100 In sum, in its administrative review determinations in Case Nos. 7 and 12, the United States acted inconsistently with Articles 10, 14, 19.4, 21.1 and 21.2 of the SCM Agreement since the US Department of Commerce did not take into account the privatizations that occurred after the original investigation and did

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[353] *See* Appellate Body Report, *US – Lead and Bismuth II*, WT/DS138/AB/R, at para. 63:
"… We believe that it is important to distinguish between the original investigation leading to the imposition of countervailing duties and the administrative review. In an original investigation, the investigating authority must establish that *all* conditions set out in the *SCM Agreement* for the imposition of countervailing duties are fulfilled. In an administrative review, however, the investigating authority must address those issues which have been raised before it by the interested parties or, in the case of an investigation conducted on its own initiative, those issues which warranted the examination."

not re-examine the conditions of application of the SCM *vis-à-vis* the privatized producers. In failing to examine the conditions of the said privatizations (whether they were at arm's-length and for fair market value) the US Department of Commerce did not determine whether the privatized producers continued to receive any benefit from any prior financial contribution (subsidization). Therefore, in Case Nos. 7 and 12, the United States was not entitled to continue to impose duties to countervail pre-privatization, non-recurring subsidies as it did. Since these countervailing duties were imposed without legal basis pursuant to the SCM Agreement they should be removed accordingly.

E. Examination of Privatizations in Sunset Reviews

1. Claims and Arguments of the Parties

7.101 The European Communities claims that the application of the US sunset review procedures in Case Nos. 8, 9, 10 and 11 is inconsistent with Article 21.1 and 21.3 of the SCM Agreement. The United States contests this claim.

7.102 The European Communities submits that an investigating authority cannot determine whether there is a likelihood of continuation or recurrence of subsidization without considering whether, and the extent to which, a benefit continues to accrue and that this requires the authority to carry out a new, detailed investigation, in which it determines, on the basis of positive evidence, the likelihood of continuation or recurrence.[354] The European Communities argues that, under Article 21.3 of the SCM Agreement, it is for the investigating authority to make a determination of continuing injurious subsidization. In this regard, it indicates that to premise examination of evidence in a determination under Article 21.3 on the evidence having been examined in a review under Article 21.2 is inconsistent with the SCM Agreement, especially in the case of non-exporting producers which under the United States' regulation are precluded from requesting an Article 21.2 administrative review. The European Communities points out that the CIT reached the same conclusion in the *Dillinger* case when it found that the US Department of Commerce was not entitled to base its findings in sunset reviews only on evidence gathered in the initial investigation.[355]

7.103 The European Communities also argues that the United States inappropriately reverses the burden of proof in sunset reviews to the exporting producers when they do not respond to the notice of initiation of the sunset review. The European Communities argues that the investigating authority cannot just presume that there is a likelihood of continuation or recurrence of injurious subsidization merely because certain interested parties have not responded to a notice of initiation. The European Communities believes that under Article 21.3 of the SCM Agreement it is for the authorities to determine, and not for the respondent to disprove that there is a likelihood of continuation or

[354] *See* EC's second written submission, paras. 71-72.
[355] *AG Dillinger Huttenwerke et al v United States* ("*Dillinger*"); Court No. 00-09-00437 (Ct. Int'l Trade 28 February 2002), at 14. Exhibit EC-34 to the EC's second written submission.

recurrence.[356] Therefore, the European Communities concludes that this reversal of the burden of proof is inconsistent with Article 21.3 of the SCM Agreement.[357]

7.104 The United States considers that an investigating authority need not revisit *ex officio* its subsidy determination in a sunset review under Article 21.3 of the SCM Agreement. The United States considers that where there have been no administrative reviews of a countervailing duty order, the only evidence of subsidization which an investigating authority need take into account is evidence from the original investigation. The United States submits that in the four sunset reviews covered by this dispute, the US Department of Commerce was under no obligation, pursuant to Article 21.3, to convert its sunset reviews into full-blown administrative reviews of the respective countervailing duty orders.[358]

7.105 The United States does not seem to contest the issue of the burden of proof as such, but rather the nature of the sunset review obligation. The United States believes that, absent an administrative review, the only evidence of subsidization it is required to evaluate in a sunset review, in order to determine the likelihood of continuation or recurrence of the countervailable subsidies, is that contained in the original investigation. The United States maintains that sunset reviews are not the appropriate proceedings to evaluate new and complex evidence of subsidization.

2. Evaluation by the Panel

7.106 The parties have made frequent references to the ongoing dispute in *United States – Corrosion Resistant Carbon Steel Flat Products from Germany* (WT/DS213) where the European Communities is claiming that the United States' sunset review legislation, administrative rules and practice are contrary to the United States' obligations under the SCM Agreement and the WTO Agreement. In the present dispute the European Communities is limiting its claims on the WTO-compatibility of the "application" of this sunset review practice in Cases No. 8, 9, 10 and 11.

7.107 As mentioned before, Article 21.1 of the SCM Agreement sets out a general rule:

> "A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury."

7.108 The first sentence of Article 21.3 seems to provide a specific application of the general rule in Article 21.1 when it states:

> "Any definitive countervailing duty shall be terminated on a date not later than five years from its imposition (or from the date of the most recent review under paragraph 2 if that review has covered

[356] *See* EC's second written submission, paras. 70 and 72.
[357] *See* EC's second written submission, para. 76.
[358] *See* US' first written submission, para. 89.

> both subsidization and injury, or under this paragraph), unless the authorities determine, in a review initiated before that date on their initiative or upon a duly substantiated request made by or on behalf of the domestic industry within a reasonable period of time prior to that date, that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury."

7.109 The Panel reads these provisions as imposing a presumption that a countervailing duty will be terminated after five years unless the investigating authority initiates a review (*ex officio* or upon a request from the domestic industry) and determines, in that review, that there is a likelihood of continuation or recurrence of subsidization and injury. Both parties in fact admit that it is for the importing Member to "determine", at the expiry of the first five-year application period, that there is a likelihood of continuation or recurrence of subsidization and injury upon expiry of the countervailing duty.

7.110 The parties disagree, however, on the extent of this obligation to "determine" the likelihood of continuation or recurrence of injurious subsidization and whether this obligation requires consideration of the "magnitude" of subsidization. The parties also disagree on whether developments taking place since the initial investigation should be taken into account when determining whether injurious subsidization is likely to continue or recur. Given our terms of reference, we are of the view that we need to respond to this claim only to the extent that the sunset reviews involve privatizations.

7.111 The United States considers that when there have been no administrative reviews of a countervailing duty order, the only evidence of subsidization which an investigating authority need take into account in a sunset review is evidence from the original investigation. We disagree with this contention. The object of a sunset review is to determine, in light of developments that have occurred since the original investigation, whether subsidization and injury will continue or recur. Article 21.3 provides clearly that the importing state must determine whether subsidization "is likely to lead to continuation or recurrence". To ignore any such development and to limit the evidence that the importing Member is to examine only to that included in the original investigation renders the sunset review a mere formality. We are of the view that the sunset review is a mechanism distinct from the administrative review which, pursuant to Article 21.2 of the SCM Agreement, can be requested by any interested party provided that a reasonable period of time has elapsed since the imposition of the duties. To subject the operationalization of the sunset review to prior administrative review procedures would effectively nullify the presumption that countervailing duties must terminate after five years unless the importing Member determines that subsidization and injury are likely to continue or recur.

7.112 During the second hearing the representative of the United States stated that the privatization of a company whose exports are subject to a countervailing duty order following the original imposition of a countervailing duty may be a fact that the US Department of Commerce would examine in a sunset review, providing that the exporting company or the exporting Member brings evidence

that the subsidy was, for instance, paid back on the occasion of privatization. As discussed above, the United States is of the view that an arm's-length privatization at fair market value, as such, cannot serve to demonstrate the absence of benefit relevant to the sunset review countervailing determination. The United States maintains that evidence of arm's-length and fair market value privatization could not automatically alter its prior decision to amortize a subsidy for a period extending after the privatization.

7.113 The Panel is of the view that privatization of the state-owned producer (of the goods subject to countervailing orders), is a fact that the importing Member is obliged to consider and examine in the context of a sunset review- as it may yield evidence that subsidization does not exist which in itself is relevant to assessing the likelihood of continuation or recurrence of subsidization and injury, as mandated by Article 21.3 of the SCM Agreement.

7.114 We consider that in a sunset review investigation the importing Member is obliged to examine at least all the evidence provided by any interested party, not just the importing producer, and relating to the existence or removal of the subsidization forming the basis for the countervailing measures; only then can the investigating Member be able to conclude whether subsidization exists and is likely to continue or recur.[359] Privatization is a fact that the importing Member "cannot simply ignore", as it may bring evidence that subsidization was terminated. As further discussed in paragraphs 7.60-7.89above, if privatization at arm's-length and for fair market value has taken place, the benefit resulting from a prior subsidization bestowed upon the state-owned producer no longer accrues to the privatized producer under investigation. In the absence of any benefit there cannot be any subsidization. Without subsidization, a Member cannot impose countervailing duties. Although speaking about the administrative review procedure, the Appellate Body made clear that "in order to establish the continued need for countervailing duties, an investigating authority will have to make a finding on *subsidization*, i.e., whether or not the subsidy continues to exist. If there is no longer a subsidy, there would no longer be any need for a countervailing duty".[360]

7.115 In the present dispute, the United States argues that in Case Nos. 8, 9, and 11, the exporting firms did not cooperate with the US Department of Commerce.[361] There is evidence that, for the sunset reviews in Case Nos. 8[362],

[359] We note that the CIT reached a similar conclusion when it found that the US Department of Commerce's practices in sunset reviews are inconsistent with the US legislation, as "[b]y its nature, then, a sunset review is designed to account for changes in law that have a bearing on whether countervailable subsidies will continue or recur." We note also that the US Court rejected the US Department of Commerce's arguments that it was not appropriate to reach the privatization issue in a sunset review or that an interested party participating in a sunset review must have first requested and completed an administrative review. *Dillinger*, Court No. 00-09-00437, at 32.

[360] Appellate Body Report in *US – Lead and Bismuth II*, WT/DS138/AB/R, *supra* footnote 85, at para. 54.

[361] Case No.10 is the *Dillinger* dispute, and the exporting producer participated in all the investigations and reviews.

9[363] and 11[364], the European Communities (and its member States) had informed the US Department of Commerce of the said privatizations and offered further information on the fair market value and arm's-length conditions of such transactions. The United States does not deny this fact. To the extent that the United States was informed of such privatizations and there is evidence that the European Communities offered further information on the conditions of the privatization transactions, the Panel considers that the US Department of Commerce, in failing to take into account such privatizations and to examine the conditions of the said privatization, chose to ignore relevant evidence and therefore its conduct in the sunset reviews at issue was inconsistent with Article 21.1 and 21.3 of the SCM Agreement.

7.116 Since the sunset reviews in Case Nos 8, 9, 10, and 11 were conducted on the basis of the gamma methodology, the Panel finds that the United States failed to examine the conditions of such privatizations and to determine whether the privatized producers received any benefit from the prior subsidization to the state-owned producers, in violation of Articles 10, 14, 19.4 and 21.1 and 21.3 of the SCM Agreement. In those Cases, the United States was not entitled to continue to countervail pre-privatization, non-recurring subsidies as it did. Since these countervailing duties were therefore maintained without legal basis pursuant to the SCM Agreement, they should be removed accordingly.

7.117 We note that in Case Nos. 8 and 10, the United States admits that the privatizations took place at arm's-length and for fair market value.[365] Therefore, the US Department of Commerce should have concluded that the privatization at arm's length and for fair market value rebutted the presumption, if any, that the benefit from the prior subsidization bestowed upon the state-owned producer continued to accrue to the privatized producer under investigation since the latter had paid full market value for the assets and shares of the state-owned producer. The sunset review determinations in Case Nos. 8 and 10 are, therefore, inconsistent with Articles 10, 14, 19.4, 21.1 and 21.3 of the SCM Agreement. The United States was therefore not entitled to impose duties to countervail pre-privatization non-recurring subsidies since no benefit accrued to those privatized producers. These countervailing duties were therefore maintained contrary to the SCM Agreement and should therefore be removed accordingly.

F. The WTO Compatibility of US Section 1677(5)(f)

1. Claims and Arguments of the Parties

7.118 The European Communities claims that Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit, prevents the United States

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[362] *Cut-to-Length Carbon Steel Plate from the United Kingdom* (exp. sunset review), *supra*, footnote 51 In this case the Department Of Commerce determined that the submissions by the GOUK and the European Communities were "inadequate for purposes of conducting a full sunset review." *Ibid.*

[363] *Corrosion-Resistant Carbon Steel Flat Products from France*, footnote 58, at 18063.

[364] *Cut-to-Length Carbon Steel Plate from Spain, supra*, footnote 67, at 18308.

[365] See the admission from the United States *infra*, paras. 2.39 and 2.45.

from systematically recognizing the principle that an arm's-length, fair market value transaction precludes the pass through of any benefits from pre-transaction financial contributions to the post-transaction entity. The European Communities is of the view that Section 1677(5)(F) was specifically designed to prevent the US Department of Commerce from applying a "*per se* rule" that a benefit stream does not survive a fair market value arm's-length transaction.[366] The European Communities asserts that Section 1677(5)(F), to the extent that it allows the US Department of Commerce to impose countervailing duties without assessing the existence of countervailable subsidization after a privatization or change in ownership, is inconsistent with Articles 1.1(b), 10, 14, 19 and 32.5 of the SCM Agreement and with Article XVI.4 of the WTO Agreement.

7.119 The United States contends that Section 1677(5)(F) does not mandate an either/or approach to the question of whether pre-privatization subsidies benefit a post-privatization entity.[367] The United States argues that the plain language of Section 1677(5)(F) demonstrates its discretionary nature. In this regard, the United States contends that the text of Section 1677(5)(F) clearly provides that a change in ownership does not by itself mean that a past countervailable subsidy is no longer countervailable, nor does it mean that it continues to be countervailable. The United States argues that the statute leaves the investigating authority discretion to make its decision. It further argues that the SAA also supports the view that Section 1677(5)(F) is discretionary and not mandatory. The SAA states that the purpose of Section 1677(5)(F) is to clarify that "the sale of a firm at arm's-length does not automatically, and in all cases, extinguish any prior subsidies conferred," and that it is the Administration's intent that "Commerce retains the discretion to determine whether, and to what extent…previously conferred countervailable subsidies" are eliminated."[368]

2. Evaluation by the Panel

(a) Possibility to Challenge a Legislation as such - Mandatory/Discretionary Distinction

7.120 Under GATT and WTO dispute settlement procedures, a measure can be challenged if it is binding and not discretionary, even if it is not yet applied or in force.[369] Only legislation that "requires" a violation of GATT/WTO rules can be found to be inconsistent with WTO rules. [370] The Appellate Body in *US – 1916 Act* confirmed that:

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[366] To support its view the European Communities refers to *Final Results of Redetermination pursuant to Court Remand, Delverde Srl. v. United States* Consol. Ct. No. 96-08-01997 (Ct. Int'l Trade 2 December 1997), at 33. Exhibit EC–28 to the EC's first written submission. (In the version of this Remand Redetermination supplied to the Panel, the relevant text can be found on page 16).

[367] *See* US' first written submission, para. 91.

[368] *See* US' first written submission, paras. 94-96.

[369] Panel Report, *United States - Taxes on Petroleum and Certain Imported Substances* ("*Superfund")*, adopted 17 June 1987, BISD 34S/136, paras 5.26-5.29.

[370] *See* Panel Report, *United States – Anti-Dumping Act of 1916 – Complaint by the European Communities* ("*US – 1916 Act (EC)*"), WT/DS136/R and *United States – Anti-Dumping Act of 1916 – Complaint by Japan* ("*US – 1916 Act (Japan)*"), WT/DS162/R and WT/DS162/Add.1, *supra*,

> "the concept of mandatory as distinguished from discretionary legislation was developed by a number of GATT panels as a *threshold consideration* in determining when legislation as such – rather than a specific application of that legislation – was inconsistent with a Contracting Party's GATT 1947 obligations.[371] The practice of GATT panels was summed up in *United States – Tobacco*[372] as follows:
>
> > … panels had consistently ruled that legislation which mandated action inconsistent with the General Agreement could be challenged as such, whereas legislation which merely gave the discretion to the *executive authority* of a contracting party to act inconsistently with the General Agreement could not be challenged as such; only the actual application of such legislation inconsistent with the General Agreement could be subject to challenge.[373] (emphasis added)[374]

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footnote 249, adopted 26 September 2000, as upheld by the Appellate Body Report, *United States Anti-Dumping Act of 1916* ("*US – 1916 Act*") WT/DS136/AB/R,WT/DS162/AB/R; Panel Report, *United States – Measures Affecting the Importation, Internal Sale, and Use of Tobacco*, adopted 4 October 1994, BISD 41S/131; Panel Report, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, Report of the Panel, adopted 7 November 1990, BISD 37S/200; Panel Report, *European Economic Community – Regulation on Imports of Parts and Components*, adopted 16 May 1990, BISD 37S/132; *and* Panel Report, *Superfund*, BISD 34S/136.

[371] [Original footnote] Panel Report, *US – Superfund*, BISD 34S/136 - The reason it must be possible to find legislation as such to be inconsistent with a Contracting Party's GATT 1947 obligations was explained as follows: [the provisions of the GATT 1947] are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade.

[372] [Original footnote] Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, WT/DS162/AB/R quoting: Panel Report, *United States – Measures Affecting the Importation, Internal Sale, and Use of Tobacco*, adopted 4 October 1994, BISD 41S/131.

[373] [Original footnote] Appellate Body Report at para. 118 *Ibid*., para. 118, referring in footnote to: Panel Report, *United States - Superfund*, BISD 34S/136, p. 160; Panel Report, *EEC - Parts and Components*, *supra*, footnote 20, pp. 198-199; Panel Report, *Thailand - Cigarettes*, *supra*, footnote 34, pp. 227-228; Panel Report, *United States - Malt Beverages*, *supra*, footnote 34, pp. 281-282 and 289-290; Panel Report, *United States - Denial of Most-Favoured Nation Treatment as to Non-Rubber Footwear from Brazil*, adopted 19 June 1992, BISD 39S/128, p. 152.

[374] Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, WT/DS162/AB/R, DSR 2000:X, 4793, at para. 88. See also at footnote 45 to para. 88*:*

> "The reason it must be possible to find legislation as such to be inconsistent with a Contracting Party's GATT 1947 obligations was explained as follows: [the provisions of the GATT 1947] are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade. Panel Report, *United States – Superfund*, BISD 34S/136, footnote 34, para. 5.2.2."

> "Thus, the relevant discretion, for purposes of distinguishing between mandatory and discretionary legislation, is a discretion vested in the *executive branch* of the government".[375]

7.121 Three recent panel reports provided that legislation "as such" is considered mandatory if it cannot be applied in a manner consistent with the SCM Agreement. In these three cases, the panels concluded that although it was possible to conceive that the laws would be applied in a manner incompatible with WTO rules, the relevant competent authorities had the discretion to apply them consistently with such rules. Therefore, the said laws did not necessarily violate the SCM Agreement.[376]

7.122 In sum, a piece of legislation would not violate the WTO if it can be applied by the executive authority of the WTO Member in a manner consistent with the WTO Agreement; WTO Members are presumed to administer their national laws in conformity with their WTO obligations.[377]

7.123 While only legislation that mandates a violation of WTO obligations can be WTO-inconsistent, we are of the view that the existence of some form of executive discretion alone is not enough for a law to be *prima facie* WTO-consistent, what is important is whether the government has an effective discretion to interpret and apply its legislation in a WTO-consistent manner. [378]

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[375] See Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, WT/DS162/AB/R, *supra*, footnote 374, at para. 89.

[376] See Panel Report, *United States – Measures Treating Export Restraints as Subsidies* ("*US – Export Restraints*"), WT/DS194/R, adopted 23 August 2001, DSR 2001:XI, 5767, paras. 8.126–8.132; Panel Report, *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU* ("*Brazil – Aircraft (Article 21.5 – Canada II*")), WT/DS46/RW/2, adopted 23 August 2001, DSR 2001:X, 5481, paras. 5.11-5.13, 5.43, 5.48, 5.5, 5.55, 5.126, 5.142; and Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft* ("*Canada – Aircraft Credits and Guarantees*") WT/DS222/R, adopted 19 February 2002, paras. 7.56–7.62.

[377] Article 26 of the Vienna Convention on the Law of Treaties. Done in Vienna, 23 May 1969, 1155 U.N.T.S. 331. The Panel in *US – Section 301 Trade Act* also accepted the US submission that: "In US law, it is an elementary principle of statutory construction that 'an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains.' *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804). While international obligations cannot override inconsistent requirements of domestic law, 'ambiguous statutory provisions. . . [should] be construed, where possible to be consistent with international obligations of the United States.' *Footwear Distributors and Retailers of America v. United States*, 825 F. Supp. 1078, 1088 (Ct. Int'l Trade), appeal dismissed, 43 F. 3d 1486 (Fed. Cir. 1994) citing *DeBartolo Corp. v. Florida Gulf Coast Building and Trades Council*, 485 U.S. 568 (1988)." Panel Report, *United States – Sections 301 – 310 of the Trade Act of 1974* ("*US – Section 301 Trade Act*"), WT/DS152/R, adopted 27 January 2000, *supra* footnote 248, at footnote 681 to para. 7.108. Members are also presumed not to contravene their mandatory legislation in order to administer their WTO obligations. Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R , adopted 16 January 1998, *supra* footnote 247, at paras. 69-70.

[378] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at paras. 7.53-7.54 concludes, while discussing claims under Article 23 of the DSU, that legislation that maintains executive discretion may also violate WTO obligation if such discretion is prohibited by the relevant WTO agreement.

(b) The Examination by the Panel of National Laws and Other Domestic Legal Instruments

7.124 Where the alleged violation at issue is domestic legislation, an examination of the relevant aspects of municipal law is essential to determining whether a Member has complied with its obligations.[379] It is a well-established practice of legal interpretation in international jurisprudence that "where the determination of a question of municipal law is essential to the Court's decision in a case, the Court will have to weigh the jurisprudence of the municipal courts."[380]

7.125 When analysing municipal law, a Panel should not interpret the law "as such", but rather establish the meaning of the disputed legislation as a *factual element* and determine whether the factual element constitutes conduct by the respondent Member contrary to its WTO obligations.[381] In *India – Patents (US)*, the Appellate Body said:

> "There was simply no way for the Panel to make this determination without engaging in an examination of Indian law. But, … in this case, the Panel was not interpreting Indian law "as such"; rather, the Panel was examining Indian law solely for the purpose of determining whether India had met its obligations under the TRIPS Agreement." [382]

7.126 In *US – 1916 Act (EC)*, the panel – upheld by the Appellate Body, stated that even if the text of the law in question were clear on its face, it was necessary to examine the domestic application of that law, its historical context and legislative history and subsequent declarations of the United States' authorities in order to asses its compatibility with WTO law.[383]

7.127 In *US – Section 301 Trade Act*, while examining claims of violation of Article 23 of the DSU, the panel concluded that in cases where the violation is legislation as such, "internal elements legally relevant to the construction of the legislation should be determinative."[384] That panel also concluded that the elements of national laws are often inseparable and "should not be read independently from each other when evaluating the overall conformity of the law with WTO obligations."[385] In addition, the panel noted that US Government

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[379] Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R, *supra* footnote 247, at para. 66.
[380] *Brazilian Loans*, PCIJ, Series A, Nos. 20/21, p.124 cited in *Elettronica Sicula S.p.A. (ELSI)*, Judgment, ICJ Reports 1989, p. 47, para. 62.
[381] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at para. 7.18 citing Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R, adopted 16 January 1998, *supra* footnote 247, at para. 66.
[382] Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R, *supra* footnote 247, para. 66.
[383] Panel Report, *US – 1916 Act (EC)*, WT/DS136/R, *supra*, footnote 249, at para. 6.48. *See a*lso Panel Report, *United States – Section 337 of the Tariff Act of 1930*, adopted 7 November 1989, BISD 36S/345.
[384] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at para. 7.114.
[385] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at para. 7.27.

action includes not only the legislature and executive, but the *judiciary* as well.[386]

7.128 The Panel considers that in its examination of the compatibility of Section 1677(5)(F), it should consider the United States' internal elements, legally relevant to the construction of the legislation under examination, to see whether the US Department of Commerce has the effective discretion to apply Section 1677(5)(F) consistently with the WTO Agreement.

(c) Can US Section 1677(5)(F) be Effectively Applied in a WTO-Consistent Manner?

7.129 As we developed in paragraphs 7.60 to 7.89above, if the purchaser (the company and the shareholders of the privatized producer) of the state-owned producer pays fair market value, it has paid for the advantage conferred by a prior financial contribution (subsidization). Thus the privatized producer has not received any countervailable benefit under the SCM Agreement. When informed of such a change in ownership for consideration, the importing Member is obliged to examine the conditions of the privatization transaction since it is possible that the benefit may cease to accrue to the privatized producer. Where the privatization takes place at arm's-length and for fair market value, the importing Member must reach the conclusion that no benefit accrued to the privatized producer.

7.130 We note at the outset that Section 1677(5)(F) only refers to transactions at arm's-length and no reference is made to "fair market value". When we requested that the United States explain the meaning of arm's-length in the United States' law and its difference from fair market value, the representative of the United States said there was a great deal of confusion about those terms in the United States and that he was not in a position to reply.[387] We also note that the SAA, in interpreting Section 1677(5)(F), makes it clear that an arm's-length transaction is presumed to be a transaction in normal market conditions, i.e. a transaction at fair market value. This is especially so as it includes in its definition of arm's-length transactions, transactions between related parties when the terms of the transactions are as if the parties were not related, i.e. subject to full and normal market conditions:

> "For purposes of section 771(5)(F), the term 'arm's-length transaction' means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties."[388]

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[386] *Ibid.*, at footnote 700 to para. 7.136 (emphasis added).
[387] *See* US' response to question No. 15 posed by the Panel.
[388] SAA 1994 U.S.C.C.A.N 3773, 4241. Exhibit EC–25 to EC's first written submission. (Note that in the version supplied to the Panel the quoted text appears on page 928.)

7.131 So for the purpose of these findings, we shall consider the definition of "arm's-length transaction" in Section 1677(5)(F) as to include the concept of "fair market value" as well.

7.132 The Panel is asked whether Section 1677(5)(F) would allow the United States to systematically conclude that in cases of arm's-length and fair market value privatizations, no benefit initially determined for the state-owned producer continues to accrue to the privatized producer and thus, no countervailing duty can be imposed or maintained against products exported by the privatized producer.

7.133 Section 1677(5)(F) provides that:

> "A change in ownership of all or part of a foreign enterprise or the productive assets of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even if the change in ownership is accomplished through an arm's-length transaction."[389]

7.134 We note that Section 1677(5)(F) does not expressly mandate the same person methodology. In fact, it does not prescribe any specific methodology for determining whether a change in ownership extinguishes the benefit from a prior financial contribution. What it does, however, is to make it clear that a change in ownership at arm's-length cannot, in and of itself, be dispositive of the determination of the existence of benefit. As the United States explained before the Panel, the legislation provides the US Department of Commerce with a degree of discretion to assess the impact of the change in ownership on the continued existence of a benefit and that the US Department of Commerce chose to exercise such discretion in developing its same person methodology.

7.135 The Panel acknowledges that privatizations are very complex matters and the assessment of the conditions under which the privatization takes place – i.e., whether it was at 'arm's-length and for fair market value – are also complex. Thus, in situations of allegations of privatization for consideration, the importing Member must be able to determine whether the transaction was at 'arm's-length and for fair market value.

7.136 In our view, once it has determined that the privatization took place at 'arm's-length and for fair market value, the importing Member must conclude, pursuant to the SCM Agreement, that the benefit from prior financial contribution (subsidization) to the state-owned producer does not continue to accrue to the privatized producer.[390]

7.137 The issue before us is whether, in situations of arm's-length privatizations for fair market value, Section 1677(5)(F) can be applied without violating the

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[389] Uruguay Round Agreements Act, Pub. L. No. 103-465, 108 Stat. 4809 (1994); 19 U.S.C. § 1677(5)(F). Exhibit EC–4 to the EC's first written submission.

[390] The Panel recalls that: "if it is found that specific WTO obligations prohibit a certain type of legislative discretion, the existence of such discretion in the statutory language would presumptively preclude WTO consistency". Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at para. 7.54.

SCM Agreement, as interpreted by the Panel and the Appellate Body report in *US – Lead and Bismuth II* and by this Panel. In other words, the issue is whether, in situations of arm's-length privatizations for fair market value, the application of Section 1677(5)(F) will necessarily violate the SCM Agreement.

7.138 The Panel believes that if, and to the extent that, the US Department of Commerce could exercise its own executive discretion in a manner compatible with the WTO - that is to reach systematic conclusions that in cases of an arm's-length privatization for fair market value, no benefit accrues to the privatized producer from the prior financial contribution (subsidization) bestowed to the state-owned producer – it could be concluded that the plain wording of Section 1677(5)(F) does not require the United States to violate the WTO Agreement. Although it is possible to conceive that Section 1677(5)(F) would be applied in a manner incompatible with WTO rules, the statutory language alone indicates that the competent authority could have the discretion to implement Section 1677(5)(F) consistently with WTO law. As such, the legislation alone could not be said to be inconsistent with the SCM Agreement.

7.139 We are of the view, however, that when examining internal legislation, a Panel must look to all the elements that establish its meaning, not just the statutory language. Therefore, it is also necessary to look at other domestic interpretive tools such as the legislative history, the SAA, and relevant judicial interpretations to the extent that they form part of the effective operationalization of the legislation.[391]

7.140 As we discuss hereafter, in the particular circumstances of this case, it seems that the aggregate impact of the object and purpose of Section 1677(5)(F), its legislative history, its interpretation by the US Court of Appeals for the Federal Circuit and the SAA, are such as to prohibit the United States from exercising its executive discretion so that it can systematically conclude that in cases of 'arm's-length privatization for fair market value, no benefit accrues to the privatized producer from prior financial contribution bestowed to the state-owned producers, as provided for by our findings in paragraphs 7.60 to 7.89 above. We proceed to examine these potentially legally relevant internal elements.

(i) The Legislative History of US Section 1677(5)(F)

7.141 The origins of Section 1677(5)(F) lie in the pre-Uruguay Round litigation in the United States courts over the US Department of Commerce's change in ownership methodology. The European Communities claims, and the United States has not contested, that Section 1677(5)(F) was designed to reverse the

[391] Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at paras. 7.25 - 7.27. The Appellate Body seemed to endorse this principle in, Appellate Body Report, *India – Patents (US)*, WT/DS50/AB/R, *supra* footnote 247, at paras. 60-63 when it examined the relative importance of various administrative and legislative actions taken by India to fulfill its obligations under Article 70.8(a) of the *TRIPS Agreement*.

decisions of the CIT in *Saarstahl I*[392] and *Inland Steel*[393] and therefore neutralize the effect of the CIT's rulings in *Saarstahl I* and *Inland Steel* declaring the gamma methodology contrary to US law.[394]

7.142 In the *Delverde III* case, the US Department of Commerce argued before the US Court of Appeals for the Federal Circuit that Section 1677(5)(F) had been adopted in order to overrule the decisions in *Inland Steel* and *Saarstahl I*[395] that had concluded that "[b]ecause the countervailable benefit does not survive the arm's-length transaction, there is no benefit conferred to the purchaser and, therefore, no countervailable subsidy within the meaning of the [the US CVD statute]".[396]

(ii) The US SAA's Interpretation of Section 1677(5)(F)

7.143 This understanding is confirmed by the United States itself. The SAA points out that:

> "Section771(5)(F) provides that a change in the ownership of 'all or part of a foreign' enterprise" (i.e. a firm or a division of a firm) or the productive assets of a firm, even if accomplished through an arm's-length transaction, does not by itself require Commerce to find that past countervailable subsidies received by the firm no longer continue to be countervailable. For purposes of section 771(5)(F), the term 'arm's-length transaction' means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties.
>
> Section 771(5)(F) is being added to clarify that the sale of a firm at arm's-length does not automatically, and in all cases, extinguish

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392 *Saarstahl I*, 858 F. Supp. 187.

393 *Inland Steel Bar co. v. United States* 858 F. Supp. 179 (Ct. Int'l Trade 1994).

394 The European Communities refers to David Codevilla, *Discouraging the practice of what we preach, Saarstahl I, Inland Steel and the implementation of the Uruguay Round of GATT 1994* 3 Geo. Mason Independent L. Rev. 435 The European Communities explains that the author was a key Congressional staffer associated with the drafting of § 1677(5)(F) and the URAA more generally. LEXIS-NEXIS version attached as Exhibit EC–23 to EC's first written submission.

395 See *Delverde III*, 202 F.3rd 1360 where the US Court of Appeals for the Federal Circuit noted, in footnote 3: "Both parties tell us that the Change of Ownership provision was intended to overrule the decision of the Court of International Trade in *Saarstahl AG v. United States*, 858 F. Supp. 187 (Ct. Int'l Trade 1994) ("*Saarstahl I*")."

396 The following excerpt explains the gist of the *Saarstahl I* Court judgment: "Where a determination is made that a given transaction is at arm's-length, one must conclude that the buyer and the seller have negotiated in their respective self-interests, the buyer has taken into consideration all relevant facts, and the buyer has paid an amount which represents the market value of all it is to receive. Because the countervailable benefit does not survive the arm's-length transaction, there is no benefit conferred to the purchaser and, therefore, no countervailable subsidy within the meaning of the [the US countervailing duty statute]. The purchaser, thus, will not realize any competitive countervailable benefit and any countervailable duty assigned to it amounts to a penalty […] Taken from the EC first written submission, para. 140.

> any prior subsidies conferred. Absent this clarification, some might argue that all that would be required to eliminate any countervailing duty would be to sell subsidized productive assets to an unrelated party. Consequently, it is imperative that the implementing bill correct and prevent such an extreme interpretation."[397]

7.144 The SAA refers to itself as "an authoritative expression of the Administration's views regarding the interpretation of the Uruguay Round agreements and the United States' obligations in implementing them, including under domestic law, as agreed between the Administration and Congress". The same Panel (*US – Export Restraints*) considered:[398]

> "Accordingly, we consider that the SAA constitutes authoritative interpretive guidance in respect of the statute. As such, given its unique authority as interpretive guidance, the SAA is of fundamental importance in this dispute, in the sense that the statute cannot be properly interpreted without reference to the SAA."[399]

(iii) Object and Purpose of the Legislation

7.145 We note that the SAA states that "it is imperative that the implementing bill correct and prevent such an *extreme interpretation*" (referring to the ruling in *Saarstahl I*). We understand that the object and purpose of Section 1677(5)(F) is to prohibit the US Department of Commerce from doing what we believe the SCM Agreement, as interpreted by the Appellate Body and Panel Reports in *US – Lead and Bismuth II* and this Report, requires the US Department of Commerce to do; i.e. to reach systematic conclusions that in cases of arm's-length privatizations for fair market value, the exporting Member has rebutted the presumption, if any, that the benefit from prior financial contributions (or subsidization) continues to accrue to the privatized producer. The SAA qualifies as an "extreme interpretation to be corrected", what we believe to be the correct interpretation of the SCM Agreement.

7.146 It seems clear to this Panel, and the United States admits as much, that Section 1677(5)(F) was designed so as to ensure that in situations of arm's-length change in ownership for fair market value, benefit from prior subsidy is never automatically considered to have passed to the new privatized producer. The United States, in the course of the *Delverde III* litigation quoted the US Department of Commerce in one of its findings:

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[397] SAA 1994 U.S.C.C.A.N 3773, 4241 Exhibit EC–25 to EC's first written submission.

[398] Panel Report, *US – Export Restraints*, WT/DS194/R, *supra* footnote 376, at para. 8.95. The Panel in *US – Section 301 Trade Act*, explained the importance of the SAA as follows: "The SAA thus contains the view of the Administration, submitted by the President to Congress and receiving its imprimatur, concerning both interpretation and application and containing commitments, to be followed also by future Administrations, on which domestic as well as international actors can rely." Panel Report, *US – Section 301 Trade Act*, WT/DS152/R, *supra* footnote 248, at para. 7.111. The Panel also concluded that the SAA is "an important interpretive element in the construction of the statutory language." *Ibid.*, at 7.133.

[399] Panel Report, *US – Export Restraints*, WT/DS194/R, *supra* footnote 376, at para. 8.100.

> "Section 771(5)(F) only acts to preserve the ability of the Department to exercise its discretion, and it accomplishes this goal by overturning the approach ordered in *Saarstahl I*, which had mandated that the Department find that an arm's-length transaction, in and of itself, precludes any pass-through to the purchaser."[400]

(iv) The US Judicial Interpretation of Section 1677(5)(F)

7.147 While the legislative history and the SAA are relevant, the decision of the US Court of Appeals for the Federal Circuit in the *Delverde III* case is determinative in establishing the meaning of Section 1677(5)(F) in the United States. In the context of its examination of the gamma methodology, the US Court of Appeals for the Federal Circuit in *Delverde III* discussed and analysed Section 1677(5)(F) and interpreted it as preventing the adoption of a *per se* (i.e. systematic) rule on the effect of a change in ownership transaction. The US Court of Appeals for the Federal Circuit stated:

> "This provision [§1677(5)(F)] clearly states that a subsidy cannot be concluded to have been extinguished solely by an arm's-length change in ownership. However, it is also clear that Congress did not intend the opposite, that a change in ownership always requires a determination that a past countervailable subsidy continues to be countervailable, regardless whether the change in ownership is accomplished through an arm's-length transaction or not. If that had been Congress's intent, the statute would have so stated. Rather, the Change of Ownership provision simply prohibits a *per se* rule either way."[401]

7.148 We note that the US Court of Appeals for the Federal Circuit relied specifically on the legislative history to determine the Congressional intent in promulgating the statute. The definition of "arm's-length transaction" contained in the SAA[402], quoted in para. 7.143above, is identical to the wording in the House of Representatives Report cited by the US Court of Appeals for the Federal Circuit as the basis for its interpretation of the meaning of the statute.[403]

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[400] Final Results of Redetermination pursuant to Court Remand, *Delverde Srl. v United States* Consol. Ct. No. 96-08-01997. (Note that in the version of this Remand Redetermination supplied to the Panel, the quoted text can be found on page 16.)

[401] *Delverde III.*, 202 F.3rd 1360, at 5.

[402] "For purposes of section 771(5)(F), the term "arm's-length transaction" means a transaction negotiated between unrelated parties, each acting in its own interest, or between related parties such that the terms of the transaction are those that would exist if the transaction had been negotiated between unrelated parties." SAA 1994 U.S.C.C.A.N 3773, 4241 Exhibit EC–25 to EC's first written submission

[403] The Panel recognizes that the House of Representatives Report is not, as such, in the record. However, it is cited by the Federal Circuit in *Delverde III*. The Panel has decided to look at the full document in order to respond to the United States' comments in the US' Request for Interim Review. The Panel also notes that the US Court of Appeals for the Federal Circuit stated that the Senate Report was "nearly identical" to the House Report it cited. *Delverde III* 202 F.3d. 1360, at 1366-67.

The Panel also notes that throughout its discussion of both the *Delverde III* case and the *Saarstahl II* case, the Court seems to use the two terms interchangeably. Therefore, based on the definition of arm's-length provided by Congress, the interchangeable use of the terms arm's-length and fair market value by the US Court of Appeals for the Federal Circuit, and the United States' inability to explain how United States law differentiates between the two, the Panel is of the view that although one can reasonably interpret the two concepts as being different, the United States' legislation and US Court of Appeals for the Federal Court decision seem to have defined arm's-length to include fair market value."[404]

7.149 So, according to the US Court of Appeals for the Federal Circuit, Section 1677(5)(F) prevents a *per se* rule that privatization at arm's-length and for fair market value extinguishes the benefit *vis-à-vis* the privatized producer. In other words, the US Court of Appeals for the Federal Circuit has determined that Section 1677(5)(F) prevents the US Department of Commerce from developing any methodology implementing Section1677(5)(F) whereby it is required to find that the benefit from the prior financial contribution (or subsidization) is extinguished *vis-à-vis* the privatized producer solely by arm's-length privatizations at fair market value. The Panel notes that the US Department of Commerce has itself argued that "the Federal Circuit in *Delverde III* was quite clear that 19 U.S.C. Section1677(5)(F) precludes *per se* rules, including one that would automatically treat the change in ownership as extinguishing prior subsidies."[405]

7.150 The Panel understands that law, in a common law legal system, is continuously evolving. However, the current state of the law in the United States today is that expressed by the US Court of Appeals for the Federal Circuit in *Delverde III*. The United States has provided no evidence of other dispositive decisions by the Federal Circuit or the United States Supreme Court (the highest court in the United States), that would alter the binding nature of the US Court of Appeals for the Federal Circuit's holding in *Delverde III* or the Panel's understanding of what that judgment requires of the US Department of Commerce. The Panel would like to point out that in no way is it proposing that any particular methodology be adopted by the United States. The Panel examined *Delverde III*, not to assess or discuss the compatibility of the gamma methodology with the statute, but to understand the nature and legal effects of Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit, in the United States' legal system.

7.151 We are of the view that benefit and thus subsidization are extinguished *vis-à-vis* the privatized producer solely by an arm's-length and fair market value privatization. While Section 1677(5)(F) prohibits a *per se* rule that benefit and

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[404] US' request for Interim Review, para. 44.

[405] Defendant's Memorandum in Opposition to Plaintiff's Motion for Judgment upon the agency record, *Acciai Speciali Terni et al. v United States et al.* Court No. 01-00051 (Ct. Int'l Trade 5 October 2001). (Extracts; cover page, table of contents, and pages 9 to 18 attached as Exhibit EC-26) *cited in* EC's first written submission, para. 150.

thus subsidization are extinguished *vis-à-vis* the privatized producer solely by an arm's-length and fair market value privatization, the SCM Agreement, as interpreted by the panel and the Appellate Body in *US – Lead and Bismuth II* and this Panel, requires that the domestic laws and regulations and practices mandate the authorities to find that in all cases of arm's-length fair market value privatization, no benefit from prior financial contributions (subsidization) to the state-owned producer continues to accrue to the privatized producer.

7.152 Since the United States itself has argued that the *Delverde III* ruling clearly precludes *per se* rules, including one that would automatically treat the change in ownership as extinguishing prior subsidies[406], the Panel believes that the current interpretation of Section 1677(5)(F) by the US Court of Appeals for the Federal Circuit, which is binding upon the Court of International Trade and the US Department of Commerce, would prevent the United States from applying Section 1677(5)(F) in a manner consistent with the SCM Agreement.

7.153 We would like to note that a distinction must be drawn with the conclusion of the Appellate Body in *US – 1916 Act* on the relevance of judicial opinion as discretionary governmental action under WTO law. In *US – 1916 Act*, the Appellate Body stated:

> "Lastly, we note that, before the Panel and before us, the United States invoked the distinction between mandatory and discretionary legislation to argue that the 1916 Act cannot be mandatory legislation because United States' courts have interpreted or may interpret the 1916 Act in ways that would make it consistent with the WTO obligations of the United States. As we have seen, in the case law developed under the GATT 1947, the distinction between mandatory and discretionary legislation turns on whether there is relevant discretion vested in the *executive branch* of government. The United States, however, does not rely upon the discretion of the executive branch of the United States' government, but on the interpretation of the 1916 Act by the United States' courts. In our view, this argument does not relate to the distinction between mandatory and discretionary legislation."[407]

7.154 In this Report, we examine the US Court of Appeals for the Federal Circuit, not as the "exerciser" of governmental discretion but rather in its role as establishing a determinative meaning of Section 1677(5)(F) for the United States. [408] Both the *US – 1916 Act* dispute and the current dispute are concerned

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[406] Defendant's Memorandum in Opposition to Plaintiff's Motion for Judgment upon the agency record, *Acciai Speciali Terni et al. v United States et al.* Court No. 01-00051 (Ct. Int'l Trade 5 October 2001). (Extracts; cover page, table of contents, and pages 9 to 18 attached as Exhibit EC-26) *cited in* EC's first written submission, para. 150.

[407] *See* Appellate Body Report, *US – 1916 Act*, WT/DS136/AB/R, WT/DS162/AB/R, *supra* footnote 374, at para. 100.

[408] There is a well established principle of jurisprudence in the United States that "It is emphatically the province and duty of the judicial department to say what the law is." *Marbury v. Madison* 5 U.S.

with the relationship between the Executive and Judicial Branches of the United States. The Appellate Body in *US – 1916 Act* recognized that the Executive Branch cannot instruct the Judiciary, and therefore the United States could not rely on the Judiciary's exercise of discretion in a manner compatible with the WTO. [409] However, it is known that in the United States' law, the Judiciary can make binding determinations. Therefore, we can rely on judicial interpretations as an indicator of how the US Department of Commerce is required to apply Section 1677(5)(F).

(v) Does Section 1677(5)(F) Mandate a Violation of the WTO Agreement?

7.155 During the second hearing the Panel asked the representative of the United States whether Section 1677(5)(F) would allow it to reach systematic conclusions that in cases of fair market value privatization, no benefit initially determined for the state-owned producer continued to accrue to the privatized producer and thus, no countervailing duty can be imposed or maintained. The answer provided by the representative of the United States was that even if the Panel was to reach the conclusion that there was such a rule, the United States' legislation did not have to be amended, as the US Department of Commerce could comply with such findings within the parameters of the existing Section 1677(5)(F). The United States' representative did not discuss the impact of the SAA or the US Court of Appeals for the Federal Circuit judgment on this discretion.

7.156 In our view, the plain wording of Section 1677(5)(F), in maintaining the US Department of Commerce's discretion, does not require a violation of the SCM Agreement. However, the SAA (which is an authoritative interpretation of the obligations contained in Section 1677 (5)(F)) and the US Court of Appeals of the Federal Circuit's decision in *Delverde III* (which constitutes a binding determination of what Section 1677(5)(F) actually means in the United States' law and what the legislation requires from the United States' authorities) clearly demonstrate that the United States is bound to a non-compliant application of Section 1677(5)(F). In sum, we are of the view that together with the other provisions of the SCM Agreement, Article 32.5 as well as Article XVI.4 of the WTO Agreement require the United States to maintain a legislation, regulations and practices that guarantee that in cases of fair market value privatization at arm's-length no benefit *vis-à-vis* the privatized producer is determined to continue from prior subsidization or financial contributions bestowed on a state-owned producer. In the United States' legal system, Section 1677(5)(F) prohibits

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(1 Cranch) 137, 177 (1804). *See* also Panel Report, *US – 1916 Act (EC)*, WT/DS136/R, *supra*, footnote 249, para. 2.14 and footnote 21.

[409] The Appellate Body in *India – Patents (US)*, WT/DS50/AB/R, also concluded that conformity with WTO obligations cannot be obtained by an administrative promise to disregard its own binding internal legislation, i.e. by an administrative undertaking to act illegally. Appellate Body Report, *India – Patents (US)*, *supra* footnote 247, at paras. 69-71. We are of the view that this principle extends to any binding law, independently from the source.

de facto the US Department of Commerce from recognizing that in all cases where an 'arm's-length privatization for fair market value takes place, no benefit from prior financial contributions (subsidization) to the state-owned producer can continue to accrue to the privatized producer. We fail to see how the US Department of Commerce could exercise its alleged executive discretion under 1677(5)(F) in a WTO-compatible manner when it is prohibited by its Courts (and the SAA) from systematically concluding that in cases of 'arm's-length privatization for fair market value, no benefit continues to accrue to the privatized producer from prior financial contributions (or subsidization) to the state-owned producer, as provided for by our findings in paragraphs 7.60 to 7.89 above.

7.157 Article 32.5 of the SCM Agreement and Article XVI.4 of the WTO Agreement require that a Member ensure the conformity of its legislation with the SCM Agreement and the covered agreements respectively. The Panel concludes that the aggregate effect of the legislative history, object and purpose of Section 1677(5)(F), the SAA, and the determinative interpretation of that legislation by the US Court of Appeals for the Federal Circuit, is to mandate an application of Section 1677(5)(F) that will be inconsistent with Articles 10, 14, 19, and 21 of the SCM Agreement since it prohibits the relevant authority from adopting a general rule that in all situations of arm's-length privatizations for fair market value, no benefit from prior financial contributions (or subsidization) to the state-owned producer continues to accrue to the privatized producer, even though Section 1677(5)(F)'s statutory language alone would not mandate a violation of the SCM Agreement and the WTO Agreement. [410]

7.158 As Section 1677(5)(F) is found to be inconsistent with the SCM Agreement, the United States has failed to ensure conformity with the SCM Agreement as required by Article 32.5 of the SCM Agreement and Article XVI.4 of the WTO Agreement. In maintaining such WTO-incompatible laws, regulations and practices, the Panel concludes that the United States is also acting in a manner inconsistent with Article 32.5 of the SCM Agreement and with Article XVI.4 of the WTO Agreement.

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 Therefore, pursuant to the findings above, the Panel concludes that:

(a) The six determinations in the original investigations, based on the gamma methodology, are inconsistent with the SCM Agreement, since the US Department of Commerce did not examine whether the privatizations were at arm's-length and for fair market value;

[410] We would like to recall that our conclusions and findings are limited to cases of full privatization and for consideration at fair market value and we have not examined the broader issue of whether any change of ownership triggers the obligation to re-examine the conditions of application of the SCM Agreement *vis-à-vis* the new owner(s). We note that Section 1677(5)(F) deals with all and any such change of ownership and therefore also addresses situations, other than situations involving full privatization as those covered by the present Panel Report.

thus the United States failed to determine whether the new privatized producer received any benefit from prior financial contributions previously bestowed to state-owned producers. By failing to determine the existence of a benefit prior to imposing countervailing duties the United States has violated Articles 14, 19.1, and 19.4 of the SCM Agreement, which prohibit the imposition of countervailing duties where there has been no subsidization or in excess of any existing subsidization. Since the United States has imposed countervailing duties that are inconsistent with Articles 14, 19.1 and 19.4 the United States has also violated Article 10 which requires that countervailing duties be imposed consistently with the SCM Agreement.

Therefore the countervailing orders in:

– Stainless Sheet and Strip in Coils from France (C-427-815) (Case No. 1);
– Certain Cut-to-Length Carbon Quality Steel from France (C-427-817) (Case No. 2);
– Certain Stainless Steel Wire Rod from Italy (C-475-821) (Case No. 3);
– Stainless Steel Plate in Coils from Italy (C-475-823) (Case No. 4);
– Stainless Steel Sheet and Strip in Coils from Italy (C-475-825) (Case No. 5);
– Certain Cut-to-Length Carbon-Quality Steel Plate from Italy (C-475-827) (Case No.6).

are inconsistent with Articles 10, 14, 19.1 and 19.4 of the SCM Agreement.

(b) The two determinations made in the context of administrative reviews and based on the gamma methodology (Case No. 7) and on the same person methodology (Case No. 12), are inconsistent with the SCM Agreement since the US Department of Commerce did not examine whether the privatization that occurred after the original imposition of countervailing duties, was at arm's-length and for fair market value; thus the United States failed to determine whether the privatized producers received any benefit from the financial contributions previously bestowed to the state-owned producers. By failing to determine the continued existence of a benefit, prior to its decision to maintain countervailing duties, the United States has violated Articles 14, 19.4, 21.1 and 21.2 of the SCM Agreement, which prohibit a Member pursuant to an administrative review from maintaining countervailing duties where there has not been any determination of continued subsidization and thus of a continued need for countervailing duties. Since the United States has maintained countervailing

duties that are inconsistent with Articles 14, 19.4, 21.1 and 21.2 the United States has also violated Article 10 which requires that countervailing duties be imposed and thus maintain consistently with the SCM Agreement.

Therefore the countervailing duty orders in

– Cut-to-Length Carbon Steel Plate from Sweden (C-401-804) (Case No. 7); and

– Grain-Oriented Electrical Steel from Italy (C-475-812) (Case No. 12).

are inconsistent with Articles 10, 14, 19.4, 21.1 and 21.2 of the SCM Agreement.

(c) The four determinations made in the context of sunset reviews and based on the gamma methodology are inconsistent with the SCM Agreement, since the US Department of Commerce did not examine whether the privatizations, that occurred after the original imposition of countervailing duties, were at arm's-length and for fair market value. Thus the United States failed to determine whether the privatized producers received any benefit from the financial contributions previously bestowed to the state-owned producers. By failing to determine the likelihood of continuation or recurrence of a subsidization, prior to its decision to maintain countervailing duties, the United States has violated Articles 14, 19.4, 21.1 and 21.3 of the SCM Agreement, which prohibit a Member, pursuant to a sunset review, from maintaining countervailing duties where there has not been any determination of likelihood of continuation or recurrence of subsidization and thus of a continued need for countervailing duties. Since the United States has maintained countervailing duties that are inconsistent with Articles 14, 19.4, 21.1 and 21.3 the United States has also violated Article 10 which requires that countervailing duties be imposed or maintained consistently with the SCM Agreement.

Therefore, the countervailing duty orders in

– Cut-to-Length Carbon Steel Plate from United Kingdom (C-412-815) (Case No. 8);

– Certain Corrosion-Resistant Carbon Steel Flat Products from France (C-427-810) (Case No. 9);

– Cut-to-Length Carbon Steel Plate from Germany (C-428-817) (Case No. 10); and

– Cut-to-Length Carbon Steel Plate from Spain (C-469-804) (Case No. 11).

are inconsistent with Articles 10, 14, 19.4, 21.1 and 21.3 of the SCM Agreement.

Moreover, since the United States has admitted that the privatizations in Case Nos. 8 and 10 were at arm's-length and for fair market value, no benefit accrued to the privatized producers from the prior financial contribution to the state-owned producer. In maintaining countervailing duties in response to pre-privatization non-recurring subsidies, notwithstanding the absence of any benefit to the privatized producer, the United States violated Articles 10, 14, 19.4, 21.1 and 21.3 of the SCM Agreement.

(d) Once an importing Member has determined that a privatization has taken place at arm's-length and for fair market value, it must reach the conclusion that no benefit resulting from the prior financial contribution (or subsidization) continues to accrue to the privatized producer. To the extent that Section 1677(5)(F), as interpreted by the US Court of Appeals for the Federal Circuit and the SAA, requires the US Department of Commerce to apply a methodology where the benefit from a prior financial contribution is not systematically found to no longer accrue to the privatized producer solely by virtue of an arm's-length for fair market value privatization, is preventing the United States from exercising a WTO-compatible discretion. Therefore, Section 1677(5)(F) is inconsistent with Articles 10, 14, 19 and 21 of the SCM, as interpreted by the Panel and the Appellate Body Reports in *US – Lead and Bismuth II* and this Panel. As Section 1677(5)(F) is found to be inconsistent with the *SCM Agreement*, the United States has failed to ensure conformity with Article 32.5 of the *SCM Agreement* and Article XVI.4 of the WTO Agreement respectively.

8.2 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment of benefits under that agreement. The United States did not provide any evidence to rebut this presumption. Accordingly, the Panel concludes that, to the extent the United States has acted inconsistently with the provisions of the SCM Agreement and of the WTO Agreement, it has nullified or impaired benefits accruing to the European Communities under these Agreements.

8.3 The Panel recommends that the Dispute Settlement Body request the United States to bring its measures into conformity with its obligations under the SCM Agreement and the WTO Agreement.

ANNEX A

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
1	***Stainless Sheet and Strip in Coils from France*** C-427-815 Usinor-Sollac	**original investigation** 8.6.99 – CVD: 5.38%	Loans with special characteristics; shareholders advances Steel intervention fund. (accounts for bulk of CVD imposed).	Pre-July 1995: French Gov't [GOF] 90.2%; Public offering – July 1995 §§Post-July 1995: GOF 9.8%, "stable shareholders" 14% (of these 10% were GOF controlled banks or entities), By 22 Oct. 1997: GOF 1% 1998: GOF 0%	gamma methodology NB: Court remand investigation (same person methodology)	Appeal before US CIT Judgment rendered on 4 January 2002, condemning same person methodology – (Exhibit EC-29).
2	***Certain Cut-to-Length Carbon Quality Steel from France*** C-427-817 Usinor-Sollac; GTS Industries	**original investigation** 29.12 99 – CVD: 5.56% (Usinor); 6.86% (GTS)	Equity infusion as a result of conversion of Loans with Special Characteristics and Steel Intervention Fund bonds into shares of common stock, and shareholders advances. (accounts for all of countervailing duties imposed) Subsidies in question granted to Usinor group, and allocated pro-rata to GTS (a member of the group).	GTS – pre-1992: Dillinger 10.27% Change in ownership – 28 Dec 1992 1992 – 1995: GTS: Dillinger 100% Dillinger: DHS 95.3% DHS: Usinor 70% Usinor: *see supra* post-1996: DHS: Usinor 48.75%	gamma methodology NB: Court remand investigation (same person methodology)	Appeal before US CIT. Judgment rendered on 4 January 2002, condemning same person methodology – (Exhibit EC-30)

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
3	***Certain Stainless Steel Wire Rod from Italy*** C-475-821 Cogne Acciai Speciali	**original investigation** 29.7.98 – CVD: 22.22%	Equity infusions to Finsider and ILVA Pre-privatization Assistance Debt forgiveness (accounts for at least 21.74 per cent of the CVD rate).	Early 1990's: Instituto per la Riconstruzione Industriale (IRI) (Italian Gov't): 100%, thereafter by IRI subholding companies, Finsider S.p.A., Deltasider S.p.A. or ILVA S.p.A. 31 Dec. 1992 (CAS) created: CAS: 100% Cogne S.p.A., also a state-owned company. 27 Dec. 1993: CAS: 100% GE.VAL. S.p.A.	**gamma** methodology	Final determination 7.1.98
4	***Stainless Steel Plate in Coils from Italy*** C-475-823 Acciai Speciali Terni	**original investigation** 31.3.99 – CVD: 15.16%	Equity infusions to Terni, TAS and ILVA Benefits from 1988-90 restructuring of Finsider Debt forgiveness of ILVA to AST (accounts for at least 13.42 per cent of the CVD rate)	Sept. 1993 ILVA speciality steels division was spun-off to create Acciai Speciali Terni (AST) first as a limited liability company and then as a stock company. AST: 100% IRI 14 July 1994: AST: 100% KAI (holding company of a private investor consortium)	gamma methodology NB: Court remand investigation ("***same person***" methodology)	Appeal before US CIT. Judgment rendered on 1 February 2002, condemning same person methodology – (Exhibit EC-31)

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
5	***Stainless Steel Sheet and Strip in Coils from Italy*** C-475-825 Acciai Speciali Terni	**original investigation** 8.6.99 – CVD: 12.22%	see supra (accounts for 10.49 per cent of the CVD rate)	see supra	gamma methodology	Appeal before US CIT (suspended pending resolution in appeal in case 4).
6	*Certain Cut-to-Length Carbon-Quality Steel Plate from Italy* C-475-827 ILVA	**original investigation** 29.12.99 – CVD: 26.12%	Equity infusions to Nuova Italsider and (old) ILVA Debt forgiveness Capital grants to Nuova Italsider under law 675/77 (accounts for 22.68 per cent of CVD rate)	Sept. 1993: ILVA's (old) carbon steel flat products division was spun-off to create Laminati Piani (ILP), incorporated as a stock company (S.p.A.), ILP: 100% IRI March. 1995: privatization ILP: 100% Riva Acciaio S.p.A January 1997 ILP renamed ILVA (new).	gamma methodology NB: Court remand investigation ("***same person***" methodology)	Appeal before US CIT

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
7	***Cut-to-Length Carbon Steel Plate from Sweden*** C-401-804 SSAB Sventskt Stal	**administrative review** 7.4.97 – CVD: 1.91%	Equity infusions .51% *ad valorem* Structural Loans .26% *ad vlaorem* Forgiven Reconstruction Loans 1.14% *ad valorem* CVD measures imposed of 1.91 per cent *ad valorem* 7 April 1997.	SSAB was privatized in three stages: Pre privatization: SSAB: 100% Gov't of Sweden (GOS) **Stage 1: 1987** SSAB: 66% GOS. GOS sold one third of its shares to a consortium of international investors. **Stage 2: 1989** SSAB: 47.8% GOS. GOS and the investors sold part of their remaining shares. Shortly afterwards SSAB's shares were introduced on the stock exchange. **Stage 3: 1992:** GOS floated bonds to which were attached warrants to purchase the remaining GOS shares. By **Feb. 1994** all warrants were exercised SSAB now held by more than 30,000 small shareholders.	gamma methodology	Final determination 7.04.1997 Never challenged in the US Courts.

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
8	***Cut-to-Length Carbon Steel Plate from UK*** C-412-815 British Steel plc	**sunset review** 7.4.00 – CVD: 12.00% (original duty imposed 1993)	Government equity infusions Cancelled NLF debt (accounts for bulk of CVD rate)	Pre-1988, British Steel Corporation (BSC) 100%.owned by UK Gov't, no shares. 26 July 1988: a Public Limited Company named British Steel plc (BS plc) was incorporated. UK Gov't: 100% shares 23 Nov. 1988: public offering of 2 billion ordinary shares	gamma methodology	Final determination on 7.4.00.
9	***Certain Corrosion-Resistant Carbon Steel Plate Products from France*** C-427-810 Usinor	**sunset review** 6.4.00 – CVD: 15.13% (original duty imposed 1993)	Equity infusions as a result of the conversion of Loans with Special Characteristics Shareholders and Steel Intervention Fund bonds into shares of common stock; shareholders advances (accounts for bulk of CVD rate)	see supra Usinor history.	gamma methodology	Final determination on 7.4.00.

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
10	***Cut-to-Length Carbon Steel Plate from Germany*** C-428-817 Dillinger Huttenwerke Saarstahl	**sunset review** 2.8.00- CVD: 14.84% (original duty imposed 1993)	Structural improvement aids Subsidies in form of debt relief provided to DHS in connection with its creation in 1989 (accounts for full amount of CVD rate)	Pre-1989: Saarstahl Völkingen GmbH: 76 % by Gov't of Saarland (a German lander) and 24 % by, Arbed-Finanz Deutschland GmbH, a subsidiary of Arbed Luxembourg. 15 June 1989: merger of Saarstahl Völkingen GmbH with Dillinger (owned by Usinor Sacilor) into a holding company (DHS). After the merger DHS: 70% Usinor Sacilor, 27.5% Saarland, 2.5 %. On 30 June 1989, DHS transferred the assets and liabilities of the former Saarstahl Völkingen GmbH into the newly created subsidiary, Saarstahl. Thus DHS became a holding company with two operating subsidiaries, Saarstahl and Dillinger. 1993 –DHS sold its 100% interest in Saarstahl to Gov't of Saarland. 1997 – Gov't of Saarland transfers majority of shareholdings in Saarstahl to third parties pursuant to plan of reorganization.	"***gamma***" methodology in original investigation	Appeal before the CIT. Judgment rendered on 28 February 2002 finding various aspects of the US Department of Commerce's sunset practice inconsistent with the US statute. (Exhibit EC-34).

Case No.	Product/Company	Type of investigation/Date/ rate of imposition of CVD	Alleged countervailable subsidies (contributions made prior to privatization)	Privatization	Methodology	Status of the case
11	***Cut-to-Length Carbon Steel Plate from Spain*** C-469-804 Aceralia	**sunset review** 7.4.2000 – CVD: 36.86% (original duty imposed 1993)	law 60/78 (loans and infusions) Royal decree 878/81 (Loans, grants and infusions) 1984 council of ministers meeting (infusions, loan guarantees and grants) 1987 government delegated commission on economic affairs (loans, grants and retirement benefits) (accounts for bulk of CVD)	Three phase privatization: CSI – Corporacion Siderurgica (predecessor of Aceralie) **Phase one** Arbed purchased 35% of shares and became the "*technological partner*" (1 Aug. 1997) **Phase two:** Corporacion JM. Aristrain purchased 11% and Gestamp SL purchased 1% and became "*supporting partners*" (17 Oct. 1997) **Phase three**: the remaining shares were sold by an international subscription open to private investors. (March 1998).	gamma methodology	The US Department of Commerce published its final determination on 7.4.00.
12	***Grain-Oriented Electrical Steel from Italy*** C-475-812 Acciai Speciali Terni	**administrative review** 7.7.00 – CVD: 14.25% **sunset review** 1.11.00 – CVD: maintenance of original CVD imposed 1994	Equity infusions to Terni, TAS and ILVA Benefits from 1988-90 restructuring of Finsider Debt forgiveness of ILVA to AST Pre-privatization benefits under law 451/94 for ILVA Residua (accounts for 11.50 per cent of CVD)	Acciai Speciali Terni privatized Dec 1994 (see Case No. 4 supra).	same person methodology	On appeal before US CIT.

CANADA – MEASURES AFFECTING THE IMPORTATION OF MILK AND THE EXPORTATION OF DAIRY PRODUCTS, SECOND RECOURSE TO ARTICLE 21.5 OF THE DSU BY NEW ZEALAND AND THE UNITED STATES

Report of the Appellate Body
WT/DS103/AB/RW2,
WT/DS113/AB/RW2

Adopted by the Dispute Settlement Body
on 17 January 2003

Canada, *Appellant*
New Zealand, *Appellee*
United States, *Appellee*
Argentina, *Third Participant*
Australia, *Third Participant*
European Communities, *Third Participant*

Present:
Baptista, Presiding Member
Sacerdoti, Member
Taniguchi, Member

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Canada – Dairy (Article 21.5 – New Zealand and US)	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001 Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/RW, WT/DS113/RW, adopted 18 December 2001, as reversed by the Appellate Body Report, WT/DS103/AB/RW, WT/DS113/AB/RW
Canada – Dairy (Article 21.5 – New Zealand and US II)	Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/RW2, WT/DS113/RW2, 26 July 2002
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135
US – FSC	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000, as modified by the Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1677
US – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323
US – Wheat Gluten	Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/AB/R, adopted 19 January 2001

I. INTRODUCTION

1. Canada appeals certain issues of law and legal interpretations in the Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States* (the "Panel Report").[1] The Panel was established to consider a complaint by New Zealand and the United States that certain measures taken by Canada to comply with the recommendations and rulings of the Dispute Settlement Body (the "DSB") in *Canada – Dairy*[2] are not consistent with Canada's obligations under the *Agreement on Agriculture* and the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*").

2. In *Canada – Dairy*, the original panel and the Appellate Body found, *inter alia*, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The original panel and the Appellate Body also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule to the *General Agreement on Tariffs and Trade 1994* (the "Schedule") and that, therefore, Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*. On 27 October 1999, the DSB adopted the original panel and Appellate Body reports.

3. On 23 December 1999, pursuant to Article 21.3(b) of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), Canada, New Zealand, and the United States agreed that the reasonable period of time for Canada to implement the recommendations and rulings of the DSB would expire on 31 December 2000.[3] On 11 December 2000, the parties agreed to extend this period of time until 31 January 2001.[4]

4. Canada subsequently adopted certain measures with a view to implementing the recommendations and rulings of the DSB. These measures are described in Section II of this Report. Taking the view that certain of these measures were not consistent with Canada's obligations under the *Agreement on Agriculture* and the *SCM Agreement*, New Zealand and the United States requested, on 16 February 2001, that the matter be referred to a panel pursuant to Article 21.5 of the DSU.[5]

5. On the same day, New Zealand and the United States also requested authorization from the DSB to suspend concessions and other obligations, as provided for in Article 22.2 of the DSU.[6] Canada objected to the level of

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[1] WT/DS103/RW2, WT/DS113/RW2, 26 July 2002. In this Report, we refer to the panel that considered the second recourse to Article 21.5 of the DSU by New Zealand and the United States—and whose findings are the subject of this appeal—as the "Panel".

[2] The recommendations and rulings of the DSB resulted from the adoption, by the DSB, of the panel report in *Canada – Dairy*. In this Report, we refer to the panel that considered the original complaint brought by New Zealand and the United States as the "original panel".

[3] WT/DS103/10, WT/DS113/10, 7 January 2000.

[4] WT/DS103/13, WT/DS113/13, 13 December 2000.

[5] WT/DS103/16, 19 February 2001; WT/DS113/16, 19 February 2001.

[6] WT/DS103/17, 19 February 2001; WT/DS113/17, 19 February 2001.

suspension proposed and the matter was referred to arbitration, pursuant to Article 22.6 of the DSU.[7] However, the parties agreed to request the arbitrator to suspend its work pending the outcome of the Article 21.5 proceedings.[8]

6. The panel in *Canada – Dairy (Article 21.5 – New Zealand and US)*[9] found that Canada provided, through its "commercial export milk" ("CEM") mechanism, "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The panel also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule and that, therefore, Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*. The Appellate Body reversed the panel's findings on the grounds that the panel had erred in its interpretation of Article 9.1(c). The Appellate Body held that the appropriate standard, in those proceedings, for determining whether "payments" are made under Article 9.1(c), is not, as held by the first Article 21.5 panel, the domestic price, but rather the producer's costs of production. However, in the light of the factual findings made by the first Article 21.5 panel, the Appellate Body was unable to determine whether the implementation measures involved such "payments" and, hence, export subsidies within the meaning of Article 9.1(c). Consequently, the Appellate Body was also unable to determine whether these measures were consistent with Articles 3.3 and 8 of the *Agreement on Agriculture*.[10]

7. On 6 December 2001, before adoption of the panel and Appellate Body reports in the first Article 21.5 proceedings[11], New Zealand and the United States requested the establishment of a second Article 21.5 panel. They maintained that the measures taken by Canada to comply with the recommendations and rulings of the DSB of 27 October 1999, that is, the same measures at issue in the first Article 21.5 proceedings, were inconsistent with Canada's obligations under the *Agreement on Agriculture*.[12]

8. On 18 December 2001, Canada, New Zealand, and the United States agreed that the arbitration previously requested by Canada under Article 22.6 of the DSU would remain suspended pending the outcome of the second Article 21.5 proceedings.[13] The parties also agreed that New Zealand and the United States would request that the work of the Panel be suspended pursuant to Article 12.12 of the DSU until 18 February 2002.[14]

9. In the Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 26 July 2002, the Panel concluded that:

> … Canada, through the CEM scheme and the continued operation of Special Milk Class 5(d), has acted inconsistently with its

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7 WT/DS103/18, 28 February 2001; WT/DS113/18, 28 February 2001.
8 WT/DS103/14, 5 January 2001, para. 9; WT/DS113/14, 5 January 2001, para. 9.
9 In this Report, we refer to this panel as the "first Article 21.5 panel".
10 Appellate Body Report, Canada – Dairy (Article 21.5 – New Zealand and US), paras. 126-127.
11 The DSB adopted the panel report and the Appellate Body Report in *Canada – Dairy (Article 21.5 –New Zealand and US)* on 18 December 2001.
12 WT/DS103/23, 6 December 2001; WT/DS113/23, 6 December 2001.
13 WT/DS103/24, 2 January 2002; WT/DS113/24, 2 January 2002.
14 *Ibid*. This request, however, did not extend to matters relating to panel composition.

> obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, by providing export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in excess of its quantity commitment levels specified in its Schedule for exports of cheese and "other dairy products". In light of our alternative finding … that Canada has acted inconsistently with its obligations under Article 10.1 of the *Agreement on Agriculture*, we conclude that Canada has acted inconsistently with its obligations under Article 8 of the *Agreement on Agriculture*. [15]

The Panel recommended that the DSB request Canada "to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the *Agreement on Agriculture*." [16]

10. On 23 September 2002, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU, and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). [17] On 3 October 2002, Canada filed its appellant's submission. [18] On 18 October 2002, New Zealand and the United States each filed an appellee's submission. [19] On the same day, Argentina and the European Communities each filed a third participant's submission. [20] On the same day, Australia notified the Appellate Body Secretariat that, although it would not file a written submission, it intended to participate at the oral hearing. [21]

11. The oral hearing in the appeal was held on 31 October 2002. The participants and Argentina, Australia, and the European Communities presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. BACKGROUND

12. The original panel found, *inter alia*, and the Appellate Body upheld, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. It was also found that these subsidies were being provided for quantities of exports that exceeded the quantity commitment level specified in Canada's Schedule. The original panel concluded, and the Appellate Body upheld, that Canada, therefore,

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15 Panel Report, para. 6.1.
16 Panel Report, para. 6.3.
17 Canada appeals the Panel's findings under Articles 3.3, 8, 9.1(c), 10.1, and 10.3 of the *Agreement on Agriculture*.
18 Pursuant to Rule 21 of the *Working Procedures.*
19 Pursuant to Rules 22 and 23(3) of the *Working Procedures.*
20 Pursuant to Rule 24(1) of the *Working Procedures*.
21 Pursuant to Rule 24(2) of the *Working Procedures*.

had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*.[22]

13. By way of implementation, Canada abolished Special Milk Class 5(e) and restricted export subsidies under Special Milk Class 5(d) to its commitment levels.[23] At the same time, Canada established a new class of milk, Class 4(m), under which over-quota milk can be sold as domestic animal feed. Canada otherwise left unchanged its domestic milk supply management system, under which domestic milk supply is controlled through the allocation of quota to individual milk producers by government agencies.[24] Generally, a producer can sell milk domestically only within the limits of its quota. The only exception is that a producer can sell over-quota milk in the new Class 4(m) as domestic animal feed, but for a much lower price.[25] Moreover, the price of domestic milk is fixed by government agencies. Government agencies also market domestic milk, collect the sales proceeds and distribute these proceeds among producers.[26]

14. Canada also introduced a new category of milk for export processing, known as "commercial export milk" ("CEM"). Sales of CEM are made by Canadian producers to Canadian processors, for processing of that milk into various dairy products for export. These sales are made pursuant to "pre-commitment" contracts, that is, contracts concluded in advance of milk production.[27] Canadian producers may sell any quantity of CEM to processors on terms and conditions freely negotiated between the producer and the processor. Sales of CEM do not require a quota or any other form of permit from the Canadian government or its agencies. Revenues derived from sales of CEM are collected directly by producers, without government involvement. However, if a dairy product derived from CEM is sold on the domestic market, the processor is liable to financial penalties for diverting the dairy product into the domestic market. The factual aspects of the new scheme are set out in greater detail in the Panel Report.[28]

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[22] Panel Report, *Canada – Dairy*, para. 8.1(a); Appellate Body Report, *Canada – Dairy*, para. 144(b).

[23] Canada's quantity commitment levels, as contained in Part IV, Section II, of its Schedule, are: 3,500 tonnes for butter; 44,953 tonnes for skim milk powder; 9,076 tonnes for cheese; and 30,282 tonnes for other milk products.

[24] In response to questioning at the oral hearing, Canada stated that, when the milk supply management system was created, quota was allocated among existing farmers. Canada also indicated that quota is a transferable right and that an active market for quota has developed. The price of quota on this market is currently in the range of C$15,000-C$30,000/kg of butterfat per day.

[25] The administered price for Class 4(m) milk is C$10 per hectolitre ("hl"), as opposed to C$49.48/hl and C$56.06/hl, which is the price range for domestic industrial milk. Canada does not dispute these figures. (Panel Report, footnote 410 to para. 5.116)

[26] For a more detailed description of the pre-existing milk supply management system see Appellate Body Report, *Canada – Dairy*, paras. 6-16; and Panel Report, *Canada – Dairy*, paras. 2.1-2.66.

[27] At the oral hearing, Canada informed the Appellate Body that, generally, producers pre-commit to sell CEM at least 30 days in advance of the sale.

[28] Panel Report, paras. 2.2-2.4. See also Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 3.1-3.9. The average CEM price is approximately C$29/hl. (Panel Report, para. 5.60)

III. WRITTEN ARGUMENTS OF THE PARTICIPANTS AND THE THIRD PARTICIPANTS

A. Claims of Error by Canada – Appellant

1. Article 10.3 of the Agreement on Agriculture—Rules of Evidence

15. Canada argues that the Panel's interpretation of Article 10.3 is "plainly erroneous", as this provision sets out a "reverse" burden of proof that requires the responding Member to establish a rebuttable presumption that its measures are not inconsistent with its obligations. It then falls upon the complaining Members to present evidence and argument to rebut this presumption.

16. Canada contends that the Panel erroneously imposed a minimal burden on the complaining Members in examining whether they had made out a *prima facie* case. Canada also submits that it had presented sufficient evidence to raise a rebuttable presumption showing that there is no export subsidy and that the United States and New Zealand did not succeed in rebutting this presumption. Had it properly applied Article 10.3, the Panel would have ruled in favour of Canada.

2. Article 9.1(c) of the Agreement on Agriculture—"Payments Financed by Virtue of Governmental Action"

17. Canada claims that the Panel erred in finding that Canada's measures provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* and disagrees with the Panel's findings both with respect to "payments" and to "financed by virtue of governmental action".

(a) "Payments"

18. With respect to "payments", Canada argues, first, that the Appellate Body intended the cost of production standard to be based on the costs of individual dairy farmers and not on a single, industry-wide average cost of production figure. Canada points to statements of the Appellate Body such as "each producer decid[ing] for *itself*", "value of the milk to *the* producer", and "cost incurred by *the* producer" as demonstrating that the Appellate Body focused on the costs of production of the individual milk producer. An industry-wide average, in Canada's view, does not have "any relevance" to the decisions of individual producers participating in CEM transactions.

19. Second, Canada argues that the Panel erred by including imputed returns for family labour, return to management, and return to equity in a cost of production determination. Imputed returns constitute government intervention in the marketplace and are included in the Canadian Dairy Commission (the "CDC") annual cost of production survey to ensure that dairy farmers obtain "a

fair return for their labour and investment".[29] Further, returns to family labour, management, and owner's equity are derived from the profits of the dairy enterprise. Canada asserts that profits are distinct from costs and are, therefore, excluded from the cost of production determination.

20. Third, Canada maintains that marketing, transport, and administrative costs are not production costs and, therefore, should not be included in the cost of production determination. Canada also disagrees with the Panel's finding that the costs of acquiring quota should be included in the cost of production determination. Quota costs should be treated as marketing costs confined to the domestic market and not as relevant in examining export sales. Moreover, Canada considers that quota is an intangible asset with an indefinite useful life and therefore disagrees with the Panel's conclusion that Generally Accepted Accounting Principles ("GAAP") permit amortization of quota costs.

21. Finally, Canada disputes the nature of evidence which the Panel, in Canada's view, required in order to show that "payments" are not being made. According to Canada, the Panel held that there would be no "payments" if Canada could establish that the individual producer's costs of production allow the producer to participate in the CEM market without incurring losses. Canada argues that the Panel, in so holding, required Canada to match the costs of individual producers participating in CEM transactions with the returns obtained by those same producers. This would place on Canada a burden that it "cannot possibly be expected to meet".[30] Canada alleges that Article 9.1(c) cannot contemplate the existence of "payments" where a Member demonstrates that a significant proportion of producers have costs of production allowing them to participate in CEM transactions, while recouping their total cost of production.

(b) "Financed by Virtue of Governmental Action"

22. Canada submits that the Panel erred by finding a "demonstrable link" between the financing of "payments" on the sale of CEM and Canadian "governmental action". Canada believes that for a demonstrable link to exist between these two elements, there must be affirmative governmental action over the decisions of producers, for instance, where the government provides, raises, furnishes, or manages funds. Canada alleges that, where, as in the present case, government does no more than establish a framework merely *enabling* producers and processors, if they so choose, to freely negotiate the purchase and sale of milk for export, payments are not "financed by virtue of governmental action". Canada argues that, as the Appellate Body said, the Canadian government does not *oblige* or *drive* producers to produce and sell CEM.[31]

23. In Canada's view, exempting processors of CEM from any requirement to pay the domestic administered price and the prohibition of diversion of CEM into the domestic market are not demonstrably linked to the financing of any

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[29] See Section 8 of the Canadian Dairy Commission Act (R.S.C. 1985, c. C-15), Exhibit CDA-3 submitted by Canada to the Panel; Exhibit NZ-8 submitted by New Zealand to the Panel.

[30] Canada's appellant's submission, para. 47.

[31] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 117.

payments and are in no way inconsistent with Canada's obligations under the covered agreements. Similarly, Canada contends that the practice of pre-committing sales of CEM does not "finance" payments, but rather ensures that CEM is not surplus milk.

24. Next, according to Canada, the Panel's reliance upon the notion of "cross-subsidization" introduces a "foreign" and "open-ended notion" into Article 9.1(c) without this discipline having been negotiated and accepted by WTO Members.[32] The domestic regulated price does not finance "payments" within the meaning of Article 9.1(c) because it is linked only to the domestic market. Canada further alleges that it makes no sense that a producer would willingly produce additional milk and sell it at a loss. Canada also contends that a finding of "cross-subsidization" cannot, in any case, extend to the approximately 100 CEM producers in Canada that do not sell milk in the domestic market.

3. Article 10.1 of the Agreement on Agriculture—"Export Subsidies"

25. Canada submits that, if the Panel had correctly interpreted item (d) of the Illustrative List of Export Subsidies (the "Illustrative List") in Annex I of the *SCM Agreement* in the light of the context provided by Article 1.1(a)(1)(iv) of that Agreement, it could only have concluded that CEM is not provided "indirectly through government-mandated schemes". The Panel also erred in rejecting the evidence presented by Canada, showing that CEM is available on terms as favourable as those applicable to milk components under Canada's Import for Re-Export Program ("IREP"). Therefore, in Canada's view, CEM sales do not constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

B. Written Arguments of New Zealand – Appellee

1. Article 10.3 of the Agreement on Agriculture—Rules of Evidence

26. New Zealand argues that, if the Panel did not apply the burden of proof rules as set forth in Article 10.3, this was to Canada's advantage, because Canada was relieved from a burden it would otherwise have borne. Furthermore, the Panel's analysis "makes clear" that the Panel *did* require Canada to establish that no export subsidy existed and that Canada failed to discharge that burden. New Zealand submits that, in any event, any error made by the Panel in interpreting Article 10.3 had no impact on the outcome of the case.

[32] Canada's appellant's submission, para. 91.

2. Article 9.1(c) of the Agreement on Agriculture—"Payments Financed by Virtue of Governmental Action"

(a) "Payments"

27. New Zealand contends that Canada's objections to the Panel's application of the average total cost of production standard are founded on a rejection of this standard's inherent logic. Canada's approach would make the standard "fundamentally unworkable" and would "void it of any content". [33]

28. New Zealand submits, first, that a determination whether producers make sales of CEM at prices below the average total cost of production can be made only by looking at an average industry-wide determination of the total cost of production. According to New Zealand, a determination of the average total cost of production on the basis of individual producer costs of production, as proposed by Canada, is "simply unworkable" [34] and implies that the average total cost of production of each and every Canadian producer would have to be considered in order to determine whether any "payments" have been made.

29. Second, New Zealand argues that imputed costs of family labour, return to management, and return to equity must be included in the cost of production determination, because these costs represent costs incurred by the producer. New Zealand considers that these imputed costs are distinct from profits, as profits are "something over and above" all fixed and variable costs. [35] New Zealand also believes that the Panel was correct to rely on CDC cost of production data, as these are based on an objective study and are subject to audit.

30. Third, New Zealand submits that Canada's complaint about the Panel's treatment of transport and marketing costs, as well as of quota costs, is also without merit. All these costs, according to New Zealand, are costs incurred by the producers that must be recouped in the sales price. Describing costs as "marketing" costs, rather than "production" costs, does not alter this fact. New Zealand also argues that the cost of quota cannot be eliminated by assigning it to the domestic market, because the Appellate Body has said that costs related to both the domestic and the export markets have to be taken into consideration.

(b) "Financed by Virtue of Governmental Action"

31. New Zealand opines that the essence of Canada's objections to the Panel's conclusions on the phrase "financed by virtue of governmental action" is that the relevant governmental action does not "oblige" or "drive" producers to "produce and sell" CEM. However, in New Zealand's view, the Appellate Body did not find that "payments" can only be "financed by virtue of governmental action" where producers are "obliged" or "driven" to produce and sell CEM. Rather, the Panel correctly examined whether there was a demonstrable link between the governmental action and the financing of "payments".

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[33] New Zealand's appellee's submission, paras. 3.08 and 3.17.
[34] *Ibid.*, para. 3.35.
[35] *Ibid.*, para. 3.23.

32. In New Zealand's view, exempting the processor from the requirement to pay the higher domestic price is clearly linked to the financing of "payments". The sole purpose of the exemption is to make milk available for export processing. This would not be possible if processors had to purchase milk at the domestic price.

33. With respect to the Canadian argument that the notion of "cross-subsidization" is "foreign" to the *Agreement on Agriculture* and any other covered agreement, New Zealand claims that cross-subsidization is relevant under the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*"). Also, the possibility of cross-subsidization under Article 9.1(c) was identified, as a relevant consideration, by the Appellate Body in the first Article 21.5 proceedings.

3. Article 10.1 of the Agreement on Agriculture—"Export Subsidies"

34. In New Zealand's view, Canada's arguments that the Panel should have derived guidance from Article 1 of the *SCM Agreement* in its interpretation of item (d) of the Illustrative List of the *SCM Agreement* would artificially narrow the scope of item (d). The Panel, in New Zealand's view, applied item (d) in accordance with its terms, and it was unnecessary to look elsewhere to restrict or expand the scope of that provision. New Zealand also agrees with the Panel that IREP imports are available to export processors on commercially less favourable terms than CEM.

C. Written Arguments of the United States – Appellee

1. Article 10.3 of the Agreement on Agriculture—Rules of Evidence

35. The United States argues that Canada's objection to the Panel's interpretation of Article 10.3 overlooks the fact that the Panel's approach could only serve to benefit Canada, since the Panel unnecessarily examined initially whether the complainants had made out a *prima facie* case. However, the United States is of the view that this additional step did not change the outcome of the dispute.

2. Article 9.1(c) of the Agreement on Agriculture—"Payments Financed by Virtue of Governmental Action"

(a) "Payments"

36. The United States opines that the Panel properly concluded that Canadian milk producers are making "payments" to Canadian milk processors. First, the United States submits that the Panel correctly found that the Appellate Body, in the first Article 21.5 proceedings, did not intend an individual cost of production

standard and that a cost of production benchmark based on individual producers was "unworkable". [36]

37. Second, the United States agrees with the Panel that all economic costs should be included in the cost of production benchmark. With respect to imputed costs, the Panel correctly recognized that investment of family labour, management, and capital in the dairy enterprise involves economic opportunity costs. The fact that the CDC calculates these costs annually and includes them in its survey of costs of production contradicts Canada's argument that a determination of a proper amount for imputed returns to family labour, management, and owner's equity is inherently speculative as well as subjective. The United States asserts that the use of this data to establish the domestic regulated price does not detract from the validity of this data.

38. Third, the United States also agrees with the Panel that marketing, transportation, and administrative costs are to be included in the cost of production standard, as they represent real costs that a producer must recoup in order to remain in business over time. Similarly, the cost of obtaining a production quota represents a real cost that a producer will incur in the production of milk, regardless of its treatment under accounting principles.

39. Finally, the United States submits that the Panel correctly found that Canada's individual producer data does not establish that producers are not making "payments" to processors. Canada was unable to provide evidence correlating individual producer's costs of production with sales by each producer in the CEM market, and the Panel correctly declined to assume that only those producers with costs of production below the CEM price participate in the CEM market.

(b) "Financed by Virtue of Governmental Action"

40. The United States argues that Canada's objections to the Panel's findings with respect to the phrase "financed by virtue of governmental action" are without merit. The United States disagrees with Canada's apparent contention that the Appellate Body has already ruled on the governmental action element of Article 9.1(c). The Appellate Body did not find that Article 9.1(c) requires that producers be "obliged" or "driven" to produce additional milk for export.

41. In the United States' view, the Appellate Body explained, in the first Article 21.5 proceedings, that relevant governmental action could include the regulation of the supply and price of milk in the domestic market. The Panel then rightly concluded that a profit-maximizing milk producer will consider the extent to which the cost-covering, regulated price of domestic milk allows it to make additional sales in the CEM market while still covering its marginal costs. Canada is incorrect in its assertion that the Panel found that Canadian governmental action merely makes it possible for producers to make "payments".

42. The United States agrees that Canada's policies of exempting the processor from paying the higher domestic price, and of prohibiting diversion of

[36] United States' appellee's submission, para. 29.

CEM into the domestic market support the Panel's finding that payments are "financed by virtue of governmental action". Through these policies, Canadian governmental action ensures that the bulk of non-quota milk will be channelled into the CEM market.

43. The United States also agrees with the Panel that the requirement to pre-commit CEM sales creates an additional incentive to dedicate a larger quantity of milk to the CEM market than would otherwise be the case. As a result, the pre-commitment policy supports the Panel's finding of a "demonstrable link" between governmental action and the financing of "payments".

44. Finally, the United States believes that Canada mischaracterizes the Panel's analysis of Canada's regulation of the domestic supply and price of milk. The Panel did not create any new form of subsidization or new WTO obligation; rather, the Panel "carefully" followed the Appellate Body's guidance in this regard and used the term "cross-subsidization" as a convenient shorthand expression in its analysis of the governmental action in the form of the regulation of the domestic price and supply of milk.[37] The United States asserts that the Panel carefully considered whether the domestic regulated price allowed producers to engage in less remunerative CEM sales, while at least covering their marginal costs of production.

3. Article 10.1 of the Agreement on Agriculture—"Export Subsidies"

45. According to the United States, the Panel correctly found that Canada's CEM scheme is inconsistent with Article 10.1 of the *Agreement on Agriculture*. Contrary to Canada's allegations, the Panel did not overlook relevant context in applying item (d) of the Illustrative List of the *SCM Agreement*. Furthermore, the United States agrees with the Panel that Canadian milk processors obtain CEM at more favourable terms than whole milk powder through IREP.

D. Written Arguments of the Third Participants

1. Argentina

46. Argentina agrees broadly with the Panel's reasoning under Article 9.1(c) and considers that, given the characteristics of the Canadian milk supply system—as discussed by the Panel—,Canadian producers will channel their surplus production into the CEM market. Argentina also submits that the use of the phrase "by virtue of", rather than of the word "by", indicates that Article 9.1(c) covers circumstances where "payments" are not financed directly by government, and where government does not intervene directly in the provision of "payments", but nevertheless creates "a whole set of circumstances" that ultimately lead to "payments" on exports.[38]

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[37] United States' appellee's submission, para. 61.
[38] Argentina's third participant's submission, para. 26.

47. As regards Article 10.1 of the *Agreement on Agriculture*, Argentina concurs with the Panel that Canada failed to establish the absence of the three elements of export subsidies contemplated by item (d) of the Illustrative List of the *SCM Agreement*. A governmental measure that falls under item (d) of the Illustrative List of the *SCM Agreement* is, at the same time, an "export subsidy" within the meaning of Article 10.1, even if no charge on the public account is involved.

2. European Communities

48. The European Communities agrees with Canada that the Panel incorrectly interpreted Article 10.3 of the *Agreement on Agriculture*. The correct standard of proof to be applied in this case is that Canada should make out a *prima facie* case to establish that its measure does not constitute an "export subsidy".

49. With respect to the issue of "payments" under Article 9.1(c) of the *Agreement on Agriculture*, the European Communities considers that the average total cost of production is not the appropriate benchmark for assessing whether there are "payments" within the meaning of Article 9.1(c). The Panel's standard makes it possible to find a subsidy where no "benefit" is provided and, in any event, the standard is "unworkable".[39] The Panel also erred in including in the cost of production standard an amount for profit as well as cost items such as family labour, return on management, and return on equity. Finally, in examining the evidence of "payments", the Panel imposed an insurmountable burden of proof on Canada.

50. With respect to the phrase "financed by virtue of governmental action", the European Communities "fully supports" Canada's appeal.[40] The Panel applied a standard that contradicts the Appellate Body's guidance in that the Panel found that it was sufficient to show that governmental action makes sales possible. None of the four governmental actions identified by the Panel—that is, prohibition on diversion of CEM into the domestic market; the exemption of export processors from paying the fixed domestic price; cross-subsidization; and the pre-commitment requirement—is sufficient to establish that producers are obliged or driven to provide CEM.

51. The European Communities opines that the Panel added to the obligations under Article 9.1(c) of the *Agreement on Agriculture*. An interpretation of the term "financed" as also covering payments-in-kind goes beyond the ordinary meaning of the term. Article 9.1(c) includes private party payments only to the extent that "payments" are financed from the proceeds of a levy imposed on the agricultural product concerned. Accordingly, the European Communities submits that, for a measure to fall under Article 9.1(c), the government must "impose" or "mandate" payments.[41]

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[39] European Communities' third participant's submission, title of section IV.A.1 (b), p. 12.
[40] *Ibid.*, para. 67.
[41] *Ibid.*, title of section IV.B.4 (b), p. 25.

52. The European Communities further contends that the Panel's findings are based on the assumption that WTO Members intended to prevent cross-subsidization, that is, that WTO Members intended to target the *omission* of governments to prevent the "natural economic behaviour" of cross-subsidization.[42] However, Article 9.1(c), like all WTO law, is concerned only with governmental *actions*, not also with governmental *omissions*.

53. The European Communities disagrees with the Panel's findings on Article 10.1 of the *Agreement on Agriculture*. The notion of an export subsidy under this provision must be read "co-extensively"[43] with the basic definition of subsidies under the *SCM Agreement*, unless the *Agreement on Agriculture* contains an explicit derogation. In the European Communities' view, the measure at issue does not meet the basic definitional elements for a "financial contribution", under Article 1.1(a)(1)(iv) of the *SCM Agreement*, because it does not "entrust or direct a private body to carry out" a function otherwise carried out by governments. Nor is the measure a "government-mandated scheme" within the meaning of item (d) of the Illustrative List of the *SCM Agreement.*

IV. ISSUES RAISED IN THIS APPEAL

54. This appeal raises the following issues:

(a) whether the Panel erred, in paragraph 5.18 of the Panel Report, in its finding under Article 10.3 of the *Agreement on Agriculture*, with respect to the allocation of the burden of proof under that provision;

(b) whether the Panel erred, in paragraphs 5.89 and 5.135 of the Panel Report, in its finding under Article 9.1(c) of the *Agreement on Agriculture*, in particular, in finding that "commercial export milk" ("CEM") involves "payments" and that these "payments" are "financed by virtue of governmental action"; and

(c) whether the Panel erred, in paragraph 5.165 of the Panel Report, in reaching its alternative finding under Article 10.1 of the *Agreement on Agriculture*, that CEM involves export subsidies applied in a manner that is inconsistent with that provision.

V. ARTICLE 10.3 OF THE *AGREEMENT ON AGRICULTURE*— RULES OF EVIDENCE

55. At the outset of its findings, the Panel considered the significance of Article 10.3 of the *Agreement on Agriculture* for these proceedings. The Panel noted that the parties were in agreement that, under Article 10.3, Canada—the responding Member—bears the burden of proof.[44] Accordingly, the Panel

[42] European Communities' third participant's submission, para. 115.
[43] *Ibid.*, para. 125.
[44] Panel Report, para. 5.13. See also Panel Report, paras. 3.4-3.5.

opined that, if the complaining Members demonstrated "that Canada has exceeded its export subsidy reduction commitment levels on certain dairy products", it would be for Canada to establish that it is not providing export subsidies in relation to the exports exceeding its commitment levels.[45] In that respect, the Panel stated that:

> … an operational interpretation of Article 10.3 requires that the Complainants make a *prima facie* showing that the elements of the claimed export subsidies are present.
>
> … [P]rovided that the Complainants make out a *prima facie* case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies under either Article 9.1(c) or Article 10.1, *it will then be for Canada*, pursuant to Article 10.3 of the *Agreement on Agriculture* … to establish that [these products] do not benefit from these particular types of export subsidies.[46] (underlining added)

56. Thus, the Panel envisaged a three-step process under Article 10.3:

(i) The *complaining* Member(s) must demonstrate that the responding Member has exported an agricultural product in quantities that exceed the quantity commitment level specified in its Schedule to the *General Agreement on Tariffs and Trade 1994* (the "Schedule");

(ii) the *complaining* Member(s) must next "make out" a *prima facie* case that "the elements of the claimed export subsidies" are present; and

(iii) the *responding* Member(s) must establish that no export subsidy has been granted for exports of the product in excess of the quantity commitment level.

57. Canada considers that the Panel erred by requiring the complaining Members to make out a *prima facie* case of their claims. In consequence, Canada argues that the Panel failed properly to apply the burden of proof. Canada asserts that Article 10.3:

> … sets out a reverse burden of proof, which … requires the respondent to establish a rebuttable presumption that its measures are not inconsistent. It is then up to the complainant to present evidence and argument that rebuts this presumption.[47]

58. In its appeal, Canada submits that the original panel in *Canada – Dairy*[48] correctly interpreted Article 10.3.

59. In the original panel proceedings, the panel made the following remarks on Article 10.3:

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[45] Panel Report, para. 5.15.
[46] *Ibid.*, paras. 5.18-5.19.
[47] Canada's appellant's submission, para. 31.
[48] In this Report, we refer to the panel that considered the original complaint brought by New Zealand and the United States as the "original panel".

> This provision *shifts the burden of proof* from the complainant to the defendant. A defending party (i.e., the exporting country) alleging that exports in excess of its reduction commitment level are not subsidized must demonstrate that no export subsidy in respect of this excess has been granted. All parties in dispute agree that the wording of Article 10.3 has this effect of reversing the usual burden of proof. [49] (emphasis added; footnote omitted)

60. The original panel did not require the complaining Member to make out a *prima facie* case; that is, the second step above was not included in the reasoning. Instead, the original panel read Article 10.3 as allocating the burden of proof to the responding Member to demonstrate that no subsidies were provided for exports exceeding the commitment levels (that is, the third step above). [50]

61. In the first Article 21.5 proceedings, the panel expressed a very similar view, opining that "when reduction commitments have been exceeded, Article 10.3 has the effect of reversing the usual burden of proof". [51] That panel did not require the complaining Members to make out a *prima facie* case of the elements of the claimed export subsidy.

62. The meaning of Article 10.3 of the *Agreement on Agriculture* was also addressed in the original proceedings in *US – FSC*. In that dispute, the panel considered it "evident" that Article 10.3 "shifts" or, as it also said, "reverses", the usual rule that the burden of proof is on the complaining Member to establish its claims. [52] That panel also made no mention of any requirement for the complaining Member to make out a *prima facie* case of the elements of the claimed export subsidy.

63. Although Article 10.3 of the *Agreement on Agriculture* has been examined by several panels, this is the first time that we examine the interpretation of this provision.

64. Before addressing Article 10.3, it is useful to recall our view of the burden of proof as a general matter. This issue was first examined in *US – Wool Shirts and Blouses*, where we stated that:

> … various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. Also, it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is

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[49] Panel Report, *Canada – Dairy*, para. 7.33.

[50] The original panel also established that Canada had exported dairy products in quantities exceeding the quantity commitment level (that is, the first step above). (*Ibid.*, para. 7.34)

[51] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.3.

[52] Panel Report, *US – FSC*, paras. 7.136 and 7.161.

> true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.[53] (footnotes omitted)

65. In *EC – Hormones*, we said:

> The initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency with a particular provision of the *SPS Agreement* on the part of the defending party, or more precisely, of its SPS measure or measures complained about. When that *prima facie* case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency.[54]

66. Thus, we have consistently held that, as a general matter, the burden of proof rests upon the complaining Member. That Member must make out a *prima facie* case by presenting sufficient evidence to raise a presumption in favour of its claim. If the complaining Member succeeds, the responding Member may then seek to rebut this presumption. Therefore, under the usual allocation of the burden of proof, a responding Member's measure will be treated as WTO-*consistent*, until sufficient evidence is presented to prove the contrary. We will not readily find that the usual rules on burden of proof do not apply, as they reflect a "canon of evidence" accepted and applied in international proceedings.

67. Article 10.3 of the *Agreement on Agriculture* reads:

> *Prevention of Circumvention of Export Subsidy Commitments*
>
> …
>
> 3. Any Member which claims that any quantity exported in excess of a reduction commitment level is *not* subsidized *must establish that no export subsidy*, whether listed in Article 9 or not, *has been granted* in respect of the quantity of exports in question. (emphasis added)

68. This provision requires that a specific Member, in defined circumstances, "establish that no export subsidy … has been granted". We begin by identifying the specific Member and circumstances to which Article 10.3 applies. The provision refers to a Member making a "claim" that certain exports are "*not* [being] subsidized". Although the word "claim" usually refers to an assertion by a complaining Member that a measure is WTO-*inconsistent*, in this provision the word "claim" refers to an assertion by a responding Member that a measure is WTO-*consistent*. The "claim" to which Article 10.3 refers is, therefore, a defensive argument made by the responding Member.

69. Article 10.3 does not impose any substantive obligations regulating the grant of export subsidies under the *Agreement on Agriculture*. Rather, Article 10.3 provides a special rule for proof of export subsidies that applies in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.

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[53] Appellate Body Report, *US – Wool Shirts and Blouses*, at 335.
[54] Appellate Body Report, *EC – Hormones*, para. 98.

70. In identifying the nature of the special rule, it is useful to analyze the character of claims brought under these provisions. Pursuant to Article 3 of the *Agreement on Agriculture*, a Member is *entitled* to grant export subsidies within the limits of the reduction commitment specified in its Schedule.[55] Where a Member claims that another Member has acted inconsistently with Article 3.3 by granting export subsidies in excess of a quantity commitment level, there are *two* separate parts to the claim. First, the responding Member must have exported an agricultural product in quantities exceeding its quantity commitment level. If the quantities exported do not reach the quantity commitment level, there can be no violation of that commitment, under Article 3.3. However, merely exporting a product in quantities that exceed the quantity commitment level is not inconsistent with the commitment. The commitment is an undertaking to limit the quantity of exports that may be *subsidized* and not a commitment to restrict the volume or quantity of exports *as such*. The second part of the claim is, therefore, that the responding Member must have granted export subsidies with respect to quantities exceeding the quantity commitment level. There is, in other words, a *quantitative* aspect and an *export subsidization* aspect to the claim.

71. Under the usual rules on burden of proof, the complaining Member would bear the burden of proving both parts of the claim. However, Article 10.3 of the *Agreement on Agriculture* partially alters the usual rules. The provision cleaves the complaining Member's claim in two, allocating to different parties the burden of proof with respect to the two parts of the claim we have described.

72. Consistent with the usual rules on burden of proof, it is for the complaining Member to prove the first part of the claim, namely that the responding Member has exported an agricultural product in quantities that exceed the responding Member's quantity commitment level.

73. If the complaining Member succeeds in proving the quantitative part of the claim, and the responding Member contests the export subsidization aspect of the claim, then, under Article 10.3, the responding Member "*must establish* that no export subsidy … has been granted" in respect of the excess quantity exported. (emphasis added) The language of Article 10.3 is clearly intended to alter the generally-accepted rules on burden of proof. The verb "establish" is synonymous with the verbs "demonstrate" and "prove".[56] Moreover, the auxiliary verb "must" conveys that the responding Member has an obligation—or legal burden—to "establish" or "prove" that "no export subsidy … has been granted".

74. The plain meaning of the text is borne out by the immediate context of Article 10.3 of the *Agreement on Agriculture*. Article 10 is entitled "*Prevention of Circumvention of Export Subsidy Commitments*". As a subparagraph of this provision, Article 10.3 pursues this aim. The significance of Article 10.3 is that,

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[55] Under Articles 3.1 and 3.3 of the *Agreement on Agriculture*, "commitments limiting subsidization" of exports are specified in the Schedule in terms of "budgetary outlay and quantity commitment levels".

[56] *The Shorter Oxford English Dictionary*, C.T. Onions (ed.) (Guild Publishing, 1983), Vol. I, p. 682; *Roget's Thesaurus of English words and phrases* (Longman Group Limited, 1982), p. 809.

where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-*inconsistent* export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary. This reversal of the usual rules obliges the responding Member to bear the consequences of any doubts concerning the evidence of export subsidization. Article 10.3 thus acts as an incentive to Members to ensure that they are in a position to demonstrate compliance with their quantity commitments under Article 3.3.

75. With respect to the export subsidization part of the claim, the complaining Member, therefore, is relieved of its burden, under the usual rules, to establish a *prima facie* case of export subsidization of the excess quantity, provided that this Member has established the quantitative part of the claim. We, therefore, do not agree with the Panel that the complaining Member must make out a *prima facie* case in support of this part of its claim. In practice, the complaining Member may wish to present evidence to rebut any evidence presented by the responding Member. However, the complaining Member is not required to lead in the presentation of evidence to panels, and it might well succeed in its claim even if it presents no evidence—should the responding Member fail to meet its legal burden to establish that no export subsidy has been granted with respect to the excess quantity.

76. We, therefore, find that the Panel erred, in paragraph 5.18 of the Panel Report, in its interpretation of Article 10.3 of the *Agreement on Agriculture*, by imposing upon the complaining Members the duty to make out a *prima facie* case in support of all aspects of their claims under Articles 3.3, 8, 9.1(c), and 10.1.[57] When the Panel had determined that the complainants had established that Canada had exported dairy products in quantities exceeding its quantity commitment levels, it should have proceeded directly to require Canada to establish that the exports of dairy products did not benefit from export subsidies. Instead, the Panel's next step was to require the complaining Members to "make a *prima facie* showing that the elements of the claimed export subsidies are present."[58] However, as the Panel found that the complaining Members had made out such a *prima facie* case, the Panel went on correctly to hold that it is for Canada "to establish that Canadian exports of cheese and 'other milk products' do not benefit from these particular types of export subsidies."[59]

77. Thus, although the Panel's interpretation was in error, this error does not vitiate any of the Panel's findings under Articles 3.3, 8, 9.1(c), and 10.1 of the *Agreement on Agriculture*. The Panel found that the complaining Members *had* made out a *prima facie* case that CEM involved export subsidies. Although the Panel should not have engaged in this inquiry, the inquiry led the Panel to find, correctly, that Canada was obliged to prove that it had not granted export subsidies for the dairy products exported in excess of the quantity commitment level. The Panel, therefore, arrived at the legal situation envisaged by Article

[57] The Panel reiterated this error in para. 5.19 of the Panel Report.
[58] Panel Report, para. 5.18.
[59] *Ibid.*, para. 5.19.

10.3 and, thereafter, properly applied the rules on burden of proof in that provision with respect to proof of the export subsidization aspect of the claim. The Panel concluded that Canada "failed to establish" that CEM did not involve export subsidies.[60] We will examine, below, the appeals that Canada makes against this finding under Articles 9.1(c) and 10.1 of the *Agreement on Agriculture*. However, we see no reason to disturb these findings on the grounds that the Panel misinterpreted Article 10.3.

VI. ARTICLE 9.1(c) OF THE *AGREEMENT ON AGRICULTURE*— "PAYMENTS FINANCED BY VIRTUE OF GOVERNMENTAL ACTION"

78. The second issue appealed by Canada is whether the Panel erred in its interpretation and application of Article 9.1(c) of the *Agreement on Agriculture*. This issue raises two separate questions: (a) whether the Panel erred in finding that CEM involves "*payments*" under Article 9.1(c); and (b) having found that CEM involves "payments", whether the Panel erred in finding that these "payments" are "*financed by virtue of governmental action*". We will examine these questions in turn.

79. Before turning to the question of "payments", we note that Canada does not appeal, and we will not address, the Panel's finding that the alleged CEM payments are made "*on the export*" of agricultural products, as required by Article 9.1(c) of the *Agreement on Agriculture*.[61]

A. "Payments"

80. The Panel began its reasoning by recalling that "payments" under Article 9.1(c) of the *Agreement on Agriculture* include "payments-in-kind" made through the supply of goods or services.[62] The Panel noted that we held, in the first Article 21.5 proceedings, that the existence of payments-in-kind, for purposes of CEM, should be determined by comparing CEM prices with "some objective standard … reflect[ing] the proper value" of milk to the producer.[63] The Panel also observed that we held that "the *average total cost of production* represents the appropriate standard" in these proceedings.[64]

81. Before the Panel, the parties disagreed as to how the average total cost of production standard (the "COP standard") should be determined. The Panel "doubted" that Canada was correct to argue that the standard should be each

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[60] Panel Report, paras. 5.136 and 5.164.
[61] See *ibid.*, para. 5.23.
[62] *Ibid.*, para. 5.26, referring to Appellate Body Report, *Canada – Dairy*, para. 112; and to Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 71 and 76.
[63] *Ibid.*, para. 5.27, referring to Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 74-75, 96, and 104.
[64] *Ibid.*, para. 5.28, referring to Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 87. (emphasis added) See also Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96.

individual producer's costs of production, rather than a single *industry-wide* average figure, as proposed by the complaining Members.[65] The Panel also found that Canada did not demonstrate why imputed costs for family labour and management, and for owner's equity, as well as quota, transport, marketing, and administrative costs, should not be included in calculating the COP standard, as suggested by the complaining Members.[66]

82. Despite these doubts regarding Canada's position, the Panel made two distinct findings on the existence of "payments"; one based on Canada's interpretation of the COP standard and the other based on the complaining Members' interpretation. The Panel ruled that, *even assuming Canada's interpretation of the standard were correct*, the evidence submitted by Canada did *not* support Canada's position that payments were not made.[67] The Panel also considered that the complaining Members' evidence was sufficient to establish a *prima facie* case that payments were made, on the basis of their interpretation of the COP standard.[68]

83. As the Panel came to an identical conclusion under both interpretations of the COP standard, it concluded that it was "*unnecessary [for it] to decide in this case* which of these two interpretations is the correct one."[69] Therefore, the Panel did *not* express any definitive views on the proper application of the COP standard.

84. In its appeal, Canada makes four primary arguments on the question of "payments". Canada contends: first, that the Panel erred in considering that the COP standard should be applied on an industry-wide basis; second, that the Panel erred in finding that the COP standard includes "non-monetary costs", such as the costs of family labour and management, and of owner's equity, that do not represent actual cash costs incurred by the producer; third, that the Panel erred in finding that the COP standard extends to costs associated with selling milk, such as quota, transport, marketing, and administrative costs, whereas Canada submits that it covers only the on-farm costs of producing milk; and fourth, that the Panel erred in its assessment of the evidence by placing a burden on Canada that it "cannot possibly be expected to meet".[70] Before examining these four arguments, we provide general observations relating to Article 9.1(c).

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65 Panel Report, paras. 5.50-5.51.
66 *Ibid.*, para. 5.85.
67 *Ibid.*, paras. 5.65 and 5.87.
68 *Ibid.*, paras. 5.34 and 5.86.
69 *Ibid.*, para. 5.90. (original italics; underlining added) We note, however, that the Panel also stated, in para. 5.126 of the Panel Report, that "imputed costs of family labour, return to management, return to equity, and production quota, as well as transport, marketing and administrative costs … are properly to be included in a calculation of the average total cost of production."
70 Canada's appellant's submission, para. 47.

1. General Remarks on Article 9.1(c) of the Agreement on Agriculture

85. The word "payment", in Article 9.1(c) of the *Agreement on Agriculture*, denotes a "transfer of economic resources".[71] Although a monetary payment certainly involves such a transfer, the same is equally true where goods or services are transferred for less than full value. Recognizing this, we upheld the original panel's finding that the ordinary meaning of the word "payment", in Article 9.1(c) of the *Agreement on Agriculture*, "encompasses 'payments' made in forms other than money".[72]

86. In these second Article 21.5 proceedings, New Zealand and the United States assert that non-monetary "payments" are effected through the supply of goods—CEM. The issue is, therefore, whether supplies of CEM, by Canadian producers, involve a transfer of economic resources to processors.

87. In examining this question in the first Article 21.5 proceedings, we took into account that Article 9.1(c) of the *Agreement on Agriculture* describes an unusual form of subsidy in that "payments" can be made by private parties, and need not be made by government.[73] Moreover, "payments" need not be funded from government resources, provided they are "financed by virtue of governmental action".[74] Article 9.1(c), therefore, contemplates that "payments" may be made and funded by private parties, without the type of governmental involvement ordinarily associated with a subsidy. Furthermore, the notion of payments encompasses a diverse range of practices involving monetary transfers, or transfers-in-kind. We, therefore, determined that, in identifying whether "payments" are made, it is necessary to consider the particular features of the alleged "payments", by whom they are made, and in what circumstances. Thus, we found that the standard for determining the existence of "payments" under Article 9.1(c) must be identified after careful scrutiny of the factual and regulatory setting of the measure.[75]

88. In the case of CEM, we took into account the fact that the alleged "payments" are made by private parties through the supply of milk. Moreover, subject to the requirement to pre-commit sales of CEM, the private parties are entirely free to produce milk for sale as CEM, and it is for them to agree the price, volume, and timing of the sale with the buyers.[76] In these particular circumstances, we considered that the determination of whether "payments" are made depends on a comparison between the price of CEM and an "objective standard or benchmark which reflects the proper value of the [milk] to [its] provider".[77] We found that, in the circumstances of this dispute, the standard for

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[71] Appellate Body Report, *Canada – Dairy*, para. 107.
[72] *Ibid*., para. 112.
[73] Appellate Body Report, Canada – Dairy (Article 21.5 – New Zealand and US), paras. 113 and 115.
[74] *Ibid*., para. 114.
[75] *Ibid*., para. 76.
[76] In response to questioning at the oral hearing, Canada affirmed us that pre-commitment of CEM sales must be made at least 30 days in advance of the sale date.
[77] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 74.

determining the proper value of CEM is the average total cost of production of the milk (the COP standard), as this standard represents the economic resources the producer invests in the milk. If CEM is sold at less than its proper value, "payments" are made, because there is a transfer of the portion of economic resources not reflected in the selling price.

89. We also provided certain guidance on the determination of the COP standard:

> The average total cost of production would be determined by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets.[78] (original italics)

90. With these general observations in mind, we turn to Canada's four primary arguments on "payments".

2. Individual Producer's Costs of Production or Industry-wide Average

91. Canada argues that the Panel erred in considering that the COP standard is a single, *industry-wide* average cost of production figure, rather than each *individual* producer's costs of production.[79]

92. Although the Panel expressed "doubts" that the COP standard should be each individual producer's costs, rather than an industry-wide figure, we note that it did not reach a definitive view on this question.[80] Instead, as we said, the Panel examined the evidence from the perspective of the alternative positions, and found against Canada under each of them.[81]

93. Canada asserts that we found, in the first Article 21.5 proceedings, that the COP standard is based on individual producer's costs of production. However, this question was not specifically examined, nor resolved, in the first Article 21.5 proceedings.

94. For purposes of resolving this question, it is relevant to consider the *nature* of the obligations imposed under the *Agreement on Agriculture*. That Agreement, which is annexed to the *Marrakesh Agreement Establishing the World Trade Organization*, is an international agreement to which Canada is a party, as a sovereign State. Pursuant to this Agreement, Canada has undertaken a number of different obligations. Among these are the obligations in Articles 3.3

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[78] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96.

[79] We note that, although Canada argues that the COP standard should be each individual producer's costs of production, Canada presented evidence based on ten industry-wide groupings, giving an average cost of production figure for each of these groups. For each group or "decile", Canada gave the lowest and highest individual cost of production figure. The Panel also makes this point: "While speaking of the costs to individual producers, not industry-wide average costs, Canada has only provided the Panel with average costs, albeit averages within ten groupings of producers." (Panel Report, para. 5.64)

[80] Panel Report, paras. 5.50 and 5.90.

[81] *Ibid.*, paras. 5.86-5.87.

and 8 of the *Agreement on Agriculture* not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule. Accordingly, under Article 3.3, Canada has undertaken not to provide the export subsidies listed in Article 9.1 "in excess of … [its] quantity commitment levels".

95. However, under Article 9.1(c) of the *Agreement on Agriculture*, it is not solely the conduct of WTO Members that is relevant. We have noted that Article 9.1(c) describes an unusual form of export subsidy in that "payments" can be made and funded by private parties, and not just by government.[82] The conduct of private parties, therefore, may play an important role in applying Article 9.1(c). Yet, irrespective of the role of private parties under Article 9.1(c), the obligations imposed in relation to Article 9.1(c) remain obligations imposed on Canada. It is Canada, and not private parties, which is responsible for ensuring that it respects its export subsidy commitments under the covered agreements. Thus, under the *Agreement on Agriculture*, any "export subsidies" provided through private party action in Canada are deemed to be provided by Canada, and count towards Canada's export subsidy commitment levels.

96. We believe that the standard for determining the existence of "payments", under Article 9.1(c), should reflect the fact that the obligation at issue is an international obligation imposed on Canada. The question is not whether one or more individual milk producers, efficient or not, are selling CEM at a price above or below their individual costs of production. The issue is whether Canada, on a national basis, has respected its WTO obligations and, in particular, its commitment levels. It, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations.

97. By contrast, if the benchmark were to operate at the level of each individual producer, there would be a proliferation of standards, requiring individual-level inquiry and application of Article 9.1(c), as if the obligations under the *Agreement on Agriculture* involved rights and obligations of individual producers, rather than WTO Members.

98. We, therefore, find that the COP standard for determining whether the sale of CEM involves "payments", under Article 9.1(c) of the *Agreement on Agriculture*, is an industry-wide average figure that aggregates the costs of production of all producers of milk.[83] Although the Panel did not express any firm view on this issue, we see no error in the Panel's treatment of this question.

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[82] *Supra*, para. 87.

[83] We consider that it may be appropriate for the industry-wide cost of production figure to be determined using a statistically valid sample of all producers.

3. Imputed Costs

99. Canada objects to the inclusion, in the COP standard, of an imputed amount for the costs of the producer's family labour and management, and for the costs of owner's equity. Canada contends that, as the producer does not incur a cash cost for these items, they are not relevant because the COP standard does not include "non-monetary" costs.[84] Rather, Canada says, these items are rewarded by any profits earned if revenues from milk sales exceed costs.

100. The Panel did not find that these imputed costs are to be included in the COP standard nor that they are to be excluded from it. Instead, the Panel examined the evidence from the perspective of these two positions, and found against Canada under each of them.[85]

101. In examining this issue, we recall that the notion of "payment", in Article 9.1(c), covers transfers of economic resources, irrespective of the means by which the resources are transferred. Thus, the transfer may be effected in monetary form or equally by a transfer of goods or services for less than full value.[86]

102. In these proceedings, the purpose of the COP standard is precisely to determine whether supplies of CEM involve payments-in-kind that are made in a form other than money. If the COP standard were confined solely to cash costs, as Canada argues, this would overlook the possibility of "payments" being made in the form of non-cash resources invested in the production of milk. Thus, the COP standard must cover *all* of the economic resources invested in the production of milk and which may be transferred, irrespective of whether the resources involve an actual cash cost.

103. We are satisfied that any labour or management services provided by the farmer's family to the dairy enterprise are relevant economic resources invested in the production of milk and must be included in the COP standard. For the dairy farmer, and his or her family, the investment of services in the dairy enterprise has an economic cost, as those services cannot be put to an alternative remunerative use. We observe that both the United States and New Zealand submitted evidence to the Panel in support of the view that, from the perspective of economic theory, any labour and management services provided to an enterprise involve such an economic "opportunity" cost.[87] Moreover, we believe that remuneration of family labour and management services is not part of the profits of the dairy farm. Rather, profits are the proceeds remaining after all costs, including such salary costs, have been accounted for.

104. The same is also true of any equity the owner invests in the dairy enterprise. The allocation of such capital is, clearly, an investment of economic

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[84] Canada's appellant's submission, para. 59.

[85] Panel Report, para. 5.90. We note, however, that the Panel also "recalled", in para. 5.126 of the Panel Report, that these imputed costs "are properly to be included in a calculation of the average total cost of production."

[86] Appellate Body Report, *Canada – Dairy*, paras. 107-112.

[87] Exhibit NZ-23 submitted by New Zealand to the Panel; Exhibit US-35 submitted by the United States to the Panel.

resources and carries an economic opportunity cost to the owner because the capital cannot simultaneously be invested elsewhere.[88] Again, the profits of the dairy enterprise are the proceeds after all costs, including the cost of equity, have been accounted for.

105. Moreover, it would be incongruous if the costs of family labour and management were excluded from the COP standard when provided by family, but included when provided by others.[89] Likewise, it would be curious if the cost of capital, of which equity is one type, were excluded from the COP standard when capital is provided through the owner's equity, but included when it is provided through, for instance, debt, merely because the cost of debt is expressed in recurring cash outlays for interest payments. In each case, the dairy enterprise is incurring an economic cost and that cost should be appropriately reflected in the costs of production.

106. Accordingly, we find that any failure to include in the COP standard the costs of family labour and management, or of owner's equity, would understate the costs of milk production, and may lead to a non-monetary "payment" going undetected.

107. Although it is clear that the COP standard includes all economic costs, even if they are non-cash costs, we acknowledge that a specific value cannot be as readily ascribed to non-cash costs as it can to cash costs. However, we do not believe, as suggested by Canada, that this practical difficulty precludes the application of an objective COP standard.

108. In some situations, it may be appropriate for a panel to value non-monetary costs using a methodology set forth in a Member's Generally Accepted Accounting Principles ("GAAP"). In that respect, we observe that Canada did not contest the amounts the Canadian Dairy Commission (the "CDC") ascribed to depreciation using the rules in Canadian GAAP.[90] However, although GAAP provide an objective valuation methodology for some non-monetary costs, they may not address all such costs.[91] If GAAP rules do not provide an appropriate basis for valuing a particular cost, a panel should attempt to determine a value

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[88] The documentary evidence submitted by New Zealand and the United States is equally supportive of the view that, in economic theory, investment of equity involves an economic opportunity cost. (*Ibid*.)

[89] We note that, according to the Canadian Dairy Commission Handbook ("*CDC Handbook*"), family labour and management is treated as an imputed, non-cash cost, "regardless of whether or not the family member is paid for his/her labour". (*CDC Handbook*, p. 26, Exhibit NZ-4 submitted by New Zealand to the Panel; Exhibit US-22 submitted by the United States to the Panel) Thus, in some cases there may be an actual cost for family labour and management which is excluded by the CDC and replaced by an imputed cost using the CDC's methodology. Canada's argument would, in fact, exclude both an actual cost incurred by the dairy enterprise and an imputed cost. We note also that the *CDC Handbook* defines a family member in broad terms to include: "the producer, the producer's spouse, children, brothers, sisters, sons-in-law, daughters-in-law and parents." (*CDC Handbook*, p. 25, principle 8, Exhibit NZ-4 submitted by New Zealand to the Panel)

[90] *CDC Handbook*, pp. 23-24, Exhibit NZ-4 submitted by New Zealand to the Panel; Exhibit US-22 submitted by the United States to the Panel.

[91] We note that GAAP typically provide accounting rules for corporations, often publicly listed, and not for smaller family-run enterprises. As such, many countries' GAAP may not provide rules on imputed costs for family labour, management, or owner's equity.

for relevant non-monetary costs using an objective methodology that is reasonable in the circumstances. Clearly, a panel must base itself on the evidence before it, applying the applicable rules on burden of proof.

109. We note that New Zealand and the United States submitted evidence to the Panel in the form of CDC data that includes an imputed amount for the costs of family labour and management, and of owner's equity. The methodologies the CDC used to arrive at the costs for these items are set forth in the *CDC Handbook* and seem, to us, to be perfectly reasonable.[92] In our view, the Panel did not err in placing reliance upon these data and the methodologies underlying them. Although we acknowledge that other equally reasonable valuation methods may exist, we note that Canada did not submit, pursuant to Article 10.3 of the *Agreement on Agriculture*, evidence of any alternative method for valuing these inputs.

110. We, therefore, find that the COP standard for determining whether "payments" exist, under Article 9.1(c) of the *Agreement on Agriculture*, includes all monetary and non-monetary economic costs of production, such as the costs of family labour and management, and of owner's equity. We see no error in the Panel's approach to this issue.

4. Selling Costs

111. Canada suggests that, for purposes of Article 9.1(c) of the *Agreement on Agriculture*, only the farm-based costs of producing milk should be taken into account in the COP standard, so that the costs of selling milk—such as quota, transport, marketing, and administrative costs—would be excluded.[93]

112. The Panel did not find that these selling costs are to be included in the COP standard, nor that they are to be excluded from it. Instead, the Panel examined the evidence from the perspective of both positions and found against Canada under each of them.[94]

113. We recall that the COP standard represents the producer's investment of economic resources in milk and, hence, in these proceedings, the proper value of the milk to the producer.[95] In our view, costs incurred by the producer in selling milk are as much a part of the economic resources the producer invests in the milk as are farm-based production costs. Indeed, the costs incurred to make sales

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[92] *CDC Handbook*, pp. 26-31, Exhibit NZ-4 submitted by New Zealand to the Panel; Exhibit US-22 submitted by the United States to the Panel.

[93] Although Canada considers that these costs should be excluded from the COP standard, Canada also considers that sales proceeds referable to transport, marketing, and administration inputs should be deducted from the sales price in comparing the COP standard to CEM prices. (Canada's appellant's submission, para. 64) As Canada stated at the oral hearing, the *result* is, therefore, the *same* as if these costs were *included* in the COP standard and *included* in the price. However, leaving aside the practical implications of Canada's position, the legal issue remains whether it is appropriate for selling costs to be included in the COP standard.

[94] Panel Report, para. 5.90. We note, however, that the Panel also "recalled", in para. 5.126 of the Panel Report, that the cost of quota, and transport, marketing and administrative costs "are properly to be included in a calculation of the average total cost of production."

[95] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96.

are a vital part of the process by which the producer earns revenues through producing milk. If the producer sells milk at a price sufficient to cover only the farm-based production costs, it transfers to the processor any resources invested in selling the milk, such as the value of transport, marketing, and administration. There would, in such circumstances, be a "payment" of the value of these additional selling costs. Accordingly, these costs must be included in the COP standard in the comparison with the sales price of CEM.

114. In addition, we can see no reason to exclude the cost of quota from the COP standard. On the contrary, to the extent that the acquisition or retention of quota involves economic costs for the dairy producer, these costs should be reflected in the COP standard. In that respect, we are not persuaded by Canada that the cost of quota should be excluded from the COP standard because it relates solely to the domestic market. In the first Article 21.5 proceedings, we held that the COP standard must be determined for "*all* milk, *whether destined for domestic or export markets*".[96] Thus, in principle, the costs of quota form part of the COP standard. It remains, however, to decide how quota costs are to be incorporated into the standard.

115. In these second Article 21.5 proceedings, there is very little evidence on record relating to the cost of acquiring or retaining quota, and the Panel did not make any specific findings relating to the cost of quota. Instead, in the absence of evidence, the Panel made a general statement that, "[i]f anything, additions reflecting the cost of quota" should be made to the CDC data on costs of production.[97] In other words, the Panel believed that the CDC data understated the real costs of production because they did not include an amount for the cost of quota. But the Panel was unable to quantify the addition it believed should be made. As the Panel had found that the evidence before it supported a finding that CEM sales are, on average, made at a price below the COP standard, this general remark did not have any bearing on the Panel's conclusion.[98] In the light of this fact, and in the absence of evidence relating to quota, we make no determination as to how, precisely, the cost of quota should be reflected in the COP standard.

116. Accordingly, we find that any transport, marketing, and administrative costs are to be included in the COP standard applied under Article 9.1(c), as are any costs of acquiring and retaining quota. The Panel committed no error of law in its assessment of these costs.

5. Assessment of Evidence

117. We recall that the Panel examined the evidence from two different perspectives—that is, using both the complaining Members' and Canada's

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[96] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96. (original italics; underlining added)

[97] Panel Report, para. 5.85.

[98] *Ibid.*, para. 5.89.

proposed COP standards. The Panel found that, under both of these standards, "payments" were being made through the supply of CEM. [99]

118. Canada submits that the Panel erred in its assessment of the evidence by placing a burden on Canada that it "cannot possibly be expected to meet." [100] Canada's argument relates to the Panel's assessment of the evidence *using Canada's proposed COP standard*, that is, a COP standard applied on an "individual", as opposed to an "industry-wide" basis, and *excluding* from the COP standard, the costs of family labour and management, and of owner's equity, and also quota, transport, marketing, and administrative costs.

119. We have held that the COP standard is to be determined on an industry-wide basis and that it *includes* all the costs that Canada proposed be excluded, as they involve economic resources invested in the production of milk. [101] As such, the Panel's examination of the evidence from Canada's perspective is rendered moot, because it is based on a legal standard that we have found to be the incorrect one. Any review of the Panel's treatment of the evidence must, instead, focus on its examination of the evidence which *included* the various costs Canada proposed to exclude. That is, we must review the Panel's comparison of the price of CEM with the COP standard *including* the costs of family labour and management, and of owner's equity, and also quota, transport, marketing, and administrative costs.

120. The evidence submitted to the Panel by the complaining Members, in the form of CDC data, included amounts for all these costs, other than quota. According to this evidence, the industry-wide cost of production figure for the year 2000 was C$57.27 per hectolitre ("hl"), and for 2001, it was C$58.12/hl. The average prices for CEM for these periods were C$29/hl and C$31.72/hl, respectively. [102] Thus, as the Panel found, on an industry-wide basis, CEM prices are significantly below the COP standard. On the basis of this evidence, the Panel found that there was a *prima facie* case that "payments" are being made. [103] Moreover, under Article 10.3 of the *Agreement on Agriculture*, the burden of proof was on Canada to establish the contrary. The Panel found that Canada had not satisfied that burden. [104] We can see no error in the Panel's assessment of the evidence. [105]

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[99] Panel Report, para. 5.89.
[100] Canada's appellant's submission, para. 47.
[101] *Supra*, paras. 110 and 116.
[102] Panel Report, para. 5.33; Canada's response to Question 61 posed by the Panel during the Panel proceedings.
[103] Panel Report, para. 5.89.
[104] *Ibid*.
[105] Pursuant to Article 11 of the DSU, a panel must make an objective assessment of the facts. As such, a panel is the trier of facts, responsible for evaluating the credibility and weight of the evidence. As we have stated, we will interfere with a panel's assessment of the evidence only if the panel has exceeded the bounds of its discretion as trier of facts. (Appellate Body Report, *US – Wheat Gluten*, para. 151)

6. Conclusion on "Payments" under Article 9.1(c)

121. For all these reasons, we uphold the Panel's finding, in paragraph 5.89 of the Panel Report, that the supply of CEM, by producers to processors, involves "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

B. "Financed by Virtue of Governmental Action"

122. We turn now to the second element of Canada's appeal of the Panel's findings under Article 9.1(c) of the *Agreement on Agriculture*—whether the Panel erred in finding that "payments", made on the sale of CEM, are "financed by virtue of governmental action".

123. The Panel recalled that there must be a "demonstrable link" between governmental action and the financing of "payments". [106] The Panel proceeded to examine several actions of the Canadian government in regulating the supply of domestic milk and CEM. It concluded that New Zealand and the United States had made out a *prima facie* case that a demonstrable link exists between these Canadian governmental actions and the financing of CEM payments. Further, the Panel found that Canada had failed to establish, pursuant to Article 10.3 of the *Agreement on Agriculture*, that these governmental actions were not demonstrably linked to the financing of the payments. [107]

124. On appeal, Canada argues that the Panel erred under Article 9.1(c) of the *Agreement on Agriculture*, in particular by finding that a "demonstrable link" exists between Canadian governmental action and the financing of CEM payments. Canada claims that it has removed government action from "every stage of the export transaction" and that producers and processors "freely choose to enter into export transactions". [108] Therefore, Canada argues that no demonstrable link exists between governmental action and financing of CEM payments.

125. Article 9.1(c) of the *Agreement on Agriculture* provides:

> *Export Subsidy Commitments*
>
> 1. The following export subsidies are subject to reduction commitments under this Agreement:
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> …
>
> (c) payments on the export of an agricultural product that are *financed by virtue of governmental action*, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived; (emphasis added)

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[106] Panel Report, para 5.106, referring to Appellate Body Report, *Canada – Dairy*, para. 113.
[107] *Ibid.*, paras. 5.133-5.135.
[108] Canada's appellant's submission, paras. 74 and 101.

126. The phrase "financed by virtue of governmental action" has three distinct elements—"governmental action"; "by virtue of"; and "financed"—which we will address in turn.

127. As regards "governmental action", we held in the first Article 21.5 proceedings that "the text of Article 9.1(c) does not place any qualifications on the types of 'governmental action' which may be relevant under Article 9.1(c)."[109] Instead, the provision gives but one example of governmental action that is "included" in Article 9.1(c)—however, this example is merely illustrative.[110] Accordingly, we stated that Article 9.1(c) "embraces the full-range" of activities by which governments "'regulate', 'control' or 'supervise' individuals".[111] In particular, we said that governmental action "regulating the supply and price of milk in the domestic market" might be relevant "action" under Article 9.1(c).[112] Moreover, the governmental action may be a single act or omission, or a series of acts or omissions.

128. We observe that Article 9.1(c) does not require that payments be financed by virtue of government "*mandate*", or other "*direction*". Although the word "action" certainly covers situations where government mandates or directs that payments be made, it also covers other situations where no such compulsion is involved.[113]

129. Although the term "governmental action", when read in isolation, is somewhat open-ended, perhaps even abstract, the words "by virtue of" clarify further the meaning of this term. In the first Article 21.5 proceedings, we opined:

> The words "by virtue of" indicate that there must be a demonstrable link between the *governmental action* at issue and the *financing* of the payments, whereby the payments are, in some way, financed as a result of, or as a consequence of, the governmental action.[114] (original italics)

130. The words "by virtue of", therefore, express the relationship between "governmental action" and the "financing" of payments for the purpose of Article 9.1(c). The essence of that relationship is the "nexus" or "link" between "action" and "financing".

131. Thus, although Article 9.1(c) extends, in principle, to *any* "governmental action", not every governmental action will have the requisite nexus to the financing of payments. In the first Article 21.5 proceedings, we observed that

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[109] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 112.

[110] The example given is "payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived".

[111] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 112.

[112] *Ibid.*

[113] Article 9.1(c) of the *Agreement on Agriculture* may be contrasted with Article 9.1(e) of the *Agreement on Agriculture*, as well as with Article 1.1(a)(1)(iv) of the *SCM Agreement*, and items (c), (d), (j), and (k) of the Illustrative List of Export Subsidies (the "Illustrative List") of the *SCM Agreement*. In these provisions, some kind of government mandate, direction, or control is an element of a subsidy provided through a third party.

[114] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 113.

"[g]overnments are constantly engaged in regulation of different kinds in pursuit of a variety of objectives."[115] Yet, we went on to say that regulation that merely *enables* payments to occur will not suffice for those payments to be regarded as "financed by virtue of governmental action". We stated:

> [Where regulation merely enables payments to occur], the link between the governmental action and the financing of the payments is too tenuous for the "payments" to be regarded as "*financed* by virtue of governmental action" … within the meaning of Article 9.1(c). Rather, there must be a tighter nexus between the mechanism or process by which the payments are *financed* …[116] (original italics)

132. This brings us to the meaning of the word "financing". The word refers generally to the mechanism or process by which financial resources are provided to enable "payments" to be made. The word could, therefore, be read to mean that government itself must provide the resources for producers to make payments. However, Article 9.1(c) expressly precludes such a reading, as it states that "payments" need *not* involve "a charge on the public account". This is borne out by the fact that the text indicates that "financing" need only be "by virtue of governmental action", rather than "by government" itself. Article 9.1(c), therefore, contemplates that "payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government."[117] Indeed, as we have said, payments may be made, and funded, by private parties.[118]

133. The word "financing" must, nonetheless, be given meaning. Accordingly, even if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds "payments", such that the requisite nexus exists between "governmental action" and "financing".

134. These general remarks illustrate well that "[i]t is extremely difficult … to define in the abstract the precise character of the required link between the governmental action and the financing of the payments, particularly where payments-in-kind are at issue."[119] In each case, the alleged link must be examined taking account of the particular character of the governmental action at issue and its relationship to the payments made.[120]

135. With this mind, we turn to the facts of this dispute. We recall that we have described the key features of the Canadian regulatory system in paragraphs 12-14 of this Report.[121]

136. We have also upheld the Panel's finding that producers make "payments", under Article 9.1(c) of the *Agreement on Agriculture*, to processors through sales

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115 Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115.
116 *Ibid.*
117 Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 114.
118 *Supra*, para. 87.
119 Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115.
120 *Ibid.*, para. 115.
121 See also Panel Report, paras. 2.1-2.4.

of CEM at prices that are below the COP standard. As a result, producers' sales revenues do not recoup all of the costs associated with producing and selling CEM. As this short-fall in revenues must be "financed" from some other source, sales of CEM necessarily involve the "financing" of "payments". The crucial question is the *source* of that financing and, in particular, whether the financing occurs "by virtue of governmental action".

137. The Panel considered that "a significant percentage" of Canadian milk producers are able to cover the entirety of fixed and variable costs of production through in-quota sales of domestic milk. As a result, the Panel opined, these producers can afford to make export sales at marginal cost.[122] The Panel found that governmental action regulating the domestic milk market "cross-subsidizes many sales that otherwise would not be made or would at least constitute sales at a loss."[123]

138. We note that CEM is produced almost exclusively by the same producers who supply milk to the domestic market.[124] It is not contested that these producers use the same production facilities to produce domestic and export milk—that is, the same land, cattle, buildings, machinery, milking facilities, and so on. Indeed, in some provinces, even after production, both regulatory classes of milk have common storage and transportation facilities.[125] There is, in other words, a single line of production for all milk, whatever its destination market.

139. Where fungible goods, such as milk, are produced using a single line of production, but sold in two different markets, the fixed costs of production are, in principle, shared between sales revenues from both markets. However, in the event that one of the two markets offers much higher revenues, a disproportionately large part, possibly even all, of the shared fixed costs may be borne by sales made in the more remunerative market.

140. Where sales in the more remunerative market bear more than their relative proportion of shared fixed costs, sales in the other market do not need to cover their relative proportion of the shared fixed costs in order to be profitable.[126] Rather, these sales can be made profitably *below* the average total cost of production. If the more remunerative sales cover *all* fixed costs, sales in

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[122] See also Panel Report, para. 5.128.

[123] *Ibid.*, para. 5.127.

[124] According to Canada, approximately 100 milk producers produce CEM without, at the same time, holding a domestic quota. (Canada's response to Question 2(c) posed by the Panel during the Panel proceedings, confirmed by Canada's response to questioning at the oral hearing) These 100 producers represent approximately 0.5% of all 19,000 Canadian milk producers and 1.25% of all 8000 CEM producers. (Panel Report, paras. 3.70 and 5.55) Moreover, the export market represents only 3.62 percent, by volume, of the total Canadian milk production. (Canada's response to questioning at the oral hearing)

[125] See, for instance, the Agreement on Commercial Milk Export between the British Columbia Milk Producers Association, the Mainland Dairymen's Association, and the British Columbia Dairy Council, p. 2, Exhibit US-21 submitted by the United States to the Panel.

[126] Even if sales in the more remunerative market do not cover *all* of the shared fixed costs, they may bear a higher relative proportion of those costs, such that sales in the less remunerative market can be made at a price below the average total cost of production, because these sales do not need to cover their entire relative proportion of shared fixed costs.

the other market can be made profitably at any price above marginal cost. In these situations, the higher revenue sales effectively "*finance*" a part of the lower revenue sales by funding the portion of the shared fixed costs attributable to the lower priced products.

141. In Canada, the domestic price of milk is fixed by a government agency—the CDC—on the basis of an annual survey of producers' costs of production. The CDC has a statutory mandate to ensure that, through the administered price, a "fair return" is secured for "efficient producers". The CDC sets this administered price on the basis of data covering 70 percent of producers, such that these 70 percent of producers can, on average, cover *all* of their costs of production, including *all fixed costs*, through domestic sales of milk.[127] Moreover, for other producers, domestic sales will cover a significant part, if not all, of the fixed costs. This suggests, to us, that a large proportion of producers can finance the sale of CEM at a price that is below the COP standard *as a result of participation in the domestic market*.[128] In that respect, we note also that the domestic milk market represents 96.4 percent, by volume, of total Canadian milk production, with export production representing only 3.6 percent, by volume.[129]

142. We observe that, although there is a large proportion of producers that could sell CEM below the COP standard, the proportion of producers who have actually made at least one CEM sale is around 40 percent of all producers.

143. In these circumstances, we agree with the Panel that the evidence indicates that a "significant percentage" of producers are "likely" to make sales of CEM at below the costs of production as a result of highly remunerative in-quota sales in the domestic market. For these producers, domestic sales are likely to "finance" payments made on the sale of CEM. Although the Panel's finding is based on "likelihood", this likelihood seems, to us, to be rather high. Any producer whose fixed costs have been, in large part, covered by domestic sales, and who has sufficient capacity to produce for the export market, has a powerful profit incentive to sell CEM at a competitive export price, even if that price is below the average total cost of production, as long as the price is above marginal costs of production. In any event, we recall that, pursuant to Article 10.3 of the *Agreement on Agriculture*, Canada bears the burden of proving that sales of CEM do not involve the granting of export subsidies.

144. It falls now to consider the role of the Canadian government in financing payments made on the sale of CEM. We have agreed with the Panel that a

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[127] Panel Report, para. 5.128.

[128] In addition to the *CDC Handbook*, the Panel also referred to newspaper articles submitted by New Zealand to support its view that a significant proportion of producers covers their fixed costs through domestic sales. (Panel Report, para. 5.128; Exhibit NZ-7 submitted by New Zealand to the Panel) In the two newspaper articles, the President of Dairy Farmers Canada and the Chairman of Dairy Farmers Ontario asserted, respectively, that only 25 percent and 39 percent of producers would cover all their costs at the price fixed by the CDC. At the oral hearing, Canada cautioned that such newspaper opinions should be treated "carefully". In any event, we note that even these figures tend to indicate that a large proportion of producers covers most, if not all, of their fixed costs through in-quota domestic sales.

[129] Canada's response to questioning at the oral hearing.

significant percentage of producers are likely to finance sales of CEM at below the costs of production as a result of participation in the domestic market. Canadian "governmental action" controls virtually every aspect of domestic milk supply and management.[130] In particular, government agencies fix the price of domestic milk that renders it highly remunerative to producers. Government action also controls the supply of domestic milk through quota, thereby protecting the administered price. The imposition by government of financial penalties on processors that divert CEM into the domestic market is another element of governmental control over the supply of milk. Further, the degree of government control over the domestic market is emphasized by the fact that government pools, allocates, and distributes revenues to producers from all domestic sales. Finally, governmental action also protects the domestic market from import competition through tariffs.[131]

145. In our view, the effect of these different governmental actions is to secure a highly remunerative price for sales of domestic milk by producers. In turn, it is due to this price that a significant proportion of producers covers their fixed costs in the domestic market and, as a result, has the resources profitably to sell export milk at prices that are below the costs of production.

146. Accordingly, we agree with the Panel that "governmental action" in the domestic market plays a critical part in the "financing" of payments made by a significant percentage of producers on the sale of CEM. As such, we agree with the Panel that payments made through the supply of CEM at below the COP standard are financed by virtue of this governmental action.[132] We also agree with the Panel that Canada failed to establish the contrary, pursuant to Article 10.3 of the *Agreement on Agriculture*.

147. We do not agree with Canada that the circumstances indicate that the Canadian government has merely created a regulatory framework whereby it has enabled producers to sell CEM at prices that are below the costs of production. Certainly, producers decide for themselves whether and when to sell CEM. However, governmental action in the domestic market goes further than simply creating a regulatory environment in which producers choose to make export payments using their own resources. Rather, as we have said, Canadian governmental action is instrumental in providing a significant percentage of

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[130] We recall that certain aspects of the supply and management of milk in Canada were examined in the original proceedings in this dispute. In those proceedings, we found that the agencies managing the supply of milk were "government" agencies. (Appellate Body Report, *Canada – Dairy*, para. 118)

[131] For instance, in its Schedule, Canada has established a tariff quota of 64,500 tonnes for fluid milk (tariff headings 0401.10.10 and 0401.20.10) for cross-border purchases imported by Canadian consumers, with an in-quota tariff rate of 7.5 percent since 2001; outside this tariff quota, since 2001, Canada's bound tariff is 241.3 percent, but not less than C$34.5/hl. For yogurt (tariff heading 0403.10), the tariff quota is 332 tonnes and is limited to yogurt in retail-sized containers only; outside this quota, since 2001, the applicable bound tariff rate is 237.5 percent, but not less than 46.6¢/kg. "Fresh (unripened or uncured) cheese" (tariff heading 0406.10) falls under a tariff quota of 20,411,866 tonnes; outside this quota, since 2001, the applicable bound tariff rate is 245.6 percent, but not less than 451.1¢/kg.

[132] Panel Report, paras. 5.133-5.135.

producers with the *resources* that enable them to sell CEM at below the costs of production.

148. Canada also objects that this reasoning brings "cross-subsidization" under Article 9.1(c) of the *Agreement on Agriculture*.[133] We have explained that the text of Article 9.1(c) applies to any "governmental action" which "finances" export "payments". The text does not exclude from the scope of the provision any particular governmental action, such as regulation of domestic markets, to the extent that this action may become an instrument for granting export subsidies. Nor does the text exclude any particular form of financing, such as "cross-subsidization". Moreover, the text focuses on the consequences of governmental action ("by virtue of which") and not the intent of government. Thus, the provision applies to governmental action that finances export payments, even if this result is not intended. As stated in our Report in the first Article 21.5 proceedings, this reading of Article 9.1(c) serves to preserve the legal "distinction between the domestic support and export subsidies disciplines of the *Agreement on Agriculture*".[134] Subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the Agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the "export subsidies" disciplines of Article 3.3.

149. In our view, the nexus between the Canadian governmental actions in regulating the domestic market and the financing of payments made on the sale of CEM is sufficient, on its own, for us to uphold the Panel's finding that these payments are financed "by virtue of" governmental action. However, we note that, besides these actions, the Panel also relied on other forms of governmental action in support of its conclusion on this issue.[135] The first of these was that *processors* are exempt from paying the higher domestic price for milk when they purchase CEM.[136] We do not believe that this action influences the "financing" of payments by the producer. Certainly, this action explains why the *processor* of CEM is not *required* to pay the higher domestic price for CEM. However, the mere fact that the processor is not obliged to buy CEM at the domestic price does not demonstrate a link between this exemption and the financing of payments by the *producer* on the sale of CEM. The exemption is, in short, not linked to the mechanism by which the producer funds the payments.

150. The second other form of governmental action relied on by the Panel was "the prohibition on the diversion of CEM back into the domestic regulated

[133] The Panel used this term to describe the fact that sales revenues from one market—the domestic market—finance a portion of the costs associated with sales made in another market—the CEM market. (Panel Report, paras. 5.127, 5.130, and 5.134)
[134] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 90.
[135] Panel Report, para. 5.134.
[136] *Ibid.*, paras. 5.115-5.116.

market".[137] We have already mentioned this factor in our analysis of governmental action.[138]

151. The final governmental action relied on by the Panel was the requirement for producers to pre-commit to sell CEM. The Panel found that this requirement creates "an additional incentive" to sell a larger quantity of CEM than would be the case if producers could decide to sell to that market "*ex post*".[139] Although this may be the case, we also consider it possible that producers are able to make a reasonably accurate prediction of production levels, particularly as pre-commitment occurs on a 30-day basis.[140] Further, we think producers are just as likely to err on the side of caution to ensure that CEM sales do not prejudice their ability to exhaust their quota entitlement to sell milk at the higher domestic price. In the light of these doubts, we attach no weight to the pre-commitment requirement.

152. Before concluding, we wish to comment on Canada's arguments concerning the approximately 100 producers out of the 8,000 who sell CEM, and out of the total of 19,000 producers that do *not* participate in the domestic market at all and sell solely CEM.[141] Canada argues that the Panel erred in finding that, for these producers, sales of CEM involve payments "financed by virtue of governmental action". We do not believe that it is necessary for us to make any findings regarding these 100 producers. The complaint made by New Zealand and the United States is that Canada has acted inconsistently with its export subsidy commitments under the *Agreement on Agriculture*. Canada may act inconsistently with these commitments, as we have found, even if some producers never make payments financed by virtue of governmental action.

153. We also wish to emphasize that we do not suggest that Canada's domestic supply management system is inconsistent with Canada's obligations under the covered agreements and, specifically, the *Agreement on Agriculture*. The consistency of Canada's domestic milk supply management system is *not* at issue in these proceedings. However, pursuant to Articles 3.3, 8, and 9.1(c) of the *Agreement on Agriculture*, Canada must ensure that it confines, to its export subsidy reduction commitment levels, any export "payments" which are "financed by virtue of" the governmental action Canada takes to regulate the domestic milk market.

154. In conclusion, therefore, we uphold the Panel's finding, in paragraph 5.135 of the Panel Report, that the supply of CEM, by producers to processors, involves payments which are "financed by virtue of governmental action", within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

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137 Panel Report, paras. 5.117 and 5.134.
138 *Supra*, para. 144.
139 Panel Report, para. 5.130.
140 Canada's response to questioning at the oral hearing.
141 See *supra*, footnote 124.

C. Conclusion on Article 9.1(c) of the Agreement on Agriculture

155. We have upheld the Panel's finding that the supply of CEM involves "payments" on the export of dairy products and also its finding that these payments are "financed by virtue of governmental action". Accordingly, we uphold the Panel's finding, in paragraph 5.136 of the Panel Report, that the supply of CEM involves export subsidies under Article 9.1(c) of the *Agreement on Agriculture*.

156. In consequence, we also uphold the Panel's conclusion, in paragraph 6.1 of the Panel Report, that, through the combination of the supply of CEM and the operation of Special Milk Class 5(d), Canada has acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*.

VII. ARTICLE 10.1 OF THE *AGREEMENT ON AGRICULTURE*— "EXPORT SUBSIDIES"

157. Canada also appeals the Panel's alternative finding, in paragraph 5.165 of the Panel Report, that, if the CEM scheme does not involve export subsidies under Article 9.1(c) of the *Agreement on Agriculture*, it nevertheless constitutes export subsidies under Article 10.1 of that Agreement.[142] In making this alternative finding, the Panel recalled that Article 10.1 of the *Agreement on Agriculture* is residual in character to Article 9.1 of the *Agreement on Agriculture* and that a measure cannot simultaneously be an export subsidy under both Article 9.1 and Article 10.1.[143] The Panel stated that its alternative finding under Article 10.1 of the *Agreement on Agriculture* would be relevant only if we were to reverse its finding that the CEM scheme falls within Article 9.1(c) of that Agreement.[144]

158. As we have concluded that the CEM scheme involves export subsidies under Article 9.1(c) of the *Agreement on Agriculture*, those subsidies cannot, by definition, simultaneously be export subsidies under Article 10.1. Therefore, the condition on which the Panel premised its alternative finding under Article 10.1 of the *Agreement on Agriculture* does not arise. In these circumstances, both the Panel's reasoning and its finding under Article 10.1 of the *Agreement on Agriculture* are moot and of no legal effect. There is, therefore, no reason for us to rule upon Canada's appeal of the Panel's finding under Article 10.1, nor to make any finding under this provision.

VIII. FINDINGS AND CONCLUSIONS

159. For the reasons set out in this Report, the Appellate Body:

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[142] See also Panel Report, paras. 5.174 and 6.1.
[143] See *ibid.*, para. 5.140, referring to Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 121.
[144] See *ibid.*, paras. 5.141 and 5.174.

(a) *reverses* the Panel's interpretation of Article 10.3 of the *Agreement on Agriculture* in paragraph 5.19 of the Panel Report, according to which a complaining Member would be required to make out a *prima facie* case in support of all aspects of its claims under Articles 3.3, 8, 9.1(c), and 10.1 of the *Agreement on Agriculture*, but *holds* that this error did not vitiate the Panel's findings under Articles 3.3, 8, 9.1(c), and 10.1 of that Agreement;

(b) *upholds* the Panel's finding, in paragraphs 5.89 and 5.135 of the Panel Report, that Canada, through the combination of the supply of CEM and the operation of Special Milk Class 5(d), has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies listed in Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; and

(c) declines to rule on the Panel's alternative finding under Article 10.1 of the *Agreement on Agriculture* in paragraph 5.165 of the Panel Report, as, in the light of the Appellate Body's finding in subparagraph (b) above, that alternative finding is moot and of no legal effect.

160. The Appellate Body recommends that the DSB request that Canada bring its measures found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under the *Agreement on Agriculture*, into conformity with that Agreement.

CANADA – MEASURES AFFECTING THE IMPORTATION OF MILK AND THE EXPORTATION OF DAIRY PRODUCTS

Second Recourse to Article 21.5 of the DSU by New Zealand and the United States

Report of the Panel
WT/DS103/RW2,
WT/DS113/RW2

Adopted by the Dispute Settlement Body
on 17 January 2003
as Modified by the Appellate Body Report

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I. INTRODUCTION

1.1 On 23 December 1999, pursuant to Article 21.3(b) of the DSU, Canada, New Zealand and the United States agreed (WT/DS103/10-WT/DS113/10) on the reasonable period of time for implementation of the recommendations and rulings of the Dispute Settlement Body (the DSB) in the matter of "Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products". According to the terms of the 23 December 1999 agreement, as amended on 11 December 2000 (WT/DS103/13-WT/DS113/13), the staged implementation process, including any new measures for the export of dairy products, was to be completed by 31 January 2001.

1.2 On 19 January 2001, Canada circulated to all Members of the DSB (WT/DS103/12/Add.6-WT/DS/113/12/Add.6) its "final status report", pursuant to Article 21.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the DSU). In that report Canada affirmed "that it will be in full compliance with the rulings and recommendations of the DSB by the conclusion of the implementation period" on 31 January 2001.

1.3 New Zealand and the United States consider that Canada has failed to comply with the above-mentioned recommendations and rulings of the DSB by 31 January 2001.

1.4 Without prejudice to their rights under the WTO, and in accordance with paragraph 1 of the 21 December 2000 "Agreed Procedures between Canada, New Zealand and the United States under Articles 21 and 22 of the Dispute Settlement Understanding in the follow-up to the dispute in *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*" (WT/DS113/14 and WT/DS103/14, respectively) ("Agreed Procedures"), New Zealand and the United States requested consultations with Canada on 2 February 2001. Consultations were held on 9 February 2001, but failed to resolve the dispute.

1.5 On 16 February 2001, pursuant to Article 21.5, and as envisaged in the Agreed Procedures, New Zealand and the United States accordingly requested the establishment of a panel in this matter and requested that the DSB refer the matter to the original panel, if possible (WT/DS113/16 and WT/DS103/16, respectively.)

1.6 On 16 February 2001, New Zealand and the United States also requested authorization from the DSB, pursuant to Article 22.2 of the DSU, to suspend the application to Canada of tariff concessions and other obligations under the General Agreement on Tariffs and Trade 1994 (GATT 1994) covering trade in

the amount of US$35 million for each complainant. On 28 February 2001, pursuant to Article 22.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Canada objected to the level of suspension of tariff concessions and other obligations under the GATT 1994 proposed by New Zealand and the United States (WT/DS113/17 and WT/DS103/17, respectively). In accordance with the provisions of Article 22.6 of the DSU and as envisaged in the Agreed Procedures, Canada therefore requested that this matter be referred to arbitration.

1.7 In accordance with the "Agreed Procedures", the Complainants did not object to the referral of the level of suspension of concessions or other obligations to arbitration pursuant to Article 22.6 of the DSU. In this case, New Zealand and the United States agreed to request the arbitrator to suspend its work until either (a) the adoption of the Article 21.5 compliance panel report; or (b) if there were an appeal, the adoption of the Appellate Body report.

1.8 At its meeting on 1 March 2001, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel, if possible, the matter raised by New Zealand and the United States in documents WT/DS113/16 and WT/DS103/16, respectively.

1.9 The report of the Article 21.5 panel was circulated to Members on 11 July 2001. On 4 September 2001, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report on *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (Recourse to Article 21.5 by New Zealand and the United States) and certain legal interpretations developed by the panel. The Appellate Body rendered its report on 3 December 2001.

1.10 On 6 December 2001, New Zealand (WT/DS113/23) and the United States (WT/DS103/23) requested the establishment of a second Article 21.5 panel as they considered that there continued to be "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 Canada and New Zealand and Canada and the United States, respectively, within the terms of Article 21.5 of the DSU. New Zealand and the United States therefore requested, pursuant to Article 21.5 of the DSU, that this matter be referred to the original panel.

1.11 On 18 December 2001 Canada, New Zealand and the United States agreed to an amendment of the "Agreed Procedures" which provides that the arbitration requested by Canada under Article 22.6 will remain suspended until the DSB finds that Canada has failed to comply with the recommendations and rulings of the DSB or that the measures taken by Canada to comply with the recommendations and rulings of the DSB are inconsistent with the covered agreements as referred to in the second Article 21.5 compliance panel request. Alternatively, if the DSB were to find that Canada has complied with the recommendations and rulings of the DSB, the Complainants will withdraw their request under Article 22.2 of the DSU. Further, the amendment stated that following establishment of the second compliance panel in accordance with

paragraph 2 of the Understanding, the Complainants will request that, with the exception of all matters relating to Panel composition, the work of the Panel be suspended pursuant to Article 12.12 of the DSU until 18 February 2002.

1.12 At its meeting on 18 December 2001, the Dispute Settlement Body (DSB) decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by New Zealand and the United States in documents WT/DS113/23 and WT/DS103/23, respectively.

(i) Terms of Reference

1.13 At that DSB meeting, it was also 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 the United States in document WT/DS103/16 and by New Zealand in document WT/DS113/16, the matter referred to the DSB by the United States and New Zealand in those documents and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

(ii) Composition of Panel

1.14 The Panel was composed on 17 January 2002 as follows:

Chairperson: Mr Ernst-Ulrich Petersmann

Members: Mr Guillermo Aguilar Alvarez

Mr Peter Palečka

1.15 Argentina, Australia and the European Communities reserved their third party rights.

1.16 The Panel held a meeting with the Parties on 22-23 April 2002 and with the Third Parties on 23 April 2002. The report of the Panel was submitted to the Parties on 24 June 2002.

II. FACTUAL ASPECTS

(i) Previous System

2.1 Under the Canadian supply management system, introduced on 1 August 1995, a processor who wished to export had to obtain a permit from the Canadian Dairy Commission (CDC), allowing it to buy milk under Special Milk Class 5(d) and (e). Class 5(e), referred to as "surplus removal", was made up of both in-quota and over-quota milk. Class 5(d) referred to specific negotiated exports including cheese under quota destined for the markets of the United States and the United Kingdom, as well as evaporated milk, whole milk powder and niche markets. The permit also specified the dairy products to be exported. The CDC only issued Special Milk Class 5(e) permits when all demand for milk

in the domestic market was met. Once the processor had obtained the CDC permit, it approached the local marketing board, which made milk available to the processor at the regulated price and with a guaranteed margin. Prices for Classes 5(d) and (e) were negotiated and established on a case-by-case basis with the processors/exporters. The CDC conducted these negotiations in accordance with the criteria agreed upon in the Canadian Milk Supply Management Committee (CMSMC).

(ii) Canada's Implementation Measures

2.2 Canada's implementation of the rulings and recommendations of the DSB left in place the domestic price support mechanism and production quota but eliminated Special Milk Class 5(e) and restricted exports of dairy products under Special Milk Class 5(d) to Canada's export subsidy commitment levels.[1] Canada also created a new class of domestic milk, Class 4(m), under which any over-quota milk can be sold as animal feed at a regulated price on the domestic market.[2] In addition, Canada deregulated milk for export processing (other than milk exported under Special Milk Class 5(d)) by introducing a new category of "commercial export milk" (CEM), by definition exempt from the pricing regulations applicable to milk destined for the domestic market and destined for export. There are no volume, pricing or timing restrictions on such exports.

2.3 The diversion of CEM or of products made therefrom onto the domestic market is prohibited and subject to penalties. Under pre-commitment contracts, producers decide in advance of production how much milk to sell as CEM which is then delivered first out of the tank to processors.[3] Price and volume of CEM are negotiated directly between the processor and the producer.[4] The governments in Ontario and Quebec require that all export participants operate through a single commercial export exchange.[5] These "bulletin boards" are part of the operational framework within which commercial export transactions take place.[6]

2.4 Pursuant to the *Canadian Dairy Commission Act*[7], the *Dairy Products Marketing Regulations*[8] have been modified to exclude CEM and cream from

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1 Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/AB/RW and WT/DS113/AB/RW, DSR 2001:XIII, 6865, paras. 4 and 79.
The full titles of the relevant panel and Appellate Body reports are provided in the Annex on page 373.

2 *Ibid.*, para. 4.

3 *Ibid*. The panel in *Canada - Dairy (Article 21.5 – New Zealand and US)* noted that DFO General Milk Regulation 09/00 defines CEM as milk that is pre-committed and first out of a producer's tank.

4 *Ibid.*, paras. 4 and. 79.

5 Panel Report, Canada – Dairy (Article 21.5 – New Zealand and US), DSR 1999:VI, 2097, para. 3.8.

6 *Ibid.*

7 R.S.C. 1985, c. C-15 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

8 SOR/94-466 (Exhibit CDA-1B). The Dairy Products Marketing Regulations were amended by *the Regulations Amending the Dairy Products Marketing Regulations*, C. Gaz. 2001.II.57 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

federal licensing[9], quota[10] and levy requirements[11] and from the requirement to market this milk through the provincial marketing boards. Furthermore, the milk delegation orders issued to provinces pursuant to *the Agricultural Products Marketing Act*, R.S.C. 1985, c. A-6, have been amended to remove provincial authority regarding CEM or cream.[12] As a consequence of the changes made under *the Dairy Products Marketing Regulations* and the *Ministerial Direction*[13], the regional pooling agreements (the P-9, P-6 and P-4 Agreements) do not apply to CEM. The national pooling agreement, the P-9, provides for a domestic surplus management Class, Class 4(m).

(iii) Previous Panel and Appellate Body Judgements

2.5 In its report of 17 May 1999, the original panel in *Canada - Dairy* concluded that Canada "through Special Milk Classes 5(d) and (e) … has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies as listed in Article 9.1(a) and Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; … "[14] In its report of 23 September 1999 the Appellate Body upheld the findings in the original panel report with respect to Articles 3.3, 8 and 9.1(c) of the *Agreement on Agriculture*.[15] In respect of Article 9.1(a), the Appellate Body did not uphold the reasoning of the panel, but it reserved its judgement on the question of whether Classes 5(d) and 5(e) conferred export subsidies within the meaning of Article 9.1(a).[16] The Appellate Body recommended that Canada bring those measures found to be inconsistent with its obligations under the *Agreement on Agriculture* into conformity with that agreement.[17] Canada's implementation of the Appellate Body ruling has resulted in the elimination of Special Milk Class 5(e) and the restriction of Class 5(d) to the export of dairy products within Canada's export subsidy commitment levels.[18]

2.6 Considering that Canada had failed to comply with the above-mentioned recommendations and rulings of the DSB by 31 January 2001 or since the expiry of that period, New Zealand and the United States requested consultations with

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[9] *Supra*, note 31, s. 3(3) and s. 7 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).
[10] *Ibid.*, s. 4, 5 and 6.
[11] *Ibid.*, s. 3(3).
[12] See Order Amending Milk Orders Under the *Agricultural Products Marketing Act*, SOR/2001-16, C. Gaz. 2001.II.67 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).
[13] Published in Canada Gazette, 3 January 2001.
[14] Para. 8.1(a).
[15] Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 144(b).
[16] *Ibid*., para. 144(a).
[17] *Ibid.*, para. 145.
[18] Canada Gazette Part II, Vol.135, No.1: Regulatory Impact Analysis Statement for the Regulations under the Canadian Dairy Commission Act amending the Dairy Products Marketing Regulations. The amendment to section 7.1 "provides that export subsidies for Canadian dairy products will be provided only by a program established under para. 9(1)(i) of the CDC Act (Special Milk Class 5(d))." (New Zealand's Exhibit NZ-6)

Canada on 2 February 2001 (WT/DS103/15-WT/DS113/15) and subsequently the establishment of a panel pursuant to Article 21.5 of the DSU (WT/DS103/16-WT/DS113/16).

2.7 The Article 21.5 panel submitted its report to the parties on 5 July 2001 (WT/DS103/RW). The panel concluded that Canada had continued to act inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, by providing export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in excess of its quantity commitment levels specified in its Schedule for exports of cheese, for the marketing year 2000/2001.

2.8 On 4 September 2001, Canada appealed certain issues of law covered in the Article 21.5 panel report, pursuant to Article 16.4 of the DSU. The Appellate Body rendered its report on 3 December 2001.[19] In reversing the panel's finding on the correct benchmark for the determination of the existence of "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* and in consequently reversing the panel's findings that the provision of CEM constitutes "payments" and export subsidies under that provision, the Appellate Body also reversed the panel's finding that Canada has acted inconsistently with its obligations under Articles 3.3 and 8 of that Agreement. Because the Appellate Body considered that in light of the factual findings by the panel in *Canada – Dairy (Article 21.5 – New Zealand and US)* it was unable to determine whether or not the measure at issue was an export subsidy within the meaning of Article 9.1(c) and consequently whether or not Canada's measures were consistent with its WTO obligations, it could not complete the analysis of the parties' claims under Article 10.1 of the *Agreement on Agriculture* and declined to examine the consistency of the measure at issue with Article 3.1 of the Agreement on Subsidies and Countervailing Measures (*SCM Agreement*).[20]

III. MAIN ARGUMENTS

3.1 **New Zealand** requests that the Panel find that Canada has breached Articles 3.3, 8 and 9.1(c) of the *Agreement on Agriculture*. In the alternative to its argument on Article 9.1(c), New Zealand requests the Panel to find that Canada has breached Article 10.1 of the *Agreement on Agriculture*. New Zealand therefore requests the Panel to recommend to the DSB that Canada bring its export measures into conformity with its obligations under the *Agreement on Agriculture*.

3.2 The **United States** requests that the Panel find that Canada has breached Articles 3.3, 8, and 9.1(c), or alternatively, Article 10.1, of the *Agreement on Agriculture*. In addition, the United States requests that the Panel find that Canada has breached Article 3 of the SCM Agreement. The United States requests that the Panel direct Canada to bring its export measures for dairy products into conformity with its WTO obligations.

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[19] Appellate Body Report, Canada - Dairy (Article 21.5 – New Zealand and US), *supra*, footnote 1.
[20] *Ibid.*, paras. 121, 125, 126 and 127.

3.3 **Canada** requests the Panel to reject the claims of New Zealand and the United States and find that Canada's measures, including federal measures and the provincial measures of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia, New Brunswick and Prince Edward Island, fully implement the recommendations and rulings of the DSB and are consistent with Canada's WTO obligations.

A. Burden of Proof

3.4 Referring to Article 10.3 of the *Agreement on Agriculture*, **New Zealand** and the **United States** submitted that Canada bears the burden of establishing that its dairy management measures, including those taken to comply with the DSB's recommendations, have not subsidized dairy exports in excess of its commitment levels under that *Agreement*.

3.5 **Canada** does not contest its burden of proof under Article 10.3 of the *Agreement on Agriculture*.

B. Article 9(1)(c) of the Agreement on Agriculture

3.6 The **Complainants** submitted that there are two key questions to be resolved in determining whether Canada's CEM scheme provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. First, whether there have been "payments" on the export of an agricultural product and, second, whether any such payments have been "financed by virtue of governmental action." According to the complainants, the CEM scheme fulfils both of these conditions and thus constitutes an Article 9.1(c) export subsidy.

1. "Payments"

3.7 The **Complainants** noted that in the original *Canada - Dairy* proceeding[21], the Appellate Body accepted that the concept of "payments" in Article 9.1(c) of the *Agreement on Agriculture* includes the notion of "payments-in-kind", and this was not contested in *Canada - Dairy Article 21.5*."[22] Furthermore, it is uncontested that the provision of a product at a discount constitutes such an in-kind payment because it is equivalent to the provision of a portion of the product free of charge.

3.8 **Canada** submitted that for a measure to fall within Article 9.1(c) of the *Agreement on Agriculture*, there must be "payments on the export of an agricultural product that are financed by virtue of governmental action."

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[21] Appellate Body Report, Canada - Dairy (Article 21.5 – New Zealand and US), *supra*, footnote 1, para. 112.

[22] *Ibid.*, para. 71.

(i) Average Total Costs of Production-Proper Value

3.9 The **Complainants** noted that in *Canada - Dairy Article 21.5* the Appellate Body gave content to its statement in *Canada - Dairy* that discounts amounting to "payments" arose because the Special Milk Class milk for export was sold to processors at "reduced rates (that is at below market-rates)."[23] At issue was the question of the benchmark against which any such "discount" should be measured. The Appellate Body stated that the existence of a "reduced rate" and hence a "payment" should be determined by comparing the CEM price to the "*proper value*" of the milk to the producer.[24] If the CEM price proved to be lower than the milk's value to the producer, the producer's sale of that milk at the CEM price would constitute a transfer of resources - a "payment" - to the export processor.

3.10 This led the Appellate Body to conclude, the Complainants continued, that the "proper value" of milk to producers, should be measured in terms of the producers' "average total costs of production". If the export prices obtained by producers were sufficient to recover their average fixed and variable costs of production, they would not suffer a loss (i.e. a transfer of resources) in the long run. In that circumstance, under the Appellate Body's standard, no "payments" would take place within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. It concluded that the "average total cost of production" must be determined "by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets."[25]

3.11 The Complainants submitted that there is no universal criterion or standard for determining "cost of production". However, for the purposes of determining whether there has been a "payment" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, the Appellate Body has set out what has to be taken into account in this case in an "average total cost of production" determination. It noted that milk production "requires an investment in fixed assets, such as land, cattle and milking facilities, and an outlay to meet variable costs, such as labour, animal feed and health-care, power and administration."[26] These "fixed and variable costs", it concluded, would have to be recouped in the long-term in order for producers to be profitable.[27]

3.12 Referring to paragraph 87 of the Appellate Body report in *Canada - Dairy Article 21.5* concerning fixed and variable costs and to paragraph 92 with respect to the correct benchmark in this case, **Canada** submitted that the method adopted by the Appellate Body is to determine what it costs a producer to produce milk, so that this number can be fairly compared to prices of CEM. Furthermore, the use of the words "investment" and "outlay" is indicative of what the Appellate

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[23] Appellate Body Report, Canada - Dairy (Article 21.5 – New Zealand and US), *supra*, footnote 1, para. 113.
[24] *Ibid.*, para. 74.
[25] Ibid, para. 96.
[26] *Ibid.*, para. 87
[27] *Ibid.*

Body considered as cost of production in the context of costs actually incurred and expended by the producer. Canada considered that these words, along with the idea expressed by the Appellate Body that "fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup in the long-term to avoid making losses", do not allow for the consideration of imputed amounts.

3.13 Canada submitted that the approach adopted by the Appellate Body is consistent with the arguments put forward by Canada before the first *Canada - Dairy Article 21.5* panel. This method also provides a relevant standard for assessing an individual producer's cost of production for purposes of these proceedings, as it is based on values to which producers actually respond when deciding whether to enter the export market, and not on government intervention. This method of measuring cost of production is also consistent with the Generally Accepted Accounting Principles (GAAP). In the context of GAAP, "cost" is "[t]he amount of the expenditure to obtain goods or services"[28] and "expenditure" is "[a] disbursement, a liability incurred … for the purpose of obtaining goods."[29] Therefore, Canada submitted, the costs to be included in the measurement of cost of production are those that result from actual expenditures and would exclude imputed costs and returns.

(ii) The Canadian Dairy Commission

3.14 The **Complainants** noted that the Canadian Dairy Commission (CDC) makes an annual cost of production determination as the basis for setting the target price for industrial milk. Thus, the Complainants considered it appropriate to look at that determination to see whether it provides an assessment of the "average total cost of production" that conforms with the test set out by the Appellate Body.

3.15 The Complainants further noted that the guidelines for the CDC's cost of production determination are set out in the CDC publication *National Cost of Production Input to the Pricing of Industrial Milk, Handbook of COP Principles and Practices (CDC Handbook*).[30] The stated policy objective of the CDC's cost of production exercise is to provide "efficient producers with the opportunity for a fair return for their labour and investment."[31] The cost of production determined by the CDC has traditionally been based on a consolidation of the results of provincial cost of production surveys. The provincial surveys cover a sample of dairy operations designed to represent "an efficient segment of the dairy industry."[32] Each province calculates the cost of production for a hectolitre of milk "on a standardised basis, for each producer in each provincial sample."[33] The data is "collected for the provincial study by trained technicians" and

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[28] Terminology for Accountants, page 58 ("cost"). (Canada's Exhibit CDA-1).
[29] *Ibid.*, page 88 ("expenditure").
[30] Exhibit NZ-4 and Exhibit US-22.
[31] CDC Handbook, section 2.1.
[32] *Ibid.*
[33] *Ibid.*, section 4.3.

"accounting concepts are based on generally accepted accounting principles (GAAP) and that "[e]ach provincial study is subject to audit by the CDC."[34] The most recent survey was completed by the CDC itself using a uniform approach across Canadian provinces.[35] Thus, the national cost of production measurement that results from the CDC's calculation represents the cost of production of a standardised, efficient producer.

3.16 The Complainants submitted that although the CDC's methodology understates the actual costs of milk production, it appears to conform in large measure with the requirements for determining the average total cost of production set out by the Appellate Body in *Canada - Dairy Article 21.5*. The four major components utilised by the CDC for determining the cost of production are cash costs, government rebates and other revenues, capital costs, and family labour. The CDC accounts for both the fixed and the variable costs incurred in the production of milk. It identifies labour as a cost and includes paid labour, family labour and management. It includes a return on investment in fixed assets, thus, according to the Complainants, addressing capital costs. The Complainants considered that it is essential that the CDC do all of this in order to ensure that the efficient producer does not suffer a loss over the long term. The CDC's cost of production determination is part of the process leading to the setting of the target price for industrial milk. That target price has to allow efficient milk producers "to recover their cash costs, labour and investment related to the production of industrial milk."[36] The Complainants considered, however, that although the CDC's determination of the cost of production represents a reasonable guide to the "average total cost of production" test set by the Appellate Body, it is a conservative determination of the cost of production of milk in Canada.

3.17 The **United States** recalled that every year the CDC surveys Canadian dairy farms in order to calculate their cost of production. The CDC then uses this information to set the domestic price for milk (see paragraph 3.14 above). The United States was of the view that the methodology used by the CDC corresponds to the standard set forth by the Appellate Body in this case.

3.18 Recalling the statement by the Appellate Body that the average total cost of production calculation had to be made on the basis of "all" milk[37], the **Complainants** noted that the CDC's determination of cost of production excludes certain producers from its calculation. First, producers whose production is less than 60 per cent of the average provincial yearly production are excluded.[38] This is essentially an exclusion of small, inefficient farms and thus of farms with higher production costs. Second, the CDC Handbook explains that the calculation does not include the 30 per cent of farms with the highest

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[34] CDC Handbook, section 4.3.
[35] See Exhibit NZ-5, CDC Executive Summary of 2000 COP Determination.
[36] CDC Handbook, section 2.2.
[37] Appellate Body Report, Canada - Dairy (Article 21.5 – New Zealand and US), *supra*, footnote 1, para. 96.
[38] CDC Handbook, section 4.1.

costs of production.[39] These exclusions are designed to meet the CDC's objective of focusing on efficient producers. However, since those excluded are producers with a higher cost of production, the cost of production measurement reached by the CDC underestimates the average total cost of production of milk in Canada as a whole and thus lowers the reported average total cost of production.

3.19 **Canada** submitted that contrary to the position adopted by the Complainants (see paragraphs 3.14-3.18 above) the CDC methodology does not correspond to the requirements for determining the average total cost of production set out by the Appellate Body. The CDC methodology is prepared for a different purpose than the one put forward by the Appellate Body. The CDC methodology, which reflects government economic and social policy objectives (i.e., the government's intervention in the marketplace), embodies not only actual monetary costs incurred in milk production, but also imputed returns to dairy farm resources that do not involve actual outlays.

3.20 With respect to the claim by the Complainants in paragraph 3.18 above concerning the exclusion of small producers from the sample, Canada explained that only the province of Ontario collects cost of production data from a sample representative of all dairy farms, regardless of production levels. Data from this province show that the cost of production for all dairy farms is not significantly higher than the cost of production for those with production of at least 60 per cent of the provincial average. Since Ontario is one of the largest milk-producing provinces, it is not unreasonable to assume that these results are representative of the entire country. Canada submitted in conclusion that the data do not support a finding that a "payment" within the meaning given to that term by the Appellate Body under Article 9.1(c) for purposes of these proceedings is being made by independent milk producers to dairy processors on the production and sale of CEM.

(iii) Administered Domestic Price

3.21 Referring to Canada's arguments with respect to the inappropriateness of the CDC's calculations in relation to the Appellate Body's standard (see paragraph 3.19 above), the **United States** submitted that it is the actual economic cost of production which is being measured in both instances. That the ultimate price set by the Canadian government reflects "government economic and social policy objectives" does not affect the accuracy or relevance of the underlying cost data. The Appellate Body recognized that it is the administered *price* that is based "not only on economic considerations but also on other social objectives," not the underlying cost data.[40] Indeed, fundamental economic theory holds (as well as just basic common sense) that the absence of a cash outlay does not mean that a cost was not actually incurred.

3.22 Thus, the inclusion of costs for family labour, management services and capital is consistent with the Appellate Body standard and grounded in economic

[39] Handbook of COP Principles and Practices, page 7.
[40] Appellate Body Report, Canada - Dairy (Article 21.5- New Zealand and US), *supra*, footnote 1, para. 81.

theory. These are costs that are incurred by the producer and if not recovered will result in losses in the long run. This is precisely what the Appellate Body's standard seeks to measure. In economic terms, the United States continued, these costs represent opportunity costs or the costs associated with opportunities that are foregone by not putting the producers' resources to their best use.[41] These resources include family labour, its managerial services and its capital. There is a cost associated with using all of these resources.

3.23 **Canada** submitted that the CDC cost calculation is used as the major element in setting the administered domestic price. Accordingly, the CDC cost calculation together with the administered price ensures that the statutory objective of the CDC, which is to "provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment"[42], is met. To guarantee that the calculation of target returns provides a fair return to "efficient producers", the CDC methodology eliminates 30 per cent of the producers in each provincial sample with the highest cost of production.

3.24 **New Zealand** submitted that there are two distinct aspects to the determination of the administered price for milk. The first is the computation of the cost of production of milk on the basis of surveys, and the second is the setting of the target or administered price in the light of that computation and of other factors. The former, as described in the CDC Handbook, is an objective process. Costs are based on the results of provincial surveys, and there is no suggestion that the data in these surveys are anything other than objective. Nor is there a suggestion that the figures used are not actual figures resulting from those surveys. They are not figures that have been inflated or discounted on the basis of economic and social objectives.

3.25 It is the second part of the process, the fixing of the administered price, New Zealand continued, in which governmental economic and social objectives come into play. The price can be set above or below the amount determined by the cost of production calculation. That is a matter of social choice. As well as taking the cost of production survey into account, the CDC sets the target price after giving consideration to "consultations with major dairy industry stakeholder representatives from the farm, processing, further processing, restaurant and consumer sectors, as well as other economic indicators".[43] That a choice exists here does not taint the CDC's methodology for determining the cost of production and turn it into one that is based on social choice rather than on the objective collection and computation of data.

(iv) Imputed Costs

3.26 **New Zealand** submitted that even if the government chooses an administered price which is the same as the result of the CDC's cost of

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[41] Mansfield, Edwin, Microeconomics: Theory and Applications (Fourth Edition, New York: W.W. Norton and Company, 1982), p.178. Exhibit US-35.

[42] *Canadian Dairy Commission Act*, R.S.C. 1985, c. C-7, section 8. (Exhibit CDA-3)

[43] See Exhibit NZ-7, "Increases to Support Prices for Butter and Skim Milk Powder", CDC News Release, 14 December 2001.

production analysis, this does not make that analysis any less relevant to the Appellate Body's average total cost of production test. Furthermore, both debt and equity represent alternative means of financing an investment in fixed assets.

3.27 **Canada** explained that to meet the statutory objective described above (see paragraph 3.23 above), the CDC is required to include imputed or assigned returns to unpaid labour, management, and owner's equity (i.e., residual amounts resulting from the operation of an enterprise) in its calculation of cost of production. However, such amounts are not actual outlays expended on the production of milk, nor do they represent an investment in fixed assets and, according to Canada, it is these that the Appellate Body sought to include in the total cost of production. Accordingly, such amounts should not be included in the cost of production calculated on the basis of the approach put forward by the Appellate Body.

3.28 Returns on labour and equity are essentially the profits of the enterprise; Canada continued, they are not costs of production. The profit of an enterprise is the residual amount that is available after the cost of production and other expenses are deducted from the revenues of the enterprise.[44] This profit is the amount that is available to remunerate those who have a stake in the enterprise for their investment of capital and labour, and to reinvest in the enterprise. In its report, the Appellate Body did not consider profit as an amount that the producer must spend to produce the milk or that must be recovered in the long-term to avoid making losses. Canada considered that there is therefore strong support in the Appellate Body's reasoning that such profit is distinct from and should not be included in the calculation of cost of production.[45]

3.29 Referring to Canada's arguments above and to Article 31 of the *Vienna Convention on the Law of Treaties*, **New Zealand** considered that the context in which the words "investment" and "outlay" appear makes very clear that the Appellate Body refers to the production of goods and services involving an "investment in economic resources"[46], i.e. far from the "actual expenditures" limitation that Canada wishes to place on the term investment. Further, after identifying the "investment" and "outlay" that will represent the producer's fixed and variable costs, the Appellate Body said, "[t]hese fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup in the long-term to avoid making losses."[47] Canada focuses on the notion of "spending", which accords with its view that only actual expenditures are to be included, and ignores the notion of

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[44] *CICA Handbook – Accounting*, vol. I (Toronto: The Canadian Institute of Chartered Accountants, 1998), Section 1000, para. 27 [hereinafter "*CICA Handbook*"]. (Exhibit CDA-4)

[45] In the para.s of the Appellate Body report *Canada - Dairy (Article 21.5 - New Zealand and US)* in which the Appellate Body explained the meaning of total cost of production (particularly para. 87), profit is not mentioned. Para. 95 contains a direct reference to profit, but the structure of this phrase "not only to recover the total cost of production, but also in the hope of making profits" strongly suggests that, in the view of the Appellate Body, profit is distinct from average total cost of production and, by extension, not part of the standard reflecting proper value.

[46] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.

[47] *Ibid*.

"recouping" in order to avoid losses. New Zealand considered that a producer that sells its product at a price that does not allow it to recover imputed costs is absorbing those costs to the benefit of the purchaser. This is nothing more than a transfer of economic resources from the producer to the purchaser. In the opinion of New Zealand, the reasoning of the Appellate Body with respect to marginal costs also applies to imputed costs.

3.30 New Zealand submitted that generic definitions of terms without reference to the context in which they appear or the purpose for which they are used are misleading. GAAP does not provide a universal definition of the words "cost" and "expenditure" applicable in all circumstances, and thus it provides no guidance to the particular circumstances of determining whether payments within the meaning of Article 9.1(c) of the *Agreement on Agriculture* have been made. In short, it is not possible to achieve the objective the Appellate Body was seeking to achieve by narrow definitions of the terms "investment", "outlay", "cost" and "expenditure" that result in costs that producers incur being left out.

3.31 The **United States** noted that according to the Appellate Body, analysis under Article 9.1(c) must be based on a "standard that focuses upon the motivations of the independent *economic* operator".[48] Consistent with this line of reasoning, the Appellate Body explained that "[f]or any *economic* operator, the production of goods or services involves an investment of *economic* resources."[49] The Appellate Body then offered some examples of the types of fixed and variable costs that should be taken into account in calculating the cost of production for milk producers. It is clear from the Appellate Body's statements and reasoning that the production of milk involves an "investment of economic resources," and that all economic costs should be taken into account, not just actual cash outlays as argued by Canada. If an economic operator recuperates only its actual cash outlays, it will incur losses in the long run and eventually fail. Canada's selective reliance upon the use of the words "investment" and "outlay" is inconsistent with the context in which they were used by the Appellate Body.

3.32 With respect to the arguments in paragraph 3.28 above concerning returns on labour and equity, **New Zealand** considered that Canada's use of the term "profit" is highly ambiguous. New Zealand submitted, and as the CDC's cost of production methodology recognises, that labour, management and owner's equity are costs that are incurred by the producer. Producers who do not cover those costs in selling milk are not recouping their losses over the long term as the Appellate Body contemplated. Failure to include a return on family labour or on investment in the price that a producer charges a processor involves a transfer of economic resources from the producer to the processor – precisely what the Appellate Body's test is seeking to discover. Although, as pointed out in paragraph 3.16 above, the CDC's methodology is a conservative one and

[48] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 92.
[49] *Ibid.*, para. 87.

underestimates the true cost of production, it provides a reasonable guide to the application of the average total cost of production test.

3.33 The cost of labour and equity capital represent an "opportunity cost", i.e., the income that these resources could generate if put to an alternative use and this opportunity cost must be recovered in the long run if a business is to continue. It makes no economic sense to say that a producer who employs family labour has a lower cost of production than a producer who uses hired labour. Nor does averaging across producers produce a meaningful average total cost of production if the costs of some producers (those who hire labour) are taken into account and the costs of other producers (those who use family labour) are not.

3.34 The **United States** considered that Canada's suggestion (see paragraph 3.28 above) that the farm which hires labour and management services is incurring a cost, while the farm that uses family labour and management is making a profit is absurd. It further submits that it is equally absurd to suggest that the farm that finances its operations with debt incurs a cost (i.e. interest expense), but that the farm that finances its operations with equity is making a profit. Any economic operator, including the Canadian dairy farmer, will take these non-cash costs into account in calculating its cost of production to determine whether it is going to be able to stay in business in the long run.

3.35 The United States noted that Canada does not dispute the accuracy of the CDC's calculation of the cost of family labour, management and capital, which is relied upon by the Complainants. Rather, Canada argues that, as a conceptual matter, those costs should not be included. According to the United States, Canada's proposed standard does not represent the true economic cost of producing milk and is not consistent with the Appellate Body report in this case.

3.36 **Canada** considered that there are essentially four main points of contention between the Parties in determining how to apply the standard put forward by the Appellate Body: (i) whether an amount for imputed returns to family labour, management and owner's equity should be included in the calculation of "average total cost of production"; (ii) how to treat marketing costs and quota; (iii) whether the "average total cost of production" should be calculated on the basis of the total costs of production of individual producers or the total costs rolled into a single industry-wide average; and (iv) Canada's presentation of its data on cost of production and CEM returns.

3.37 According to Canada, there are a number of reasons to reject the Complainants' position with respect to imputed returns. First, had the Appellate Body intended imputed returns or opportunity costs to be included in the calculation of cost of production, it could have said so since it was aware of their inclusion by the CDC in its calculation of a cost of production figure, as referred to in paragraph 100 of its report. Instead, the Appellate Body described the cost of production standard to be applied in these proceedings in terms of

"investment"[50] and "outlay"[51]. The words "opportunity costs" or "imputed returns" do not appear in the language used by the Appellate Body.

3.38 Secondly, Canada continued, the inclusion of imputed returns in the calculation of cost of production reflects the government's intervention in the domestic marketplace. Imputed returns are included in the CDC methodology for calculating cost of production because the purpose of that methodology is to set prices that provide dairy farmers "with the opportunity of obtaining a fair return for their labour and investment." The Appellate Body was quite clear that, in determining whether a "payment" exists under Article 9.1(c), a distinction had to be drawn between circumstances where government intervenes in a marketplace and circumstances, as in this case, where a producer acts in the ordinary course of business. To accept the argument of the Complainants would be to substitute the determination of an acceptable profit by private parties in commercial transactions with a government assessment of what this profit should be, and, thus, to effectively draw the government back in where it does not belong.

3.39 Further, returns on family labour, management and owner's equity are derived from the profits of the dairy enterprise. According to Canada, the Appellate Body did not intend to include any measure of "profit" in its definition of total cost of production. Its explanation of total cost of production (particularly paragraph 87) does not include profit. Paragraph 95 contains a direct reference to "profit" and the structure of the sentence "… not only to recover the total cost of production, but also in the hope of making profits" indicates in the view of Canada that the Appellate Body considers that "profit" is distinct from "average total cost of production". This is not surprising, as independent milk producers do not need to recover "profits". To avoid making a loss, producers need to recoup their costs.

3.40 Canada considered that a determination of what constitutes an appropriate amount for imputed returns to family labour, management and owner's equity is highly speculative and subjective. In commercial export transactions, profit margins are a function of individual decisions made by each independent economic operator. Thus, subjecting a determination of profitability to WTO scrutiny would be contrary to the requirement of the Appellate Body for an "objective standard". To do so would also introduce uncertainty and unpredictability into export subsidy disciplines under the *Agreement on Agriculture*. Accepting the cost of production figure calculated by the CDC would lead to these results because it includes a policy-driven determination of profitability. The CDC methodology is appropriate for the purposes for which it is used. However, this purpose is different from the one put forward by the Appellate Body.

3.41 Finally, Canada reiterated that arguing that the cost of production calculated by the CDC is the appropriate benchmark is another way to reintroduce the same benchmark specifically rejected by the Appellate Body.

[50] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.
[51] *Ibid.*

The CDC calculation of cost of production is the major element in setting the administered domestic price, and both are established through government intervention. Comparing the CDC cost of production to prices of CEM is, therefore, no different than comparing these prices to Canada's administered domestic price. Indeed, the cost of production calculated by the CDC varies little from the administered domestic price.

(v) Quota as an Intangible Asset

3.42 Another limitation on the CDC's cost of production determination, the **Complainants** submitted, is the exclusion from the calculation of the cost of holding production quota. There appears to be no justification for this exclusion. In *Canada - Dairy Article 21.5*, the Appellate Body stated that the cost of production calculation must include the fixed costs of producing all milk.[52] The cost of holding production quota is a fixed cost[53] which would increase the CDC's total average cost of production.

3.43 The Complainants submitted further that a quota is an intangible asset and a resource defined by the International Accounting Standards Committee (IASC), as "(a) controlled by an enterprise as a result of past events; and (b) from which future economic benefits are expected to flow to the enterprise."[54] As such, the standard set for intangible assets by the IASC, (IAS 38) requires that it be "amortised on a systematic basis over the best estimate of its useful life."[55] **New Zealand** added that the IFCN includes quota in its list of factors to be incorporated in any dairy cost of production calculation.[56] Since quota represents a considerable expenditure by a producer,[57] failure by the CDC to include quota within its cost of production calculation again understates the true cost of production.

3.44 **Canada** replied that there are several reasons why quota costs should not be included in such a calculation. First, quota is an entitlement to *sell* milk onto the regulated domestic market at a higher price; it is not a restriction on *production*[58] and there is no requirement in Canada for producers to hold quota in order to produce and sell milk. Furthermore, it does not make sense to treat

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[52] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US*), *supra*, footnote 1, para. 96.

[53] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, DSR 2001:XIII, 6865, para. 6.53 and footnote 147.

[54] See Exhibit NZ-18, *International Accounting Standards Committee*, "International Accounting Standard: Intangible Assets", September 1998, page 3.

[55] *Ibid*, page 5.

[56] See Exhibit NZ-6.

[57] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.53 and footnote 147.

[58] Quota only limits a producer's right to obtain the domestic administered price (specifically Classes 1 through 5(d) excluding 4(m)), not his or her overall production level. However, a producer who pre-commits can also sell CEM under contract. Milk production in excess of domestic quota can be marketed under Class 4(m), albeit at a low price. Also, the Panel will recall from the previous Article 21.5 proceedings that there are producers in Canada who do nothing other than produce commercial export milk and these producers do not hold any quota.

costs associated with the acquisition of quota as a cost of production of *all* milk, since producers can and do produce and sell CEM without quota. Arguing that quota represents a cost of production is adding to the finding of the Appellate Body words that are not there. The Appellate Body has called for an examination of costs that the producer spends in producing the milk. Also, since any quota costs are marketing expenses associated with sales in the domestic market, it follows that these costs should be recovered from returns obtained from that market. Furthermore, Canada continued, as concerns the argument with respect to amortisation of a quota due to its nature as an "intangible asset" in paragraph 3.43 above[59], no such amortisation is appropriate. North American accounting standards do not require the cost of acquisition of assets such as quota to be amortised at all. The useful life of quota is indefinite.[60] According to CICA, "…[w]hen an intangible asset is determined to have an indefinite useful life, it should not be amortised until its life is determined to be no longer indefinite."[61] The Financial Accounting Standards Board of the United States also states that intangible assets with indefinite useful lives do not need to be amortised.[62] However, an annual test of the value of the asset compared to its purchase cost is required. In the case of Canadian dairy quota, no impairment of value would be detected by such a test and therefore no current year cost in 2000 or 2001 would be recorded for quota in the financial statements of Canadian dairy farms prepared according to GAAP. Accordingly, there are no quota costs that need to be considered.

3.45 With respect to Canada's argument that quota is not a restriction on production (see paragraph 3.44 above) **New Zealand** submitted that this argument is a continuation of Canada's distinction between costs related to production and costs related to selling. New Zealand reiterated that a producer has to recover all of these costs if it is to remain in business, regardless of whether those costs are listed in the same column on a balance sheet. Thus, quota costs cannot be dismissed by treating them as relating to sale rather than to production. As concerns Canada's argument with respect to the indefinite life of a quota, New Zealand submitted that regardless of whether intangible assets should or should not be amortised, quota represents an investment that has to be recovered if the producer is to avoid losses over the long term. Hence, quota also has to be included in determining the average total cost of production if the result is to provide a meaningful test of whether there is a transfer of economic resources from producers to processors for export.

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[59] The IASC is an advisory body to national standards setters; however all the regulatory and compliance force is at the national level. Canada notes that on the IASC web site (http://www.iasc.org.uk/), the IASC itself says that it "has no authority to require compliance with its accounting standards".

[60] *CICA Handbook – Accounting*, Section 3062, para. 15 states that "[w]hen no legal, regulatory, contractual, competitive, economic or other factors limit the useful life of an intangible asset to the enterprise, the useful life of the asset is considered to be indefinite." (Exhibit CDA-6)

[61] *Ibid.*, para. 10.

[62] *Goodwill and Other Intangible Assets*, Summary of Statement No. 142 (Financial Accounting Standards Board), June 2001. (Exhibit CDA-7)

3.46 The **United States** considered that regardless of how quota is treated under accounting principles, it represents an economic cost to farmers that produce for the domestic market - a cost that is usually quite high.[63] In accordance with the Appellate Body's determination, the cost of production should be based on all milk production, regardless of the milk's ultimate destination. Accordingly, any and all costs associated with the domestic market, such as quota, should be included in the benchmark. Even Canada admits that this is a cost that producers will seek to recover from the returns of milk sold in the domestic market.

(vi) Cost of Capital

3.47 The **United States** considered that the CDC's calculation is understated also because the cost of capital is calculated based upon the acquisition cost or book value of assets, such as land, as opposed to the market value of the assets.[64] The real cost of production for a producer is dependent upon the current market value of the property, not what that particular producer happened to pay for the asset any number of years ago.

3.48 With respect to the argument by the United States in paragraph 3.47 above concerning capital costs, **Canada** explained that GAAP requires assets to be recorded at their historical cost. Financial statements are prepared primarily using the historical cost basis of measurement whereby transactions and events are recognized in financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place.[65] Other bases of measurement are also used but only in limited circumstances.[66]

3.49 The **United States** responded that, regardless of how capital is recorded according to accounting principles, its economic cost is measured by its market value. Thus, the fact that the CDC uses book value to estimate the cost of capital results in an understatement of the cost of production. However, the fact that the CDC methodology understates the cost of milk production does not mean that the CDC methodology cannot be used in this proceeding. As explained, for instance, in paragraphs 0 - 3.54 above, even with this understated cost estimate, the average CEM price is below the average total cost of production for dairy farmers in Canada.

(vii) Cost of Marketing Milk

3.50 **Canada** was also of the view that, in accordance with the approach put forward by the Appellate Body, costs of *marketing* milk (i.e., transportation, administration and marketing fees) should not be included in the calculation of

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[63] Indeed, Canada itself has emphasised that "there is an active commercial market in the trading of quota at privately negotiated rates."(See para. 54 of the second submission of Canada in the proceedings in the first recourse to Article 21.5 of the DSU.) For example, for butter fat, quota can cost as much as CDN $25,000 per kilogram in Quebec and CDN $20,000 per kilogram in Ontario.

[64] Exhibit US-22, page 3.

[65] *CICA Handbook – Accounting*, Section 1000, para. 53. (Exhibit CDA-4)

[66] *Ibid*., para. 54.

cost of *production* of milk, as these are not outlays that the producer must incur in the physical production of milk to the point of the farm gate. This is consistent with GAAP, which holds that production costs are classified separately from sales and marketing expenses.[67] Canada submitted that while marketing expenses are not costs of production, a producer would normally seek to recover those expenses from the returns obtained from the market in which the goods are sold.

3.51 Canada submitted that, contrary to what the Complainants assert, Canada did take marketing costs into account. However, marketing costs are not production costs. Including these in cost of production would therefore not be consistent with the Appellate Body's approach based on the cost of producing milk, not marketing milk. In Canada's view, the Complainants make an assertion, which is not supported by the words of the Appellate Body. As mentioned above, while marketing costs are not production costs, they are costs that must be recovered if a producer hopes to make a profit. Although Canada did not include marketing costs in its calculation of cost of production, Canada did deduct marketing costs attributable to sales in the export market from the prices of CEM to reflect actual returns from sales in that market (see also paragraphs 3.50 above and 3.65 below). Having done this, Canada considered that it has provided a fair and consistent comparison between the cost of producing milk and the net returns from selling it.

3.52 The **Complainants** considered that the farm gate is only relevant if the sale takes place there. In short, the exclusion of marketing costs from the calculation of the average total cost of production undermines the value of that test for determining whether producers are transferring economic resources to processors. The Complainants submitted that the Appellate Body set a standard which included all costs an economic operator must recover in order to avoid incurring losses in the long run. Indeed, Canada even acknowledges that the producer will attempt to recover marketing costs from the sale of milk. As a matter of fact, the Complainants added, there is no other revenue stream from which to recover these costs or to which these costs should be allocated.

(viii) Calculation of Average Total Cost of Production (single producer versus industry-wide average)

3.53 The **Complainants** noted that in *Canada - Dairy Article 21.5*, the Appellate Body took the view that there would be "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* if the price paid for milk by processors for export was lower than the "average total cost of production." They considered that in the present case, even the CDC's own calculation of cost of production shows that test is easily met. The Complainants further noted that based on this data, the CDC estimated that the average total cost of production per hectolitre of milk in Canada was CDN $57.51 in 1998, CDN $56.43 in 1999, CDN $57.27 in 2000 and CDN $58.12 in 2001. This data alone is sufficient to establish that Canada's average total cost of production

[67] *CICA Handbook – Accounting*, Section 3030, para. .06. (Exhibit CDA-5)

exceeds CEM prices by a substantial margin. Public information posted by Ontario and Quebec show that the weighted average price of CEM in the 12-month period between August 2000 and July 2001 was CDN $29.[68]

3.54 Thus, the **United States** submitted, the average total cost of production exceeded the average price for that period by CDN $28.27.[69] Further, inasmuch as it is extremely unlikely that costs of production could have dropped more than CDN $20 since July 2001 (the last dairy year for which CDC data is presently available), it is a virtual certainty that the average total costs of production (as estimated by the CDC) have exceeded CEM prices since that time. Adjusting for the CDC's exclusions as described above would show that the difference between CEM prices and producers' costs of production (and hence the size of the "payments" for Article 9.1(c) purposes) is much greater than the CDN $20 plus margin that the basic comparison of CEM prices and CDC data above would suggest. Thus, producers have failed to recover their fixed and variable costs by a substantial margin making the so-called "market" transactions for CEM demonstrably uneconomic in the long run. The Appellate Body's test for the existence of "payments" under the CEM scheme is easily met.

3.55 The **Complainants** concluded that, applying the test set out by the Appellate Body in *Canada - Dairy Article 21.5*, processors have access to milk at a price that is less than the "average total cost of production" of that milk. In the words of the Appellate Body, "the price charged by the producer is less than the milk's proper value to the producer."[70] Accordingly, Article 9.1(c) "payments" from producers to export processors have occurred under the CEM scheme.

3.56 **Canada** submitted that, when applying the approach put forward by the Appellate Body to calculate a producer's on-farm average total cost of production for all milk, the result would be a figure that would include the following costs: costs associated with fixed costs (i.e., interest payments, depreciation of buildings and equipment, and net heifer replacement cost) and an outlay to meet variable costs (i.e., costs for materials such as feed, seed, fertilizer, and water; costs for hired labour; costs of farm administration; and costs for property taxes and insurance). The complete list of elements in the calculation appears in "Explanation of COP Calculation".[71]

3.57 Based on the above, Canada explained that it calculated producers' average total cost of production, relying on the most recent and comprehensive data on milk production costs from annual provincial surveys based on a statistically valid national sample of milk producers, thus obtaining a representative sample of 274 dairy farms (broken down into "deciles") whose costs are surveyed. These data were for the year 2000. Canada noted that the CDC uses the same data in establishing its cost of production figure. The validity

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[68] Exhibit US-3.
[69] *Ibid.*
[70] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 73.
[71] Exhibit CDA-8

of using these data in making the cost computations for purposes of these proceedings is not in dispute.

3.58 The number of producers in the sample from which the data are gathered is considered representative of the population of producers in Canada.[72] To be consistent with the approach put forward by the Appellate Body, Canada included the production outlays of the 30 per cent high cost producers that are excluded by the CDC in its methodology. In other words, the cost of production figures presented by Canada are based on the entire population in the sample, and not just the most efficient 70 per cent. Although the Complainants have criticised that aspect of the CDC methodology, Canada was of the view that its method of calculating cost of production resolves the Complainants complaint.

3.59 There is a significant variation of average total cost of production among individual producers given that in Canada there are in excess of 19,000 dairy production enterprises. Applying the Appellate Body's approach as detailed above shows total cost of production figures ranging from CDN $18.53/hl for the lowest decile[73] to CDN $46.60/hl for the highest decile. Given the Appellate Body's focus on the cost of production of individual producers and not an industry-wide average, Canada was of the opinion that it is more relevant for the purposes of these proceedings to examine a range of total costs of production and not a single average total cost.[74] The results of Canada's cost of production computations are presented in Exhibit CDA-9.[75]

3.60 With respect to Canada's examination of "a range of total costs of production and not a single average total cost." (see paragraph 3.56 above), the **Complainants** were of the view that this is not consistent with the Appellate Body's requirement that the "payment" is to be measured by the average total cost of production for all milk. **New Zealand** considered that, as a matter of principle, the determination of whether subsidization exists on the basis of deciles of producers – groups that may be constantly changing – does not provide any sort of predictability either in terms of making WTO commitments or in terms of applying them.[76] Nor can the question of subsidization depend

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[72] The data used do not include producers whose milk production is less than 60 per cent of the annual average in their province. Thus, Canada is unable to include those producers in its calculations. However, those small farms provide 18 per cent of Canada's total milk production. Since the average production costs are weighted by production, the omission of this small sub-population should not lead to a dissimilar result.

[73] All producers in the data sample were ranked according to their cost of production and then divided into ten equal groups (deciles). The lowest decile is the one with the lowest average cost. Exhibit CDA-9 presents the results for all deciles. Commercial export milk prices and returns are also presented by deciles.

[74] For any given statistical average, some farms will necessarily be above and some below, especially where costs vary widely (as dairy production costs do). That a producer may fall above an industry average production cost does not affect that farmer's production and sales decisions, or determine whether he or she may make money in a particular market at a given time and price. What matters is the producer's cost structure and other individual circumstances, not industry cost averages.

[75] Cost of Production Results. (Exhibit CDA-9)

[76] The European Communities also raises concerns about the predictability of individual-based producer cost of production determinations. European Communities' Third-Party Submission, para. 13.

upon whether a particular individual producer sells above or below the cost of production. Contrary to the express words of the Appellate Body and to the practice of the CDC, Canada seeks to reinterpret the requirement that all milk be considered in determining the average total cost of production as a "focus on the cost of production of individual producers and not an industry-wide average". Canada cites no authority for this proposition.

3.61 The **United States** submitted that the Appellate Body did not find that the existence of a "payment" under Article 9.1(c) does depend upon whether any given individual producer may or may not happen to recoup its total cost of production. The United States further submitted that, Canada's statement that the Appellate Body "focus[ed] on the cost of production of individual producers and not an industry-wide average" (see paragraph 3.56 above) is contradicted by the Appellate Body's explanation of the calculation of the new standard. Referring to paragraph 96 of the Appellate Body's report with respect to *all* milk, the United States submitted that the Appellate Body was focused on an industry-wide average, and not on individual producers. For this reason, and other reasons explained below, Canada's exhibits, including exhibit 14 in particular, should be disregarded because they are only based upon the cash outlays of individual producers (broken down into "deciles") and therefore are inconsistent with the Appellate Body's standard.

3.62 **Canada** submitted, with reference to Complainants' arguments for an industry-wide "average total cost of production", that the Appellate Body's reference to "all milk" in paragraph 96 of its report refers to the need to include the production costs of *all* milk, domestic and export. It nowhere says or suggests that the cost of production analysis requires the averaging of all producers into a single industry-wide cost. As concerns "the milk producers" in paragraph 104, the Appellate Body stated that the standard for these proceedings is "the average total cost of production of the milk producers". "Milk producers" cannot automatically be interpreted as meaning the "industry". Rather, a review of the Appellate Body's report and the words used in the finding on "payment" supports Canada's position that "average total cost of production" be calculated on an individual producer basis rather than on an industry-wide basis.

3.63 With respect to the number of instances in the Appellate Body report where it referred to producer in the singular, Canada submitted that the focus should be on the costs associated with the actual producer, not the costs associated with the industry as a whole. Consistent with the approach of the Appellate Body, Canada recorded all actual production costs for a representative sample of individual producers in the industry and presented these figures in deciles and ranges. Presentation on a basis of ranges is, according to Canada, the best available measure of individual producers' costs and decisions.

3.64 The next step in the analysis of whether a "payment" exists under Article 9.1(c), Canada submitted, is to compare the total average cost of production of individual producers against the returns realised on sales of CEM. Accordingly, Canada has identified the prices of CEM to which the cost of production ranges of individual producers should be compared.

3.65 The only prices of CEM publicly available in Canada are from the three provinces that have electronic commercial exchanges (i.e., bulletin boards), namely Quebec, Ontario, and Manitoba which account for approximately 80 per cent of all production of CEM. [77] CEM prices are not readily available from the other provinces as this information is proprietary and confidential in nature. The information obtained from these commercial exchanges reveals that from August 2000 (i.e., the date when commercial export transactions began) to January 2002, CEM prices ranged from a low of CDN $23.79/hl to a high of CDN $40.12/hl.[78] It should be noted, Canada continued, that prices on the commercial exchanges overstate the actual returns to producers because they include marketing expenses.[79] As a result, Canada deducted these amounts from the prices referred to above.[80] With these deductions, the CEM returns range from a low of CDN $20.69/hl to a high of CDN $37.02/hl.

3.66 According to Canada, comparing average total costs of production of individual producers to CEM returns demonstrates how producers are able to sell CEM at prices that cover their average total cost of production.[81] Indeed, the costs of production of over three-quarters of milk producers (fully 77 per cent), accounting for three-quarters of milk production, fall within the range of CEM returns. The results provide strong support for Canada's position that payments are not being provided by producers to processors through CEM transactions.

3.67 **New Zealand** submitted that the results which Canada achieves with its cost of production analysis are questionable as it has not included producers whose milk production is less than 60 per cent of the annual average in their province (see footnote 72 above). Thus, Canada still excludes a significant category of producers whose costs are likely to be higher. Furthermore, although Canada states that "CEM returns range from a low of CDN $20.69/hl to a high of CDN $37.02/hl" (see paragraph 0 above), an analysis of the data provided by Canada shows that only 28 per cent of CEM milk has been sold for prices greater than CDN $29.90/hl. By contrast, approximately 60 per cent of producers have average costs in excess of that figure even using costs of production as defined by Canada.[82] New Zealand submitted that this gives quite a different impression than that found in paragraph 3.66 above where Canada states that 77 per cent of producers have average costs less than the highest CEM price. By failing to account for the low proportion of CEM sales at prices in excess of CDN $29.90/hl, Canada's statement is misleading. If the costs of production were as calculated by the CDC (which itself is an underestimation of the average total costs of production as detailed above), Canada's decile approach would show

77 CEM Producers & Volumes. (Exhibit CDA-10)
78 CEM Bulletin Board Prices and Volumes (Ranges). (Exhibit CDA-11)
79 See Explanation of CEM Returns in Exhibit CDA-12.
80 See CEM Returns and Volumes (Ranges) in Exhibit CDA-13.
81 Comparisons of Production Costs and CEM Returns. (Exhibit CDA-14)
82 See New Zealand Analysis of Canadian Exhibits CDA-9 and CDA-13 set out in Exhibit NZ-24.

that no Canadian producer has costs of production less than the average CEM price.[83]

3.68 Referring to Canada's arguments in paragraphs 3.65 and 3.66 above, the **United States** replied that exhibit CDA-14 is misleading and distortive since it suggests that the producers with the higher cost of production are obtaining the higher CEM return. Yet, there is no evidence to suggest that the farms in decile 10 of production costs in CDA-9 are obtaining the CEM returns in decile 10 in CDA-13. The United States was of the view that Canada implicitly recognizes this in footnote 85 above. In other words, even though CDA-14 insinuates that the high cost producers are matched with the high CEM returns, Canada acknowledges that its conclusion is really based on the fact that there must be individual producers represented within the range somewhere that are recovering their total cost of production in the CEM "market." As explained above, however, the Appellate Body's standard requires a comparison of the "average total cost of production." Obviously, in crafting this standard, the Appellate Body realised that some producers would recover their cost of production and some would not.

3.69 Even using Canada's cost of production calculation (which excludes several of the actual costs described above),[84] the United States continued, Canada's exhibit 14 shows that roughly 60 per cent of Canadian producers could not cover their costs of production at CDN $30. Furthermore, a review of the information presented on CDA-13 shows that approximately 70 per cent of milk sold on the CEM "market" obtains a return of CDN $30 or less.

3.70 There is only a minority of high-cost producers, **Canada** replied, whose costs would not be covered by the prices of CEM.[85] However, as noted by the Appellate Body, the majority of Canadian dairy farmers choose not to participate in the CEM market.[86] Such a situation is likely to continue unless, and until, individual producers perceive that it is in their economic interests to participate. As of December 2001, less than 40 per cent of producers (approximately 8,000) in Canada had participated in such a transaction and many of these (34 per cent)

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[83] Canada does not provide a single figure representing the average cost of production using its methodology. Nevertheless, from Exhibit CDA-9 it is clear that the average is around CDN $31/hl, some CDN $26/hl less than the CDC figure set out in para. 3.83 above. This margin, when applied to each decile in Exhibit CDA-9, indicates that when CDC costs of production are used no Canadian producer has costs of production less than the average CEM price of around CDN $29/hl.

[84] Canada also claims that it has resolved the downward bias in the CDC calculation complained of by the Complainants by including in its calculations the 30 per cent of high-cost producers excluded by the CDC. However, in footnote 72 above Canada admits that it has not included the producers whose milk production is less than 60 per cent of the annual average in their province, which accounts for 18 per cent, or almost one-fifth, of Canada's total milk production. Because small farms tend to have higher costs of production, the exclusion of these producers further understates the true average total cost of production.

[85] The production of producers who can cover their cost of production by commercial export milk sales is more than enough to account for total commercial export milk production. Commercial export milk production accounts for 3.6 per cent of Canada's total milk production. (Exhibit CDA-10)

[86] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, paras. 79 and 117.

did so for only a short time.[87] Furthermore, as held by the Appellate Body, even if the average total cost of production of an individual producer who participates in CEM sales happens to be above the prices of CEM, that does not *ipso facto* mean that a payment is provided by that producer. The Appellate Body held that to the extent a producer is able to recoup his or her total cost of production in the long-term, there would be no "payments".[88]

3.71 As concerns the Complainants' arguments with respect to Canada's presentation of its data on cost of production, Canada explained that the average cost to produce one hectolitre of milk ranges from a low of CDN $7.01 to a high of CDN $66.80 while CEM returns, i.e. the price minus the marketing costs, range from CDN $20.69 to CDN $37.02. The exhibits and narrative explain the calculations. A comparison of the costs and revenues in Exhibit CDA-14 shows that since CEM transactions commenced in August 2000, the costs of production of over three-quarters of milk producers fall within the range of CEM returns.

3.72 Canada submitted that the data available for the short period since CEM sales began (August 2000) do not allow for a realistic consideration of whether producers who may sell CEM at a price that does not cover their average total cost of production would recover such costs in the long-term. As with any new market, this first year of operation represents a period of adjustment. Producers are testing out the market, determining whether to become regular producers of CEM; to revert to domestic sales only; or to strike some balance between the two. Whatever they do depends upon the producer's individual economic situation. In short, Canada considers that the data provide no support for the position of the Complainants that CEM transactions are uneconomic in the long run (see for instance paragraph 3.54 above, and paragraphs 3.78 and 3.132 - 3.133 below).

3.73 Commenting on Canada's arguments in paragraphs 0 and 3.72 above, **New Zealand** considered those arguments faulty. Whether transactions are economic in the long-term is not a matter of trial and error. It is a matter of simple economics. Products that are sold at a price that does not allow the producer to recover all costs of production are going to be uneconomic. There is no need to wait to see if this will happen. By eliminating imputed costs from any cost of production determination, Canada is obscuring the issue of whether sales of CEM involve a transfer of economic resources from producers to processors for export.

3.74 **Canada** was of the view that there is nothing misleading about the data. Indeed, Canada's presentation of costs and returns was clear enough for both the United States and New Zealand to determine that about 40 per cent of Canadian producers are able to cover their costs of production with CEM returns of CDN $29.90, which they claim to be close to the average price of CEM (see also paragraph 3.70 above). Indeed, Canada continued, had the Complainants picked the lower end of the spectrum of returns, they would have found that a

[87] Frequency of Producers Participating in CEM. (Exhibit CDA-15)

[88] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.

substantial number of Canadian producers could participate in CEM transactions and cover their costs of production. For example, only 10 per cent of returns on CEM have been below CDN $25.25; yet the average total production costs of nearly 25 per cent of Canadian milk producers are below this amount. Regardless of what average CEM return the Complainants choose as a basis for their argument, the data presented by Canada demonstrates that producers are clearly able to sell CEM at prices that cover their "average total cost of production."

3.75 Commenting on Canada's arguments in paragraph 3.72 above with respect to "the too short period since commercial export sales began", the **United States** considered that in referring to the long run, the Appellate Body was describing the types of costs that must be recovered in order to avoid losses. The point is that if the average total cost of production exceeds the average CEM price, the producer will incur losses in the long run. The comparison is accomplished *now*, not at some point in the indefinite future. In order to remain faithful to the Appellate Body's standard and avoid comparing apples to oranges, the United States continued, the average total cost of production must be compared to the average CEM price. As explained in paragraph 3.53 above, the average CEM price for Quebec and Ontario for the dairy year 2000 was approximately CDN $29.[89] For the same time period, the CDC calculated the average total cost of production as CDN $57.27. Even with this understated cost, the average total cost of production exceeded the CEM price by a substantial margin. Hence, applying the test set forth by the Appellate Body, "payments" from producers to processors have occurred under the CEM scheme.

3.76 **Canada** considered that, if a producer's participation in the CEM market were to be examined on the basis of the producer's most relevant consideration, whether the transaction covers all of his or her incremental costs of production for the additional milk required for that transaction (fixed and variable), one would conclude that an even greater proportion of producers could successfully participate in the CEM market. Canada submitted that for the reasons stated above, "payments" within the meaning of Article 9.1(c) are not being provided by Canadian producers to processors with respect to CEM transactions.

3.77 With reference to Canada's arguments that it has met the test set forth by the Appellate Body with respect to producers average total cost of production, **New Zealand** replied that Canada's calculation of the cost of production of milk does not include all of the costs of producing milk. If producers sell milk to processors at prices which do not cover the average total cost of producing milk they are, in effect, making a transfer of economic resources to the processor. The result is the same as making a monetary payment to the processor. It is a payment-in-kind and hence a "payment" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The determination of whether there has been a transfer of economic resources, New Zealand continued, must be based on a real measurement of the cost of production, covering both what a producer spends and what he/she must recover over the long term in order to avoid making

[89] Exhibit US-3.

losses.[90] If the test for determining the average total cost of production fails to do this, then it is ineffective in measuring whether economic resources have been transferred from producer to processor for export.

3.78 New Zealand considered that what Canada has shown is that when producers sell milk on the CEM market, they do not recover an amount that is sufficient to avoid making losses. They are foregoing a portion of the "proper value" of milk, thus transferring economic resources to processors for export. They are making "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

3.79 New Zealand submitted in conclusion that Canada has misinterpreted the Appellate Body's average total cost of production test and constructs instead a cost of production calculation that does not measure the costs that producers must spend and recover in order to avoid making losses. A proper application of the test set out by the Appellate Body in *Canada - Dairy Article 21.5* shows that producers make "payments" to processors for export by selling milk at a price that is less than the average total cost of production.

3.80 **Canada** replied that the "payment" issue is not about whether "average total cost of production" should be calculated on a "cash-basis accounting" or on an "economic costs" basis. It is well recognized that there is no standardised method for measuring production costs in the agricultural sector, in Canada or internationally. The issue is about interpreting the findings and the particular words of the Appellate Body in establishing "average total cost of production", a determination which must be consistent with the Appellate Body's finding that prices of CEM must be compared against "some objective standard or benchmark". The debate is over what costs an independent milk producer acting by itself without government interference must spend in order to produce the milk and the total amount it must recover in the long-term, in order to avoid making a loss.

3.81 The cost methodology employed by Canada in this case is based on fixed and variable costs representing the amount the producer must spend to produce milk and that he or she must recoup in the long-term to avoid making a loss. Canada considered that its use of actual outlays for fixed and variable costs is consistent with the findings of the Appellate Body. By contrast, the CDC methodology is not the right benchmark in these proceedings since it has been developed to serve domestic policy objectives and to that end includes certain imputed amounts that are not actual costs that the producer must spend to produce milk and recoup to avoid making a loss. However, Canada is not challenging the validity of the cost survey data included in the CDC calculation or the purpose for which the CDC calculation is used.

[90] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.

(ix) Definition of "export subsidies"

3.82 The **Complainants** submitted that in determining the meaning of "export subsidies" under Article 10.1, it was noted by the panel in *Canada - Dairy* that Article 1(e) of the *Agreement on Agriculture* defines export subsidies, unless the context requires otherwise, as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement"[91], an approach confirmed by the Appellate Body in *US–FSC*.

3.83 **Canada** noted that the *Agreement on Agriculture* does not define the term "subsidy". However, as the Appellate Body has indicated, the definition of "subsidy" in Article 1.1 of the *SCM Agreement* provides important contextual guidance in defining an "export subsidy" under Article 1(e) of the Agreement on Agriculture.[92] The definition of "subsidy" under the *SCM Agreement* consists of two discrete elements: (i) a "financial contribution" or "income or price support" by a government; (ii) which confers a benefit.[93] Canada considered that the claims above ignore the very basis of this dispute. The report of the Appellate Body in the original proceedings found that government was indispensable to enable the supply of milk for export purposes since government agencies stood completely between producers of the milk and the processors or exporters.[94] In response to this finding, Canada has removed those governmental agencies and permitted producers and processors to enter into export transactions free of governmental control. Canada has thus deregulated the CEM market, meaning that the government has no hand in setting the time, amount, or price of export sales. The only design in Canada's implementation of CEM is to remove government influence from the export business.

3.84 Canada submitted that as "integral parts"[95] of a "single undertaking"[96], sharing numerous cross linkages[97] the two Agreements should, to the extent permitted by the wording, be interpreted consistently. Extremely helpful in this regard are the insights into Article 9.1(c) provided by the government "financial contribution" concept, which, as suggested by the Appellate Body in *Canada - Aircraft*[98] and by the panel in *US - Export Restraints*[99], is, according to Canada, a cornerstone to the meaning of a "subsidy" in the *SCM Agreement*. In particular, *US - Export Restraints* holds that government entrusting or directing a private

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91 Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.124. This approach has been confirmed by the Appellate Body in *US–FSC*, DSR 2000:III, 1619, paras. 190-196.

92 Appellate Body Report, *US–FSC*, *supra*, footnote 91, para. 136.

93 Panel Report, *US - Export Restraints*, DSR 2001:XI, 5767, para. 8.20; Panel Report, *Canada – Export Credits*, para. 7.64; and Appellate Body Report, *Brazil –Aircraft*, DSR 1999:III, 1161, para. 157.

94 Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 120.

95 Marrakesh Agreement Establishing the World Trade Organization, Article II.2.

96 Appellate Body Report, *Brazil – Desiccated Coconut*, DSR 1997:I, 167, at 177.

97 For example, both the *SCM Agreement* and the *Agreement on Agriculture* share a common core definition that refers to "subsidies contingent … upon export performance." See *US–FSC*, para. 121.

98 Appellate Body Report, *Canada –Aircraft*, DSR 1999:III, 1377, para. 156.

99 Panel Report, *US–Export Restraints*, *supra*, footnote 93, para. 8.20.

body to carry out certain functions contains the notions of government *delegation* or *command*.[100]

3.85 *US - Export Restraints* expressly rejects the proposition that the focus should be on the *effects* or *results* of government action, Canada continued, suggesting instead that the focus should be on the *nature* of that action: "the existence of a financial contribution by a government must be proven by reference to the action of the government".[101] In the words of the panel in *US - Export Restraints*: "we do not see how the reaction of private entities to a given governmental measure can be the basis on which the Member's compliance with its treaty obligations under the WTO is established." This finding is fully consistent with the Appellate Body's statement in this case that governmental action that merely enables a private person to make and finance a payment is too tenuous a linkage to support a finding of an export subsidy under Article 9.1(c). Thus, the perceived effects of government action on private behaviour or, to put it another way, on the presumed reaction of private entities to governmental intervention in the domestic market cannot be the basis for assessing WTO consistency. Canada submitted that the test proposed by the Complainants is substantially broader than the test applied under the subsidy definition in the *SCM Agreement* and attempts to impose a construction on the language of Article 9.1(c) it cannot reasonably bear.

3.86 **New Zealand** replied that Canada seeks to limit the scope of the definition of export subsidy in the *Agreement on Agriculture* by the words used in the *SCM Agreement*. Canada's arguments ignore the language of Article 9.1(c) and seek to undermine the ordinary meaning of the provision by asking the Panel to refer to unrelated provisions (and language) in the *SCM Agreement*. In so doing, Canada refers to jurisprudence which has taken note of the linkages between, and shared heritage of, the *Agreement on Agriculture* and the *SCM Agreement*,[102] but then, in the opinion of New Zealand, over-states that linkage and heritage.

3.87 **Canada** retorted that the term "subsidy" is used by New Zealand throughout its argument on "financed by virtue of governmental action", which is the core term of the very same *SCM Agreement*. Canada's case is focused on the words of Article 9.1(c) as interpreted by the Appellate Body. The *SCM Agreement* is part of the context that must be taken into account in interpreting those words. There is support for this argument in the preamble of Article 9.1(c), which provides that "[t]he following export subsidies are subject to reduction commitments under this Agreement" and in the finding of the Appellate Body in *US–FSC* and the original Appellate Body finding in this case.

3.88 The **Complainants** replied that *US - Export Restraints* was brought under Article 1.1(a)(1)(iv) of the SCM Agreement, not the *Agreement on Agriculture*, and therefore the report in that dispute provides no support for Canada's position.

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[100] Panel Report, *US–Export Restraints*, *supra,* footnote 93, para. 8.29.
[101] *Ibid*., para. 8.34.
[102] See, for example, Appellate Body Report, *Brazil - Desiccated Coconut*, DSR 1997:I, 167, at 169-170; and Appellate Body Report, *US–FSC*, *supra,* footnote 91, para. 136.

As concerns the concept of "financial contribution", the *SCM Agreement* has no relevance to Article 9.1(c) of the *Agreement on Agriculture*, which is concerned with "payments" and not with a "financial contribution". Moreover, Article 1.1(a)(1)(iv) of the *SCM Agreement* links the concept of "financial contribution" to an "entrustment" or "direction" by government.[103] The words "entrust" and "direct" are nowhere to be found in Article 9.1(c) of the *Agreement on Agriculture* and therefore offer no contextual guidance to its interpretation.

2. "financed by virtue of governmental action"

3.89 The **Complainants,** referring to the second element of Article 9.1(c) of the *Agreement on Agriculture*, noted that in *Canada - Dairy* the Appellate Body stated that "payments" were to be regarded as "financed by virtue of governmental action" if "governmental action" was "indispensable" to the transfer of economic resources.[104] In *Canada - Dairy Article 21.5*, the panel took the view that governmental action would be indispensable to the provision of lower-priced milk to processors for export if governmental action, *de jure* or *de facto* prevents Canadian milk producers from selling more milk on the regulated domestic market, at a higher price, than to the extent of the quota allocated to them; and obliges Canadian milk processors to export all milk contracted as lower priced CEM, and, accordingly, penalises the diversion by processors of milk contracted as CEM to the domestic market.[105]

3.90 The panel considered that these two conditions were met, stating that "the payment is "financed by virtue of governmental action" in that lower priced CEM would not be available to Canadian processors *but for* the above federal and provincial actions (i) restricting supply on the domestic milk market, obliging producers, at least *de facto*, to sell outside-quota milk for export, and (ii) obliging processors to export all milk contracted as CEM, and penalising diversion by processors of CEM into the domestic market." [106]

3.91 The **United States** added that in its recent report in this dispute, the Appellate Body concluded that, because it could not complete the analysis of the "payment" prong of Article 9.1(c) due to the lack of data on costs of production, it need not decide whether the panel was correct that the alleged payments had been "financed by virtue of government action." Thus the Appellate Body neither reversed nor affirmed the panel's conclusion on this point.

3.92 The **Complainants** noted that the Appellate Body in *Canada - Dairy Article 21.5* analysed the meaning of the phrase "financed by virtue of governmental action" and observed that "Mere governmental action" is not enough. "The words "by virtue of" indicate that there must be a demonstrable link between the *governmental action* at issue and the *financing* of the

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[103] Panel Report, *US–Export Restraints*, *supra*, footnote 93, paras. 8.26-8.44.
[104] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 120.
[105] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.42.
[106] *Ibid*., para. 6.77. Emphasis in original.

payments".[107] The payments have to be financed in some way "as a consequence of the governmental action."[108] Although the Appellate Body recognised the difficulty of defining in the abstract the precise link that is necessary between governmental action and the financing of payments, the Complainants continued, it noted that governmental action which establishes a regulatory framework "merely enabling a third person freely to make and finance 'payments'" is insufficient.[109] However, the Appellate Body recognized that "the existence of such a demonstrable link must be identified on a case-by-case basis, taking account of the particular governmental action at issue and its effects on 'payments' made by a third person."[110]

3.93 The Complainants recalled the Appellate Body's acknowledgement that, taken as a whole, the panel's reasoning was "directed towards establishing the demonstrable link between governmental action and the financing of the payments."[111] However, the Appellate Body said, "even though Canadian governmental action prevents further domestic sales, we do not see how producers are obliged or driven to produce additional milk for export sale. As we have said above, each producer is free to decide whether or not to produce additional milk for sale as CEM."[112] Thus, the Appellate Body disagreed with the panel's characterisation of the CEM measures as, "obliging producers, at least *de facto*, to sell outside-quota milk for export."[113]

3.94 In the present case, the Complainants continued, the "payment" is financed by the producer accepting a price for export milk that does not cover the "average total cost of production" of milk (i.e., a payment-in-kind). These payments have to be "financed by virtue of governmental action" for the requirements of Article 9.1(c) of the *Agreement on Agriculture* to be fully met. The term "financed" as it appears in Article 9.1(c) covers both "the financing of monetary payments and payments-in-kind."[114] The question, then, is whether this financing by producers of "payments" to processors can, in the words of the Appellate Body, be demonstrably linked to, or seen to be a consequence of, governmental action.[115] There has to be, as the Appellate Body said, a "tighter nexus between the mechanism or process by which the payments are financed, even if by a third person, and governmental action."[116]

3.95 **Canada** submitted that the Appellate Body held that "the link between governmental action and the financing of payments will be more difficult to establish, as an evidentiary matter, when the payment is in the form of a payment-in-kind rather than in monetary form, and all the more so when the

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[107] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 113. Emphasis in original.
[108] *Ibid*.
[109] *Ibid*., para. 115.
[110] *Ibid*.
[111] *Ibid.*, para. 116.
[112] *Ibid.*, para. 117.
[113] *Ibid.*
[114] *Ibid.*, para. 114.
[115] *Ibid*., para. 113.
[116] *Ibid.*

payment-in-kind is made, not by the government, but by an independent economic operator."[117] Thus, Canada continued, in this case, which involves an alleged payment-in-kind made not by a government but by independent operators, the Appellate Body standard would require a particularly clear and convincing showing of the required linkage. Canada considered that the facts of this case do not permit such a finding. The Appellate Body also held that "[i]t is extremely difficult … to define in the abstract the precise character of the required link between the governmental action and the financing of the payments, particularly where payments-in-kind are at issue."[118] However, that is what the Complainants are asking the Panel to do.

3.96 The governmental action by virtue of which payments are financed in the present case, the **Complainants** submitted, is the very construction of the CEM scheme itself. This has two components; (i) a prohibition on producers selling non-quota milk into the domestic market, with appropriate sanctions to support this prohibition, and (ii) the exemption of processors for export from the requirement to purchase only from milk supplied under Classes 1 to 5(d).[119] In *Canada - Dairy Article 21.5*, the Appellate Body distinguished between "a regulatory framework simply enabling a third person freely to make and finance" those "payments"[120] and circumstances where there was a demonstrable link between the financing of "payments" and governmental action.[121]

3.97 Referring to the arguments with respect to the measures described in paragraph 3.96 above, **Canada** responded that it does not deny that the governmental actions referred to by the Complainants establish a framework under which processors have access to milk for export without those processors having to pay the administered price. As Canada has repeatedly explained, and the Appellate Body has accepted, processors and producers freely negotiate the prices of CEM. However, even if a sale of CEM by a producer to a processor at less than the administered domestic price or "average total cost of production" calculated by the CDC were to constitute a "payment", which Canada denies, that "payment" would not be "financed by virtue of governmental action" by the mere fact that it has occurred. As already stated, the Appellate Body rejected this as being sufficient to meet the "financing" element of Article 9.1(c), because such a conclusion would not give meaning to the word "finance".

3.98 With respect to the arguments concerning "the very construction of the CEM scheme", Canada considered that this fails to consider the Appellate Body statement that "[g]overnments are constantly engaged in regulation of different

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[117] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 113.
[118] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 115.
[119] Like the CEM Scheme, Class 5(d) provides discounted milk to processors for export, but unlike CEM, Class 5(d) is recognised by Canada as providing export subsidies.
[120] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 115.
[121] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US),, supra,* footnote 53, paras. 6.50-6.54.

kinds in pursuit of a variety of objectives."[122] In particular, the Appellate Body envisaged that "governmental action might establish a regulatory framework merely enabling a third person freely to make and finance "payments". In this situation, the link between the governmental action and the financing of the payments is too tenuous for the "payments" to be regarded as "*financed* by virtue of governmental action" (emphasis added) within the meaning of Article 9.1(c). Rather, there must be a tighter nexus between the mechanism or process by which the payments are *financed*, even if by a third person, and governmental action."[123]

3.99 Canada submitted further that the Complainants' arguments in paragraph 3.96 above with respect in particular to the "two components" are without merit. Even though these governmental actions may exist, it does not mean they "finance" any "payments". The fact that processors do not have to pay the higher regulated price is not proof that "payments" to processors are "financed by virtue of governmental action". On the contrary, Canada explained, the measures identified by the Complainants as the governmental action that finances "payments" protect a producer's entitlement to the higher domestic price. They have no relation or "link" to any alleged sale by a producer of milk to a processor at below his or her cost of production. These "measures" also include restrictions on sales into the domestic market. It is these measures taken in combination which protect a producer's entitlement to the higher domestic price (supply management).

3.100 The **Complainants** submitted that even if the producers are freely choosing to produce non-quota milk, as the Appellate Body observed, once they do so, governmental action prohibits them from selling this milk onto the higher priced domestic market, i.e. they have no choice but to sell it in the export market. If the producer were making the decision, the choice would obviously be to sell in the higher-priced domestic market and recover its fixed and variable costs. From the producer's perspective, the governmental action is the prohibition against the selling of non-quota milk into the higher-priced domestic market. The Complainants were of the view that it is easy to see the "demonstrable link" between the government's prohibition on selling milk in the domestic market without quota and the "payment" made by the producer's sale of non-quota milk in the CEM market. It is also easy to see that the financing of the "payments" made by producers to processors – the selling of milk at a price that is less than the average total cost of production – is "a consequence of"[124] governmental action, and that the governmental action is "indispensable" to the financing of the "payments".[125] Producers are not forced to produce extra milk. But when they do,

[122] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 115.
[123] *Ibid*.
[124] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US*, *supra*, footnote 1, para. 113.
[125] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US*), *supra*, footnote 53, para. 6.41.

they have no option but to sell in the CEM market and thereby make a "payment" to processors.[126]

3.101 Referring to Canada's arguments in paragraph 3.99 above, the **United States** submitted that Canada does not explain how exempting export milk from the high domestic price protects a producer's entitlement to that high price. The United States reiterated that Canada could manage and control its domestic supply of milk without exempting export milk from the high price. It may mean that Canada's dairy processors would no longer be able to export because they cannot compete without subsidization, but the right to maintain and subsidize domestic production does not also provide a right to subsidize export production beyond the applicable reduction commitments.

3.102 Since the arguments made by the Complainants are the same arguments as those they made before the first Article 21.5 panel and Appellate Body, **Canada** considered that the language used by the Appellate Body in addressing the "financed" element of Article 9.1(c) is therefore of the utmost relevance. A careful review and a proper application of this language, provides, according to Canada, a strong indication that the Appellate Body considered the arguments of the Complainants and did not find them convincing. It is not unreasonable to argue that the Appellate Body contemplated and rejected anticipated arguments by the Complainants. Indeed, the Appellate Body appeared to suggest that unless the Complainants can come up with something better than a simple assertion that "access equals financing", their claims should be rejected.

3.103 Canada further submitted that the Appellate Body standard with respect to a "demonstrable link" requires a particularly clear and convincing showing of the required linkage. The facts of this case do not permit such a finding. For a "demonstrable link" to exist between governmental action and the financing of payments, the former must be focused or directed towards the latter. There must be a clear and evident connection between the two. Government obliging or directing producers to produce and sell CEM would be but one example of such a link. Other examples are found under Canada's Special Class system. The Panel is well aware that under the former Class 5(e), Canada controlled the volume of milk for export, set the price, pooled producer revenues, paid the producers, and issued permits to processors. Canada exercised similar controls under the earlier producer-levy system.

3.104 By removing governmental action at every stage of the export transaction, which Canada did based on the decision of the Appellate Body in the original dispute, such transactions, when they occur, are not "financed by virtue of governmental action". When individual producers and processors, not government, decide to produce, purchase and sell milk for export and determine the price, volume and timing of the transactions, Canada considered that there is a complete absence of governmental action on which the "demonstrable link" of which the Appellate Body spoke can be established. In contrast to the former

[126] The only other permitted avenue for disposal of over-quota milk (other than destruction) is for use in animal feed under Class 4(m) – a use which obtains substantially lower prices than the export market.

Special Class 5(e) and the levy example in Article 9.1(c), the measures identified by the Complainants are not focused or directed towards the financing of export transactions.

3.105 The **Complainants** considered that focusing on the producer, shows only part of the picture. It is the processor for export who receives the "payment" and thus can export. For the processor, the link between access to lower-priced milk and governmental action is clearly "demonstrable". If there were no prohibition on the sale of non-quota milk into the domestic market, producers would not make low-priced sales of milk to processors for export. Processors would have to access their milk from that domestic market at the higher prices that pertain there. It is governmental action that makes it possible for processors to receive these "payments" from producers. Furthermore, the "governmental action" by virtue of which "payments" are financed goes beyond the prohibition on the sale of non-quota milk into the domestic market. Without the governmental exemption of processors from purchasing milk at the higher regulated prices for export purposes there would be no CEM market and this exemption which is made explicit in provincial marketing regulations[127] (i.e. governmental action) is available only to processors for products that are exported.

3.106 The Complainants noted that milk qualifying as "CEM" is exempt from most domestic regulations, including the domestic price regulations that cover milk for the domestic market. Without this exemption, the CEM scheme could not function as prices for processors then would be too expensive and therefore un-competitive on world markets, i.e., milk is available in the CEM market only because the economically rational choice of selling it at above the "average total cost of production" has been denied by governmental action. In other words, the Complainants continued, producers are selling in the export market, not because there is no demand in the higher-priced domestic market and the producers are therefore making a commercial choice to sell in the lower-priced export market, but because they cannot sell non-quota milk in the domestic market due to the government prohibition. As a result, the producer is foregoing revenue not based upon "commercial" reasons but as a direct consequence of governmental action. This situation described and relied upon by the panel has not changed under the substituted provincial export programmes.

3.107 The Complainants submitted that even if Canada considers the prohibition of non-quota milk in the domestic market as necessary to maintaining the integrity of its supply management system, it does not mean that the CEM scheme is a logical consequence or necessary feature of a supply management system. Other countries operate dairy supply management systems without this feature. The Complainants referred in particular to the system maintained by the European Communities. The Complainants considered that the government-created CEM scheme is not an unintended consequence of Canada's domestic supply management system. Nor is it a "spill-over" benefit of that system (see also paragraph 3.115 below). It represents a deliberate choice of the Canadian

[127] Exhibits NZ-9 to NZ-17. Examples of the relevant provincial exemptions are set out in footnote 22. See also Exhibit US-26.

government to make lower-priced milk available for processors for export. Without the exemption from the cost of the higher-priced domestic milk, Canadian processors could not compete on the world markets for dairy products.

3.108 **Canada,** referring to paragraph 113 of the Appellate Body report in *Canada - Dairy Article 21.5* with respect to "a demonstrable link", submitted that contrary to what is suggested by the Complainants, any alleged "payments" made by an independent private party would not be "financed by virtue of governmental action" by the mere fact that the government, somehow, regulates some aspects of the industry within which that private party operates. Export transactions occurring outside of Special Class 5(d) take place without government interference or control of any kind, and as such, do not benefit from export subsidies. The facts of this dispute establish without question that even if "payments" were made by certain independent producers, which Canada denies, any such payments would not be financed as a consequence of any governmental action. Accordingly, Canada has fully implemented the recommendations and rulings of the Dispute Settlement Body (DSB), reflecting the findings and conclusions of the original panel, as modified by the Appellate Body in *Canada–Dairy*.[128]

3.109 Canada submitted that the Appellate Body contemplated and rejected the position of the Complainants. Accordingly, even if it can be said that a "CEM scheme" exists, such a "scheme" is one into which producers and processors voluntarily decide to enter without government compulsion, direction, or control. The mere fact that such a "scheme" exists would not be sufficient to establish a clear and convincing linkage to the financing of any "payments".

3.110 The **Complainants** responded with respect to Canada's arguments in paragraph 3.98 (tighter nexus) and 3.108 (demonstrable link) above that Canada seeks to read into the Appellate Body's report words which are not there and to mis-characterise the position taken by the Complainants. They do not argue, as Canada alleges (see paragraph 3.108 above), that payments made by an independent party would be financed by virtue of governmental action "by the mere fact that the government, somehow, regulates some aspects of the industry within which that private party operates." Similarly, Canada mis-characterises the Appellate Body's findings as the Appellate Body made no findings with respect to the question of "financed by virtue of governmental action" and could therefore not have "contemplated and rejected" the position of the Complainants, as Canada claims (see paragraphs 3.102 and 3.109 above). Furthermore, although the Appellate Body disagreed with the panel's characterisation of the CEM scheme as "obliging producers, at least *de facto*, to sell outside-quota milk for export", it also noted that "the Panel's reasoning, taken as a whole, was directed towards establishing the demonstrable link between governmental action and the financing of the payments".[129] (See also paragraph 3.93 above.)

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[128] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, and Panel Report *Canada -Dairy (Article 21.5 – New Zealand and US, supra*, footnote 53*)*.

[129] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 116. In footnote 90 of its report, the Appellate Body outlined in detail the approach taken by the

3.111 Contrary to assertions made by the Complainants, **Canada** argued, producers do not take surplus production or "non-quota milk" and sell it as CEM. Rather, producers pre-plan and pre-commit their milk production, including the production of CEM. Governments are not involved in this independent decision-making process. Pre-commitment and first milk out of the tank do not provide processors with a predictable supply of milk. These practices merely provide the framework under which processors can enter into enforceable private contracts with individual producers for milk supplies.

3.112 Canada, noting the Appellate Body's reversal of the panel's finding with respect to "driven or obliged"[130] and further noting that the Appellate Body did not directly address the second measure identified by the panel as governmental action that finances payments (i.e., the sanction for diversion of export milk into the domestic market), submitted that the reasoning of the Appellate Body must also apply in rejecting the panel's finding regarding the effects of this measure. There is no link between this measure and the financing of any alleged payments. A penalty provision on *processors* for diversion of dairy products manufactured with CEM after production does not, in any way, oblige or drive *producers* to produce and sell this milk. It does not alter the basic conclusion reached by the Appellate Body that each producer is free to decide whether or not to produce additional milk for sale as CEM.

3.113 Without a government "mechanism or process" that either makes unprofitable sales on behalf of producers or obliges or drives them to do so, Canada considered that there is an absence of evidence based on which to find the demonstrable link. For Article 9.1(c) to apply, there must be governmental action focused or directed towards the financing of the alleged "payments" (e.g., setting prices, controlling volume, managing producer returns, as under Special Class or producer levy systems). A regulatory framework that merely enables a third person freely to make and finance "payments" is, according to Canada, insufficient to engage Article 9.1(c). Accordingly, any alleged "payments" that may be made by independent producers are not, "financed by virtue of governmental action".

3.114 Replying to the arguments by Canada above, the **Complainants** considered that they clearly identify, in paragraph 3.94 above, the elements of governmental action by virtue of which payments are financed in the present case. They considered that the governmental action that finances the payments in this case is manifest. The Complainants noted that in addressing the issue of "financed by virtue of governmental action", Canada focuses on the producer, ignoring the fact that the recipient of the subsidy is the processor, i.e. the focus in this case must be on the *dairy processor*. Thus, the question is whether the processor for export receives a subsidy which is financed by virtue of

panel in establishing the demonstrable link between the governmental action and the financing of the payments.

[130] *Ibid.*, para. 117.

governmental action, a question the Complainants believed should be answered in the affirmative.

3.115 The Complainants reiterated that it is the enforced segregation of the market that permits exporters to purchase milk for export at discounted prices. By exempting milk for export from the high domestic administered price, Canada has created a separate pool of milk that would not otherwise exist and which is available exclusively for dairy processors for export. It is the government exemption of export milk from the high domestic price which finances the payment to processors. This is not a case where there are "spill-over benefits" from the domestic supply management system, as mentioned earlier (see paragraph 3.107 above). Canada has made the deliberate choice to exempt export milk from the higher domestic price so that its processors can compete in the world market. This exemption is not necessary to maintain the Canadian domestic supply system, a fact that Canada itself has recognised.[131] Rather, the government has chosen to subsidize its processors in this way in order to help them increase their exports. Without this government exemption, there would be no low-priced milk for export. It constitutes government action which is indispensable to the transfer of resources from the producers to the processors.

3.116 Referring to the Complainants arguments in paragraph 3.115 above with respect to the focus on the processor confuses, according to **Canada**, the concept of "financed by virtue of governmental action" with the concept of "benefit". The issue is whether the alleged "payments" by independent producers are "financed by virtue of governmental action". This determination is made by considering the relationship between the governmental actions identified by the Complainants and the "financing" of the alleged "payments". As concerns the exemption from the high domestic administered price, Canada replied that it does not dispute that, as a consequence of these deregulation measures, processors are not required to pay the administered domestic price for commercial export milk. This can be characterized as an "exemption". An "exemption" from the requirement to pay the administered domestic price is not necessary to the protection of entitlement to the domestic administered price. However, the fact that processors have access to milk for export without paying the administered domestic price and, thereby, having no limits on their ability to export, is not *per se* WTO inconsistent. There is no obligation under the *Agreement on Agriculture* to limit exports. The obligation rather is to limit exports that benefit from export subsidies. Not having to pay the administered domestic price does not ensure processors access to milk for export at any particular price. Prices are whatever processors and producers agree they will be. Canada was of the view that the fact that processors have access to milk without paying the administered domestic price does not amount to governmental action by virtue of which payments are financed within the meaning of Article 9.1(c). There is no tight nexus or "demonstrable link" between this governmental action and the financing of any alleged "payments".

[131] Canada's Response to Question No. 14.

3.117 The **United States**, referring to the Appellate Body's observation concerning the "demonstrable link" test as set out in paragraph 3.92 above[132], and to what it considered as Canada's misinterpretation of that report (see paragraph 3.113 above), submitted that if the fact that producers are not obliged to sell into the export market were determinative of the second prong of Article 9.1(c), the Appellate Body would have found that the second prong was not satisfied as it would not have needed additional facts to complete that analysis. Referring to paragraph 116 of the Appellate Body's report in *Canada - Dairy Article 21.5*, the United States noted that it did not so find. The United States considered that the fact that producers are not obliged to sell into the export market is irrelevant. There is no basis in the text of Article 9.1(c) for the conclusion that the governmental action prong requires that the government force producers to participate in the subsidy programme, or even that the governmental action be "focused or directed towards the financing of the alleged payments," as claimed by Canada (see paragraph 3.113 above). The point is that once farmers do produce over-quota milk, they are compelled by government action to transfer economic resources to the processors.

3.118 **New Zealand** submitted with reference to Canada's position (shared by the European Communities[133]) regarding the "demonstrable link", that there is nothing in the WTO disciplines on export subsidies to suggest that government compulsion to participate in a subsidy scheme is a necessary precondition to the establishment of an export subsidy. As the Appellate Body pointed out, "each producer is free to decide whether or not to produce additional milk for sale as CEM", and they are not "obliged or driven" to produce such milk.[134] The decision to participate in a subsidy programme will depend on a number of factors. For example, the cross-subsidization resulting from sales at the higher administered domestic price[135] may make it "rational" for a producer to produce CEM milk. The motivations of producers may, as the Appellate Body pointed out, be relevant to determining the existence of a "payment"[136], but they are not relevant to the determination of whether payments have been financed by virtue of governmental action.

3.119 To meet the requirements of Article 9.1(c) there must be, as the Appellate Body has said, a "demonstrable link" between the receipt of that subsidy by the processor and the governmental action in question which has to show that the governmental action is indispensable to the receipt of the subsidy. Producers choose whether to produce CEM milk. What is relevant is that the CEM scheme,

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[132] See also Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 115.
[133] Paras. 4.36 and 4.37 below.
[134] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 117.
[135] This possibility was noted by the Appellate Body at para. 94 of *Canada - Dairy (Article 21.5 – New Zealand and US).*
[136] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 92.

established and maintained by governmental action, provides processors for export with access to milk at prices below the average total cost of production.

3.120 The Appellate Body[137] made clear, New Zealand continued, that where governmental action merely establishes a regulatory framework that enables a third person freely to make and finance "payments", this does not constitute the necessary "demonstrable link". The CEM scheme, however, is constructed so that processors for export are exempted from the requirement to pay the higher domestic administered price that is applicable to all other milk. As a result, any producer entering into a sale and purchase transaction with a processor necessarily makes a "payment" to the processor. A payment is financed as a matter of course whenever a producer sells milk on to the CEM market.

3.121 New Zealand considered that it is irrelevant that producers decide whether or not to enter the CEM market. Under SMC, producers had the same choice as to whether or not to produce over-quota milk.[138] Furthermore, Canada has not addressed the elements of governmental action that the Complainants have identified. Since the burden of proof in this case rests with Canada, it has not discharged that burden. Indeed, on the key question of whether governmental measures underpin the operation of the CEM scheme, Canada appears to concede the point. Canada explains the measures that the Complainants identify as the governmental action which finances the payments in this case as measures that "protect a producer's entitlement to the higher domestic price"(see paragraph 3.99 above). If this is true, then it is also true that the same governmental action ensures that processors for export remain shielded from these higher domestic prices, ensuring that Canadian milk products are able to compete on the lower-priced world markets.

3.122 The **United States** reiterated that whether or not producers are freely choosing to produce milk for export[139], producers are not freely choosing to finance the payment. The government has made this choice by ensuring that the sale of that milk from the producer to the processor includes a transfer of economic resources to the processors. The transfer is guaranteed by the exemption from the higher administered price for domestic milk which the United States considered has nothing to do with maintaining the domestic supply system. In Canada's terms, it is governmental action "focused and directed"(paragraph 3.113 above) to the financing of payments to processors. The "demonstrable link" between the government action and the financing of the payment is, according to the United States, crystal clear.

3.123 **New Zealand** added that Canada's attempt to import the idea that governmental action must be "directed" towards the financing of a payment in order to show a "demonstrable link" (see paragraph 3.113 above) is

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[137] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 115.

[138] See, for example, Panel Report, *Canada - Dairy*, DSR 1999:VI, 2097, paras. 2.39-2.58.

[139] See para. 117 of the Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, and for example para. 12 of the United States second submission to the panel in the proceedings on the first recourse by the United States to Article 21.5 of the DSU.

unsubstantiated and un-compelling. New Zealand was of the opinion that what Canada is really trying to do is have the Panel distance itself from the language of Article 9.1(c) of the *Agreement on Agriculture*. This would not only turn the interpretative rules of the *Vienna Convention* on their head, but would render Article 9.1(c) meaningless.

3.124 New Zealand considered that Canada's proposed test for determining whether "payments" have been "financed by virtue of governmental action" is inconsistent with the Appellate Body's requirement that there be a demonstrable link between the payment and the governmental action. As has been shown, the demonstrable link resulting from the governmental action in respect of both producers and processors for export is clear. The action of government is indispensable to the transfer of economic resources from producers to processors for export.

3.125 The **United States** was of the view that Canada's arguments mis-characterize the United States position and misstate the Appellate Body report. It has been demonstrated that Canada has failed to meet its burden of showing that the "payments" are not financed by virtue of governmental action. The evidence is quite clear that only through the exercise of governmental powers do processors receive "payments" when they purchase milk for export production. There is unquestionably a demonstrable link between governmental action and the financing of the payment.

3.126 **New Zealand** submitted that from the perspective of export subsidies, Canada's deregulation involves replacing one form of regulation with another form of regulation. While it is a fact that export subsidies on agricultural products are yet to be eliminated, this provides no justification for Canada's claim that the definition of subsidies under the *Agreement on Agriculture* is somehow narrower than the one that applies under the *SCM Agreement*.[140] The definition in Article 9.1(c) of the *Agreement on Agriculture* must be applied in accordance with its terms.

C. Article 10.1 of the Agreement on Agriculture.

3.127 The **Complainants** submitted that even if Canada's CEM scheme would be found not to satisfy the requirements of Article 9.1(c), it would nevertheless violate Article 10.1 of the *Agreement on Agriculture* by providing export subsidies that circumvent (or threaten to circumvent) Canada's export subsidy commitments.

3.128 **New Zealand** referred to *Canada - Dairy*, in which case the panel said that the application of the first part of this provision requires two elements to be established. First, there must be "export subsidies not listed in paragraph 1 of Article 9". And second, those export subsidies must be "applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy

[140] See para. 117 of the Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, and for example para. 12 of the United States second submission to the panel in the proceedings on the first recourse by the United States to Article 21.5 of the DSU.

commitments."[141] Alternatively, if it can be shown that "non-commercial transactions" have been used to circumvent export subsidy commitments, this too will constitute a violation of Article 10.1. The **United States** added that in *US - FSC*, the Appellate Body stated that the obligations under Article 10.1 come into play when three factors are present: the two factors mentioned above plus that the subsidy is contingent on export.[142]

3.129 The **Complainants** reiterated that in determining the meaning of "export subsidies" under Article 10.1, it was noted by the panel in *Canada - Dairy* that Article 1(e) of the *Agreement on Agriculture* defines export subsidies, unless the context requires otherwise, as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement"[143], an approach confirmed by the Appellate Body in *US - FSC*.[144] Referring to the panel report in *Canada - Dairy*[145], the Complainants submitted that since Article 10 applies to export subsidies other than those listed in Article 9, it therefore applies to any subsidy contingent upon export performance that is not included in the export subsidies listed in Article 9.1.

3.130 **Canada** noted that the Parties agree that the *SCM Agreement* provides the appropriate context for identifying any export subsidy under Article 10.1.

(i) Illustrative List of Export Subsidies

3.131 The **Complainants** considered that specific guidance can be obtained from the practices considered in the *SCM Agreement* to be export subsidies, focusing in particular on paragraph (d) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement*.[146] Paragraph (d) specifically addresses the situation where a government provides inputs, indirectly through a government-mandated scheme, to exporters "on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption." A footnote to paragraph (d) provides: "The term 'commercially available' means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations."

3.132 The Complainants further considered that the CEM scheme, like the Special Milk classes scheme, fulfils all of the elements of paragraph (d) for the provision of an export subsidy which were identified in *Canada - Dairy*.[147] First, dairy processors continue to have access to milk for dairy products for export which is priced on more favourable terms than would be available to such

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[141] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 7.120.
[142] Appellate Body Report, *US - FSC*, *supra*, footnote 91, paras. 135-154.
[143] Panel Report, *Canada - Dairy*, DSR 1999:VI, 2097, para. 7.124. This approach was confirmed by the Appellate Body in *US - FSC*, *supra*, footnote 91, paras. 190-196.
[144] *Ibid.*, paras. 190-196.
[145] Para. 7.125
[146] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, paras. 7.126 - 7.132.
[147] *Ibid.*, para. 7.128.

processors when producing for domestic consumption, and on terms that are uneconomic to producers. The "terms or conditions … for the provision of like or directly competitive products … for use in the production of goods for domestic consumption," in paragraph (d), are indisputably less favourable than those for the provision of CEM for export processing: milk used for dairy products for domestic consumption must be quota milk under the domestic supply management system, for which processors must pay the high domestic price.

3.133 Second, the Complainants continued, the product - milk at below domestic rates - has been provided "by governments or their agencies directly or indirectly through government-mandated schemes." Milk is made available for processors for export through a government-mandated exemption of such milk from the higher regulated price and the enforced exclusion of such milk from the domestic market. Producers' only other options are to destroy such milk, or to sell it for animal feed at the even more uneconomic government-set Class 4(m) price. Government action creates the CEM market, including by exempting export processors from the requirement to purchase high-price in-quota milk; government action ensures a steady and predictable supply of CEM by requiring that producers pre-commit to CEM sales and deliver CEM first out of the tank; and the government polices the market, preventing the diversion of CEM milk and products into the higher-return domestic market (which would have the effect of driving up CEM prices and destroying the scheme's economic benefit - deep discounts on milk - to export processors).

3.134 Third, the Complainants submitted, the terms and conditions on which milk is made available to processors for export are more favourable than those available to them on world markets. The facts underlying the original panel's finding on this point have not changed. For all practical purposes, commercial imports of fluid milk for processing cannot enter Canada due to import restrictions.[148] Thus, if processors want to export dairy products, their only choice is to use domestically-produced milk. The Complainants were of the view that this is not a choice which is "unrestricted and depends only on commercial considerations" in the sense of the footnote to paragraph (d).

3.135 Referring to Canada's argument that imported milk is available to processors for export under its Import for Re-Export Program (IREP), the Complainants submitted, as was noted in the panel reports in both *Canada - Dairy* and *Canada - Dairy Article 21.5*, that access to milk under the IREP depended on the discretionary issue of a permit by the Minister as well as on the payment of the in - quota tariff rate[149], not on commercial considerations.[150] Both panels concluded that the terms and conditions for accessing imported milk under that Program were not commercially attractive in comparison with milk

[148] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 53, paras. 7.53-7.55, 7.131.
[149] *Ibid.*, paras. 4.71 and 4.78.
[150] *Ibid.*, paras. 6.25-6.26 and 7.53.

available under Special Milk Classes 5(d) and 5(e).[151] With respect to IREP, the Appellate Body in *Canada - Dairy Article 21.5* observed that "[i]n assessing whether alternative sources of supply are available on more favourable terms, we consider that panels should take account of all the factors which affect the relative "attractiveness" in the marketplace of the different goods or services."[152] The Appellate Body went on to emphasise that if an import permit was "granted to importers as a matter of course, in the context of straightforward import procedures, and if import fees were only administrative charges to cover expenses, these formalities would be unlikely, on their own, to mean that imports were available on less favourable terms and conditions."[153] If the terms and conditions on which IREP was made available were more favourable, the Complainants were of the view that the amount of milk obtainable through IREP would be significantly larger.[154] Thus, Canada's CEM scheme constitutes the provision of export subsidies within the meaning of paragraph (d) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.

3.136 **Canada** submitted that the alleged export subsidy under Article 10.1 of the *Agreement on Agriculture* is not an export subsidy of the type identified under Item (d) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* as alleged by the Complainants. Referring to the text of Item (d), Canada submitted that the term "commercially available" means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations. Three requirements must all be found to exist for a measure to fall within the definition of an export subsidy in Item (d) of the Illustrative List: (i) the raw materials for use in the production of exported goods must be provided by government or their agencies either directly or indirectly through a government-mandated scheme; (ii) the raw materials must be provided on terms and conditions more favourable than those that apply to raw materials for use in the production of goods for the domestic market; and (iii) those terms and conditions must be more favourable than those commercially available on world markets to processors.[155]

3.137 A threshold issue relating to the first requirement, Canada continued, is the meaning of the provision of goods by governments "directly or indirectly through government-mandated schemes." In that regard every export subsidy illustrated in Annex I of the *SCM Agreement* is by definition an Article 1.1 "subsidy" that is contingent on export performance. The words "indirectly through a government-mandated scheme" in Item (d) must therefore have a

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[151] *Ibid.*

[152] Appellate Body Report, *Canada Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, footnote 55.

[153] *Ibid.*

[154] In addition, it should be noted that because government action has foreclosed the option to sell additional milk on the domestic market, processors for export are in a position to negotiate a price that is below the price they would have to pay through IREP even if it were available on commercial terms. Producers have no option if they produce non-quota milk other than to sell it to processors for export.

[155] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra*, footnote 53, para. 7.128.

meaning consistent with Article 1.1(a)(1)(iv). To hold otherwise would impermissibly graft a new type of "financial contribution" onto the definition of "subsidy" in the *SCM Agreement*. As the Appellate Body has held, "… principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended."[156]

3.138 With respect to Canada's arguments in paragraph 3.137 above, **New Zealand** submitted that Article 3.1 of the *SCM Agreement* makes it clear that the subsidies listed in the Illustrative List are export subsidies for the purposes of the *SCM Agreement*. Once it is determined that a particular practice falls within the description contained within one of the paragraphs of Annex I, then that practice is deemed to be an export subsidy, without further reference to Article 3.1 or Article 1.1 of the *SCM Agreement*. As has been recognised in a number of rulings[157] there is therefore no need for paragraph (d) practices to be then examined through the spectrum of Article 1.1 of the *SCM Agreement*. As concerns Canada's reference to the Appellate Body's ruling on *India - Patents*, New Zealand submitted that this case appears to contradict Canada's position. By arguing that paragraph (d) has to be limited by reference to Article 1.1 of the SCM Agreement and, more specifically, has to be read in the context of Article 1.1(a)(1)(iv) of the SCM Agreement, Canada is indeed trying to introduce the terms "entrust" and "direct" into paragraph (d)[158] - terms that are only found in Article 1.1(a)(1)(iv).

3.139 **Canada** reiterated that the Canadian governments do not directly themselves provide CEM to processors, nor do they "entrust or direct" producers to do so through an authoritative instruction or command. Thus, the first of the three requirements of Item (d) is not met. The issue of whether the other two conditions of Item (d) are met is, therefore, moot. However, it is undisputed that CEM itself is sold at prices set by the world market.[159] When the panel in *Canada - Dairy Article 21.5* addressed Item (d), the point of contention was whether the world market terms were "available" to processors through Canada's IREP. The panel's decision in that prior proceeding that world market terms are not available to processors through IREP was based on its findings with respect to IREP's requirement that imports are subject to securing a permit from the Department of Foreign Affairs and International Trade. The Appellate Body addressed this finding in its discussion of possible benchmarks for determining the existence of "payments" under Article 9.1(c) of the *Agreement on Agriculture*.

3.140 Referring to the situation described by the Appellate Body in its report in *Canada - Dairy Article 21.5*[160] concerning the terms and conditions on which

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[156] Appellate Body Report, *India – Patents*, DSR 1998:I, 9, para. 45.
[157] See for instance Panel Report, *Canada - Autos*, DSR 2000:VII, 3043, para. 10.197 and Panel Report, *Brazil - Aircraft Article 21.5*, DSR 2000:IX, 4093, para. 6.42.
[158] See para. 3.139 below.
[159] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 83.
[160] Footnote 55, page 23

IREP is available, **Canada** submitted that of the 2,317 IREP permit requests from August 2000 (when commercial export sales commenced) to February 2002, no request was denied. Further, the fees involved are minuscule, less than one tenth of one per cent (0.025 per cent) of the IREP import values. Nor, contrary to the Complainants' suggestions (see paragraph 3.135 above), do the in-quota tariff duties assessed on IREP imports affect processor decisions. Dairy products are imported under IREP duty-free (including imports from the United States and significant levels of imports of certain dairy products from New Zealand), or at rates of 7.5 per cent or less. Where tariffs are assessed, duty drawback permits the importer to recover these low tariffs.[161] In short, Canada asserted, the permitting requirement, fees, and any applicable in-quota tariff rates associated with IREP are not formalities that make IREP a commercially non-viable alternative to CEM.

3.141 **New Zealand**, referring to the arguments in paragraphs 3.131-3.135 above, and to Canada's response in paragraph 3.140 with respect, in particular, to Canada's duty drawback scheme, submitted that, as acknowledged by Canada, processors for export face an additional administrative hurdle in having to lodge an application in relation to a duty drawback scheme as well. As the Appellate Body in *Canada - Dairy Article 21*.5 observed, New Zealand continued, "panels should take account of all the factors which affect the relative 'attractiveness' in the marketplace of the different goods or services" when assessing whether alternative sources of supply are available on more favourable terms.[162] New Zealand reiterated that IREP milk would not be an attractive proposition for processors for export when they are faced with the in-quota tariff rate and permit fees on top of the discretionary issuance of the permit itself and other regulatory requirements.

3.142 The other relevant element, **Canada** submitted, is to determine whether CEM prices are available to exporters through IREP. As the Appellate Body has stated, a finding under this element requires, in the context of the current dispute, an examination of the competitive relationship between CEM and imports under IREP.[163] The Appellate Body also noted that "[i]mports under IREP, generally, involve whole milk powder, while CEM involves fluid milk."[164] Canada has already presented data demonstrating the comparability of prices for whole milk powder imported under IREP and prices for CEM[165], and current data show that the milk equivalent price of whole milk powder continues to be competitive with the price of CEM.[166] For the above reasons, therefore, neither the first nor the third prerequisites for an Item (d) violation have been met.

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[161] Drawback is limited on exports to the United States and Mexico under separate and unrelated requirements of the North American Free Trade Agreement.

[162] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, footnote 55.

[163] *Ibid.*, para. 67.

[164] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US*, footnote 37.

[165] See Canada's response to Panel Question No. 10 in *Canada - Dairy Article 21.5* proceedings.

[166] In 2001, Canada imported 15,737,202 kgs. of whole milk powder under IREP, which represents a value of CDN $46,387,255. Therefore, the average price of whole milk powder per kilogram was

3.143 In response to Canada's arguments in paragraph 3.142 (and footnote 166) above, the **United States** submitted that it does not agree that a discretionary permit requirement, no matter how routine its issuance, and an administrative fee constitute "formalities" which do not affect the commercial attractiveness of the IREP option. Such "formalities" are at a minimum an administrative burden that will make IREP purchases less attractive then CEM purchases which require no such steps. Indeed, as mentioned elsewhere, the fact that the IREP is so infrequently accessed constitutes persuasive evidence that its terms and conditions are less favourable than those available under Canada's export schemes.

3.144 Second, Canada relies upon imports of whole milk powder which must be re-hydrated for most end-uses requiring additional time and expense. Third, Canada admits that a tariff rate of 7.5 per cent applies to many imports under the IREP[167], an additional cost which renders the terms of IREP imports less favourable than CEM milk which does not incur that cost. Further, the IREP would require obtaining duty drawback, an additional factor that renders the conditions of IREP less favourable. Fourth, and perhaps most important, the United States continued, the prices of IREP whole milk powder are less favourable than the prices of CEM fluid milk, using the conversion factor that the Dairy Farmers of Canada recommends (7.78 litres of milk from one kilogram of whole milk powder) provides a milk equivalent price of CDN $37.70/hl at the port, which is more than the average price of CEM milk.[168] Moreover, to be properly compared with CEM milk prices, transportation and re-hydration charges must be added to the already non-competitive IREP price.

3.145 Finally, whole milk powder is not used in the production of cheese or "other milk products," the two categories of exports at issue here. Rather, whole milk powder is predominately used in the production of confectionery products (i.e. candy) in Canada. Thus, the evidence does not support Canada's assertion that Canadian manufacturers of cheese and "other milk products" are accessing whole milk powder imports under the IREP or, even if they were, that the terms are as favourable as under the CEM scheme. Thus, because the CEM scheme satisfies each of the criteria identified in Paragraph (d) of the Illustrative List, the CEM scheme provides export subsidies for purposes of the SCM Agreement. As the SCM Agreement is part of the context of the Agreement on Agriculture, the fact that the CEM scheme provides subsidies identified in the Illustrative List

CDN $2.95. As Canada explained in answer to question no. 10 from the previous *Canada - Dairy Article 21.5* panel, there is no standard conversion factor for whole milk powder. However, using a conversion factor of 11 kg., the standard used by the CDC and commonly used in the Canadian dairy industry and by Canadian dairy research institutes, the price of whole milk powder would be CDN $32.42/hl, or as argued by the United States using a conversion factor of 12.04 kg., the price would be CDN $35.49/hl, both of which fall within the range of commercial export milk prices, i.e., CDN $23.79-CDN $40.13/hl.

[167] Imports from the United States are exempt from these tariffs as a result of the North American Free Trade Agreement.

[168] See Exhibit US-34.

supports a finding that the CEM scheme constitutes an export subsidy under Article 10.1 of the Agreement on Agriculture.

3.146 With respect to Canada's arguments concerning paragraph (d) of the Illustrative List, the United States considered that Canada's arguments are without legal support. Because the question in this case is one of export subsidies, as this panel stated in its original report, it is more appropriate "to examine what practices are considered under the SCM Agreement to be 'export subsidies', rather than to examine how that Agreement defines the more general concept of a "subsidy" in its Article 1." In doing so, the panel considered paragraph (d) of the Illustrative List of Export Subsidies contained in Annex I to the SCM Agreement to be the most relevant paragraph. Referring to the conditions to be fulfilled to satisfy the requirements of paragraph (d) of the Illustrative List, the United States reiterated that for the reasons discussed above in paragraphs 3.131-3.135, Canada's CEM scheme satisfies each of these elements. Contrary to Canada's suggestion, the United States continued, it is not necessary first to conduct a separate analysis to demonstrate that the specific terms of Article 1.1(a)(1)(iv) are satisfied in order to fulfil the requirements of paragraph (d). Indeed, Canada itself agrees with this approach. In *Brazil - Aircraft*, Canada argued, and the panel agreed, that if a measure satisfies the Illustrative List, it is not necessary to consider whether it satisfies the broader definition of a "subsidy" in Article 1 of the *SCM Agreement*.[169] The United States considered finally that it has established under the fourth element of paragraph (d) that the terms and conditions on which milk is made available to processors for export are more favourable than those available to them from other sources.

3.147 **Canada** submitted, in response to the Complainants arguments with respect to Item (d) of the Illustrative List (see paragraphs 0 - 0, above) that in *US–FSC*, the Appellate Body held that all export subsidies prohibited by the SCM Agreement must meet the general definition of subsidy set out in Article 1.1 and in *Canada – Autos*, the panel noted that, "all [of the] practices identified in the Illustrative List are subsidies contingent on export performance." In *Brazil – Aircraft*, the panel held that once it is shown that a measure falls under the Illustrative List, it is *per se* an export subsidy, and it is not necessary to have regard to Article 1. Here, in contrast, there is an issue as to the meaning of what is meant by "indirectly through a government mandated scheme." It is, therefore, necessary to have regard to Article 1 of the SCM Agreement.

3.148 Further, in *US–Export Restraints*, Canada continued, the panel held that under the SCM Agreement Article 1 "subsidy" definition, a transfer of economic resources can be effected either directly under subparagraphs (i) to (iii) or indirectly through private bodies under subparagraph (iv). The panel held that a provision of goods only leads to a finding of a financial contribution under Article 1.1(a)(1)(iv), that is, the government only provides goods indirectly

[169] Panel Report, *Brazil - Aircraft Article 21.5* DSR 2000:IX, 4093, para. 6.42. This is consistent with the text of Article 3.1(a) of the SCM Agreement which provides that subsidies illustrated in Annex I shall be prohibited.

through a private body, if government entrusts or directs a private body to provide goods through delegation or an authoritative instruction or command. Canada submitted that it has demonstrated that government, in this case, has not delegated or given any instruction or command to individual producers to provide CEM to processors. Rather, individual producers and processors enter into commercial export transactions of their own volition.

3.149 Canada considered that there is no valid legal basis for not adopting an interpretation of "indirect" in Item (d) that is consistent with a meaning of that concept in Article 1. Accordingly, Canada does not provide goods "*indirectly* through a government mandated scheme" within the meaning of Item (d). It is also clear that neither the government nor their agencies provide CEM to processors *directly*. The first element of Item (d) not having been met, there is no export subsidy within the meaning of that provision.

3.150 **New Zealand** submitted, with respect to the arguments in paragraphs 3.147 - 3.149 above that no authority is cited, and of course none could be, for limiting the meaning of "indirectly" in paragraph (d) by reference to a specific provision of Article 1.1 - a provision that Canada, not the treaty, describes as "indirect" subsidization. New Zealand considered that Canada's arguments have no foundation in the text of paragraph (d).

3.151 As concerns the arguments above with respect to administrative formalities, **Canada** submitted that these arguments have already been rejected by the Appellate Body. Nor does Canada agree that a tariff makes imports under IREP less attractive. Canada considered in particular that a tariff subject to drawback, falls into the same category of "administrative formalities" as permits and fees. They are widely used throughout the world and cannot be considered a meaningful impediment to importation, in particular, when as in this case, 95 per cent of all dairy products imported under IREP come in at or very close to duty free.

3.152 Finally, Canada considered that it is not true that prices under IREP are less favourable to processors than prices of CEM. Canada presented evidence on pricing under IREP before the first Article 21.5 panel and in its first written submission in this proceeding. For all of these reasons, Canada submitted that it does not provide export subsidies on the production and sale of CEM to processors within the meaning of Item (d) of the Illustrative List of Export Subsidies.

(ii) SCM Agreement and Article XVI of GATT

3.153 The **Complainants** submitted that Article 1.1 of the *SCM Agreement* is also relevant, providing further guidance in interpreting the meaning of the term "export subsidy" in Article 10.1 of the *Agreement on Agriculture*. This provision provides further context to Article 1(e) of the *Agreement on Agriculture*, which states that the term "export subsidies" "refers to subsidies contingent upon export

performance".[170] Article 1.1 includes within the definition of a subsidy "any form of income or price support in the sense of Article XVI of GATT 1994". Article XVI describes supports which "operate directly or indirectly to increase exports of any product" (section A.1). Furthermore, section B.4 of Article XVI proscribes subsidies that "result[] in the sale of [the subsidized] product for export at a price lower than the comparable price charged for the like product in the domestic market". This includes Canada's CEM scheme whereby the federal and provincial governments and agencies have created a system which makes milk available to processors for export at below both its domestic price and its average total cost of production, milk which would not be available without the CEM scheme. The CEM scheme is thus a subsidy within the meaning of Article 1.1 of the *SCM Agreement*, as elaborated in Article XVI of GATT 1994.

3.154 Furthermore, **New Zealand** added, in both instances, the CEM scheme constitutes a "subsidy" within the meaning of Article 1.1(a)(2) of the *SCM Agreement*, and the fact that a "benefit" pursuant to Article 1.1(b) is conferred is self-evident, as milk priced below its proper value is made available to processors for export, thereby reducing processor costs.[171]

3.155 Canada cannot deny, the **United States** continued, that dairy products produced for export using CEM are priced lower than the same dairy products produced for domestic consumption. Finally, Canada does not dispute that there are no restraints on the availability of the export subsidies created by the CEM scheme. Consequently, the export schemes have already resulted in or threaten to lead to the circumvention of Canada's reduction commitment within the meaning of Article 10.1.

3.156 Thus, the **Complainants** concluded, the CEM scheme is a subsidy within the meaning of the *SCM Agreement*, and hence is an "export subsidy" within the meaning of Article 10.1 of the *Agreement on Agriculture*. It is a subsidy "contingent upon export performance". Only processors for export are granted access to milk that is priced below both its domestic price and its average total cost of production and the products must be sold on the export market.

3.157 **Canada** submitted that there is no basis upon which to classify commercial milk transactions as "income or price support" (see paragraph 3.153 above). Canada considered that the Complainants' position lacks legal analysis and factual support. First, the arguments of both Complainants regarding Article 1.1(a)(2) of the *SCM Agreement* focus on the perceived effects of commercial export transactions. Such casual treatment of this element confuses the alleged measure with its effect, both of which are required to be shown. Canada referred to the panel in *US - Export Restraints* which noted that the definition of "subsidy" in Article 1 reflects the Members' agreement not only as to the types of government action subject to the *SCM Agreement*, but also that not all

[170] Appellate Body Report, *US - FSC*, *supra*, footnote 91, para. 136; Appellate Body Report, *US - FSC Article 21.5*, DSR 2002:I, 1619, paras. 193-195; and Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 7.126.

[171] Appellate Body Report, *US - FSC Article 21.5*, *supra*, footnote 170, para. 191.

government actions that may affect the market come within the ambit of the *SCM Agreement*.

3.158 Second, Canada continued, both Complainants refer to Article XVI:4 of GATT 1994 (see paragraph 3.153 above) in support of their pure "effects" based analysis. However, the Appellate Body has already indicated that the reference to "income or price support" in Article 1.1(a)(2) of the *SCM Agreement* is to Article XVI:1 of GATT 1994 only. In the opinion of Canada, the allegations of the Complainants do not demonstrate any element of "support" of any kind in the sense of Article 1.1(a)(2) of the *SCM Agreement*. There is no evidence, since no such evidence exists, that the government establishes either a support or target price for CEM transactions or any manner of government-set income target measures for the benefit of dairy processors. CEM prices are determined based on the independent decisions of processors as to what price they are willing to pay and the independent decision of producers as to whether or not they are willing to accept that price.[172] There is no "income support" programme for processors.

3.159 The **United States** reiterated that an analysis of Article 1.1(a)(2) of the *SCM Agreement* also supports a finding under Article 10.1 of the *Agreement on Agriculture*. The United States considered, however, that there is no support in the language of that provision for requiring that the government set a "target" price or income level. Article 1.1(a)(2) points instead to "*any form* of income or price support in the sense of Article XVI of GATT 1994." Nor is there any requirement in Article XVI that the government set a "target" price or income level. Canada provides income and price support to its exporters by exempting milk used in the production of export products from the high domestic price. It is undisputed that Canadian processors could not compete in the export market without the low-price inputs (CEM milk) available to them as a result of this exemption. Thus, although the individual prices of the export contracts are negotiated by the producers and processors themselves, this government exemption from the high domestic price necessarily operates to increase the exports of dairy products from Canada. Without it, the processor would have to purchase its milk for export at the higher domestic price. This is not the "perceived effects of commercial export transactions" as argued by Canada.[173] This is the guaranteed result of the government-mandated price exemption.

3.160 Referring to New Zealand's arguments concerning "benefit" in paragraph 3.146 above, Canada replied that the *US–FSC* was a case involving the foregoing of *government* revenue through a taxation regime. The United States does not attempt to establish the required conferral of a "benefit" for purposes of establishing a subsidy through Article 1.1(a)(2) of the *SCM Agreement*. In any event, Canada has already shown that producers who are selling milk to

[172] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 79.

[173] In any event, the *US - Export Restraints* case cited by Canada is inapposite. That case was brought under Article 1.1(a)(1)(iv), not Article 1.1(a)(2). Furthermore, the language relied upon by Canada is *obiter dictum*.

processors in CEM transactions are able to recover their average cost of production over time. Accordingly, they are not providing goods at less than adequate remuneration, and no benefit therefore exists.[174]

3.161 Referring to the Complainants' arguments in paragraph 3.153 above and Canada's response in paragraph 3.157 above, **New Zealand** replied that the panel in *US - Export Restraints* made it clear that its decision was focused solely upon the specific language of Article 1.1(a)(1)(iv).[175] With respect to "benefit", New Zealand submitted that the Appellate Body in *US - FSC* indicated that where costs have been reduced, a "benefit" has been conferred. This clearly applies to the present case where processors for export are being provided with milk that is priced below its proper value. New Zealand considered that to make a distinction between government revenue foregone and a "benefit" was misplaced because a "benefit" would exist whether costs are reduced by revenue foregone by government or foregone by an independent economic operator.

3.162 With respect to the Complainants' arguments concerning income or price support (see for instance paragraph 3.153 et sequitur above) **Canada** considered that there is no support in the text of Article 1 of the *SCM Agreement* for the Complainants' theory that Canada is providing a form of "income or price support" within the meaning of Article XVI of GATT 1994. Contrary to the Complainants' assertions, there are no guarantees that any income will be generated unless it is in the economic interests of producers and processors that sales occur. The conclusion that because Canada does not prevent sales of CEM from occurring at prices mutually agreed to between buyer and seller, Canada is "supporting" the income generated by these sales is, according to Canada, inconsistent with the concept of "support". Such a conclusion would mean that any measure that enables income to be generated by milk producers could likewise be considered to be income support.

3.163 Canada submitted that there is no authority in GATT jurisprudence for such a wide interpretation of "income or price support". While this expression has never been explicitly defined under GATT law or practice, the 1960 *Panel Review Pursuant to Article XVI:5* provides some context. The panel noted that measures had to be analysed on a case-by-case basis but, in considering such matters, spoke of cases such as where a government maintains domestic prices above the world price by purchases and resales at a loss. This is far from, in the words of the Appellate Body, "…establish[ing] a regulatory framework merely enabling a third person freely to make and finance 'payments'". Canada reiterated that for these reasons, it does not provide export subsidies on the production and sale of CEM to processors within the meaning of Article 1.1(a)(2) of the *SCM Agreement* and Article XVI of GATT 1994.

[174] Appellate Body Report, *supra*, footnote 91, *US–FSC*, para. 136.
[175] See, for example Panel Report, *US - Export Restraints*, *supra*, footnote 93, para. 8.75.

(iii) Circumvention of Export Subsidy Commitments

3.164 The **Complainants** submitted that through the combined exercise of federal and provincial authority, Canada has established mechanisms in the various provinces to provide processors for export with milk that is below its domestic price and its average total cost of production, the very export subsidy that was concluded in the *Canada - Dairy* Appellate Body report to be contrary to Canada's obligations under the *Agreement on Agriculture*. The Complainants, referring to the Appellate Body report in *US - FSC*[176] noted that "to circumvent" meant to "find a way round, evade..." i.e. a Member would have found a way around or evaded its obligations if it could transfer by another means the very same economic resources or benefits that it would be prohibited from providing in another form under Article 3.3 and Article 9.1 of the *Agreement on Agriculture*.[177]

3.165 **New Zealand**, referring to Article 10.3 (burden of proof) of the *Agreement on Agriculture* and to the panel in *Canada - Dairy*[178], noted that the effect of Article 10.3 is that exporting in excess of reduction commitments raises a presumption that there has been circumvention of those commitments, and thus there is a burden on the Member to establish that the quantities in question are not subsidized. Equally, where a Member has taken measures which will enable the export of subsidized products in excess of reduction commitments, those measures threaten to lead to circumvention, even though no quantities in excess of reduction commitments have yet been exported. Thus, New Zealand continued, in the context of the present case, to the extent that Canada's CEM scheme enables the export of subsidized dairy products in excess of Canada's reduction commitment levels, it threatens to lead to circumvention of those commitments. To the extent that dairy products have been exported in excess of Canada's reduction commitments, there has been actual circumvention of Canada's reduction commitments. In either circumstance, there has been a violation of Article 10.1 of the *Agreement on Agriculture*.

3.166 The **United States** considered that the export subsidy conferred by the CEM scheme "results in, or threatens to lead to, circumvention of export subsidy commitments."[179] Canada has thus evaded its export subsidy commitments by finding a new means (the CEM scheme) to transfer to export processors the very same economic benefits (i.e. discounted milk) that it was prohibited from transferring under the SMC scheme condemned by the DSB under Article 9.1(c) of the *Agreement on Agriculture*. In *US - FSC*, the Appellate Body concluded that: " ... under Article 10.1 it is not necessary to demonstrate *actual* 'circumvention' of 'export subsidy commitments'. It suffices that 'export subsidies' are applied in a manner ... which *threatens to lead to circumvention* of export subsidy commitments."[180] In determining whether circumvention of

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[176] Appellate Body Report, *US - FSC*, *supra*, footnote 91, para. 148.
[177] *Ibid.*, para. 150.
[178] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 7.122.
[179] Article 10.1 of the *Agreement on Agriculture*.
[180] Appellate Body Report, *supra*, footnote 91, *US - FSC*, para. 148.

export subsidy commitments is likely to result, the Appellate Body concluded that the structure and other characteristics of the measure are pertinent.[181]

3.167 Under the CEM scheme, the United States continued, the Canadian government requires that non-quota milk be excluded from consumption in the domestic market. The direct consequence of that exclusion is that such milk must be used to produce either products for export or animal feed. The availability of discounted milk for export is confined only by the export opportunities available to Canada's dairy product processors. The revised export schemes lack any internal limit or control on the volume of discounted milk going to processors for export.

3.168 As in *US - FSC*, the absence of any constraints on the use of the CEM export subsidy confirms, according to the United States, that it is likely to threaten to lead to circumvention of Canada's dairy export subsidy commitments. Moreover, in this case there is not only threatened, but actual circumvention of Canada's export commitments. Indeed, Canada's exports of cheese and "other milk" products in the dairy year 2000-2001 exceeded (or for purposes of Article 10.1, circumvented) the limitations to which Canada committed itself in the *Agreement on Agriculture*.[182] Thus, the threat of additional, unchecked circumvention of Canada's dairy export subsidy commitments is no mere possibility—it is underway.

3.169 **Canada** responded that there has been no circumvention of Canada's export subsidy commitments within the meaning of Article 10.1 of the *Agriculture Agreement* since, as Canada has demonstrated, there is no export subsidy involved in commercial export milk transactions. Accordingly, the issue of circumvention is moot.

3.170 **New Zealand** submitted that Article 10.1 of the *Agreement on Agriculture* is essentially focused on ensuring that the export subsidy disciplines of the *Agreement on Agriculture* are not circumvented. But, this is clearly what Canada is attempting to do with the CEM scheme. New Zealand considered that the CEM scheme is simply a replacement for Special Milk Class 5(e). CEM is achieving precisely what was achieved under Special Milk Classes until the scheme was ruled to be contrary to Canada's obligations under the *Agreement on Agriculture*. New Zealand considered that a clearer case of circumvention could not be found.

3.171 The *Canada - Dairy* panel's observation in paragraph 7.125 of its report acknowledges that the drafters of Article 10 were trying to capture those export subsidies that did not technically meet the strict letter of Article 9.1, but nevertheless produced the same subsidization consequences. This idea was referred to as well by the Appellate Body in *US - FSC*, New Zealand continued (see also paragraph 3.146 above).

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[181] Appellate Body Report, *supra*, footnote 91, *US - FSC*, para. 149.

[182] See Exhibit US-1; Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.8. Canada is also on track to exceed its commitments for cheese and "other milk" products for the dairy year 2001-2002.

(iv) "Non-commercial transactions"

3.172 **New Zealand** submitted that even if it is not accepted that Canada has applied export subsidies not listed under Article 9.1 of the *Agreement on Agriculture* in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments in the sense of the first part of Article 10.1 of the *Agreement on Agriculture*, it has provided for "non-commercial transactions" in the sense of the second part of the same article. New Zealand considered that a non-commercial transaction is one in which private profit-maximising individuals would not, from choice, engage. They involve transactions on terms that have not been freely negotiated in an open market.

3.173 In the present case, New Zealand continued, the "market" in which these transactions take place is completely constructed. The processors for export are being provided with milk that is priced at below domestic prices and below the average total cost of production. This is achieved by prohibiting the sale of such milk in the regulated domestic market and by exempting processors for export from the obligation to purchase milk at the regulated domestic prices. Transactions that take place in such a "market" are not commercial transactions resulting from the normal operation of markets. Indeed, they are "non-commercial transactions" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

3.174 The **United States** submitted that Canada's revised export scheme is in contravention of the second clause of Article 10.1 of the *Agreement on Agriculture*. Despite the "market" trappings of the contractual arrangements between producers and processors in the sale of CEM, the United States considered that those transactions are demonstrably "non-commercial" as CEM sales are uneconomic for milk producers, who do not come close to recovering their costs of producing the milk. CEM prices have regularly fallen short of producers' fixed and variable costs of production by more than CDN $20 per hectolitre. Producers engage in these uneconomic CEM transactions, the United States continued, because the only other alternatives legally available to them - disposal, or Class 4(m) sales for animal feed - offer even less of a return on their investment. The Canadian government thus leaves them no choice but to engage in "non-commercial" sales of their non-quota milk. Those sales to export processors, in turn, have resulted in the circumvention (and threaten further, unlimited circumvention) of Canada's export subsidy reduction commitments.

3.175 The next factor in the analytical framework suggested by the Appellate Body is to consider whether the availability of discounted milk pursuant to the CEM scheme is "contingent on export performance."[183] As explained above, under the CEM scheme, the availability of discounted milk is dependent on use of the milk in the manufacture of dairy exports. Severe financial penalties prevent the sale of the discounted milk or its products for any purpose other than export. In sum, the United States submitted, Canada's CEM scheme comprises "export subsidies" or "non-commercial transactions" within the meaning of

[183] Appellate Body Report, *supra*, footnote 91, *US - FSC*, para. 141.

Article 10.1 of the *Agreement on Agriculture*, even if the CEM scheme is found not to meet strictly the definitional requirements of Article 9.1(c) of the Agreement. CEM subsidies or transactions have already resulted in the circumvention of Canada's export subsidy reduction commitments, and they threaten continued, indeed unlimited, circumvention of those commitments. As such, the CEM scheme violates Article 10.1 of the *Agreement*.

3.176 **Canada** submitted that there is nothing non-commercial about the CEM market. Nothing in the context of the *Agreement on Agriculture* detracts from or expands the ordinary meaning.[184] Producers when they decide to sell CEM, are acting in a purely commercial manner with a view to making a profit. They are engaged in an arm's-length business transaction with processors. Unlike, for example, buffer stocks of commodities that governments compile and then dispose of by any means possible such as donations or food aid, such transactions cannot be dismissed as "non-commercial." Both buyer and seller are entering into a commercial contract and assuming commercial risks. These choices are theirs, not those of the government. Canada concluded that there has been no circumvention of Canada's export subsidy commitments within the meaning of Article 10.1 of the *Agriculture Agreement* since there is no export subsidy involved in CEM transactions. Accordingly, the issue of circumvention is moot.

3.177 **New Zealand** rejected Canada's view with regard to "non-commercial" (see paragraph 3.168 above) submitting that since it has been established that sales on the CEM market take place at prices that are lower than the average total cost of production, they are by definition non-commercial transactions. Hence, there is circumvention within the meaning of Article 10.1 of the *Agreement on Agriculture*.

3.178 Replying to the arguments in paragraph 3.168 above with respect to non-commercial transactions, the **United States** submitted that the export market is a wholly contrived market. It is created by the Canadian government. As noted by the panel in the first Article 21.5 proceedings, there is no difference between the "domestic" market and "export" market in terms of the buyers, sellers and products they trade.[185] The only difference is the price of milk, which is a result of government intervention. The United States reiterated that it has demonstrated that the average price of CEM milk does not allow producers to recoup their total average cost of production in the long run. Producers engage in these uneconomic CEM transactions because the only other alternatives legally available to them - disposal, or Class 4(m) sales for animal feed - offer even less of a return on their investment. If they produce milk without quota, the Canadian government leaves them no choice but to engage in "non-commercial" sales of this milk in the CEM market. Those sales to export processors, in turn, have resulted in the circumvention (and threaten further, unlimited circumvention) of Canada's export subsidy reduction commitments.

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[184] See Exhibit CDA-19.

[185] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.16

3.179 Canada reiterated that it has not created or contrived a market for CEM. Canada has simply removed governments from decisions related to the purchase and sale of CEM. Private parties decide whether and on what terms they wish to participate in the global market for dairy products. Canada certainly did not "contrive" or "create" this global market. The transactions in which producers and processors enter are, therefore, commercial. In addition, the context of other provisions under the *Agreement on Agriculture* suggests a far narrower meaning. Articles 9.1(b) and 10.4(a) refer to "non-commercial" in the sense of transactions occurring outside of the normal market of private buyers and sellers, such as governmental sales or other disposals of food stocks for international food aid. Commercial export sales clearly do not fit within that context.

D. Articles 1.1 and 3 of the SCM Agreement

3.180 The **United States** submitted that in addition to constituting violations of Articles 9.1(c), or in the alternative, Article 10 of the *Agreement on Agriculture*, Canada's measures affecting the exportation of dairy products constitute prohibited export subsidies pursuant to Articles 1.1 and 3.1 of the *SCM Agreement*. Notwithstanding the change that Canada imposed on the form of its programmes, Canada's measures continue to meet the Appellate Body's definition of a "subsidy" under Article 1.1 of the *SCM Agreement.* [186] Canadian governmental authorities continue to provide milk for export products at a reduced rate. Under Canada's new scheme, the CDC, CMSMC, the provincial governments, the milk marketing boards and the new provincial programmes - with their penalties for milk that is not properly channelled - all work to ensure that this is the case. The Appellate Body found that, in such circumstances, "the recipient is paid in the form of goods or services."[187] This, in the opinion of the United States, constitutes a financial contribution under Article 1.1(a)(1)(iii) of the *SCM Agreement*.

3.181 The United States, referring to the Appellate Body report in *Canada - Aircraft*[188] with respect to the term "benefit", submitted that because of the incentive to sell milk at lower prices for export, the dairy processors who export are the beneficiaries of the CEM scheme in Canada. Without this scheme, milk at such discounted prices would not be available through any other channel to processors for export. Since those processors have no other source for such low-priced milk and they could not sell their dairy products into world markets if they were compelled to pay the much higher domestic prices in Canada for milk, the processors clearly receive a competitive advantage that they would otherwise lack. Since the milk for export is provided on lower terms than would otherwise be available on the market, absent the provincial pricing systems, the financial contribution provides a benefit within the meaning of Article 1.1(b) of the *SCM Agreement*.

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[186] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.
[187] *Ibid.*, para. 113.
[188] Para. 157.

3.182 The United States submitted furthermore that Canada's CEM scheme requires that milk purchased at the exempted CEM price must be exported. As such, these subsidies are "contingent on export performance" and therefore prohibited under Article 3.1 of the *SCM Agreement*. Under the CEM scheme, when a milk dealer is unable to show that all the quantities of components of the volume of milk have been exported, the milk dealer must pay a penalty. Canada's CEM scheme is, therefore, "contingent … upon export performance" and, as such, provides prohibited subsidies under Article 3.1 of the *SCM Agreement*.

3.183 In conclusion, the United States submitted that Canada's introduction of the CEM scheme to replace Special Milk Class 5(e) cannot conceal the fact that dairy processors continue to receive milk for use in the production of exported goods at prices substantially below the proper value of the milk to the producers. This price benefit is conferred through export mechanisms authorised, administered, and enforced through governmental action. Thus, there can be no doubt that Canada's current export regime for dairy products, consisting of both Special Milk Class 5(d), and the CEM scheme, provides an export subsidy within the meaning of the *Agreement on Agriculture*.

3.184 **Canada,** referring to the Appellate Body in *Canada - Aircraft*[189], replied that the nature of the government action is determinative as to whether a "financial contribution" exists under Article 1.1(a)(1). If a government has not acted in a manner enumerated in Article 1.1(a)(1), then a "financial contribution" does not exist and there can be no "subsidy". "Financial contribution" under Article 1.1(a)(1)(iii) contemplates a direct provision of goods by government. Canada already has demonstrated that governments do not provide milk to processors. Producers have the option to allocate some, none, or all of their production to the commercial export market. Governments do not make this decision on behalf of the producers. Accordingly, Canada's measures do not meet the definition of "financial contribution" under Article 1.1(a)(1)(iii). A provision of goods can still be captured under the definition of "financial contribution" in Article 1.1, Canada continued, if governments or their agencies "indirectly" provide these goods to processors in the manner set out in Article 1.1(a)(1)(iv) of the *SCM Agreement*.

3.185 For there to be a "financial contribution" within the meaning of Article 1.1(a)(1)(iv) of the *SCM Agreement*, Canada continued, the government must "entrust or direct" a "private body" to "carry out one or more of the type of functions illustrated in (i) to (iii)." That provision was recently considered in *US–Export Restraints*. In that case the panel found that "the act of entrusting and that of directing therefore necessarily carry with them the following three elements: (i) an explicit and affirmative action, be it delegation [in the case of entrusting] or command [in the case of directing]; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty."[190] Something must necessarily be delegated to someone, Canada submitted, or alternatively, someone must necessarily be commanded to do something. Further in that case

[189] Para. 156
[190] Panel Report, *US–Export Restraints*, *supra*, footnote 93, para. 8.29.

the panel rejected the notion that the requirements of Article 1.1(a)(1)(iv) are met if there is an effect or a proximate causal relationship between some government action and a benefit. The panel concluded that such an interpretation would read the financial contribution element out of the text of Article 1.[191]

3.186 Canada has not entrusted or directed producers to provide CEM to processors. Rather, producers provide CEM to processors of their own volition. Canada's measures deregulated the commercial export market and have nothing to do with the decision to produce, sell, or purchase CEM. None of these measures, or the measures which remain in place to regulate the domestic market, contains any notion of delegation or command addressed to any private party to provide CEM to processors. No government laws or regulations direct or command producers to produce or sell CEM. Likewise, no government laws or regulations force processors to purchase this milk. Rather, these decisions are left entirely to individual producers and processors. Accordingly, Canada is not "indirectly" providing goods to processors within the meaning of Article 1.1(a)(iv) of the *SCM Agreement*.

3.187 With respect to the issue of "benefit", Canada considered that it has already demonstrated that producers who are selling milk to processors in CEM transactions are able to recover their average cost of production over time and thus processors are not receiving any "advantage" or "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. Thus, since there is no "subsidy" conferred on processors within the meaning of Article 1.1(a)(1)(iii) or (iv) of the *SCM Agreement*, there can be no "export subsidy" under Article 3.1 of the *SCM Agreement*.

3.188 The **United States** submitted that it has demonstrated that Canada's CEM scheme as well as the maintenance of Special Milk Class 5(d) constitute prohibited export subsidies under Article 3 of the SCM Agreement.[192] The United States considered that Canada has not rebutted this showing.

3.189 In addition to satisfying the particular terms of Article 1.1 of the SCM Agreement, the CEM scheme also satisfies Paragraph (d) of the Illustrative List, as further discussed above. With respect to the federal level of Canada's system, the original panel and the Appellate Body's findings are more than sufficient to demonstrate that the maintenance of Special Class 5(d) is a prohibited export subsidy inconsistent with Article 3 of the SCM Agreement. At paragraph 7.132 of the original panel report, the panel found that Special Class 5(d) constituted "an export subsidy as listed in Paragraph (d) of the Illustrative List of Export Subsidies annexed to the SCM Agreement." It went on, in the next sentence, to note the "fact" that the scheme involves an export subsidy under the SCM Agreement. Indeed, this Panel need not analyse the particular requirements of

[191] Panel Report, *US–Export Restraints*, *supra*, footnote 93, para. 8.44.

[192] As demonstrated in the United States first written submission, Canada has exceeded its commitment levels and thus failed to conform to its obligations under the *Agreement on Agriculture*. As such, its measures are thus subject to scrutiny under the *SCM Agreement* (that is, Canada may not lay claim to the immunity conferred on conforming agricultural subsidies under *SCM Agreement* Article 3 and the *Agreement on Agriculture* Article 13(c)(ii)).

Article 1.1 because the CEM scheme falls within the scope of the Illustrative List of Export Subsidies. Canada itself championed this same approach successfully in another case involving export subsidies, i.e. in the original panel. The panel in the Article 21.5 proceedings in that dispute agreed.

3.190 Just as in the *Brazil - Aircraft* dispute, this Panel is confronted with a *per se* violation of Article 3 of the *SCM Agreement*, namely subsidy schemes that are described in the Illustrative List - here, in paragraph (d). The government of Canada, at both the federal and provincial level, provides milk to dairy processors for export "on terms and conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption." Canada's measures are, in Canada's own words, *ipso facto* an export subsidy and therefore prohibited.

3.191 **Canada** replied that since there is no "subsidy" conferred on processors within the meaning of Article 1.1(a)(1) or (2), including within the meaning of Item (d) of the Illustrative List, there can be no "export subsidy" under Article 3.1 of the *SCM Agreement*. When the findings of the Appellate Body are properly applied to the facts of the present case, it is clear that Canada does not provide export subsidies on the production and sale of CEM by independent milk producers within the meaning of the *Agreement on Agriculture* or the *SCM Agreement*. The evidence shows that producers are able to sell CEM at prices that cover their "average total cost of production".

IV. THIRD PARTIES' ARGUMENTS

A. Argentina

1. Article 9.1 of the Agreement on Agriculture

(i) "payments"

4.1 **Argentina** submitted that in this case, the supply of CEM (CEM) by Canadian producers amounts to a benefit for the processors that might be qualified as a "payment" under Article 9.1(c) of the *Agreement on Agriculture*. In the context of this case, the Appellate Body established, as a criterion for defining the existence of a payment, that the price charged by the producer of the milk must be less than the milk's "proper value" to the producer. On this basis, the Appellate Body established that the benchmark for comparison of prices charged by Canadian producers and determining whether they were less than the milk's "proper value" to the producer was the "average total cost of production".

4.2 The evidence contributed by the Parties to this proceeding would seem to indicate clearly that this is the case, particularly if we take as a basis the handbook of the CDC. Furthermore, the price agreed between the producer and the processor for export milk cannot simply be seen as a market price. In a market where the Government of Canada artificially distinguishes between the domestic market, which benefits from domestic support, and the export market, it is difficult to conclude that the price agreed among the producers and processors is a market price. How much freedom can there be in this export milk

market if the producer does not have alternatives? Producers are under an obligation to sell over-quota milk for export. They end up with a surplus that they cannot limit. They do not have any economically more attractive alternative. Argentina submitted further that the benefit conferred for the sale of CEM is clearly contingent upon exportation. Indeed, financial penalties are even envisaged for cases where milk for export is used for the processing of products for domestic consumption. These facts have not been challenged during these proceedings.

(ii) "by virtue of governmental action"

4.3 Having identified the existence of a payment, it must be established that the payment is "financed by virtue of governmental action". As determined by the Appellate Body, this relationship must be identified case-by-case on the basis of the effect of the governmental action on the payment made by a third party. According to the Appellate Body, "governmental action" embraces a broad range of activities, "including governmental action regulating the supply and price of milk in the domestic market".[193] Moreover, it is clear from the text of the provision that the action *does not require a charge on the public account* to be considered a subsidy under Article 9.1(c) of the *Agreement on Agriculture*. Although the words 'by virtue of' render governmental action essential, Article 9.1(c) contemplates that payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government".[194]

4.4 According to the criterion established by the original panel, it should be demonstrated that the Canadian system drives milk producers to make these payments. The Appellate Body links this situation with the degree of obligation or conditioning imposed on producers by the governmental system to produce additional milk for export. In the case at issue, it has not been disputed that by virtue of the action of the Canadian Government: (i) the milk produced over the quota for sale in the Canadian domestic market cannot be sold in the domestic market (except under class 4m), and (ii) there is a penalty for diverting this over-quota production to the Canadian domestic market. Producers have no economically attractive alternative to selling it for export (CEM) under the conditions laid down by the system. Producers are thus under an "obligation" to sell over-quota milk for export. If the domestic quota did not exist, milk processors would buy the milk for export at the same price as the milk for domestic consumption, a price that would undoubtedly be higher.

4.5 Argentina considered that Article 9.1(c) of the *Agreement on Agriculture*, covers hypotheses such as the case at issue, in which the processors purchase at a price which amounts to a benefit and do so "by virtue of governmental action", even if not directly financed by the Government. Any other interpretation would deprive the words "by virtue of" of their meaning. For reasons set out above,

[193] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US), supra,* footnote 1, para. 112.
[194] *Ibid.*, para. 114.

Argentina submitted that the Canadian regime for the supply of CEM by Canadian producers can be qualified as an export subsidy under Article 9.1(c) of the *Agreement on Agriculture*.

2. Article 10.1 of the Agreement on Agriculture

4.6 Argentina submitted that where it is not possible to demonstrate that a measure constitutes an export subsidy among those listed in Article 9.1, it must be examined to see if it constitutes a circumvention of export subsidy commitments under Article 10.1. Article 1(e) of the *Agreement on Agriculture* contains a definition of "export subsidies", which can be further clarified, if necessary, by reference to the *SCM Agreement*. In *Canada – Aircraft*, the Appellate Body established that a subsidy under Article 1.1 is a financial contribution which confers a benefit on the recipient in terms more favourable than those that would otherwise have been available to the recipient in the market.[195] It is clear from this definition that under the *SCM Agreement*, it is necessary to demonstrate a financial contribution and a benefit to prove that there is a subsidy.

4.7 For the purposes of determining the existence of a financial contribution, account must be taken of the original panel's finding that paragraph (d) of the Illustrative List of Export Subsidies was a "relevant" provision for the purposes of determining the existence of an export subsidy. Argentina submitted that, under the *Agreement on Agriculture*, government action by virtue of which the provision described in paragraph (d) of the Illustrative List takes place for use in the production of exported goods constitutes an export subsidy within the meaning of Article 10.1, even if there is no "charge on the public account". The rest of the *Agreement on Agriculture* itself also forms part of the "context" of Article 10.1. Indeed, it is the most relevant context, since it is the same Agreement.

4.8 Argentina considered that the measure challenged in these proceedings is also a form of income or price support which operates directly or indirectly to increase exports of dairy products. These exports would not be competitive in international markets if the processors were to pay the price required for milk intended for products sold on the domestic market.

4.9 Processors purchase milk on "terms or conditions … more favourable than those commercially available on world markets to their exporters" (Illustrative List of Export Subsidies, paragraph (d)) given the restrictions imposed by Canada on imports through their tariff level. As stated by the Appellate Body in *Canada - Dairy Article 21.5* with respect to the absence of an express standard for determining which measures involve "payments", "even within Article 9.1 itself, subparagraphs (d) and (c) expressly provide that the domestic market constitutes the appropriate basis for comparison".[196]

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[195] Appellate Body Report, *Canada – Aircraft*, DSR 1999:III, 1377, para. 157.

[196] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 75.

Furthermore, various paragraphs of the Illustrative List of the *SCM Agreement* contain references linked to the domestic market. Similarly, in *Canada - Aircraft*, the Appellate Body defined the benefit conferred under Article 1.1 of the *SCM Agreement* by comparing it to the market: "the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market" (paragraph 157 of the Appellate Body report). Given that what is being done here is to determine the existence of a "benefit", Argentina considered that in this case, comparison with the market price is appropriate.

4.10 It is Argentina's understanding that the "benchmark" fixed by the Appellate Body, the "total average cost of production", is limited to the determination of the concept of "payment"[197] in Article 9.1(c) of the *Agreement on Agriculture*, and should not be applied to the concept of "benefit" in the framework of the export subsidies mentioned in Article 10.1. Similarly, it should be borne in mind that the Appellate Body fixed this benchmark as the most appropriate to this case, without suggesting that it be extended to other WTO disputes. For the reasons given above, it is obvious that this type of benefit is contingent on exportation. The financial penalties for the use of export milk in the preparation of products intended for domestic consumption are proof enough.

4.11 Furthermore, Argentina considered that the challenged system at least "threatens to lead to circumvention" of export subsidy commitments assumed by Canada. According to the Appellate Body in *US - FSC*, the absence of limitations to an export subsidy "threatens to lead to circumvention of export subsidy commitments". Here, there is no fixed quota for export milk or limitation of any other kind. In any case, what counts here is Article 10.3 of the *Agreement on Agriculture*, according to which any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy has been granted in respect of the quantity of exports in question. In Argentina's view, the characteristics of the system at issue in these proceedings are such that if it does not qualify as an export subsidy under Article 9.1(c) of the *Agreement on Agriculture*, it constitutes an export subsidy which is inconsistent with Article 10.1, since it at least "threatens to circumvent" the export subsidy commitments of the granting Member.

[197] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 92. "In our view, by relying upon the total cost of production in this dispute, to determine whether there are 'payments', the integrity of the two disciplines [domestic support and export subsidies] is best respected."

B. Australia

1. Article 9.1 of the Agreement on Agriculture

(i) "payments"

4.12 **Australia** submitted that Canada's new category of milk for export processing known as CEM provides milk to dairy processors/exporters for the export of manufactured dairy products below the value of the milk to the producer. There is no limit on the sales of CEM to processors/exporters. Processors are prohibited from selling milk on the domestic market; CEM must be exported. Processors are also exempted from purchasing milk for export at regulated domestic prices. The only way that producers can sell above-quota or non-quota milk is if it is exported or used as animal feed.

4.13 In using the standard of the average total cost of production for determining whether sales of CEM involve "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, Australia considers that sales below the average total cost of production involve "payments" which are financed by virtue of governmental action. To the extent that Canada has exported dairy products in excess of its scheduled export subsidy quantity reduction commitments, it has therefore breached Articles 3.3 and 8 of the *Agreement on Agriculture*.

4.14 Article 9.1(c) of the *Agreement on Agriculture* relates to payments on the export of an agricultural product which are financed by virtue of governmental action. In the original proceedings, it was held that "payments" can include payments-in-kind. The Appellate Body, in its decision of 3 December 2001, noted that Article 9.1(c) of the *Agreement on Agriculture* does not expressly identify a standard or benchmark for determining when a measure involves "payments" in the form of payments-in-kind. It reversed the panel's finding that the "right benchmark" is the domestic market price. It also rejected the world market price as a valid basis for determining whether the CEM scheme involves "payments".

4.15 Referring to the Appellate Body statement that "the total cost of production includes *all* fixed and variable costs incurred in the production of all the units in question"[198], Australia considered that this raises two issues: what components constitute the fixed and variable costs of producing milk; and whether nationally determined cost of production data based on farm sampling represents an adequate measurement for the average total cost of production. As concerns the Appellate Body statement in paragraph 87 (fixed and valuable costs) of its report and in paragraph 96 (average total cost of production), Australia considered that the Appellate Body clearly was cognisant that "over time" producers will make investments determining both their farming capacity and costs with a view to maximising profits over time.

[198] Appellate Body Report, *Canada – Dairy (Article 21.5- New Zealand and US), supra*, footnote 1, para. 94.

4.16 Australia noted that there is no agreed international standard/definition which is applied either across the board or on a sector-specific basis of what reflects the cost of production. While there may be existing generally-accepted accounting principles and practices and efforts to develop criteria or guidelines, these vary from jurisdiction to jurisdiction. Each WTO Member therefore adopts different approaches on the methodology on the determination of the average total cost of production. As the Appellate Body notes in the context of the lack of an express standard for determining whether a measure involves "payments", "'payments' need to be scrutinised carefully in the context of the facts and circumstances relating to a particular measure and particular case".[199] However, Australia recalls that the purpose of seeking a benchmark or standard is to "isolate" the subsidy element, or as the Appellate Body notes, "whether Canadian export production has been given an advantage".[200]

4.17 As outlined in the CDC's handbook, there are inherent inaccuracies in using the average total cost of production on all milk produced in Canada. For example, Canada's approach does not fully reflect the most inefficient producers with each provincial sample reflecting 70 per cent of producers and not all costs are reflected in the cost of production, for example, the cost of production quota. The exclusion of these producers and the lack of inclusion of the cost of production quota mean that the CDC's data underestimates the cost of production. Nevertheless, Australia considers that if this CDC methodology constitutes the basis on which Canada sets its target price for industrial milk, and the system of pooling and production quotas, then it serves as a reasonable measure in the context of determining the average total cost of production in relation to the CEM scheme and in the context of the facts and circumstances relating to the CEM scheme.

4.18 Australia considered that the very purpose of the CDC methodology suggests that it would represent a reasonable methodology for determining the average total cost of production. Further, the fact that the methodology also includes imputed returns to dairy farm resources including unpaid labour, management and owner's equity and that this is noted in the CDC Handbook as one of the key cost of production factor, cannot then be rejected by Canada as not constituting actual outlays expended on the production of milk.

4.19 With reference to Canada's argument that the Appellate Body considered that investment and outlays were to be considered in determining the cost of production, Australia submitted that a full accounting of the costs of production at any time would include annual rental value of land, depreciation of capital (including replacement costs of animals), the annualised values of assets such as quota production rights, the value of owner operator and other family labour as well as paid labour and current production inputs such as feed, seed, chemicals and fertilisers used in feed production and veterinary and other animal husbandry costs.

[199] *Ibid.*, para. 76.
[200] *Ibid.*, para. 84.

4.20 Australia concluded that the CEM scheme provides Canadian processors/exporters with milk at a price which is less than the average total cost of production of that milk. Accordingly, there are "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture.* These "payments" are financed by virtue of governmental action. To the extent that Canada has exported dairy products in excess of its scheduled export subsidy quantity reduction commitments, it has therefore breached Articles 3.3 and 8 of the *Agreement on Agriculture*.

4.21 Referring to the comments in paragraph 4.2 above, **Canada** submitted that as it has demonstrated throughout the entire Article 21.5 process, there is no governmental process that provides CEM to processors. Rather, it is producers who independently elect whether or not to produce and sell their product to processors. If the producer considers that the price being offered is not adequate, the producer will not produce and sell such milk. Indeed, only a minority of Canadian dairy producers (less than 40 per cent as of December 2001) have participated in CEM transactions and many of these have done so for only a short time.[201]

4.22 As concerns the lack of limit on the sales of commercial export milk and, therefore, export milk to processor/exporters, Canada explained that as it has deregulated sales of CEM, no limit on the export of dairy products, other than the limit the market itself sets through the process of supply and demand, is either necessary or appropriate. Deregulation removes the need, and indeed the ability, of governments to impose limitations on volume or price.

4.23 Like other participants in this dispute, Australia recognizes that there is no agreed international standard or definition that is applied either across the board or on a sector-specific basis of what reflects the cost of production (see paragraph 4.16 above). The reason for this is that the standard will vary based upon the purpose of the exercise. The method used in these proceedings must accord with the finding of the Appellate Body in the context of Article 9.1(c) of the *Agreement on Agriculture*.

4.24 The purpose of the CDC methodology for the cost calculation is to establish target returns for milk sold in the domestic market.[202] In advocating the adoption of the CDC methodology Australia is, therefore, suggesting the adoption of a benchmark which has already been rejected by the Appellate Body (i.e., the domestic administered price). While Australia is correct that the CDC methodology is used as part of the basis for managing the domestic milk market, this very fact demonstrates how inappropriate it is to use this methodology for the purposes of these proceedings. The Appellate Body considered that the appropriate standard for these types of payments should be determined by the motivation of the independent economic operator involved[203] and not government regulation.

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[201] Frequency of Producers Participating in CEM. (Exhibit CDA-15)
[202] See para. 3.23 above.
[203] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, para. 92.

4.25 With respect to the arguments in paragraph 4.17 above, Canada replied that as is clear from Canada's first Submission, among the adjustments made by Canada to reflect the findings of the Appellate Body is to base its calculations on 100 per cent of the sample by adding back the 30 per cent excluded. Further, Canada does not agree with Australia that inclusion of imputed returns or annualised value of dairy quota is consistent with the standard set out by the Appellate Body for the determination of whether or not a payment exists. Estimating values which do not represent monetary costs incurred by producers cannot be reconciled with the Appellate Body's requirement for an objective cost of production methodology focused on actual outlays. In addition, while Australia appears to support the use of generally accepted accounting principles (GAAP), it also attempts to claim that the cost of production of Canadian producers should include the imputed value of owner-operator and other family labour, land, and quota rights, which clearly is not an approach consistent with GAAP.

C. European Communities

1. Article 9.1 of the Agreement on Agriculture

(i) "payments"

4.26 Referring to the Appellate Body's understanding with respect to "payments-in-kind", the **European Communities** (EC) submitted that it continues to believe that the term "payments" in Article 9.1(c) of the *Agreement on Agriculture* is confined to transfers of money and referred to all its arguments made before the Appellate Body on that issue.[204] Only because the Appellate Body did not reverse the panel's finding that this term also covers "payments-in-kind", was it then faced with the problem of determining the correct benchmark price. Recalling the new average cost of production standard developed by the Appellate Body as the "appropriate standard for these proceedings"[205] and the statement, that the "existence of payments is determined by reference to […] motivations of the independent economic operator who is making the alleged payments"[206], the "below average cost of production standard" focusing on producer motivations has at least three fundamental flaws.

4.27 First, there is no legal foundation for such a standard in the *Agreement on Agriculture*. None of its provisions allow the conclusion that the costs of production of a private party can be the benchmark for the existence of an export subsidy. As the United States have pointed out, "cost of production is such a specific, detailed standard, that normally the negotiators of an agreement would have spent a long and difficult negotiation in reaching agreement on that particular standard, and they certainly would be expected to have agreed to reflect it in the text itself".[207] Second, a cost of production test determining the

[204] European Communities' Third-Party Submission to the Appellate Body, para. 16.
[205] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, paras. 96 and 98.
[206] *Ibid*., para. 92.
[207] Statement by the United States in the meeting of the DSB on 18 December 2001, page 2.

existence of a payment by reference to *producer* motivations contradicts the notion of "payment" in Article 9.1(c) of the *Agreement on Agriculture*, which is *recipient*-oriented. The Appellate Body itself stated this clearly where it explained why the term payments could include payments-in-kind:

> Instead of receiving a monetary payment equal to the revenue foregone, the recipient is paid in the form of goods or services. But, as far as the recipient is concerned, the economic value of the transfer is precisely the same.[208]

4.28 The underlying justification for a recipient-oriented approach to the element "payment", the EC continued, is that it equals the basic concept of "benefit" which is one of the two essential elements of the notion of subsidy.[209] The decisive criterion for whether the recipient has received a benefit is the market place. In *Canada – Aircraft*, the Appellate Body held that the comparison should be made upon whether the value of what the recipient received is "on terms more favourable than those *available* to the recipient in the market".[210]

4.29 The EC considers that, if anything, the appropriate standard for determining whether payments have occurred under Article 9.1(c) of the *Agreement on Agriculture* would be what is otherwise available on the market, in particular the world market. The market place criterion can at least be derived from the other examples for export subsidies in Article 9.1 of the *Agreement on Agriculture* as well as Article 14 of the *SCM Agreement* and item d) of the Illustrative List of export subsidies in Annex I of the *SCM Agreement*. By contrast, items (j) and (k) of the Illustrative List, to which the Appellate Body referred, concern governmental export credits or related guarantee or insurance programmes but have not been established to measure whether an indirect subsidy through the provision of goods by private entities exists.

4.30 Third, the EC is seriously concerned that a producer-oriented cost of production test makes the existence of an export subsidy dependent on actions of private entities and sales data to which governments do not have access. The EC would raise the question how WTO Members should be able to calculate and notify their export subsidies and count them against their reduction commitments? The EC considers that the Panel should carefully consider whether to apply the new below-average cost of production standard.

4.31 The EC strongly disagrees with the industry-average approach, because it not only violates the general principle whereby production costs have to be analysed on a producer-by-producer basis, but it also appears to include cost information of farmers who do not produce for the export market. The Appellate Body itself has highlighted that only "about 30 per cent of Canadian producers had participated in CEM transactions".[211]

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[208] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, para. 113.
[209] *Ibid.*, paras. 87, 90 and 91.
[210] Appellate Body Report, *Canada Aircraft*, DSR 1999:III, 1377, para. 157 (emphasis added).
[211] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, *supra*, footnote 1, footnote 96.

4.32 If the Panel wanted to determine whether Canadian producers sold milk at below-cost, it would need to analyse the production costs of those who actually sold CEM. Only that approach could be squared with the wording of Article 9.1(c) of the *Agreement on Agriculture* whereby there must be a "payment *on the export*", i.e., only payments are relevant which actually occur by exporting. Moreover, the EC does not consider it possible to deduce the existence of "payments" simply from the fact that there is a differential between average total costs of production of CDN $57 as determined by the Canadian Dairy Commission for all dairy farmers and a CEM price of CDN $29.[212] The alleged average cost of production of CDN $57 even exceeds the administered *domestic* market price, which, as the EC understands it, averages CDN $52,92 per hectolitre.[213]

4.33 The Appellate Body already found that the clear differential between the prices of CEM and the *domestic market price* suggests "the possibility that the prices of CEM might be below the average total cost of production and, thus, might involve "payments under Article 9.1(c)"[214], but evidently did not consider such differential enough to complete the legal analysis.[215] The underlying reason for this is that the Appellate Body had already found that the Canadian target price as "administered prices in general, […] expresses a government policy choice based, not only on economic considerations, but also on other social objectives" and that "there can be little doubt […] that the administered price is a price that is favourable to the domestic producers."[216] The Appellate Body had clarified that the sale of CEM by the producer at less than the administered price does not necessarily imply that the producer has foregone a portion of the proper value of the milk to it.[217]

4.34 Thus, the very differential between the average price for CEM and the average cost of production determination by the Canadian Dairy Commission is obviously not capable of substantiating the existence of payments under Article 9.1(c) of the *Agreement on Agriculture*. The EC expects to be able to comment further on the methodology to be applied by the Panel to measure the existence of payments after receipt of the rebuttal submissions and reserves its position on this issue.

(ii) "by virtue of governmental action"

4.35 The EC recalled that that the existence of payments alone is not sufficient to establish an export subsidy under Article 9.1(c) of the *Agreement on Agriculture*. Such "payments" must be "financed by virtue of governmental action". The EC noted that the Appellate Body has essentially replaced the "but

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[212] See for instance paras. 3.53 and 3.75 above.
[213] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, *supra*, footnote 1,para. 101.
[214] *Ibid*.
[215] *Ibid*., paras. 101-103.
[216] *Ibid*., para. 81.
[217] *Ibid*.

for" test applied by the panel by a more elaborate "demonstrable link" approach that reflects the wording of Article 9.1(c) of the *Agreement on Agriculture*.

4.36 Referring to the Appellate Body's considerations, with respect to "demonstrable link" and "financed by virtue of government action" in paragraphs 113 and 115-117 of its report, the EC agreed, for all the reasons it has set out in the appellate proceedings, that the nature and extent of governmental involvement in cases of indirect subsidies must amount to a legal requirement to provide a certain amount of goods at a certain price.[218] Only this standard gives meaning to the terms "financed" and imposed" as used in Article 9.1(c) of the *Agreement on Agriculture* and read contextually with the terms to describe a financial contribution under Article 1.1(a)(1)(iv) of the *SCM Agreement* ("directs") and item (d) of the Illustrative List of export subsidies in Annex I of the *SCM Agreement* ("government-*mandated*").

4.37 The EC considered that the Appellate Body has given full guidance to the Panel on how it would apply that standard to the facts at hand when emphasising: "we disagree with the Panel's characterization of the measure as "obliging producers, at least *de facto*, to sell outside-quota milk for export".[219] Although the Appellate Body agrees that the Canadian governmental action establishes a regulatory regime whereby some milk producers can make additional profits only if they choose to sell milk, the Appellate Body distinguished this from what could be the decisive governmental action: the imposition of an obligation to *produce* additional milk for sale. Thus, the EC continued, the Appellate Body considers that only where there is an obligation to actually produce additional resources at below-costs there would be a sufficient nexus between governmental action and the provision of milk at below-cost prices and suggested that this nexus is missing in the Canadian system. In short, the EC takes the view that in applying the "demonstrable link" test as elaborated by the Appellate Body, the Panel can only reach the conclusion that even if payments have been made, these cannot have been financed by virtue of governmental action.

4.38 With respect to the payment "on the export", the EC noted that the Appellate Body did not address this element, because it was not appealed, but implicitly declared the panel's approach moot by reversing the findings of the panel on all elements of Article 9.1(c) of the *Agreement on Agriculture*.[220] The EC is concerned that the panel in its original report lightly equated this element with the term "contingent on the export". If this Panel addresses this third element of Article 9.1(c) of the *Agreement on Agriculture* in the course of this proceeding, because it finds that the two other conditions are met, it should carefully consider the meaning of the preposition "on" which contains a temporal element and suggests a closer nexus between the payment and actual exportation than export contingency.

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[218] European Communities' Third-Party Submission to the Appellate Body, paras. 21-25.
[219] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*, para. 117.
[220] *Ibid*., para. 126 reversing all findings in para. 6.79 of the panel report.

4.39 In sum, the EC considered that the Panel is faced with the difficult task of carrying out a remand analysis of whether the Canadian compliance measure is a producer-financed export subsidy within the meaning of Article 9.1(c) of the *Agreement on Agriculture* on the basis of a new below cost of production standard that is not rooted in the *Agreement on Agriculture* and where no methodological guidance exists. The EC is seriously concerned about this new standard because it determines the existence of "payments" by reference to producer motivations and not to what is commercially available to the *recipient* on the market, in particular the *world market*.

4.40 **Canada** submitted that it concurred with the observation of the EC that a gap between the CDC calculated target price and CEM prices cannot be assumed to constitute a payment, since "the Canadian target price as 'administered prices in general, […] expresses a government policy choice based, not only on economic considerations, but also on other social objectives'" (see paragraph 4.33 above). As the EC observed, "[T]he Appellate Body had clarified that the sale of CEM by the producer at less than the administered price does not necessarily imply that the producer has foregone a portion of the proper value of the milk to it".[221]

4.41 Canada also concurred with the observations made by the EC with respect to the nature of the demonstrable link that is required in this case. Government action that merely enables producers to do something does not meet the test. Given the particular language of Article 9.1(c) of the *Agreement on Agriculture* as well as the difficulty of which the Appellate Body spoke where the alleged "payment" is a payment-in-kind[222], there must be a much clearer and tighter linkage between governmental action and the decisions of private producers to enter into export contracts to satisfy the "financed by virtue of" element of that Article. The nexus of which the Appellate Body speaks between any payment made by independent economic operators and the nature of the governmental action on the part of Canadian governments does not exist in this case. In addition, without a tight nexus governments could not be expected to report and notify "payments" over which they had no control. Thus, as the EC correctly observes, even if payments have been made, which Canada denies, these cannot have been financed by virtue of governmental action.

V. FINDINGS

A. Claims of the Parties

1. The Complainants' Claims

5.1 New Zealand and the United States claim that Canada's commercial export milk ("CEM") system provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

[221] Appellate Body Report, *Canada - Dairy (Article 21.5- New Zealand and US)*
[222] *Ibid.*, para. 115.

5.2 New Zealand and the United States claim, in the alternative, that Canada's CEM system provides export subsidies or involves non-commercial transactions that are inconsistent with Article 10.1 of the *Agreement on Agriculture*.

5.3 New Zealand and the United States claim that Canada continues to export subsidized dairy products that exceed or threaten to exceed its export subsidy reduction commitment levels in violation of Articles 3.3 and 8 of the *Agreement on Agriculture*.

5.4 The United States claims that Canada's CEM system provides prohibited export subsidies within the meaning of Article 3.1(a) of the SCM Agreement.

5.5 New Zealand and the United States claim that Canada bears the burden of proof, pursuant to Article 10.3 of the *Agreement on Agriculture*, to establish that no export subsidy has been granted in respect of those quantities of dairy products exported in excess of its export subsidy reduction commitment levels.

2. Respondent's Claims

5.6 Canada claims that it does not provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in respect of CEM.

5.7 Canada claims that it does not provide export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

5.8 Canada claims that it does not provide export subsidies in excess of its export reduction commitment levels contrary to Articles 3.3 and 8 of the *Agreement on Agriculture*.

5.9 Canada claims that it does not provide prohibited export subsides in respect of CEM within the meaning of Article 3.1(a) of the *SCM Agreement*.

B. Context of this Case

5.10 The claims of the Parties in this case concern Canada's measures taken to comply with the recommendations and rulings of the DSB to the effect that Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, through its scheme of Special Milk Classes 5(d) and 5(e), by providing "export subsidies" within the meaning of Article 9.1(c) of that Agreement, in excess of the quantity commitment levels specified in Part IV, Section II of Canada's WTO Schedule.

5.11 The Panel recalls that under its previous system, Canada set a support price for domestic milk tied to a production quota and established Special Milk Class 5(e) for the removal of surplus milk and Special Milk Class 5(d) for milk and dairy products produced under quota for the export market.[223] Prices for Classes 5(d) and (e) were negotiated and established on a case-by-case basis between the Canadian Dairy Commission ("CDC") and the

[223] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/RW and WT/DS113/RW, *supra*, footnote 53, para. 3.1.

processors/exporters.[224] The original panel in *Canada – Dairy* found that milk under Classes 5(d) and (e) was made available to processors for export at a significantly lower price than the price of milk *for domestic use*.[225] In those proceedings, the United States submitted factual evidence showing that the price for cheese was CDN $27.28 in Special Milk Class 5(d) and CDN $26.87 in Special Milk Class 5(e) between January to June 1997.[226] All Parties also agreed that Canada's exports of butter, cheese and "other milk products" exceeded Canada's reduction commitment levels for both marketing years at issue (1995-1996 and 1996-1997).[227]

5.12 This Panel recalls that the measures taken by Canada to implement the DSB rulings and recommendations, at issue again in this second recourse to Article 21.5 of the *DSU*, left in place the domestic price support mechanism tied to a production quota but eliminated Special Milk Class 5(e) and restricted exports of dairy products under Special Milk Class 5(d) to Canada's export subsidy commitment levels.[228] Canada also created a new class of domestic milk, Class 4(m), under which any non-quota milk can be sold only as animal feed at a regulated price.[229] In addition, Canada introduced a new category of milk for export processing known as "commercial export milk" ("CEM"), the price and volume of which are negotiated directly between the processor and the producer.[230] Under pre-commitment contracts, producers decide in advance of production how much milk to sell as CEM that is delivered "first-out-of-the-tank" to processors.[231] Milk that is contracted as CEM is exempt from paying the domestic in-quota price and the diversion of CEM and dairy products made from CEM into the domestic market is subject to financial and other penalties.[232]

C. Burden of Proof

5.13 As noted in the previous section, New Zealand and the United States claim that Canada bears the burden of proof, pursuant to Article 10.3 of the *Agreement on Agriculture*, to demonstrate that no export subsidy has been granted in respect of those quantities of dairy products exported in excess of Canada's export subsidy reduction commitment levels.[233] Canada does not dispute the application of Article 10.3 in this case.[234]

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[224] *Ibid*.
[225] Panel Report, *Canada – Dairy* WT/DS103/R and WT/DS113/R, DSR 1999:VI, 2097, para. 7.50.
[226] *Ibid*., para. 2.51, reproducing US Exhibit 22
[227] *Ibid*., para. 7.34.
[228] Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/AB/RW and WT/DS103/AB/RW, *supra*, footnote 1, paras. 4 and 79.
[229] *Ibid*., para. 4.
[230] *Ibid*., paras. 4 and. 79.
[231] *Ibid*., para. 4.
[232] Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.77 and Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 4.
[233] Para. 3.4 above.
[234] Para. 3.5 above.

5.14 Article 10.3 provides:

> "Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question."

5.15 The Panel considers, therefore, that with respect to claims made under the *Agreement on Agriculture*, if the Complainants demonstrate that Canada has exceeded its export subsidy reduction commitment levels on certain dairy products, and Canada claims it is not providing export subsidies in relation to those exports, it is then for Canada to establish, pursuant to Article 10.3 of the *Agreement on Agriculture*, that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports exceeding Canada's export subsidy reduction commitment levels.

5.16 On the question of whether Canada has exceeded its reduction commitment levels, New Zealand and the United States have put forward evidence demonstrating that Canadian exports of cheese and "other milk products" in marketing year (August-July) 2000-2001 exceeded those quantities for which Canada has committed to limit its export subsidies. The Complainants also demonstrate that Canada is likely to exceed these quantities in marketing year 2001-2002.[235] The Panel further notes that Canada does not dispute that its exports exceeded the quantity in respect of which it could grant export subsidies for cheese and "other milk products" in 2000-2001 and that they are likely to do the same in 2001-2002.

5.17 Accordingly, the Panel *finds* that the Complainants have established that Canadian exports of cheese and "other milk products" in 2000-2001 have exceeded those quantities in respect of which Canada has committed to limit export subsidies and that they are likely to exceed those quantities again in 2001-2002.

5.18 Having found that Canadian exports of cheese and "other milk products" exceed Canada's reduction commitment levels, and recalling the considerations on the burden of proof as set out in paragraph 5.15 above, the Panel is of the view that an operational interpretation of Article 10.3 requires that the Complainants make a *prima facie* showing that the elements of the claimed export subsidies are present.

5.19 Once the Panel has examined the Complainants claims and arguments, and provided that the Complainants make out a *prima facie* case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies under either Article 9.1(c) or Article 10.1, it will then be for Canada,

[235] New Zealand's Exhibits NZ-1 and NZ-2; United States' Exhibits US-1. Specifically, the evidence put forward by New Zealand shows exports in excess of commitment levels of 9,692 tonnes for cheese and 16,823 tonnes for "other milk products" for 2000-2001 and an estimated excess for cheese of 8,778 tonnes and 32,600 tonnes for "other milk products" for the year 2001-2002. The evidence put forward by the United States shows an excess of exports of 8,748 tonnes for cheese and of 33,488 tonnes for "other milk products" for 2000-2001 and estimated excess of 9,608 tonnes for cheese in 2001-2002. The Panel notes that the Complainants' figures are provided by marketing year.

pursuant to Article 10.3 of the *Agreement on Agriculture*, since it claims that its exports in excess of its commitment levels are not subsidized, to establish that Canadian exports of cheese and "other milk products" do not benefit from these particular types of export subsidies.

D. Whether Export Subsidies Exist Within the Meaning of Article 9.1(c) of the Agreement on Agriculture

1. Introduction

5.20 The Complainants claim that Canada's CEM system provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

5.21 The relevant text of Article 9.1(c) reads as follows:

> "The following export subsidies are subject to reduction commitments under this Agreement: … (c) payments on the export of an agricultural product that are financed by virtue of governmental action … ".

5.22 The Panel notes that the Complainants have focused their arguments under Article 9.1(c) on: (1) whether there are "*payments*"; and (2) if so, whether such payments are "financed *by virtue of* governmental action".

5.23 As for the third element under Article 9.1(c), i.e., whether payments are made "*on the export*" of an agricultural product, the Panel recalls the finding by the panel in the first Article 21.5 *Canada – Dairy* case that since Canadian federal regulations define CEM as milk that must be exported, any payment in relation to CEM is a payment "*on the export*".[236] We further recall that Canada neither disputed nor appealed this earlier finding.[237] We shall therefore not examine this issue further in this proceeding.

5.24 Accordingly, the Panel shall restrict its analysis of whether the Complainants make out a *prima facie* case of the existence of an export subsidy, within the meaning of Article 9.1(c), to the two elements actually contested, i.e., whether there are "*payments*" and, if so, whether such payments are "financed *by virtue of* governmental action".

5.25 Provided we find that the Complainants make a *prima facie* case with respect to the existence of "payments", it will then be for Canada to attempt to discharge its burden of establishing that no "payments" are being made. Similarly, provided we find that the Complainants make a *prima facie* case that any such payments are "financed by virtue of governmental action", it will then be for Canada to attempt to discharge its burden of establishing that it is not by virtue of governmental action that any such payments are financed.

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[236] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.78.

[237] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, paras. 62-63.

2. Whether there are "payments"

5.26 The Panel recalls that, as found by the panel and confirmed by the Appellate Body in the original *Canada – Dairy* case, a payment includes a "payment-in-kind".[238] This was reaffirmed by the panel and the Appellate Body in the first *Canada – Dairy* case under Article 21.5 of the *DSU*[239] and has not been re-argued by the Parties in this second examination under Article 21.5.

5.27 At issue before the panel and the Appellate Body in the first Article 21.5 case was the appropriate benchmark to measure whether or not "payments" were being made under Canada's implementation measures.[240] The Appellate Body rejected the Article 21.5 panel's reliance on the regulated domestic price and on world market prices, finding that neither represents an appropriate benchmark for determining whether sales of CEM by producers involve payments.[241] The Appellate Body stated that the existence of a payment requires a comparison between the prices of CEM and "some objective standard reflect[ing] the proper value" of milk to the producer[242], in this case, "the average total cost of production".[243]

5.28 The Panel recalls the Appellate Body's reasoning equating "payments" with the transfer of economic resources[244] and, on this basis, focusing on whether CEM prices are sufficient to recover average fixed and variable costs of production, and thus on whether producers are able to avoid making losses in the long run.[245]

5.29 The Panel notes that the Complainants and Canada disagree on how this newly enunciated benchmark of average total cost of production should be interpreted and applied. The Panel, in recalling its analysis in paragraphs 5.18-5.19 and 5.25 above, will first examine whether the Complainants make a *prima facie* showing of the existence of "payments". Provided the Complainants make such a showing, it will then be for Canada, pursuant to Article 10.3 to establish that no "payments" within the meaning of Article 9.1(c) are being made.

(a) Whether the Complainants Make a *prima facie* Case of the Existence of "payments"

5.30 The Complainants ask the Panel to apply the "average total cost of production" benchmark, as enunciated by the Appellate Body, to the determination of whether there are payments in this case.[246] Specifically, the

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[238] Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.101; Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 112.
[239] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para 6.12; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 53, paras. 71 and 76.
[240] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, paras. 74-75, 96, 104.
[241] *Ibid.*, paras. 82, 85 and 104.
[242] *Ibid.*, para. 74.
[243] *Ibid.*, para. 96.
[244] *Ibid.*, para. 76.
[245] *Ibid.*, para. 87.
[246] Paras. 3.11 and 3.55 above.

Complainants request us to consider that the Appellate Body's cost of production benchmark should be construed as referring to an industry-wide average.[247]

5.31 For the purposes of applying the Appellate Body's benchmark, the Complainants ask the Panel to rely on survey data collected annually in accordance with the CDC Handbook of COP Principles and Practices ("CDC Guidelines") and used to set the domestic in-quota price ensuring a fair return to efficient dairy producers in the domestic market.[248] Complainants contend that the CDC survey data represents a reasonable, albeit conservative, reflection of the cost of production of the Canadian dairy industry.[249] They further contend that while the survey data excludes cost of production data for the 30 per cent least efficient producers and for producers with less than 60 per cent of the average annual output in each province[250], as well as the cost of domestic quota[251], the CDC data and Guidelines otherwise account for all the relevant cost elements, i.e., all the fixed and variable costs, of producing a unit of milk.[252]

5.32 On the question of which cost elements to include, the Complainants argue that because the Appellate Body referred to *all* fixed and variable costs, imputed costs should be included in such calculation.[253] An accurate calculation of the cost of production, they contend, cannot be limited only to cash outlays because the Appellate Body spoke in terms of the investment of economic resources required in the production of goods and the amount a producer must recoup in order to avoid making losses.[254] Thus, the Complainants assert a farmer would have to recoup the costs of family labour, return to management and equity, quota and costs for the marketing of milk in order to stay in business.[255] It would be inconsistent, they submit, to consider that a farmer using family labour and management makes a profit to the extent that this labour is not remunerated.[256] Further, the Complainants point out that equity financing represents just an alternative to debt financing that gives rise to costs.[257] On the question of including quota, the Complainants argue that quota is an investment related to the production of milk and thus a cost, regardless of whether or not generally accepted accounting principles ("GAAP") require its amortization.[258] As to marketing, transport and administrative costs, the Complainants maintain their exclusion would amount to drawing an artificial distinction between costs of production and costs associated with sale because there would not be any

[247] Paras. 3.60-3.61 above.
[248] Para. 3.16 above.
[249] *Ibid*.
[250] Para. 3.18 above.
[251] Para. 3.42 above.
[252] Para. 3.16 above.
[253] Para. 3.29 above.
[254] Paras. 3.11, 3.29 and 3.77 above citing Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 87.
[255] Para. 3.32 above.
[256] Paras. 3.32 and 3.34 above.
[257] Paras. 3.26 and 3.34 above.
[258] Paras. 3.42 – 3.43 and 3.46 above.

point in a farmer producing milk if that farmer could not afford to sell the milk.[259]

5.33 The CDC data, the Complainants point out, show an industry-wide average cost of production of CDN $58.12 per hectolitre in 2001 and of CDN $57.27 per hectolitre in 2000.[260] In contrast, they assert, the average price for CEM was CDN $29 in 2000 and continued to be close to that level in 2001.[261] Comparing these figures, they ask the Panel to conclude that sales of CEM are made well below the average total cost of production and that, hence, "payments" within the meaning of Article 9.1(c) are being made.[262]

5.34 Recalling the considerations set out in paragraphs 5.18-5.19 above, we *find* that the Complainants' case, as described in paragraphs 5.30-5.33 above, constitutes a *prima facie* showing that "payments" within the meaning of Article 9.1(c) are being made, such that Canada can reasonably attempt to discharge its burden under Article 10.3 of the *Agreement on Agriculture* of establishing why CEM sales do not involve "payments"

(b) Examination of Canada's Case on the Issue of "payments"

(i) Canada's Position on its Implementation of the DSB's Recommendations

5.35 Canada claims that it has fully implemented the rulings and recommendations of the DSB following adoption of the panel and Appellate Body reports in the original case on *Canada – Dairy*.[263] In this connection, Canada states that export transactions outside of Special Class 5(d) occur without government interference of any kind, and as such, do not benefit from export subsidies.[264]

(ii) Canada's Rejection of an Industry-Wide Application of the Benchmark

5.36 The Panel notes that Canada disagrees with the Complainants' contention that the Appellate Body intended an industry-wide calculation of the average total cost of production as the relevant benchmark for determining the existence of payments, within the meaning of Article 9.1(c).[265] In so arguing, Canada refers to the Appellate Body's statement that a payment is determined "by reference to a standard that focuses upon the motivations of the independent economic operator who is making the alleged 'payments' – here the producer –

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259 Para. 3.52 above.
260 Para. 3.53 above, based on Canadian Dairy Commission: Estimated Cost of Producing Milk.
261 Para. 3.53 above.
262 Paras. 3.54–3.55 and 3.75 above.
263 Para. 3.108 above.
264 *Ibid*.
265 Paras. 3.59, 3.62-3.63 above.

and not upon any government intervention in the marketplace."[266] Canada asserts that the Appellate Body therefore intended that an appropriate calculation of the average total cost of production should be based on the average costs of individual producers and *not* the entire dairy industry.[267] Additionally, Canada refers to the statement by the Appellate Body to the effect that "[t]he average total cost of production [should be determined] … by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets."[268] Rather than speaking here in terms of an industry-wide calculation of the average total production cost, Canada contends that the Appellate Body was merely indicating that both domestic and export production of the individual producer should be taken into account when calculating that average.[269]

5.37 Canada also draws the Panel's attention to the repeated usage of the singular form of terminology by the Appellate Body in connection with its description of the benchmark.[270] These references, Canada maintains, are indicative of the Appellate Body's focus on the cost of production of the *individual* producer.[271] Moreover, Canada suggests the reference to "milk producers" cannot automatically be interpreted as meaning the "industry".[272]

5.38 Canada further argues against using an industry-wide average cost of production benchmark because the application of "a single industry-wide average would prevent efficient producers from being able to participate in legitimate commercial transactions without being deemed to confer a 'payment' merely because of the cost of production of higher cost producers."[273] Canada argues that the application of an industry-wide average is particularly inappropriate because of the large variation of costs of production within the Canadian dairy industry.[274]

5.39 Moreover, Canada asserts that it would be very difficult for any government under an industry-wide application of the benchmark to monitor and notify its export subsidies, as costs of production within an industry may change from year to year.[275]

(iii) Applicable Benchmark in this Case

5.40 In view of the fact that the DSB has adopted the Appellate Body Report setting forth the "average total cost of production" as the relevant benchmark to

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[266] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 92.
[267] Para. 3.62 above.
[268] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 96.
[269] Para. 3.62 above.
[270] Para. 3.63 above referring to statements by the Appellate Body Report in *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, paras. 81, 86, 87, 92, 94 and 96.
[271] Para. 3.63 above.
[272] Para. 3.62 above.
[273] Canada's Response to Question No. 63.
[274] Para. 3.59 above.
[275] Canada's Comments on the Responses of New Zealand and the United States, para. 52.

determine the existence of "payments" under Article 9.1(c), and given that all Parties in this Second Recourse to Article 21.5 of the DSU are in agreement that this is the benchmark the Panel should apply[276], none of them having endorsed the criticisms set forth in the European Communities' Third-Party Submission[277], the Panel shall accordingly apply this newly enunciated benchmark in this case.

(iv) Appellate Body's Guidance on the Nature of its Newly Enunciated Benchmark

5.41 In order to assess Canada's proposed interpretation of the Appellate Body's benchmark, the Panel considers it useful to first review the guidance provided by the Appellate Body on this issue.

5.42 The Panel notes in this connection the Appellate Body's statement that "it is significant that Article 9.1(c) of the *Agreement on Agriculture* does not expressly identify a standard or benchmark for determining whether a measure involves 'payments'."[278] As general guidance, the Appellate Body said "that there are 'payments' under Article 9.1(c) when the price charged by the producer of the milk is less than the milk's *proper value* to the producer".[279] But it went on to explain that "it is necessary to scrutinize carefully the facts and circumstances of a disputed measure, including the regulatory framework surrounding that measure, to determine the appropriate basis for comparison in assessing whether the measure involves 'payments' under Article 9.1(c)."[280] Hence, the Panel understands that the standard proposed by the Appellate Body may need to change according to the particular factual and regulatory context.

5.43 In fashioning what it considered to be the appropriate benchmark, the Appellate Body emphasized that "the standard must be objective and based on the value of the milk to the producer."[281] It then posited that:

> "for any economic operator, the production of goods … involves an investment of economic resources, … an investment in fixed assets … and an outlay to meet variable costs … . These fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed

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[276] Paras. 3.9 and 0 above.

[277] We recall that only the European Communities, as a Third Party, argues against the use of the Appellate Body's "average total cost of production" benchmark, noting that this benchmark has no legal foundation in the *Agreement on Agriculture*, that it inappropriately focuses on the provider, rather than the recipient, of a payment and that it is impractical to apply. The European Communities also observes that other WTO Members, including the United States, critiqued this benchmark in the DSB meeting at which the Appellate Body Report was adopted. (paras. 4.27 – 4.33)

[278] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US), supra*, footnote 1, para. 76.

[279] *Ibid.*, para. 73.

[280] *Ibid.*, para. 76.

[281] *Ibid*., para. 86.

> from some other source, possibly 'by virtue of governmental action'."[282]

5.44 In recognizing that Members' domestic subsidies may in some instances provide spillover benefits to exports, the Appellate Body considered that such a situation should not automatically be characterized as an export subsidy, but that domestic support should not be used without limit.[283] The Appellate Body thus opined that an appropriate benchmark should respect the separation between the disciplines on domestic and export subsidies.[284] It accordingly declared that the average total cost of production is the appropriate benchmark for determining, in the circumstances of this case, whether there are "payments" within the meaning of Article 9.1(c).[285]

5.45 The Appellate Body also indicated that it favoured reliance on the average of *all fixed and variable costs* incurred in the production of a unit of milk, rather than on the *marginal (variable) costs* incurred in producing an additional unit of milk, noting that:

> "[a]lthough a producer may very well decide to sell goods … if the sales price covers its marginal costs, the producer will make losses on such sales unless all of the remaining costs associated with making these sales, essentially the fixed costs, are financed through some other source, such as through highly profitable sales of the product in another market. … In the ordinary course of business, an economic operator chooses to invest, produce and sell, not only to recover the total cost of production, but also in the hope of making profits."[286]

5.46 With the above as background, the Appellate Body concluded that:

> "in the circumstances of these proceedings, … we believe that the average total cost of production represents the appropriate standard for determining whether sales of CEM involve 'payments' under Article 9.1(c) of the *Agreement on Agriculture*. The average total cost of production would be determined by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets."[287]

(v) Panel's Analysis of the Nature of the Benchmark

5.47 The Panel notes that the Appellate Body did not specifically address whether this new benchmark – the average total cost of production of all milk –

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[282] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.
[283] *Ibid.*, paras. 89-91.
[284] *Ibid.*, paras. 91-92.
[285] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 88 and 92.
[286] *Ibid.*, paras. 94-95.
[287] *Ibid.*, para. 96.

should be assessed as an industry-wide average or on some other basis more accurately reflecting the actual costs of individual producers and their participation in the CEM market. On the one hand, the Appellate Body's enunciation of the standard seems to be consistent with an industry-wide approach, where it speaks in terms of determining "[t]he average total cost of production … by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both [domestic and export] markets."[288] In a similar vein, the Appellate Body, in recalling the Article 21.5 panel's observation that there is a clear differential between the prices of CEM and the domestic market price, stated that "[t]his suggests the possibility that the prices of CEM might be below the average total cost of production and, thus, might involve 'payments' under Article 9.1(c)."[289] On the other hand, the Appellate Body also made references to "[e]ach producer decid[ing] for itself whether, and when, to produce and sell milk as CEM"[290] and to the need to focus on the choices and "motivations of the independent economic operator".[291]

5.48 We note some additional textual support in the Appellate Body's analysis for the use of the industry-wide approach. Specifically, the Appellate Body considered that the cost of producing *all* milk should be divided by the *total number of units* of milk.[292] Had the Appellate Body wanted us to divide the cost of production of the individual producer by the total number of units of milk produced by that producer, it surely would have so instructed. The Appellate Body confirmed that it "adopted as a standard, for these proceedings, the average total cost of production of the milk *producers*".[293] (emphasis added) This would suggest that the Appellate Body was not focusing on individual producer costs, as Canada contends.

5.49 In response to the Complainants' arguments, Canada proposes an interpretation of the Appellate Body's use of the phrase "costs of producing *all* milk" as merely referring to *all* the units of milk, whether produced for the domestic or export market, of each individual producer.[294] Given the context in which the Appellate Body referred to "*all* milk", i.e., in setting forth the very method of calculating the average total cost of production, and the absence of express textual directive to that effect, the Panel is not persuaded by Canada's suggestion that we should imply that the Appellate Body intended a calculation for each *individual* producer.

5.50 In our understanding, the Appellate Body reference to "a standard that focuses upon the motivations of the independent economic operator who is making the alleged 'payments' – here the producer – and not upon any

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[288] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96.
[289] *Ibid.*, para. 101.
[290] *Ibid.*, para. 79.
[291] *Ibid.*, paras. 92 and 96.
[292] *Ibid.*, para. 96.
[293] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1 para. 104.
[294] Para. 3.62 above.

government intervention in the marketplace"[295], was made in the context of its concern that automatically characterizing any governmental intervention in the form of domestic price support that benefits exports as an export subsidy would collapse the distinction in the *Agreement on Agriculture* between domestic and export disciplines.[296] Accordingly, we have some doubts as to Canada's conclusion that the Appellate Body's benchmark should be each individual producer's average cost of production rather than an industry-wide average cost of production.

5.51 At this stage, the Panel is not persuaded that Canada is correct in its proffered interpretation of the benchmark enunciated by the Appellate Body. Nonetheless, in recalling that it is Canada's burden to establish that no payments are being made, we shall examine whether Canada, in relying on the costs to individual producers to determine the average total cost of production, provides a convincing defence that no payments are being made.

(vi) Canada's Critique of the Complainants' Reliance on the CDC Data and its Arguments in Favour of Individual Producer Data

5.52 The Panel notes that Canada, following on from its criticisms of the application of an industry-wide benchmark, proceeds to reject reliance on the CDC Guidelines and survey data as a valid basis for determining the average total cost of production.[297] While not contesting the validity of the data collected by the CDC, Canada argues that this data is collected for a different purpose and does not provide relevant information for this case.[298] Notably, Canada contends that the CDC Guidelines and the data collected in accordance with these Guidelines serve the economic and social objective of giving a fair return to efficient dairy producers, and that this is different from data on the actual costs of production.[299]

5.53 Because the CDC Guidelines and the data collected serve economic and social objectives, Canada maintains they do not provide a standard for assessing "payments" that is objective, as required by the Appellate Body.[300] Further, because the Appellate Body stated that the relevant standard should focus on the motivations of the independent economic operator and not any government intervention in the marketplace, it is inappropriate, in Canada's view, to rely on the CDC Guidelines, which are reflective of Canadian governmental policy towards the dairy industry.[301] Moreover, Canada asserts that in proposing reliance on the CDC survey data, the Complainants seek to reintroduce the

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[295] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 92.
[296] *Ibid.*, paras. 88-92.
[297] Para. 3.19 above.
[298] Paras. 3.57 and 3.19 above.
[299] Para. 3.19 above.
[300] Paras. 3.80 – 3.81 above.
[301] Paras. 3.13 and 3.19 above.

domestic administered price as the relevant benchmark.[302] Canada notes that this benchmark was explicitly rejected by the Appellate Body.[303]

5.54 Canada also argues that the CDC survey data is an inappropriate basis for determining the average total cost of production in that it excludes the 30 per cent least efficient farmers, as well as those farmers with less than 60 per cent of the average production/output in each province.[304] Canada has indicated that those small farms account for approximately 18 per cent of all milk production in Canada.[305]

5.55 However, Canada does not reject the cost of production survey data in its entirety.[306] Rather, it proposes certain adjustments to the CDC calculations.[307] First, Canada proposes including, in principle, the 30 per cent less efficient farms.[308] To the eligible pool of more than 19,000 dairy farms in the nine provinces with farms participating in the CEM market, Canada applies a "statistically valid sampling method" to obtain a representative sample of 274 dairy farms whose costs of production are surveyed.[309] The costs for each farm are computed on a per unit basis (dollars per hectolitre) and each farm is then ranked from lowest to highest according to its individual cost of production.[310] Then Canada divides the 274 farms by 10 to create 10 groupings (deciles) of producers.[311] The individual farms are then weighted according to their production and an average weighted cost is calculated for each decile.[312]

5.56 In order to provide information on the price of CEM contracts, Canada takes price and volume data from 785 CEM contracts, as reflected on the bulletin boards of Quebec, Ontario and Manitoba, and divides this number of contracts into deciles.[313] It then calculates an average CEM price, weighted according to volume, for each decile.[314] To calculate the weighted average return, Canada deducts transport, marketing and certain administrative fees from the price of CEM contracts.[315]

5.57 Comparing the CEM returns of the 785 contracts with the cost of production of 274 dairy farms, Canada purports to show that more than three-quarters (about 77 per cent) of dairy producers can cover their average costs of

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302 Para. 3.41 above.
303 *Ibid*.
304 Paras. 3.19 – 3.20 and 3.23 above.
305 Footnote 72 above.
306 Para. 3.57 above.
307 Paras. 3.56 – 3.58 above and Canada's Exhibit CDA-8.
308 Para. 3.58 above and Canada's Exhibit CDA-8.
309 Para. 3.57 above and Canada's Exhibit CDA-8.
310 Canada's Exhibit CDA-8.
311 Para. 3.57 above.
312 Canada's Exhibit CDA-8. While the Panel understands from CDA-8 that the cost of production within each decile is weighted according to output, we note Canada's Response to Question No. 39 to the effect that the cost of production within each decile is not weighted.
313 Canada's Responses to Question Nos. 41-44.
314 Canada's Exhibit CDA-11.
315 Paras. 3.51 – 3.52 and 3.65 above. The Panel notes that Canada has also deducted these transport and administrative fees from the cost of production calculations.

production through CEM sales.[316] On the same basis, Canada does not contest the fact that approximately 23 per cent of dairy producers in the sample cannot cover their average costs of production in the CEM market.[317] Nonetheless, Canada argues it is reasonable to assume that a rational producer would participate in the CEM market only if he or she could cover his or her production costs.[318] Therefore, Canada maintains, there is no reason to assume that the 23 per cent of producers who cannot cover their production costs would participate in this market.[319]

(vii) Panel's Assessment of Canada's Arguments and Data on Individual Producers' Costs

5.58 We recall Canada's argument that an individual producer's average total cost of production should be the relevant yardstick for determining whether payments are being made.[320] If Canada can convincingly show that the individual producers' costs of production allow the producers to participate in the CEM market without making losses, then, in our assessment, no payments are actually being made.

5.59 Looking at the data Canada adduces, we register concerns as to the objectivity of this evidence: while Canada includes the 30 per cent of producers excluded from the CDC survey data, it does not include cost data from the small farms with less than 60 per cent average output in each province.[321]

5.60 We further note that, in the data presented by Canada, the unweighted cost of production of the individual producers, in Canada's sample, is as low as CDN $7.01 and as high as CDN $66.80[322], while the weighted average cost ranges from CDN $18.53 to CDN $46.60.[323] At the same time, we note that the weighted CEM returns amongst the 785 contracts in the three provinces sampled, range from CDN $24.15 to CDN $33.61.[324] We recall the statement by the Complainants, uncontested by Canada, that the simple average of CEM prices in 2000 was approximately CDN $29.[325]

5.61 Thus, in comparing the non-weighted data on the individual producers' costs with the simple average CEM price, we observe that the average cost of production of some producers significantly exceeds the average CEM price. Further, if we are to accept Canada's argument that cost data and CEM returns should be weighted according to output[326], a still significant proportion of

316 Para. 3.66 above.
317 Paras 3.66 and 3.70 above.
318 Canada's Response to Question No. 4(a).
319 *Ibid*.
320 See paras. 5.36-5.37 above.
321 We recall our exposition of Canada's argument at para. 5.54 above as well as at para. 3.58 and footnote 72 above.
322 Canada's Exhibit CDA-9; Canada's Response to Question No. 41.
323 Canada's Exhibit CDA-9.
324 Canada's Exhibit CDA-13.
325 Paras. 3.66 and 3.70 above.
326 Footnote 72 above.

producers clearly cannot cover their costs through CEM sales. We recall that Canada does not contest – in fact admits – that approximately 23 per cent of dairy producers in the sample cannot cover their average costs of production in the CEM market.[327]

5.62 We also note that, according to Canada's evidence, approximately 8,000 producers, or 40 per cent of all producers (in the nine provinces), have participated, at least on occasion, in the CEM market.[328] Also according to Canada's evidence, CEM production represents approximately 3.6 per cent of all milk production in Canada.[329] Canada has also indicated that participation in the CEM market is usually only short term and that only a minority of CEM producers (12.5 per cent) participate for more than one year.[330] This may suggest that even if there are producers who can cover their marginal costs in the CEM market, CEM sales are not viable for most producers who thus may only participate in the CEM market to the extent necessary to dispose of non-quota surplus milk.[331]

5.63 Given that Canada accepts that 23 per cent of producers have production costs exceeding CEM returns, and recalling that Canada has invited us to focus on the costs of production of individual producers[332], we consider that Canada in essence asks us to extrapolate from its information that, in fact, no individual producer with costs exceeding CEM returns, sells milk into the CEM market. However, in asking the Panel to assume that only the more efficient producers participate in CEM sales, Canada, it would seem to us, is calling for an assumption that would obviate any examination pursuant to the Appellate Body's benchmark of whether sales below the average total cost of production are being made. We note, however, that the Appellate Body clearly did not exclude the possibility that a producer with total costs of production in excess of CEM returns, might make CEM sales, stating that "[t]o the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly 'by virtue of governmental action'."[333]

5.64 Having carefully considered Canada's case for focusing on the individual producer in applying the cost of production benchmark, the Panel *finds* that Canada has neither sought to correlate its data on costs of production of

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[327] Paras. 3.66 and 3.70 above.
[328] Para. 3.70 above.
[329] Footnote 85 above.
[330] Para. 3.70 above and Canada's Exhibit CDA-15.
[331] In this regard, we note that industrial milk production has exceeded Canadian requirements, defined as "domestic consumer demand and planned exports for industrial dairy products", both before and after the introduction of the CEM market. Canada's Exhibit CDA-27, reproducing CDC Annual Report 2000-2001, pages 13-14. We further note that as part of its claimed implementation of the recommendations in the original *Canada – Dairy* case, Canada asserts it has restricted its export subsidies to the quantity commitment levels for subsidized exports as set out in its Schedule. Para. 2.2 above.
[332] See paras. 5.36-5.37 above.
[333] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 87.

individual producers with any information on participation in the CEM market, nor with that on the returns they might obtain in this market. While speaking of the costs to individual producers, not industry-wide average costs, Canada has only provided the Panel with average costs, albeit averages within ten groupings of producers. The Panel *finds*, moreover, that Canada has not presented any data - indeed, admits it has no data – on the basis of which the Panel could exclude that the 23 per cent of producers with costs of production in excess of the CEM price participate in the CEM market.

5.65 Accordingly, the Panel *finds* that Canada has not been able to demonstrate, pursuant to its proposed reliance on an individual average as the relevant total average cost of production benchmark, that no payments, within the meaning of Article 9.1(c), are being made.

5.66 We recall that at least one of Canada's rationales for having the Panel focus on the costs of individual producers rather than industry-wide averages is the wide variation in the cost-of-production efficiency of dairy farmers in Canada.[334] In pursuit of this factual claim, Canada has presented evidence that merely confirms what Canada initially posited, i.e., that some farmers indeed have costs of production below CEM returns, while others do not. In our view, Canada's approach raises the two following additional problems.

5.67 First, we consider that Canada's proposed focus on the cost of production of individual producers would require a government to have access to, and make available, information on the cost of production of each producer and on whether or not the individual producer participates in the CEM market. It seems to us that only on rare occasion would a government have record-keeping of this magnitude. Quite apart from the administrative cost and unworkability of this approach, we note that even Canada has expressed doubts that the Appellate Body could have intended a benchmark for determining the existence of payments that entails a standard of proof akin to the "beyond a reasonable doubt" standard under criminal law.[335]

5.68 Second, the extensive amount of information required under Canada's proposed approach would make it very difficult for WTO Members to ensure that they are respecting their obligations under the *Agreement on Agriculture* in exercising their rights thereunder to grant domestic and export subsidies. In view of the unworkability of Canada's approach, such a Member whose exports also exceed its reduction commitment levels would have great difficulty in establishing that such exports have not benefited from export subsidies.

5.69 We recall that Canada has criticized the Complainants' proposed reliance on an industry-wide average for the cost of production benchmark, arguing that it would be very difficult for any government under an industry-wide application of the benchmark to monitor and notify its export subsidies, as costs of production within an industry may change from year to year.[336] While this may

[334] Para. 3.59 above.
[335] Canada's Comments on the Responses of New Zealand and the United States, para. 56.
[336] See para. 5.39 above.

indeed be the case, the Panel considers that monitoring and notification would be even more difficult under Canada's proposed application of the benchmark.

5.70 Nevertheless, we do see some merit in a number of the criticisms Canada expresses in relation to an industry-wide average of cost of production as the relevant benchmark. Specifically, we note Canada's argument that producers who can participate profitably in the CEM market may be deemed to confer payments if the industry-wide average cost of production exceeds CEM prices.[337] In our view, in a market exhibiting great variation in production efficiency, the application of an industry-wide cost of production benchmark could result in producers being deemed to make payments even where not one producer with costs above the industry-wide average would be selling into the export market. In addition to not telling us much – if anything – about whether or not payments to dairy processors are in fact being made, it would be odd, in the Panel's view, if an interpretation of the *Agreement on Agriculture* should result in discouraging exports by efficient farmers, and yet this is what this industry-wide average cost of production benchmark would seem to entail.

5.71 Despite the merits of these critiques, however, the Panel rejects Canada's criticism that reliance on the CDC data would amount to reintroducing the regulated domestic price as the relevant benchmark.[338] The Complainants' proposed reliance on the data collected pursuant to the CDC Guidelines is grounded in their argument, in which we concur, that this data represents a reasonably accurate and objective measure of costs of production of Canadian dairy producers. We agree with the Complainants that the fact that Canada uses this data to set the in-quota price in pursuit of social and economic objectives does not detract from the validity of the data because such objectives may become relevant in setting the in-quota price but not in calculating costs.

5.72 Moreover, we also disagree with Canada that we would in essence be reintroducing the domestic in-quota price as the relevant benchmark because it seems to us that a more accurate reflection of the average total cost of production of *all* of the Canadian dairy industry, i.e., one that also includes cost data from the 30 per cent least efficient farmers, as well as the small producers, would at any rate be substantially higher than the CDC cost figures and the domestic in-quota price.

5.73 In this connection, we take note of the CDC cost of production data, as provided by the Complainants, showing that the average cost of production of the Canadian dairy industry was CDN $57.27 in 2000 and estimated to be CDN $58.12 in 2001.[339]

5.74 The Panel notes that the Parties agree that the average CEM price in 2001 was approximately CDN $31.50[340] and in 2000 was approximately CDN $29.[341]

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[337] We recall in this connection the exposition of Canada's argument at para. 5.38 above.
[338] We recall, in this regard, that Canada does not contest the accuracy of the underlying CDC data.
[339] Para. 3.53 above.
[340] Canada's Response to Question Nos. 61-62. New Zealand's Response to Question No. 62 and United States' Response to Question No. 62.
[341] Para. 3.53 above and Canada's Response to Question No. 62.

With the average cost of production, as reflected in the CDC survey data, exceeding the average CEM price by a factor of almost two, we consider that this constitutes a strong indication that, on average, payments are being made.[342]

(viii) Canada's Proposed Exclusion of Certain Cost Elements

5.75 The parties, however, disagree as to the cost elements to be included in the calculation of the average total cost of production. Accordingly, it is necessary for us to examine whether Canada convincingly shows that certain elements for which the CDC Guidelines make allocation, should not be included in the calculation of average total cost of production in this case.

5.76 Canada argues that only actual costs, and not imputed costs, should be included in the cost calculation.[343] It proposes an interpretation of the term "costs" as being limited to cash outlays.[344] Canada therefore seeks to adjust the CDC survey data by excluding from such calculation the costs of family labour, return to management and return to equity.[345] Canada also posits that the cost calculation should be limited to production costs only, to the exclusion of production quota, marketing, transport and certain administrative costs.[346]

5.77 In arguing that the cost calculation should also exclude profits[347], Canada refers the Panel to a statement by the Appellate Body to the effect that "an economic operator chooses to invest, produce and sell, not only to recover the total cost of production, but also in the hope of making profits".[348] According to Canada's view, the Appellate Body draws a clear distinction between costs to be recouped, on the one hand, and hoped for profits on the other.[349] Canada in this context argues that family labour and return to equity are not costs to an enterprise but rather profits, and thus should not be included in calculating the cost of production.[350]

5.78 Canada also submits, in responding to the Complainants' proposed inclusion of the cost of quota, which we note is not accounted for under the CDC Guidelines, that quota should not be viewed as a restriction on production but rather as an entitlement to sell.[351] Canada further argues that the cost of quota is to be recouped in a different market, namely, the domestic market.[352] In support

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[342] The Panel notes that the data submitted by the various parties on costs of production and CEM prices are comparable with respect to the inclusion of transport, administrative and marketing fees. Canada's Exhibits CDA-11, CDA-12 and CDA-13; New Zealand's First Submission, para. 5.29; United States' First Submission, para. 29.

[343] Paras. 3.37 – 3.38 above.

[344] Para. 3.27 above.

[345] Paras. 3.28 – 3.40 above.

[346] Paras. 3.44 and 3.50-3.51 above.

[347] Paras. 3.39 – 3.40 above.

[348] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 95.

[349] Paras. 3.39 – 3.40 above.

[350] *Ibid*.

[351] Para. 3.44 above.

[352] *Ibid*.

of its position, Canada points to GAAP that "do not require" the amortization of intangible assets with an indefinite useful life[353], which, in Canada's view, includes production quota. According to Canada, only the impairment in the value of the quota in a given year, if any, as compared to that in a prior year, is to be included as a cost element.[354]

5.79 As for the exclusion of marketing, transport and certain administrative costs, Canada argues that these are costs arising in connection with *sales*, not production, which occur beyond the farm gate.[355]

(ix) Panel's Analysis of Cost Elements to be Included/Excluded

5.80 The Panel, in examining which cost elements should be included, recalls the Appellate Body guidance that *all* fixed and variable costs should be included[356], thus suggesting that there is no reason *a priori* to use only cash-based accounting methods. The Panel also takes note of the observation by the Appellate Body that the production of goods and services involves an investment of economic resources.[357] We therefore consider that we must first determine the ordinary meaning of the words "cost" and "investment" in accordance with Article 3.2 of the *DSU* and Article 31 of the *Vienna Convention on the Law of Treaties ("Vienna Convention")*. The word "cost" is defined as an "[e]xpenditure of time or labour; what is borne, lost, or suffered in accomplishing or gaining something … ".[358] The word "investment" is defined as "… investing of money (now also time or effort)…".[359] Having thus examined the ordinary meaning of the words "costs" and "investment", we do not see any basis that would require us to exclude non-monetary costs *ab initio*.

5.81 Mindful of the argument of Canada, inviting us to have recourse to GAAP in interpreting the meaning to be given to the term "cost of production", we first note that the CDC Guidelines themselves state that they are based on GAAP.[360] Second, we consider it useful to turn to the *Anti-Dumping Agreement* for contextual guidance, in line with Article 31 of the *Vienna Convention* and Article 3.2 of the *DSU*. Specifically, we turn to such contextual guidance to discern the relative weight to be given to GAAP in the proper calculation of costs of production. Article 2.2.1.1 of the *Anti-Dumping Agreement* tells us to calculate costs based upon "records kept by … the producer, provided that such records are in accordance with ge*nerally accepted accounting principles* of the exporting country and reasonably reflect the costs associated with the production

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353 Para. 3.44 above.
354 *Ibid*.
355 Paras. 3.50-3.51 above. Canada also proposes subtracting such costs to obtain the net CEM return.
356 See para. 5.45 above.
357 See para. 5.43 above.
358 *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. I.
359 *Ibid*.
360 New Zealand's Exhibit NZ – 4 and United States' Exhibit US – 22 reproducing CDC Guidelines.

and sale of the product … [and] provided that such allocations have been *historically utilized* by … the producer … ." (emphasis added)

5.82 Since Article 2.2.1.1 of the *Anti-Dumping Agreement* instructs that production costs are to be calculated using the allocations historically utilized so long as doing so is in accordance with GAAP, and since the CDC Guidelines purport to be in accordance with GAAP, we see no reason why family labour, return to management and return to equity should not be included in the definition of the cost of production in the present case.

5.83 In this context, the Panel notes the inconsistency between Canada's compensating producers for the elements of family labour, return to management and return to equity, in the domestic market, as borne out by the CDC Guidelines, while proposing to exclude these "*historically utilized*" allocations in applying the Appellate Body's cost of production benchmark. Similarly, we note the inconsistency of Canada's including marketing, transport and administrative expenses as costs when setting the domestic target price, while arguing for their exclusion in the calculation of the overall cost of production.

5.84 On whether or not to include the cost of obtaining quota in calculating the overall cost of production, we agree with the Complainants' explanation that this cost represents a real cost – even a cash outlay – that a producer will incur in the production of milk, regardless of which market the producer recoups that cost in. In our understanding, the GAAP, while possibly not requiring the amortization of quota, do not exclude such amortization. Since the Appellate Body, in referring to the total cost of production as including *all* fixed and variable costs, appears to have endorsed a broad interpretation of the term "cost", we doubt that quota should be excluded from such calculation.

5.85 Having examined what elements to include in the overall cost of production calculation, the Panel *finds* that Canada has not demonstrated why family labour, return to management, return to equity, quota and transport, marketing and administrative costs should not be included as costs of production and that, as a corollary, those deductions need to be made to the CDC survey data. In sum, we agree with the Complainants that the elements here mentioned are real costs to the producer who, if not able to recoup them, incurs losses and cannot stay in business over time. The Panel accordingly *finds* that the CDC data represent a sufficient, albeit conservative, approximation of the average total cost of production of the Canadian dairy industry. If anything, additions reflecting the cost of quota, not deductions, should be made to the cost elements reflected in the CDC survey data.

(c) Conclusion on the Issue of "*payments*"

5.86 The Panel recalls its finding at paragraph 5.34 above that the Complainants have presented a *prima facie* case that payments are being made.

5.87 The Panel also recalls its finding at paragraphs 5.64-5.65 above that Canada's proposed approach focused on the costs of production of individual producers, but absent any data reflecting individual producers' costs, their

participation or their returns in the CEM market, fails to demonstrate that no payments are being made, within the meaning of Article 9.1(c).

5.88 The Panel further recalls its finding at paragraph 0 above to the effect that Canada has not demonstrated why family labour, return to management, return to equity, quota and transport, marketing and administrative costs should not be included as costs of production.

5.89 In light of the Complainants *prima facie* case as to the existence of payments and Canada's failure to establish, pursuant to Article 10.3, that no payments are being made, the Panel *finds* that "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* are being made.

5.90 The Panel notes that we have made findings of the existence of "payments" based on both the Complainants' and Canada's interpretation of how to apply the Appellate Body's benchmark, thus making it unnecessary to decide *in this case* which of these two interpretations is the correct one.

3. Whether Payments are "financed by virtue of *governmental action"*

(a) Basis for Panel's Renewed Examination of Whether Payments are "financed by virtue of governmental action"

5.91 The Panel notes that while the Appellate Body reversed the Panel's finding as to the appropriate benchmark for determining the existence of "payments" under the first element of Article 9.1(c), it neither made a finding as to whether or not payments exist in the current case nor any findings with respect to the issue of "financ[ing] by virtue of governmental action".[361] Nevertheless, the Appellate Body, as *dicta*, provided certain indications as to the nature of the governmental action required and as to the causal link to the financing of payments.

5.92 Specifically, the Appellate Body opined that the presence of a "*demonstrable link*" between the governmental action and the financing of the payments is necessary to a showing that payments are financed *"by virtue of"* governmental action.[362] The Appellate Body equated this "demonstrable link" with a situation where there is a "*tighter nexus*" between the governmental action and the financing of payments than in a situation where there is a regulatory framework merely enabling a third person freely to make and finance payments.[363]

5.93 Thus, we deem it necessary to revisit, with the benefit of the Appellate Body's guidance, the issue of whether payments are "financed by virtue of governmental action".

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[361] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, paras. 104; 105 and 118.
[362] *Ibid.*, para. 113.
[363] *Ibid.*, para. 115

5.94 At this stage, the Panel recalls its analysis in paragraphs 5.18-5.19 and 5.25 above as to the operational interpretation of Article 10.3. We shall therefore first examine whether the Complainants make a *prima facie* showing of a demonstrable link between governmental action and the financing of payments. Provided that the Complainants make such a *prima facie* case, it will then be for Canada to establish, pursuant to Article 10.3, that any payments are not "financed by virtue of governmental action" within the meaning of Article 9.1(c).

(b) Whether the Complainants Make a *prima facie* Case

5.95 The Complainants allege that, because a producer supplies CEM at a price which does not cover average production costs, i.e., makes a payment, and because the milk thus sold must be exported pursuant to government mandate, Canada's CEM market cannot be described as a deregulated one in which private individuals freely make and accept payments.[364] Specifically, they argue that the prohibition on selling non-quota milk at the higher domestic in-quota price and on diverting CEM back into the domestic market, together with the exemption of the dairy processors from paying this higher price for CEM, constitute the governmental action by virtue of which payments are financed.[365]

5.96 The Complainants also argue that the Panel should focus its examination on the recipient of the subsidy (here, the processor), not on the provider thereof (the dairy producer).[366] In this context, the Complainants observe that under the CEM scheme, it is ensured that whenever producers make a sale they will also be making a payment.[367] Arguing that the issue of why producers choose to produce milk for the CEM market is irrelevant, the Complainants contend that what matters is that the choice of where to sell non-quota milk, once produced, is essentially a government-mandated choice.[368] The only other "options", in their view, are to destroy the milk or to sell it in the much less attractive market for animal feed.[369] Moreover, New Zealand points out, the cross-subsidization resulting from sales at the higher administered domestic price may make it rational for a producer to produce CEM.[370]

5.97 The Complainants assert that the exemption from the higher domestic regulated price is not necessary to Canada's supply management scheme because the Government need not enable processors to obtain milk below production cost.[371] Only the prohibition on diversion of non-quota milk back into the domestic regulated market, and not the exemption of processors from paying the higher domestic price, they argue, may be a significant element in Canada's price

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364 See paras. 3.94, 3.96 and 3.120 above.
365 Para. 3.96 above.
366 Para. 3.114 above.
367 Para. 3.120 above.
368 Paras. 3.117 – 3.119 and 3.121 above.
369 New Zealand's First Submission, para. 5.38, United States' First Submission, para. 44.
370 Para. 3.118 above.
371 Paras. 3.101 and 3.115 above.

support scheme.[372] Canada's scheme, they argue, functions as a deliberate export subsidy, in the absence of which Canada would not be able to export dairy products.[373]

5.98 Recalling our statement in paragraph 5.94 above, the Panel *finds* that the Complainants' case, as described in paragraphs 5.95-0 above, provides a *prima facie* showing that payments are being "financed by virtue of governmental action", such that Canada can reasonably attempt to discharge its burden under Article 10.3 of demonstrating why CEM sales are not being financed by virtue of governmental action. We shall therefore turn to an examination of Canada's case on this issue.

(c) Examination of Canada's Case on "financed by virtue of governmental action"

(i) Canada's Position Regarding the Lack of Governmental Involvement in the Export Market

5.99 In recalling a statement of the Appellate Body, to the effect that the causal link would be more difficult to establish when a payment-in-kind is made by an independent economic operator, Canada argues that, on the facts of this case, the Appellate Body standard calls for a "particularly clear and convincing showing of the required linkage".[374] Canada then argues that, in the context of the deregulated CEM market, the combination of the prohibition on selling non-quota milk on the domestic regulated market and the exemption of processors from paying the higher regulated domestic price is insufficient to meet the "rigorous standard" put forward by the Appellate Body.[375] Specifically, Canada argues that the exemption of the processors from paying the higher domestic price does not ensure processors' access to milk for export at any particular price and that there is thus no tight nexus between the financing of payments and governmental action.[376]

5.100 Referring to the Appellate Body's distinction between a regulatory framework merely enabling a third person freely to make and accept payments and one for which a tight nexus between governmental action and financing of payments is present, Canada describes its "deregulated" export market as one in which private economic operators engage in transactions at arms length and on a purely commercial basis.[377]

5.101 Moreover, Canada maintains that the Complainants' argument to the effect that access to CEM without having to pay the domestic administered price equals financing, fails to give meaning to the word "financed".[378] The mere fact

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372 Paras. 3.107, 3.101 and 3.115 above.
373 Para. 3.107 above.
374 Para. 3.95 above.
375 *Ibid*.
376 Para. 3.116 above.
377 See paras. 3.97; 3.104; 3.108-3.109 and 3.113 above.
378 Para. 3.97 above.

that processors have access to CEM without paying the domestic administered price and that there are no limits placed on their ability to export is not *per se* WTO-inconsistent, according to Canada.[379]

5.102 Canada contends that the Government is not involved in the decision to sell non-quota milk as CEM milk because, "for Article 9.1(c) to apply there must be governmental action focussed or directed towards the financing of the alleged 'payment'".[380] Canada then gives examples of what type of governmental action it considers would satisfy the test established by the Appellate Body, namely, setting prices, controlling volume or managing producer returns.[381] In addition, Canada asserts that if there was governmental action "obliging or driving" producers to produce CEM, the demonstrable link would be present.[382]

5.103 Canada also contends that to focus on the processor, as the Complainants argue, confuses the concept of "financed by virtue of governmental action" with the concept of "benefit".[383] In its view, the issue is whether the alleged payments by independent producers are financed by virtue of governmental action.[384]

5.104 Canada maintains, in addition, that under the *Agreement on Agriculture*, WTO Members may provide domestic support to agricultural producers and that the prohibition on diversion of non-quota milk into the domestic market in Canada is necessary to protect the producers' entitlement to the higher domestic support price.[385]

5.105 In invoking the *SCM Agreement* and the case on *US – Export Restraints* as important contextual guidance, Canada argues that Article 9.1(c) of the *Agreement on Agriculture* should be construed in accordance with Article 1.1(a)(1) of the *SCM Agreement*, and specifically Article 1.1(a)(1)(iv), pursuant to which "a government *entrusts* or *directs* a private body to carry out … functions … which would normally be vested in government … ", such as making direct transfers of funds, forgoing revenue or providing goods and services.[386]

(ii) Appellate Body Guidance on "financing by virtue of governmental action"

5.106 Before embarking on a detailed examination of Canada's case regarding "financed by virtue of governmental action", we consider that we should first review the guidance by the Appellate Body on this subject. The Appellate Body observed that the text of Article 9.1(c) does not qualify the relevant types of

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379 Para. 3.116 above.
380 Para. 3.103 above.
381 *Idib*.
382 *Ibid*.
383 Canada's Oral Statement, para. 56.
384 Canada's Executive Summary, para. 27.
385 At an early stage in the proceedings, Canada also argued that the exemption of the processors from paying the higher domestic price was also necessary to the domestic price support system. Canada's Submission. para. 66. However, Canada later admitted that this exemption was not necessary to this price support system. Para 3.116 above.
386 Paras. 3.147 - 3.148 above.

governmental action, but includes governmental action "regulating the supply and price of milk in the domestic market".[387] While stating that "mere governmental action" is not enough for there to be export subsidies, it opined that the presence of a "demonstrable link" between the governmental action and the financing of the payments means that payments are financed "*by virtue of*".[388]

5.107 The Appellate Body did not exclude that "payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government".[389] At the same time, the Appellate Body was careful to distinguish a "regulatory framework merely enabling a third person freely to make and finance 'payments' [for which] … the link between the governmental action and the financing of the payments is too tenuous" from a situation where there is "a tighter nexus between the mechanism or process by which the payments are *financed*, even if by a third person, and governmental action".[390]

5.108 Similarly, the Appellate Body distinguished a situation where a payment *occurs* as a consequence of governmental action from the situation where a payment is *financed* as a consequence of governmental action and for which a demonstrable link is thus present.[391] In the former situation, no such demonstrable link is present, according to the Appellate Body, "because the word 'financed', in Article 9.1(c), must also be given meaning".[392]

5.109 The Panel recalls that the Appellate Body noted that "[a]lthough the Panel addressed this issue in different ways, … the Panel's reasoning, taken as a whole, was directed towards establishing the demonstrable link between governmental action and the financing of the payments."[393] At the same time, however, the Appellate Body "disagree[d] with the Panel's characterization of the measure as 'obliging producers, at least *de facto*, to sell outside-quota milk for export'."[394] The Appellate Body also noted that it did "not see how producers are obliged or driven to produce additional milk for export sale."[395]

(iii) Panel's Examination of "financed by virtue of governmental action" in Light of the Appellate Body Guidance

5.110 The Panel recalls that in the first Article 21.5 compliance case, for the purpose of determining the link between governmental action and the financing of payments, that panel focused on the prohibition against selling non-quota milk

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[387] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 112.
[388] *Ibid.*, para. 113.
[389] *Ibid.*, para. 114.
[390] *Ibid.*, para. 115.
[391] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 113.
[392] *Ibid.*
[393] *Ibid.*, para. 116.
[394] *Ibid.*, para. 117.
[395] *Ibid.*

at the domestic in-quota price and the anti-diversion measures, as a result of which CEM, by definition exempt from the domestic pricing regulations, was left as the only viable option to transact outside the regulatory framework of price floors and quota ceilings.[396] In this earlier case, the panel spoke in terms of governmental action being "indispensable" to the financing of payments, in other words "establish[ing] the conditions which ensure that the payment takes place."[397] The panel also there found that in order to meet the "by virtue of" test in Article 9.1(c), it would have to find that financing does not occur "but for" governmental action.[398]

5.111 In light of the fact that there has not been any change in the nature or the regulation of the Canadian dairy markets since the first Article 21.5 panel examined this matter, and in light of the Appellate Body's apparent support for the reasoning employed by the first Article 21.5 panel[399], this Panel considers that it should initially focus on the same elements of governmental action as in the previous case, but applying a new test directed at determining whether governmental action is *demonstrably linked* to the financing of payments. In proceeding with our analysis, we are mindful of the distinction, rightly emphasized by the Appellate Body, between a situation where a payment is merely incidental to governmental action, and one where there is a tighter nexus between the governmental action and the effecting of a transfer of economic resources.[400]

5.112 The Panel recalls that under the previous supply management system, the Canadian government regulated price and marketing for all categories of milk.[401] Under Canada's implementation measures, the Canadian Government no longer negotiates or sets a price for its new category of export milk, called CEM, but still maintains a target price for domestic milk under quota, as well as for another new, domestic market category of milk, Class 4(m), used as animal feed.[402] Processors are exempt, by law, from paying the higher in-quota price.[403] Producers pre-commit to sell any quantity of non-quota milk as CEM and once pre-committed, such milk must be "first-out-of-the-tank", and may not be diverted back into the domestic market.[404] Processors must account for the destination of all milk contracted as CEM milk and diversion into the domestic market is subject to financial and other penalties.[405] As under the previous

[396] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, paras. 6.77 and 6.78.
[397] *Ibid.*, paras. 6.38, 6.40 and 6.44.
[398] *Ibid.*, para. 6.41.
[399] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 116.
[400] We recall in this connection the statement in the Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US*, para. *115)*.
[401] Para. 2.1 above.
[402] *Ibid*.
[403] Paras. 3.99 and 3.116 above.
[404] Para. 2.3 above.
[405] Para. 2.2 above.

system, Canada places no restrictions on the quantity of milk that may be sold into the export market.[406]

5.113 In relation to Canada's argument that the prohibition on diversion is necessary to the protection of the producer's entitlement to the higher in-quota price, we have doubts that, even assuming a measure may be necessary to a particular supply management system of a WTO Member, such "necessity" can be equated with WTO consistency. Moreover, we have doubts that the exemption of processors from paying the higher domestic in-quota price for CEM, either on its own or together with the prohibition on diversion, is necessary to the protection of the producer's entitlement to that higher price. Indeed, Canada has admitted that this exemption is not necessary to protect the producer's entitlement.[407]

5.114 Looking at the implementation measures in dispute, the Panel notes that the parties have presented arguments on the nexus, or lack thereof, both from the perspective of the processor and from that of the producer. We will begin our examination by considering this matter from the perspective of the processor.

5.115 Looking from the perspective of the dairy *processor*, it is clear that the exemption of processors from paying the higher domestic in-quota price is demonstrably linked to exports of dairy products made with Canadian produced milk because if processors had to pay the in-quota price for CEM, exports of CEM would most likely dry up. As the record undisputedly confirms, the domestic regulated price is well above the world market price for milk.[408] With milk being a principal ingredient of processed dairy products, Canadian processed dairy products using milk at the in-quota price could not be competitive on world markets. Indeed, we recall Canada's concurring statement to the effect that the exemption was adopted in order to allow for the functioning of a deregulated CEM market.[409]

5.116 Moreover, we consider that a rational, profit-maximizing processor, exempt by law from paying the in-quota price for CEM, will seek to transact for CEM at the lowest possible price. Because the processor has a legal right not to pay the in-quota price, ranging from approximately CDN $50 to CDN $56[410], a rational, profit-seeking processor, in our view, will be in a strong position to transact for CEM at a price below the domestic administered price, and thus, below the average total cost of production of Canadian dairy producers. Moreover, we consider that the unattractiveness of the other marketing option for non-quota milk, i.e., Class 4(m) milk, would put processors in a position to drive

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[406] Para. 2.2 above.
[407] Para. 3.116 above.
[408] We recall that the domestic in-quota price in the previous proceedings was shown to range from CDN $50 to CDN $ 56. Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para 6.10.
[409] Canada's Response to Question No. 14.
[410] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.10. In that report, New Zealand submitted that domestic market milk in the various classes sells for between CDN $49.48 and CDN $56.06 while the United States gave an average of CDN $52.92 per hectolitre. Canada did not contest these figures.

down the price of CEM still further. Finally, to the extent that milk sourced through IREP is substitutable and competitive with CEM, this would be yet another factor enabling processors to offer to transact for CEM at prices even below those for IREP-sourced milk. In this connection, we observe that the prices for CEM are on average lower than those for IREP-sourced milk.[411]

5.117 By virtue of the prohibition on diversion of CEM back into the domestic market, coupled with penalties, we consider that the Canadian government not only prevents the processor from seeking the highest return available for milk in the domestic market, but also ensures that the only option for a dairy processor producing a particular dairy product and wishing to sell beyond the amount manufactured through the supply of quota milk, is to produce for the export market.

5.118 Looking now from the perspective of the dairy *producer*, we note that the earlier Article 21.5 panel focused its inquiry primarily on the governmental action linked to the *sales* of CEM, not to the decision by the producer whether or not to *produce* milk for sale as CEM, and made findings only with respect to the link between governmental action and the decision to *sell*. [412]

5.119 We recall in this connection that Canada stresses that there is no governmental action obliging or driving producers to produce milk for the CEM market, invoking a statement by the Appellate Body to the same effect.[413] We also recall the Complainants' argument that the reason for why producers decide to produce milk for the CEM market is irrelevant, given that the Government does not provide any real choice as to where producers may sell non-quota milk once produced.[414]

5.120 From an economic perspective, it is clear to us that no meaningful distinction can be made between a producer's decision to *produce* non-quota milk and the decision where to *sell* that milk. These two decisions are in fact part and parcel of one integrated decision by any rational economic operator. Clearly, the decision to produce will be taken in light of the producer's costs and the sales options available, such that a producer will decide to produce only if in doing so that producer will be able to make profits or, at least, avoid making losses. In this sense, we agree with the Complainants that it may not be relevant to focus on the reasons why a producer may decide to produce. We consider that the question of whether governmental action "drives" producers to produce only becomes relevant where making sales would result in losses.

5.121 The Panel sees support for the above position in the Appellate Body's statement that governmental action can include "regulating the supply and price

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[411] We note that the price for IREP whole-milk powder is around CDN $32.45 per hectolitre, whereas the unweighted CEM price is around CDN $29 per hectolitre. cf. paras. 3.53, 3.54, 3.67, 3.74, 3.75 and footnotes 83 and 166 above.

[412] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, paras. 6.43-6.48 and 6.77.

[413] Para. 3.112 above.

[414] Paras. 3.121 – 3.122 above.

of milk in the domestic market"[415], and that "the existence of a demonstrable link [has to take account] of the particular governmental action … and its effects on payments made by a third person".[416] In this sense, all that is required is that there be governmental action, such as that regulating the supply and price of milk in the domestic market, the effect of which is that producers make payments to dairy processors. Thus, if governmental action makes possible sales into the CEM market which would otherwise be made at a loss, i.e., not allowing for recovery of fixed and variable costs, we consider, in line with the Appellate Body's statement, that there would then be a demonstrable link between governmental action and the financing of payments.

5.122 In respect of the case before us, the record confirms Canada's regulation of both the domestic in-quota price and volume of milk, as well as the prices for Class 5(d) and Class 4(m) milk.[417] As we understand it, the only sales option available to milk producers, not directly regulated by Canada, is that of the CEM market.

5.123 Due to the prohibition on selling non-quota milk at the in-quota price on the domestic market, the Canadian Government has foreclosed what would otherwise be the first-best option available to dairy producers, that of selling milk at the higher in-quota administered price. As a result of this prohibition, the only remaining options available are to produce and sell milk as CEM or as Class 4(m) animal feed, the latter yielding much lower returns. We note that the price of Class 4(m) animal feed is set by the Canadian Government at around CDN $10 per hectolitre.[418]

5.124 In our view, given the rational, profit-seeking motivations of private economic operators, and the regulation of the price for Class 4(m) by Canada, the Canadian Government ensures that the bulk of non-quota milk will be channelled into the CEM market; only a small fraction of non-quota milk – that which has not previously been pre-committed – will likely be sold as Class 4(m) animal feed.

5.125 In our assessment, the rational, profit-maximizing milk producer, in deciding whether to participate in the CEM market, will take into account the extent to which the income derived from selling milk at the in-quota price allows that producer to sell into the CEM market while at least recovering his or her marginal costs for that additional production. To the extent that the governmental support price for in-quota milk enables producers to cover their fixed and variable costs through production for sales at the in-quota price and make additional sales into the CEM market at marginal cost, we consider that a strong nexus exists.

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[415] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 112.
[416] *Ibid*., para. 115.
[417] Para. 2.2 above.
[418] Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 53, para. 6.52.

5.126 With reference to the case before us, we recall Canada's acknowledgement that, pursuant to its proposed method for calculating average total cost of production, approximately 23 per cent of milk producers would be unable to cover their fixed and variable costs in the CEM market.[419] We further recall that, in this connection, Canada's proposed method would exclude imputed costs of family labour, return to management, return to equity and production quota, as well as transport, marketing and administrative costs.[420] Nevertheless, we also recall that, in our view, all these costs are properly to be included in a calculation of the average total cost of production.[421]

5.127 If account is taken of these costs, it appears that, absent governmental support through the in-quota price, the percentage of Canadian dairy producers who would be unable to cover their fixed and variable costs through sales into the CEM market would be much higher than the 23 per cent posited by Canada. Indeed, as recalculated by New Zealand, and absent the Canadian support price for in-quota milk, fully 100 per cent of Canadian dairy producers would not be able to cover their fixed and variable costs in the CEM market.[422] Thus, in the circumstances of this case, the Panel considers that governmental action in the form of regulating the supply and price of in-quota milk produces significant effects on payments made by third persons, in that this governmental action cross-subsidizes many sales that otherwise would not be made or would at least constitute sales at a loss.

5.128 In addition, we recall that the support price for in-quota milk is set in accordance with the CDC Guidelines at a level that rewards only the 70 per cent more efficient dairy farmers.[423] The Panel notes that other sources of information from the Canadian news media, put forward by the Complainants, suggest that a substantially smaller percentage, between 25 and 39 per cent, of dairy farmers cover their costs under the in-quota price set in accordance with the CDC

[419] Paras. 3.66 and 3.70 above.
[420] See para. 5.76 above.
[421] See para. 5.85 above.
[422] New Zealand's Response to Question No. 33

A. Deciles of costs of production	B. Estimated imputed and marketing costs	C. Total costs of production	Percentage of producers	Cumulative percentage of producers
From CDA-9 CDN $ /hl	NZ rebuttal submission footnote 59 CDN $ /hl	C.=A.+B. CDN $ /hl	%	%
41.55-66.80	26	67.55-92.80	10	100
37.77-41.41	26	63.77-67.41	10	90
35.32-37.43	26	61.32-63.43	10	80
33.36-35.25	26	59.36-61.25	10	70
31.74-33.35	26	57.74-59.35	10	60
29.40-31.72	26	55.40-57.72	10	50
27.05-29.33	26	53.05-55.33	10	40
24.84-26.96	26	50.84-52.96	10	30
22.37-24.71	26	48.37-50.71	10	20
7.01-22.07	26	33.01-48.07	10	10

[423] Para. 3.23 above.

Guidelines.[424] In these circumstances, the Panel considers it likely that for a significant percentage of Canadian dairy farmers who are just barely able to cover both their fixed and variable production costs through in-quota domestic sales, the level of the in-quota price creates a strong inducement – to the extent these farmers can cover their marginal costs – to produce additional milk for sale into the CEM market.

5.129 Even though we consider that the governmental action of regulating the supply and price of milk in the domestic market produces effects on and is demonstrably linked to the financing of payments by producers, our analysis here should not be read to suggest that Article 9.1(c) requires that the governmental action *directly* finance payments made by independent economic operators. On the contrary, the Panel considers that the ordinary meaning of Article 9.1(c), and in particular the phrase " … whether or not a charge on the public account is involved … ", makes clear that governmental action need not directly finance payments. This reading has been expressly endorsed by the Appellate Body.[425]

5.130 In addition to the impact of cross-subsidization on the financing of payments by third parties, we also consider that the regulatory policy of "pre-commitment" may also have a similar impact. In our view, a rational, profit-maximizing producer who has purchased an entitlement to sell at the high in-quota price will clearly want to fill the amount of quota he or she holds and will therefore be likely to err on the side of slight overproduction[426], thus ensuring full use of the entitlement. The rational producer in these circumstances will opt for pre-committing milk production as CEM rather than face having to dispose of the milk as Class 4(m) animal feed.[427] Because of the relative unattractiveness of the price for Class 4(m) milk and because a producer cannot channel any non-quota milk that has not been pre-committed into the CEM market, the Panel considers that the policy of pre-commitment, in those provinces where it is required by law[428], provides an additional incentive to pre-commit a larger quantity of milk than the producer would market as CEM if able to allocate to that market *ex post*.

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[424] New Zealand's Exhibit NZ-7, citing press releases from the Dairy Farmers of Canada Board of Directors and the Dairy Farmers of Ontario; United States' Response to Question No. 33, citing US Exhibit 22 from the first Article 21.5 proceeding.

[425] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115; Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 108.

[426] See footnote 85.

[427] The Panel recognizes that producers who have pre-committed milk as CEM, but who are unable to meet their pre-commitment obligation, may be penalized through the operation of the governmental "first-out-of-the-tank" policy whereby the government reallocates milk produced under quota to make up for any shortfall in CEM pre-commitments. Canada's Exhibit CDA-13D in Panel Report, *Canada – Dairy,(Article 21.5 – New Zealand and US)*. However, in our view, this policy does not remove the producer incentives to pre-commit.

[428] Para. 3.65 above, citing Canada's Exhibit CDA-10. We note that the three provinces concerned, Ontario, Quebec and Manitoba, account for the bulk of all Canadian milk production, i.e., approximately 80 per cent.

(iv) The SCM Agreement as Contextual Guidance for Article 9.1 of the Agreement on Agriculture

5.131 We recall Canada's argument that the concept of export subsidies found in Article 9.1 should be interpreted with reference to Article 1.1(a)(1), and particularly Article 1.1(a)(1)(iv), of the *SCM Agreement* as context.[429] On this point, the Complainants argue that Canada is improperly seeking to narrow the scope of the *Agreement on Agriculture*.[430] Specifically, they assert that the concept of "financial contribution" in Article 1.1(a)(1) of the *SCM Agreement* has no relevance to Article 9.1(c) of the *Agreement on Agriculture* which is concerned with "payments".[431] Similarly, they state, the words "entrust[ing] or direct[ing]" in Article 1.1(a)(1)(iv) of the *SCM Agreement* has no bearing on the interpretation of Article 9.1(c) of the *Agreement on Agriculture*.[432]

5.132 In the present case, because we consider that there is a demonstrable link between governmental action and the financing of payments within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, we do not see any need to consider whether Article 1.1(a)(1) or Article 1.1(a)(1)(iv) of the *SCM Agreement* may provide relevant context. In addition, we again take note of the Appellate Body's statement that "payment" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* may include a payment made by third parties.[433] In this sense, we agree with the Complainants' arguments that Article 1.1(a)(1) of the *SCM Agreement* has a narrower meaning than Article 9.1(c) of the *Agreement on Agriculture* as interpreted by the Appellate Body. For this same reason, we see no justification for looking to the specific example of "financial contribution *by a government*" found in Article 1.1(a)(1)(iv), invoked by Canada. Again, "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* may be made by third parties. Moreover, no Party has ever suggested that the notion of government entrusting or directing private bodies to make financial contributions normally made by a government, within the meaning of Article 1.1(a)(1), has any relevance to this case.

(d) Conclusion as to Whether Payments are "financed by virtue of governmental action"

5.133 The Panel recalls its finding in paragraph 5.98 above that the Complainants make a *prima facie* case of a demonstrable link between governmental action and the financing of payments.

5.134 In light of our analysis above, the Panel *finds* that Canada, pursuant to Article 10.3, has failed to establish that governmental action – in the form of the exemption of CEM processors from paying the higher in-quota price, the

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[429] See para. 5.78 above.
[430] Para. 3.86 above.
[431] Para 3.88 above.
[432] *Ibid*.
[433] Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 113; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 96 and 115.

prohibition on the diversion of CEM back into the domestic regulated market, the cross-subsidization provided through the in-quota price and the mandated pre-commitment policy – is not demonstrably linked to the financing of payments.

5.135 The Panel therefore *finds* that payments are "financed by virtue of governmental action" within the meaning of Article 9.1(c).

4. Conclusion on Article 9.1(c) of the Agreement on Agriculture

5.136 Having found in paragraph 5.89 above that "payments" are being made, and in paragraph 5.135 above that payments are "financed by virtue of governmental action", and because the Parties have not contested the finding of the first Article 21.5 panel that any payments are made "on the export" of processed dairy products, the Panel *finds* that Canada provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

E. Article 3.3 of the Agreement on Agriculture

5.137 Having found that CEM exports are being subsidized within the meaning of Article 9.1(c), the Panel recalls the original panel's[434] and the Appellate Body's[435] findings that, as acknowledged by Canada[436], Class 5(d) exports are also subsidized within the meaning of Article 9.1(c). Since it is uncontested that Canada's exports of cheese and "other milk products" exceed Canada's export subsidy reduction commitment levels, the Panel *finds* that Canada has provided export subsidies in respect of cheese and "other milk products" in excess of its quantity commitment levels specified in its Schedule, and is therefore in breach of Article 3.3 of the *Agreement on Agriculture*.

F. Whether Export Subsidies Exist Within the Meaning of Article 10.1 of the Agreement on Agriculture

1. Introduction

5.138 In the alternative to their claims under Article 9.1(c), the Complainants have made claims under Article 10.1 of the *Agreement on Agriculture*. Canada claims that it does not provide export subsidies within the meaning of Article 10.1.

5.139 Article 10.1 provides as follows:

> "Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-

[434] Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.113.
[435] Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 124.
[436] Para. 2.2 above; Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 8.1 and Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para 144.

> commercial transactions be used to circumvent such commitments."

5.140 The Panel recalls that the original panel in *Canada – Dairy*, in its finding under that Article, considered that the elements of an Article 10.1 subsidy are whether there are: (1) export subsidies not listed in paragraph 1 of Article 9; and whether any such export subsidies are (2) applied in a manner resulting in or threatening to lead to circumvention of export subsidy commitments.[437] We note that, as the Appellate Body has stated, because Article 10.1 is residual in character to Article 9.1, a measure listed as an export subsidy in Article 9.1 cannot simultaneously be an export subsidy under Article 10.1.[438] We also recall that, as the original panel in *Canada – Dairy* stated, "measures which meet some but not all the definitional elements of the individual export subsidy practices listed in Article 9.1 would be covered by Article 10.1, provided that they meet the basic requirement of Article 1(e) that they are 'subsidies contingent upon export performance'."[439]

5.141 We have earlier examined whether or not there is an export subsidy within the meaning of Article 9.1(c), and found that an export subsidy within the meaning of Article 9.1(c) exists. However, should our finding under Article 9.1(c) be reversed on appeal, this would mean that at least one of the definitional elements of this provision would not be present. Accordingly, in order to resolve the matter in dispute, we consider it advisable to proceed to examine the Parties' claims and arguments under Article 10.1.

5.142 In recalling our consideration on the operational interpretation of Article 10.3 in paragraphs 5.18-5.19 above and in accordance with our analysis under Article 9.1(c), the Panel will first determine whether the Complainants make a *prima facie* case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture.* Provided we find that the Complainants make a *prima facie* case that export subsidies within the meaning of Article 10.1 exist, it will then be for Canada to attempt to discharge its burden, pursuant to Article 10.3, of establishing that no such export subsidies exist. Similarly, assuming the Panel finds that the Complainants provide a *prima facie* showing that the manner of application of such export subsidies results in or threatens to result in circumvention of export subsidy commitments, it will be for Canada, pursuant to Article 10.3, to establish that the manner of application does not result in or threaten to lead to circumvention of these commitments. In the same vein, should the Panel find that the Complainants make out a *prima facie* case that non-commercial transactions are being used by Canada to circumvent its

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[437] We note that the panel did not address the second phrase of Article 10.1 and considered that the first sentence comprised two elements. Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, paras. 7.118 and 7.120. We recall that the Appellate Body, in discerning the meaning of "to circumvent", noted the dictionary definition of the term as meaning "to find a way round, evade … ". Appellate Body Report, *US – FSC*, para. 148.

[438] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, *supra*, footnote 1, para. 121.

[439] Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.125.

export subsidy reduction commitment levels, it will then be for Canada to establish the contrary.

2. Whether "export subsidies" Exist

5.143 The first issue to be addressed under Article 10.1 is whether or not one or more of the definitional elements of an Article 9.1 subsidy is absent. Here, since the Complainants have only alleged one specific type of Article 9 export subsidy, that found under Article 9.1(c), we need only exclude the simultaneous applicability of Article 9.1(c) and Article 10.1, and not that of the other sub-paragraphs of Article 9.1 setting forth other types of export subsidies.[440] Although we have found all definitional elements of an Article 9.1(c) export subsidy to be present, we shall assume for the purpose of our analysis under Article 10.1 that one or more of the definitional elements of an Article 9.1(c) export subsidy is not present.

(a) Whether the Complainants Make a *prima facie* Case

5.144 The Complainants argue that the *SCM Agreement* and especially paragraph (d) of the *Illustrative List of Export Subsidies* in Annex I[441], as well as Article 1.1(a)(2) of the *SCM Agreement*[442], provide useful interpretative guidance under Article 10.1 of the *Agreement on Agriculture* on whether subsidies contingent on export performance exist. The United States argues that because the question in this dispute is one of export subsidies, it is more appropriate, as stated by the panel in the original *Canada – Dairy* case, "to examine what practices are considered under the *SCM Agreement* to be 'export subsidies', rather than to examine how that agreement defines the more general concept of a 'subsidy' in its Article 1."[443]

5.145 The Complainants state that the CEM scheme fulfils the elements of paragraph (d) of the *Illustrative List* because: (1) the goods are provided on terms more favourable than those for like goods for domestic consumption, since CEM prices are lower than those for domestic milk[444]; (2) the provision of goods is made or mandated by governments for export as a result of the governmentally created and enforced prohibition on sale in the domestic market and because the lower prices are available only for export[445]; (3) the goods are available on terms more favourable than those commercially available on world export markets because of the relative unattractiveness of IREP, i.e., the in-quota tariff, the

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[440] Even if it could be argued that the Panel, on its own initiative and despite the lack of any argumentation on the issue, would need to exclude all types of export subsidies listed in Article 9.1, a cursory review of that provision suggests to us that all those types listed involve direct forms of subsidies.

[441] Para. 3.131 above.

[442] Para. 3.153 above.

[443] Para. 3.146 above.

[444] Para. 3.132 above.

[445] Para. 3.133 above.

discretionary issuance of the permit and payment of the permit fee, in comparison to CEM, and the processor's choice thus does not depend on commercial considerations.[446]

5.146 The United States also argues that IREP whole-milk powder is not fully substitutable with fluid milk and that additional costs arise in connection with rehydration.[447]

5.147 The Complainants further contend that Article 1.1(a)(2) of the *SCM Agreement* provides relevant context to the interpretation of "export subsidy" in Article 10.1 of the *Agreement on Agriculture*.[448] They allege that the CEM system is one providing "income or price support … which operates directly or indirectly to increase exports" because the government has created a system which makes milk available to processors for export at below both its domestic price and its average total cost of production.[449]

5.148 Recalling our statement in paragraph 5.142 above, the Panel *finds* that the Complainants' case, as described in paragraphs 5.144-5.147 above, provides a *prima facie* showing that export subsidies within the meaning of Article 10.1 exist, such that Canada can reasonably attempt to discharge its burden, under Article 10.3 of the *Agreement on Agriculture*, of establishing that no export subsidies exist.

(b) Canada's Case on Whether "export subsidies" Exist

5.149 Canada argues that because there is an issue as to the meaning of "indirectly through government-mandated schemes", as set forth in paragraph (d) of Annex I of the *SCM Agreement*, it is necessary to have recourse to the general definition of "subsidy" set out in Article 1.1 of the *SCM Agreement*.[450] In this context, Canada specifically references the definition provided in Article 1.1(a)(1)(iv), according to which a government "entrusts or directs a private body" to provide goods through delegation or an authoritative instruction or command.[451] Canada maintains that the government has not instructed individual producers to provide CEM to processors but rather that they enter into commercial transactions on their own volition.[452]

5.150 Moreover, Canada contends that Canada's regulation of its dairy industry does not meet the definitional requirements of paragraph (d) of the *Illustrative List*.[453] In this connection, Canada asserts that the meaning of "indirect" in paragraph (d) should be interpreted consistently with the meaning of that term as

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446 Paras. 3.134 - 3.135 above.
447 Para. 3.144 above.
448 Para 3.153 above.
449 *Ibid*.
450 Para. 3.147 above.
451 Para. 3.148 above.
452 *Ibid*.
453 Para. 3.139 above.

it appears in Article 1.1 of the *SCM Agreement*.[454] Specifically, Canada maintains that there is no provision of products through a government mandated scheme because the government does not command or direct producers to produce CEM.[455] Canada also disputes that the prices under IREP are less favourable than prices for CEM because, in its view, the Appellate Body has already rejected that the existence of administrative formalities mean that imports are available on terms and conditions that are less favourable.[456] Tariffs, in Canada's view, fall into the same category as administrative formalities.[457] Finally, Canada submits that there is no independent requirement that a subsidy illustrated in paragraph (d) be shown to be contingent on export performance because "every subsidy illustrated in Annex I of the *SCM Agreement* is by definition an Article 1.1 'subsidy' that is contingent on export performance".[458]

5.151 In reference to Article 1.1(a)(2), Canada asserts that to conclude that because Canada does not prevent sales of CEM from occurring at prices mutually agreed to between buyer and seller Canada is thereby "supporting" the income generated by these sales is inconsistent with the concept of "support".[459]

(c) Panel's Examination of Whether "export subsidies" Exist

5.152 On the issue of how to give definition to the term "export subsidies" in Article 10.1, the Panel recalls that the Parties disagree as to whether reference to the *Illustrative List* found in Annex I of the *SCM Agreement* should be made in this case for contextual guidance.[460]

5.153 We note that Article 1(e) of the *Agreement on Agriculture* defines "export subsidies" as "subsidies contingent upon export performance", which is essentially identical to the definition of prohibited export subsidies found in Article 3.1(a) of the *SCM Agreement*. Moreover, Article 3.1(a) includes within the concept of "subsidies contingent upon export performance", those subsidies illustrated in Annex I. Accordingly, and in line with the approach adopted by the original panel on *Canada – Dairy*, we consider it appropriate to turn first to Article 3.1(a) of the *SCM Agreement* and the *Illustrative List* in Annex I to that Agreement as contextual guidance for the term "export subsidies" as contained in Article 10.1 of the *Agreement on Agriculture*.

5.154 WTO jurisprudence confirms that all of the practices identified in the *Illustrative List* of the *SCM Agreement* are subsidies contingent upon export performance, within the meaning of Article 3.1(a).[461] We note that the panel in *Brazil – Aircraft (Article 21.5 (I))* analogized the *Illustrative List* to a list of *per*

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[454] Para. 3.137 above.
[455] Paras. 3.139 and 3.142 above.
[456] Canada's Executive Summary, para. 41.
[457] Canada's Executive Summary, para. 42.
[458] Para. 3.137 above.
[459] Para. 3.162 above.
[460] See paras. 5.144 and 5.149 above.
[461] Panel Report, *Canada – Autos*, para. 10.197; Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, para. 6.42.

se violations.[462] This reasoning was implicitly endorsed by the Appellate Body in reviewing that panel's decision.[463] We therefore consider that we need not first turn to Article 1.1(a)(1), and particularly not Article 1.1(a)(1)(iv). In this connection, we note that in the first Article 21.5 compliance case in *Brazil – Aircraft*, Canada actually argued to the panel that the *Illustrative List* should be considered a *per se* list of prohibited export subsidies.[464] Neither do we think it necessary to have recourse to Article 1.1(a)(2), which the Complainants suggest also provides interpretative guidance for the meaning of "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

5.155 We shall accordingly examine the Parties' claims in relation to paragraph (d) of the *Illustrative List*, as interpretative guidance, to determine whether Canada provides a valid defence to the claim that export subsidies, within the meaning of Article 10.1 of the *Agreement on Agriculture*, exist.

5.156 Paragraph (d) of the *Illustrative List* provides in relevant part as follows:

> "The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of imported or domestic products … for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products … for use in the production of goods for domestic consumption, if … such terms or conditions are more favourable than those commercially available[57] on world markets to their exporters.
>
> [57] *(footnote original)* The term 'commercially available' means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations".

5.157 We understand that, as stated by the original panel in *Canada - Dairy*[465], paragraph (d) requires the presence of three elements: (1) the provision of products for use in export production on terms more favourable than for provision of like products for use in domestic production; (2) by governments either directly or indirectly through government mandated schemes; and (3) on terms more favourable than those commercially available on world markets.

5.158 As for the first element, the Panel notes it is uncontested that CEM prices are lower than the in-quota price of milk on the domestic market. As Canada considers it unnecessary to contest this first element[466], the Panel need not examine this issue further.

5.159 With respect to the second element, the Panel recalls Canada's contention that the regulation of its dairy industry does not meet some of the definitional requirements of paragraph (d) of the *Illustrative List*.[467] First, we note that

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[462] Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, *supra*, footnote 169, para. 6.42.
[463] Appellate Body Report, *Brazil – Aircraft (Article 21.5 (I))*, DSR 2000:VIII, 4067, para. 61.
[464] Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, Annex 1-2: Canada's Rebuttal Submission, para. 26.
[465] Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.128.
[466] Canada's First Submission, para. 102.
[467] See para. 5.150 above.

Canada asks us to interpret the meaning of "indirect" in paragraph (d) in accordance with the meaning of that term as it appears in Article 1.1 of the *SCM Agreement* and, accordingly, to find that there is no provision of products through a government mandated scheme because the government does not command or direct producers to produce CEM.[468] We also note the Complainants' response to the effect that the provision of goods is made or mandated by government for export as a result of the governmentally created and enforced prohibition on diversion of CEM into the domestic regulated market and because the lower prices for CEM are available only for export.[469]

5.160 On the interpretation of the term "indirect", we do not consider Canada's proposed reference to the terms "entrust[ing] or direct[ing] a private body … ", as contained in Article 1.1(a)(1)(iv), to be relevant to the type of governmental involvement at issue in this case. Moreover, we recall our analysis under Article 9.1(c) of the *Agreement on Agriculture*, in which we found a demonstrable link between payments and the financing by virtue of governmental action without such a degree of directness as that being called for by Canada under Article 10.1.[470] We observe that given the residual character of Article 10.1, which comes into operation only if one of the elements of an Article 9.1 export subsidy is not present, for us to rely on Canada's proposed interpretation would unduly narrow Article 10.1, thus depriving it of meaning. Rather, as the Complainants argue, we consider that the provision of goods is made or mandated by government for export as a result of the prohibition on diversion of CEM back into the domestic regulated market and the exemption which gives processors for export access to the lower CEM prices.

5.161 As for the third element, we recall our earlier observation that IREP prices are on average higher than CEM prices.[471] Based on the arguments and evidence before this Panel, we consider that the combination of the discretionary nature of the IREP permit, the permit fee itself, the in-quota tariff on IREP milk, the formalities associated with obtaining duty drawback, the limited substitutability of IREP imports and the costs of rehydration of IREP dried milk, not only make IREP milk products more expensive than CEM but generally make it a less favourable option.[472]

5.162 Finally, since Canada considers that there is no independent requirement that a subsidy illustrated in paragraph (d) be shown to be contingent on export performance because "every subsidy illustrated in Annex I of the *SCM Agreement* is by definition an Article 1.1 'subsidy' that is contingent on export performance", we decline to independently examine whether Canada's CEM system is contingent on export performance, within the meaning of paragraph (d) of the *Illustrative List*.

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[468] See para. 5.150 above.
[469] See para. 5.145 above.
[470] See paras. 5.134-5.135 above.
[471] See para. 5.116 and footnote 411 above.
[472] See paras. 5.145-5.146 above.

(d) Conclusion as to Whether "export subsidies" Exist

5.163 The Panel recalls its finding in paragraph 5.148 above that the Complainants make a *prima facie* case that export subsidies within the meaning of Article 10.1 exist.

5.164 In light of our analysis in paragraphs 5.152-5.162 above the Panel *finds* that Canada has failed to establish that any of the three required elements of an export subsidy illustrated in paragraph (d) of the *Illustrative List* is not present and that it has therefore also failed to establish that no export subsidies within the meaning of Article 10.1 exist.

5.165 Accordingly, we *find* that Canada provides export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

3. Whether there is Circumvention of Export Subsidy Commitments or a Threat Thereof

5.166 Recalling our considerations set out in paragraphs 5.18-5.19 and in paragraph 5.142 above, the Panel will first examine whether the Complainants make out a *prima facie* case that export subsidies are applied in a manner leading to or threatening to lead to circumvention of export subsidy reduction commitment levels.

(a) Whether the Complainants Make a *prima facie* Case on Circumvention

5.167 The Complainants contend that exporting or adopting measures enabling the export of subsidized products in excess of reduction commitment levels raises a presumption of circumvention or threat thereof.[473] The Complainants both argue that because of this presumption, to the extent that dairy products have been exported in excess of Canada's reduction commitment levels, there has been actual circumvention.[474] Because there is no government imposed limit on the amounts of dairy products that may be exported, and because Canada enables subsidization of exports, the Complainants argue, there is a threat of circumvention.[475]

5.168 The Panel, in recalling its finding in paragraph 5.148 and its statement in paragraph 5.166 above, *finds* that the exposition of the Complainants' case in paragraph 5.167 constitutes a *prima facie* case of circumvention or threat thereof such that Canada can reasonably attempt to discharge its burden under Article 10.3 of establishing that the manner of application of export subsidies does not result in or threaten to lead to circumvention of export subsidy reduction commitment levels.

[473] The Panel notes that while only New Zealand explicitly makes this argument, the United States also implicitly makes the same point. See para. 3.165 above.
[474] Paras. 3.165 and 3.168 above.
[475] Paras. 3.165 and 3.167 – 3.168 above.

(b) Canada's Case on Circumvention

5.169 Canada claims that because it does not provide an export subsidy, it is not circumventing its export subsidy commitments. [476] For this reason, Canada argues that the issue of circumvention is moot.[477]

(c) Panel's Examination of the Issue of Circumvention

5.170 The Panel recalls that it is for Canada, pursuant to Article 10.3, to establish that export subsidies are not being applied so as to circumvent or threaten to circumvent Canada's export subsidy commitments. We take note of Canada's argument that the issue of circumvention becomes moot because it is not providing either a subsidy or an export subsidy.[478] However, as we have found at paragraph 5.165 above that Canada is providing export subsidies of a type other than those listed in Article 9.1, we do not consider that the issue of circumvention is moot.

(d) Conclusion on the Issue of Circumvention

5.171 The Panel recalls its finding in paragraph 5.168 above that the Complainants make a *prima facie* showing of circumvention or threat of circumvention of export subsidy reduction commitment levels.

5.172 In light of our consideration in paragraph 5.170 above and because Canada does not make any further arguments on this issue, the Panel *finds* that Canada has failed to establish that export subsidies are not being applied so as to circumvent or threaten to circumvent Canada's export subsidy commitments.

5.173 We therefore also *find* that the manner of application of export subsidies circumvents or threatens to circumvent Canada's export subsidy commitments, within the meaning of Article 10.1.

4. Conclusion on Article 10.1

5.174 Recalling our findings at paragraphs 5.165 and 5.173 above, we *find* that Canada is applying export subsidies of a type not listed in Article 9.1 in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments, inconsistently with Article 10.1 of the *Agreement on Agriculture*. We emphasize that this finding is made in the alternative, in the event that our finding in paragraph 5.136 above with respect to Article 9.1(c) would be overturned on appeal.

5.175 Because we have already found in the previous paragraph that Canada has acted inconsistently with its obligations under Article 10.1, we consider it appropriate to exercise judicial economy with respect to the Parties' additional

[476] Para. 3.169 above.
[477] *Ibid.*
[478] See para. 5.169 above.

claims on whether "non-commercial transactions" are used to circumvent export subsidy commitments.

G. Whether or not Export Subsidies not in Conformity with the Agreement on Agriculture and the Commitments Specified in Canada's Schedule are Provided, Within the Meaning of Article 8 of the Agreement on Agriculture

5.176 Recalling that Article 8 of the *Agreement on Agriculture* provides that "[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement", we also *find* that as a consequence of the violations of either Article 3.3 (through Article 9.1(c)) or Article 10.1, Canada has acted inconsistently with its obligations under Article 8.

H. Whether or not Canada Provides Prohibited Export Subsidies Within the Meaning of Article 3.1 of the SCM Agreement

5.177 The United States claims, in addition, that Canada's measure is an export subsidy within the meaning of Article 3.1 of the *SCM Agreement*. Canada, in contrast, disputes this claim.

5.178 Because the Panel has found that export subsidies exist, within the meaning of Article 9.1(c) or, in the alternative, Article 10.1 of the *Agreement on Agriculture*, we consider we have made findings sufficient to resolve the matter in dispute. Should the Appellate Body, however, not uphold our finding under Article 9.1(c) and our alternate finding under Article 10.1, we deem the factual record to be complete with respect to making a finding under Article 3.1 of the *SCM Agreement*.

VI. CONCLUSIONS AND RECOMMENDATIONS

6.1 In light of the findings contained in Section V above, the Panel *concludes* that Canada, through the CEM scheme and the continued operation of Special Milk Class 5(d), has acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, by providing export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in excess of its quantity commitment levels specified in its Schedule for exports of cheese and "other dairy products". In light of our alternative finding in Section V that Canada has acted inconsistently with its obligations under Article 10.1 of the *Agreement on Agriculture*, we conclude that Canada has acted inconsistently with its obligations under Article 8 of the *Agreement on Agriculture*.

6.2 Since Article 3.8 of the *DSU* provides that "[i]n cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment", the Panel *concludes* that – to the extent Canada has acted inconsistently with its obligations under the *Agreement on Agriculture* – it has nullified or impaired benefits accruing to New Zealand and the United States under this Agreement.

6.3 The Panel *recommends* that the Dispute Settlement Body request Canada to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the *Agreement on Agriculture*.

VII. ANNEX

Abbreviations Used for Dispute Settlement Cases Referred to in the Report

Short title	Full Title
Brazil – Desiccated Coconut	Report of the panel *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/R, adopted 20 March 1997
Brazil – Aircraft	Report of the Appellate Body *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999
Brazil – Aircraft Article 21.5 (I)	Report of the panel *Brazil - Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, 9 May 2000
Canada – Aircraft	Report of the Appellate Body *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999
Canada – Autos	*Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139-WT/DS142
Canada – Dairy	Report of the panel *Canada Dairy – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/R, WT/DS113/R, adopted 27 October 1999
Canada – Dairy	Report of the Appellate Body *Canada Dairy – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R, adopted 27 October 1999
Canada – Dairy (Article 21.5 - New Zealand and US)	Report of the panel *Canada Dairy – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/RW, WT/DS113/RW, adopted 18 December 2001
Canada – Dairy (Article 21.5 - New Zealand and US)	Report of the Appellate Body *Canada Dairy – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, recourse to Article 21.5 of the DSU by New Zealand and the United States, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001
Canada – Export Credits	Report of the panel *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002
India – Patents	Report of the Appellate Body *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998
US – Export Restraints	Report of the panel *United States – Measures Treating*

Short title	Full Title
	Export Restraints as Subsidies, WT/DS194/R, adopted 23 August 2001
US – FSC	Report of the Appellate Body *United States - Tax Treatment of Foreign Sales Corporations*, WT/DS108/AB/R, adopted 20 March 2000
United States – FSC Article 21.5	Report of the Appellate Body *United States - Tax Treatment for 'Foreign Sales Corporations recourse to Article 21.5 of the DSU*, WT/DS108/AB/RW, adopted 29 January 2002

UNITED STATES – CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

Report of the Appellate Body
WT/DS217/AB/R,
WT/DS234/AB/R

Adopted by the Dispute Settlement Body
on 27 January 2003

United States – *Appellant*
Australia – *Appellee*
Brazil – *Appellee*
Canada – *Appellee*
Chile – *Appellee*
European Communities – *Appellee*
India – *Appellee*
Indonesia – *Appellee*
Japan – *Appellee*
Korea – *Appellee*
Mexico – *Appellee*
Thailand – *Appellee*
Argentina – *Third Participant*
Costa Rica – *Third Participant*
Hong Kong, China – *Third Participant*
Israel – *Third Participant*
Norway – *Third Participant*

Present:
Sacerdoti, Presiding Member
Baptista, Member
Lockhart, Member

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Argentina – Footwear (EC)	Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:I, 515.
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.
Canada – Dairy	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R and Corr.1, adopted 27 October 1999, DSR 1999:V, 2057.
Chile – Alcoholic Beverages	Appellate Body Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281.
EC – Bananas III	Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591.
EC – Bananas III (US)	Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by the United States*, WT/DS27/R/USA, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 943.
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.
EC – Sardines	Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002.
India – Patents (US)	Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9.
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97.
Korea – Dairy	Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted

Short Title	Full Case Title and Citation
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Mexico – Corn Syrup (Article 21.5 – US)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001.

Short Title	Full Case Title and Citation
US – 1916 Act	Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000.
US – 1916 Act (EC)	Panel Report, *United States – Anti-Dumping Act of 1916 – Complaint by the European Communities*, WT/DS136/R and Corr.1, adopted 26 September 2000, as upheld by the Appellate Body Report, WT/DS136/AB/R, WT/DS162/AB/R.
US – 1916 Act (Japan)	Panel Report, *United States – Anti-Dumping Act of 1916 – Complaint by Japan*, WT/DS162/R and Add.1, adopted 26 September 2000, as upheld by the Appellate Body Report, WT/DS136/AB/R, WT/DS162/AB/R.
US – Certain EC Products	Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001.
US – Countervailing Measures on Certain EC Products	Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003. Panel Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/R, adopted 8 January 2003, as modified by the Appellate Body Report, WT/DS212/AB/R.
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619.
US – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3.
US – Hot-Rolled Steel	Appellate Body Report, *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, WT/DS184/AB/R, adopted 23 August 2001.

US – Norwegian Salmon AD	Panel Report, *Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, adopted 27 April 1994, BISD 41S/I/229.
US – Offset Act (Byrd Amendment)	Panel Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/R, WT/DS234/R, 16 September 2002.
US – Section 110(5) Copyright Act	Panel Report, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/R, adopted 27 July 2000.
US – Section 129(c)(1) URAA	Panel Report, *United States – Section 129(c)(1) of the Uruguay Round Agreements Act*, WT/DS221/R, adopted 30 August 2002.

Short Title	Full Case Title and Citation
US – Section 211 Appropriations Act	Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002.
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755.
US – Underwear	Appellate Body Report, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WT/DS24/AB/R, adopted 25 February 1997, DSR 1997:I, 11.

I. INTRODUCTION

1. The United States appeals certain issues of law and legal interpretations developed in the Panel Report, *United States – Continued Dumping and Subsidy Offset Act 2000* (the "Panel Report").[1]

2. On 12 July 2001, Australia, Brazil, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand requested the establishment of a panel to examine the WTO-consistency of the United States Continued Dumping and Subsidy Offset Act of 2000 (the "CDSOA").[2] At its meeting of 23 August 2001, the Dispute Settlement Body (the "DSB") established the Panel.

3. On 10 August 2001, Canada and Mexico separately requested the establishment of a panel with respect to the same matter.[3] At its meeting of 10 September 2001, the DSB agreed to those requests and, pursuant to Article 9.1 of

[1] WT/DS217/R, WT/DS234/R, 16 September 2002.
[2] WT/DS217/5. Referred to in the Panel Report also as the "Byrd Amendment" and the "Offset Act".
[3] WT/DS234/12 and WT/DS234/13.

the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), referred the matter to the Panel established on 23 August 2001.[4]

4. Australia, Brazil, Canada, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico and Thailand (the "Complaining Parties") argued before the Panel that the CDSOA is inconsistent with Articles 18.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*"), in conjunction with Article VI:2 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"), and Article 1 of the *Anti-Dumping Agreement*; Article 32.1 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"), in conjunction with Article VI:3 of the GATT 1994 and Articles 4.10, 7.9 and 10 of the *SCM Agreement*; Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*; and Article XVI:4 of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"), Article 18.4 of the *Anti-Dumping Agreement* and Article 32.5 of the *SCM Agreement*. In addition, with the exception of Australia, the Complaining Parties contended that the CDSOA is in violation of Article X:3(a) of the GATT 1994, Article 8 of the *Anti-Dumping Agreement* and Article 18 of the *SCM Agreement*. Furthermore, in a separate claim, Mexico argued that the CDSOA is in violation of Article 5(b) of the *SCM Agreement*, and India and Indonesia asserted that the CDSOA undermines Article 15 of the *Anti-Dumping Agreement*.

5. In the Panel Report, circulated to the Members of the World Trade Organization (the "WTO") on 16 September 2002, the Panel found that the CDSOA is inconsistent with Articles 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement*; Articles 11.4, 32.1 and 32.5 of the *SCM Agreement*; Articles VI:2 and VI:3 of the GATT 1994; and Article XVI:4 of the *WTO Agreement*.[5]

6. The Panel concluded that the CDSOA nullifies or impairs benefits accruing to the Complaining Parties under the *Anti-Dumping Agreement*, the *SCM Agreement* and the GATT 1994 to the extent that the CDSOA is inconsistent with those agreements.[6] Consequently, the Panel recommended that the DSB request the United States to bring the CDSOA into conformity with its obligations under the *Anti-Dumping Agreement*, the *SCM Agreement* and the GATT 1994.[7]

7. On 18 October 2002, the United States notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the DSU, and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").[8] On 28 October

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4 WT/DS234/14.
5 Panel Report, para. 8.1.
6 *Ibid*., para. 8.4.
7 *Ibid*., para. 8.5.
8 WT/DS217/8, WT/DS234/16, 22 October 2002.

2002, the United States filed its appellant's submission.[9] On 12 November 2002, Australia, Brazil, Canada, Korea and Mexico each filed a separate appellee's submission.[10] The European Communities, India, Indonesia and Thailand filed a joint appellees' submission. Japan and Chile also filed a joint appellees' submission. On the same day, Argentina, Hong Kong, China and Norway each filed a third participant's submission.[11] Israel and Costa Rica notified the Appellate Body of their intention to appear at the oral hearing as third participants.[12]

8. In a letter dated 22 November 2002, the Director of the Appellate Body Secretariat informed the participants and third participants that, in accordance with Rule 13 of the *Working Procedures*, the Appellate Body had selected Mr. Giorgio Sacerdoti to replace Mr. A.V. Ganesan as Presiding Member of the Division hearing this appeal. The latter was prevented from continuing to serve on the Division for serious personal reasons.

9. On 5 November 2002, Canada filed a request for a preliminary ruling in respect of certain questions of fact and law that it claimed were improperly included in the United States' appellant's submission, alleging that they were not included in the Notice of Appeal. The following day, we invited the United States and the other participants and third participants to comment on the issues raised by Canada in its request for a preliminary ruling, and set 8 November 2002 as the deadline for submission of comments. We received comments from the European Communities, India, Indonesia and Thailand (as joint appellees), Japan and the United States. By letter of 8 November 2002, the Director of the Appellate Body Secretariat informed the participants and third participants that we had decided not to issue a preliminary ruling, nor to make findings, at that stage, on the substance of Canada's submissions.

10. The oral hearing was held on 28 and 29 November 2002.[13] The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Appellate Body Division hearing the appeal.

II. FACTUAL BACKGROUND

11. The CDSOA was enacted on 28 October 2000 as part of the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act, 2001.[14] The CDSOA amended Title VII of the Tariff Act of 1930 (the "Tariff Act"), entitled "Countervailing and Antidumping Duties", by adding a new Section 754 entitled "Continued Dumping and Subsidy Offset".[15]

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[9] Pursuant to Rule 21(1) of the *Working Procedures*.
[10] Pursuant to Rule 22(1) of the *Working Procedures*.
[11] Pursuant to Rule 24(1) of the *Working Procedures*.
[12] Pursuant to Rule 24(2) of the *Working Procedures*.
[13] Pursuant to Rule 27 of the *Working Procedures.*
[14] Public Law 106-387, 114 Stat. 1549.
[15] Section 754 of the Tariff Act corresponds to Section 1675c of Title 19 of the United States Code.

12. The CDSOA provides that the United States Commissioner of Customs ("Customs") shall distribute, on an annual basis, duties assessed pursuant to a countervailing duty order, an anti-dumping duty order, or a finding under the United States Antidumping Act of 1921, to "affected domestic producers" for "qualifying expenditures".[16] An "affected domestic producer" is defined as a domestic producer that: (a) was a petitioner or interested party in support of the petition with respect to which an anti-dumping duty order, a finding under the Antidumping Act of 1921, or a countervailing duty order has been entered; and (b) remains in operation.[17] The term "qualifying expenditures" refers to expenditures on specific items identified in the CDSOA, which were incurred after the issuance of the anti-dumping duty finding, or order or countervailing duty order.[18] Those expenditures must relate to the production of the same product that is subject to the anti-dumping or countervailing duty order, with the exception of expenses incurred by associations which must relate to the same case.[19]

13. The CDSOA, together with its implementing regulations issued by Customs, provides that Customs shall establish a special account and a clearing account with respect to each countervailing duty order, anti-dumping duty order, or a finding under the Antidumping Act of 1921.[20] All anti-dumping and

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[16] The CDSOA provides that: "[d]uties assessed pursuant to a countervailing duty order, an antidumping duty order, or a finding under the Antidumping Act of 1921 shall be distributed on an annual basis under this section to the affected domestic producers for qualifying expenditures. Such distribution shall be known as 'the continued dumping and subsidy offset'." (Section 754(a) of the Tariff Act)

[17] Section 754(b)(1) of the Tariff Act defines "affected domestic producer" as:

> … any manufacturer, producer, farmer, rancher, or worker representative (including associations of such persons) that –
>
> > (A) was a petitioner or interested party in support of the petition with respect to which an anti-dumping duty order, a finding under the Antidumping Act of 1921, or a countervailing duty order has been entered, and
> >
> > (B) remains in operation.
>
> Companies, businesses, or persons that have ceased the production of the product covered by the order or finding or who have been acquired by a company or business that is related to a company that opposed the investigation shall not be an affected domestic producer.

[18] Section 754(b)(4) of the Tariff Act defines the term "qualifying expenditure" as "an expenditure incurred after the issuance of the antidumping duty finding or order or countervailing duty order in any of the following categories:

> (A) Manufacturing facilities.
> (B) Equipment.
> (C) Research and development.
> (D) Personnel training.
> (E) Acquisition of technology.
> (F) Health care benefits to employees paid for by the employer.
> (G) Pension benefits to employees paid for by the employer.
> (H) Environmental equipment, training, or technology.
> (I) Acquisition of raw materials and other inputs.
> (J) Working capital or other funds needed to maintain production."

[19] Section 159.61(c) of Title 19, Code of Federal Regulations ("C.F.R.").

[20] Section 754(e)(1) of the Tariff Act, 19 C.F.R. § 159.64(a)(1)(i).

countervailing duties assessed under such orders or findings are first deposited into a "clearing account".[21] Transfers from "clearing accounts" to "special accounts" are made by Customs throughout the fiscal year.[22] Such transfers are made only after the entries[23] in question that are subject to a countervailing duty order or an anti-dumping order or finding have been properly "liquidated".[24] Thus, when, and only when, the entries have been liquidated, will the proceeds be transferred to a special account. Only once there are funds in a special account (not a clearing account), can distributions to domestic producers under the CDSOA be made.[25] Therefore, if liquidation of entries has been enjoined, for instance, by a court—perhaps pending judicial review of the determination of dumping or countervailable subsidization—or if liquidation of entries has been suspended due to an administrative review of those entries, the relevant special account will be empty and no distribution can be made to domestic producers under the CDSOA.[26]

14. Pursuant to the CDSOA, Customs shall distribute all funds (including all interest earned on the funds) from the assessed duties received in the preceding fiscal year (and contained in the special accounts) to each affected domestic producer based on a certification by the affected domestic producer that it is eligible to receive the distribution and desires to receive a distribution for qualifying expenditures incurred since the issuance of the order or finding.[27] Funds deposited in each special account during each fiscal year are to be distributed no later than 60 days after the beginning of the following fiscal year.[28] There is no statutory or regulatory requirement as to how a disbursement is to be spent.[29] The Panel found that CDSOA distributions to "affected domestic producers" made as of December 2001 totalled over $206 million.[30]

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[21] 19 C.F.R. § 159.64(a)(2).

[22] 19 C.F.R. § 159.64(b)(1)(ii).

[23] Customs defines "entry" as the process of presenting documentation for clearing goods through customs following the arrival of the goods at a port. (See United States Import Requirements at www.customs.gov/impoexpo/import).

[24] 19 C.F.R. § 159.64(b)(1)(ii). The United States explained in its first written submission to the Panel that "[u]nder United States' law, liquidation is defined as the 'final computation or ascertainment of duties' – it is Customs' determination of the grand total to be paid by the importer." (United States' first written submission to the Panel, footnote 12.) Generally speaking, it may be said therefore that the United States uses a "retrospective" assessment system under which *final* liability for antidumping and countervailing duties is determined only *after* the goods have been imported. (See "Antidumping Duties; Countervailing Duties", United States Federal Register, 19 May 1997 (Volume 62, Number 96), p. 27392)

[25] 19 C.F.R. § 159.64(b)(1)(i).

[26] United States' first written submission to the Panel, para. 13.

[27] Sections 754(d)(2) and (3) of the Tariff Act.

[28] Section 754(c) of the Tariff Act.

[29] "Distribution of Continued Dumping and Subsidy Offset to Affected Domestic Producers", United States Federal Register, 21 September 2001 (Volume 66, Number 184), p. 48549. See also Panel Report, para. 7.37.

[30] Panel Report, para. 7.44.

III. ARGUMENTS OF THE PARTICIPANTS AND THE THIRD PARTICIPANTS

A. United States – Appellant

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

15. The United States claims that the Panel erred in finding that the CDSOA is a specific action against dumping and subsidization under Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.

16. According to the United States, the Panel misapplied the "constituent elements" test as developed by the Appellate Body in *US – 1916 Act*. For the United States, the language of the CDSOA does not include the constituent elements of dumping or of a subsidy, and these constituent elements do not form part of the essential components of the statute. The United States maintains that, unlike the measure at issue in *US – 1916 Act*, the CDSOA by its terms does not impose measures on dumped or subsidized products, or impose any form of liability on importers/foreign producers/exporters when dumping or subsidization is found, and dumping or subsidization is not the trigger for application of the CDSOA. Rather, the United States argues, the CDSOA provides for the distribution of money ("triggered" by an applicant's qualification as an "affected domestic producer") from the United States government to domestic producers.

17. The United States also submits that the CDSOA is not action "in response" to dumping or a subsidy. The United States characterizes the Panel's approach as suggesting that the CDSOA could be perceived as action in response to "injury", which is separate from "dumping" or a "subsidy". According to the United States, the Panel erred in finding that, because the payments follow from the collection of anti-dumping or countervailing duties, the payments may be made only in situations presenting the constituent elements of dumping or of a subsidy. The United States claims that, under the Panel's approach, any expenditure of the collected duties would be specific action against dumping or subsidies. The United States adds that, if the collected duties were spent for international emergency relief, according to the Panel's reasoning they would be specific action against dumping or subsidies, because they would be made only where the constituent elements of dumping or of a subsidy were present. The United States maintains that the only connection that the CDSOA has with anti-dumping and countervailing duty orders is that the CDSOA limits availability of CDSOA offset payments to the universe of products covered by an existing or revoked order, and to "affected domestic producers", namely those who supported the investigation and still produce the particular product. According to the United States, CDSOA payments can and do occur at times when no order continues to exist or even when no dumping or subsidization is currently occurring. Thus, the United States concludes that the Panel's conclusion that

there is a "clear, direct and unavoidable connection"[31] between the determination of dumping or of a subsidy and CDSOA offset payments is incorrect. Rather, the United States argues that the CDSOA is an exercise of the intrinsic right of a WTO Member to provide subsidies.

18. The United States also claims that the Panel failed to read Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* in conjunction with footnotes 24 and 56 thereto to determine the meaning of "specific action". According to the United States, the footnotes to Articles 18.1 and 32.1 are an integral part of the Articles' texts and inform the meaning of "specific action". The effect of these footnotes is to permit action involving dumping or subsidies that is consistent with the GATT 1994 provisions and that is not addressed by the provisions on dumping or countervailable subsidies in Article VI of the GATT 1994. The United States argues that the Panel should have interpreted Articles 18.1 and 32.1 in a manner so as to: (1) give meaning to the footnotes' express permission to take "actions" authorized under other relevant provisions of the *WTO Agreement*; and (2) avoid the creation of any limitations on the sovereign power over fiscal matters not otherwise specifically proscribed by the WTO Agreements. In the present case, the Panel examined the CDSOA under the *SCM Agreement* and, according to the United States, did not find the CDSOA to violate any limitations set forth in that Agreement. The United States concludes that the CDSOA is covered by the footnotes 24 and 56, and, therefore, the CDSOA is not a specific action prohibited by Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement*.

19. The United States also claims that the Panel failed to consider the ordinary meaning of the term "against" in the context in which it is used or in the light of the object and purpose of the *Anti-Dumping Agreement* and Article VI of the GATT 1994. With respect to the determination of the Panel that the CDSOA operates against dumping or a subsidy, in the sense that it has an adverse bearing on dumping or subsidization, the United States argues that an action can be characterized as operating "against" dumping within the meaning of Article 18.1 of the *Anti-Dumping Agreement*, or "against" a subsidy within the meaning of Article 32.1 of the *SCM Agreement*, only if it applies directly to the dumped or subsidized imported good or an entity responsible for the dumped or subsidized imported goods, and if it burdens the dumped or subsidized imported good, or an entity responsible for the dumped or subsidized imported good. The United States says that the Panel erred by finding that the term "against" in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* encompasses any form of adverse bearing, whether it be direct or indirect, and by finding that this term does not imply a requirement that the action applies directly to the imported good or an entity responsible for it and is burdensome.

20. The United States maintains that the Panel erred by concluding that an "adverse bearing" on dumping is demonstrated by the effect of the CDSOA on the competitive relationship between dumped/subsidized goods and domestic products. The United States first criticizes the Panel for failing to provide any

[31] Panel Report, para. 7.21.

explanation for inclusion of such a "conditions of competition" test under Articles 18.1 and 32.1. The United States goes on to explain that, even though, historically, there has been a "conditions of competition" test under Article III of the GATT 1994, which is used to determine whether a measure is applied "so as to afford protection" or accords imports "treatment no less favorable" than that accorded like domestic products, Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* do not call for a "conditions of competition" test, as the language in Articles 18.1 and 32.1 is markedly different from the language in Article III of the GATT 1994. The United States points out that there is no indication in the text of Article 18.1 or Article 32.1 that use of the words "against dumping" or "against a subsidy" was intended to encompass a "conditions of competition" test.

21. The United States further submits that, even assuming, *arguendo*, that a "conditions of competition" test is applicable to an analysis under Articles 18.1 and 32.1, the CDSOA's impact on the conditions of competition would be too remote and indirect to result in a violation. The United States posits several reasons: first, the CDSOA does not mandate that qualifying expenses be based on costs incurred by domestic producers in competing with dumped/subsidized imports subject to an order; second, there is nothing in the text of the CDSOA that directs, or even provides any incentive for, domestic producers to spend disbursements to bolster their competitive position over dumped/subsidized products; third, the CDSOA cannot ensure that, even if domestic producers do use the distributed money in the production of the product covered by an order, they will be successful in improving their competitive position *vis-à-vis* foreign producers/exporters; and fourth, the CDSOA does not prohibit foreign producers from lowering prices to compete with domestic products. The United States argues, therefore, that the Panel's conclusion that the CDSOA has an adverse bearing on the conditions of competition is pure speculation.

22. The United States maintains that the Panel erred in finding that the CDSOA will have the effect of providing a financial incentive for domestic producers to file, or at least support, a petition, and that this compounds the CDSOA's adverse bearing on dumping or subsidization, because the financial incentive will likely result in a greater number of anti-dumping/countervail applications and investigations, and in a greater number of anti-dumping/countervail orders. According to the United States, even if the CDSOA were to result in more investigations being initiated and, in turn, more orders being put in place, such a result could not lead to a violation of Article 18.1 of the *Anti-Dumping* or Article 32.1 of the *SCM Agreement*. This is because the Panel did not find any provision of United States law relating to the imposition of anti-dumping or countervailing duty orders to be inconsistent with United States WTO obligations. Thus, any increase in WTO-consistent investigations and orders cannot result in violations of Articles 18.1 and 32.1. The United States goes on to state that, even assuming, *arguendo*, that an increase in WTO-consistent anti-dumping and countervailing duty investigations and orders could lead to a WTO violation, no evidence was adduced before the Panel to show that the CDSOA provides a financial incentive that will induce producers to file or

support a petition they otherwise would not file or support. According to the United States, nor was there any evidence that any such incentive will lead to an increase in investigations or orders brought before the Panel.

23. The United States argues that the Panel incorrectly relied on the stated purpose of the CDSOA to confirm that the CDSOA constitutes specific action against dumping or a subsidy. According to the United States, debates surrounding the passage of the CDSOA or the "Findings of Congress" introducing the CDSOA would be relevant to its interpretation only if the terms of the CDSOA were ambiguous and its operation unclear. In this case, because there was no allegation that the CDSOA is ambiguous, the only relevant question before the Panel was whether, by its terms, the CDSOA constitutes specific action against dumping and subsidization.

24. The United States also submits that the Panel erred in extending the Appellate Body's reasoning in *US - 1916 Act* on permissible responses to dumping to the permissible responses to subsidization under the GATT 1994 and the *SCM Agreement*. The United States contrasts the language of Article VI:2 of the GATT 1994 and Article 1 of the *Anti-Dumping Agreement* with Article VI:3 of the GATT 1994 and Article 10 of the *SCM Agreement*. The United States argues that the conclusion reached by the Appellate Body in *US – 1916 Act*—that Article VI of the GATT 1994 encompasses all measures taken against dumping—was based on the specific language of Article VI:2 of the GATT 1994 and Article 1 of the *Anti-Dumping Agreement*. The United States submits that such a conclusion cannot be extended to the subsidy provisions of Article VI of the GATT 1994 and of Part V of the *SCM Agreement*, because their scope is limited to the imposition of countervailing duties (and by implication, provisional duties and price undertakings).

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

25. The United States claims that the Panel erred in finding a violation of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. The United States argues that the Panel agreed with the United States that those provisions "require[ ] only that the statistical thresholds be met, and impose[ ] no requirement that the investigating authorities inquire into the motives or intent of a domestic producer in electing to support a petition."[32] The Panel also concluded that the United States has implemented its obligations under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* in its domestic laws and that the CDSOA did not in any way amend or modify such laws. According to the United States, the Panel should have "ended its inquiry" there.[33]

26. The United States further refers to the Panel's finding that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of

[32] United States' appellant's submission, para. 95, quoting Panel Report, para. 7.63.
[33] United States' appellant's submission, para. 97.

the *SCM Agreement* because it allegedly undermines the value of those provisions to the countries with whom the United States trades, and because it allegedly defeats the object and purpose of those articles. In this respect, the United States emphasizes that the Appellate Body has repeatedly directed panels to the *words* of the agreement to determine the intentions of parties and has explained that, as set out in Article 31 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*")[34], principles of treaty interpretation do not condone the imputation into a treaty of words or concepts that are not there. According to the United States, the Panel used the object and purpose of Articles 5.4 and 11.4, rather than the terms of those provisions, as the basis for finding a violation.

27. The United States submits that a finding of a violation cannot be based solely on the conclusion that a measure, although consistent with the text of the relevant provisions, "undermines the value"[35] of those provisions to other trading partners. According to the United States, the Panel in this case confused the basis for finding a violation of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* with the basis for making a finding of non-violation nullification and impairment under Article XXIII:1(b) of the GATT 1994.

28. The United States criticizes the Panel for its finding that the United States may be regarded as not having acted in good faith. According to the United States, there is no basis in the *WTO Agreement* for a panel to conclude that a Member has not acted in good faith, or to enforce a principle of "good faith" as a substantive obligation agreed to by WTO Members. The United States emphasizes that dispute settlement panels are subject to clear and unequivocal limits on their mandate: they may clarify "existing provisions" of covered WTO agreements and may examine the measures at issue in the light of the relevant provisions of the covered WTO agreements.[36]

29. The United States maintains that the Panel erred in conducting an analysis of whether the CDSOA creates an incentive for a domestic producer to support an investigation, despite its finding that the texts of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* do not impose an obligation to inquire into the motives behind such support. It was thus legal error for the Panel to conclude that the CDSOA creates a financial incentive to support applications in anti-dumping and countervailing duty investigations and therefore "in effect mandates"[37] domestic producers to support such petitions, and then to use this conclusion as a basis for finding that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. Moreover, according to the United States, the Panel's finding was based on "nothing more than assumption and speculation"[38] that the

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[34] Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.
[35] United States' appellant's submission, para. 101.
[36] *Ibid*., para. 106, referring to Articles 3.2 and 7.1 of the DSU.
[37] United States' appellant's submission, para. 112.
[38] *Ibid*., para. 113.

CDSOA creates a "spectre"[39] of such investigations being initiated without proper industry support.

30. The United States adds that the Panel's finding is at odds with the CDSOA and the operation of relevant United States laws. Under those laws, the United States Department of Commerce ("USDOC") alone, and not the United States International Trade Commission ("USITC"), makes a determination whether there is sufficient domestic industry support for initiation of an anti-dumping or countervailing duty investigation. The necessary declaration of support to qualify for CDSOA distributions is made by domestic producers before the USITC, and not before USDOC. Moreover, the United States notes that the CDSOA declaration of support is not required *prior* to the initiation of an investigation, and may contradict previously expressed opposition to an application. The United States adds that a domestic producer can express support as late as the final injury investigation questionnaire, which can be issued more than 200 days after an application has been filed.

31. The United States submits that the Panel's "failure to understand the operation of U.S. law is compounded by its consideration of the only two purported pieces of 'evidence' that have been advanced in support of complaining parties' claim."[40] One of the pieces of evidence is described as a letter from a domestic producer in which it reportedly changed its position to express support for an application to be able to benefit from any potential CDSOA distributions. USDOC's decision to initiate the investigations, however, had been made 294 days before the domestic producer purportedly changed its position before the USITC. Moreover, an examination of the letter reveals, according to the United States, that it is not what the Panel claimed it to be. In fact, the United States points out that "the company that authored the letter states therein that it is expressing its 'continuing' support for the petitions (*i.e.*, it is not expressing a change in position)".[41]

32. The United States also refers to a letter in which a United States' producer purportedly urged other domestic producers to support a petition against Canadian softwood lumber imports by citing the CDSOA. According to the United States, examination of the letter referencing the CDSOA shows that it was not written by a domestic producer, but instead by a law firm *informing* domestic producers of the merits and circumstances of their case, as well as various provisions of United States law, including the CDSOA. Thus, according to the United States, there was no evidence to support the Panel's conclusion. As such, there was no evidence on the record with which Complaining Parties could meet their burden to establish a *prima facie* case and, as a consequence, the Panel's finding amounts to a shifting of the burden of proof to the United States.

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[39] *Ibid*.
[40] *Ibid*., para. 118.
[41] *Ibid*., para. 120.

3. The Combination of Duties and CDSOA Offset Payments

33. The United States alleges that the Panel exceeded its terms of reference by examining claims concerning the CDSOA in combination with other United States laws and regulations. Citing Article 7 of the DSU and the Appellate Body Report in *India – Patents (US)*, the United States notes that a panel's terms of reference are limited to the claims set out in the complaining parties' request for establishment of a panel. In this case, the United States argues, the Complaining Parties' request for establishment of a panel set out a challenge to the CDSOA as such, that is, the Complaining Parties challenged the CDSOA prior to implementation and independent of any other laws. According to the United States, although the Panel acknowledged that the CDSOA was the measure at issue, the Panel proceeded to find that the CDSOA violates Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* because the *combination* of anti-dumping duties (or countervailing duties) and the CDSOA transfers a competitive advantage to affected domestic producers.

34. The United States notes, however, that the request did not include a challenge to provisions of United States laws or regulations relating to the imposition of anti-dumping or countervailing duties, or a challenge to the CDSOA in conjunction with provisions of United States laws or regulations relating to the imposition of anti-dumping or countervailing duties. Furthermore, according to the United States, the Complaining Parties did not even mention in their request for establishment of a panel the provisions of United States laws or regulations relating to the imposition of anti-dumping or countervailing duties. Therefore, the United States argues that the Panel's terms of reference were limited to determining whether the CDSOA, as such, violates identified provisions of the *WTO Agreement*.

35. The United States acknowledges that the Panel can review relevant provisions of United States law for interpretative purposes, but argues that the Panel was not at liberty to examine the CDSOA together with other provisions of United States law in order to find a WTO violation. In support of its claim, the United States refers to the Appellate Body Report in *US – Certain EC Products* and the Panel Report in *US – Section 129(c)(1) URAA*. Therefore, the United States concludes, the Panel exceeded its terms of reference by examining whether the CDSOA, in combination with United States laws on the imposition of anti-dumping duties (or countervailing duties), violates Articles 18.1 and 32.1.

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

36. The United States requests that the Appellate Body reverse the Panel's finding that the CDSOA violates Article XVI:4 of the *WTO Agreement* on the grounds that the CDSOA is consistent with Articles VI:2 and VI:3 of the GATT 1994, Articles 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement*, and Articles 11.4, 32.1 and 32.5 of the *SCM Agreement*. For the same reason, the United States requests the Appellate Body to reverse the Panel's finding that the benefits

accruing to the Complaining Parties under the *WTO Agreement* have been nullified or impaired.[42]

5. The "Advisory Opinion"

37. The United States maintains that the Panel erred by rendering an advisory opinion on a measure that was not before it. Specifically, the United States appeals the Panel's statement that "[e]ven if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion … that offset payments may be made only in situations presenting the constituent elements of dumping."[43] The United States asserts that there was no measure before the Panel where payments were funded directly from the United States Treasury and, therefore, there was no basis for the Panel to opine on what its findings would be if such a measure were presented to it. The United States emphasizes that this finding should be reversed because the Panel has no authority to make findings on a matter that is not before it.

6. Article 9.2 of the DSU

38. The United States submits that the Panel erred in denying the request by the United States for the issuance of a separate panel report in the dispute brought by Mexico. According to the United States, Article 9.2 of the DSU gives Members an unqualified right to the issuance of separate panel reports upon request. Specifically, that provision contains no requirement for a party to make its request for a separate panel report by a certain time in the panel proceeding. Nor does it, according to the United States, require the requesting party to demonstrate that it would suffer prejudice if its request is not accepted. Nor does it require that a separate interim report be issued, contrary to what the Panel stated.

B. Australia – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

39. Australia submits that the Panel did not err in concluding that the CDSOA is "specific action" against dumping or a subsidy. The Panel's position—that a measure that may be taken only in situations presenting the constituent elements of dumping is clearly specific action in response to dumping—was not an unexplained assumption. The Panel's conclusion was plainly arrived at in the context of its examination of the scope of the Appellate Body's findings concerning the meaning of the phrase "specific action against dumping" in *US – 1916 Act*.

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[42] United States' appellant's submission, para. 133.
[43] Panel Report, para. 7.22.

40. According to Australia, the Panel did not err in determining that the CDSOA acts specifically in response to dumping. The Panel correctly applied the rationale of the Appellate Body's finding in *US – 1916 Act* in holding that offset payments under the CDSOA are conditioned on a determination of dumping: offset payments are actions which may be taken only in response to conduct which presents the constituent elements of dumping. In the view of Australia, the constituent elements of dumping are built into the essential elements for eligibility under the CDSOA. A determination of dumping or subsidization is the first requirement for eligibility for offset payments under the CDSOA.

41. Australia contends that the Panel did not err when it concluded that it did not need to examine footnote 24 to the *Anti-Dumping Agreement* and footnote 56 to the *SCM Agreement*. The Appellate Body's findings in *US – 1916 Act* are fully dispositive of this matter in this dispute, and the Panel's finding is fully consistent with them. Having found the CDSOA to be "specific action against dumping" within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and "specific action against a subsidy" within the meaning of Article 32.1 of the *SCM Agreement*, the Panel correctly concluded that the CDSOA was governed solely by Articles 18.1 and 32.1. Otherwise, the Panel would have erroneously treated footnotes 24 and 56 as the primary provisions, and Articles 18.1 and 32.1 as the residual provisions.

42. Australia maintains that the Panel did not err when it concluded that the CDSOA acts "against" dumping. The Panel's conclusion that action "against" dumping must have some adverse bearing on dumping, took account of all ordinary meanings of the word "against". According to Australia, the Panel did not err when it concluded that there is no requirement that a measure act directly on an imported dumped product or entities responsible for that product. The Panel correctly noted that Article 18.1 of the *Anti-Dumping Agreement* refers only to measures that act against "dumping" as a practice, and that there is no express requirement that the measure must act against the imported dumped product, or entities responsible for that product. The Panel similarly noted that Article 32.1 of the *SCM Agreement* refers to specific action against "a subsidy", not action against the imported subsidized product or a responsible entity. In the view of Australia, the notion of "direct" does not necessarily attach to the term "against". For Australia, the Panel considered both the meaning and the context of the word "against", was mindful of the Appellate Body's findings in *US – 1916 Act*, and correctly concluded that the ordinary meaning of the term "against", which is not qualified in any way in Article 18.1, encompasses any form of adverse bearing, be it direct or indirect.

43. Australia submits that the Panel did not err in finding that the CDSOA has an adverse bearing on dumping. The United States argues that the Panel did not examine whether the CDSOA burdens imports or the entity responsible for their importation, but rather whether the CDSOA distorts the conditions under which imports compete. However, according to Australia, this argument is premised on the Panel having erred in concluding that there is no requirement that a measure act directly on an imported dumped product or a responsible entity. As the Panel

did not err in making that conclusion, the United States' argument is not sustainable. In any case, Australia maintains that the Panel's conclusion that the CDSOA has an adverse bearing on dumping is correct. Offset payments to "affected domestic producers" when combined with anti-dumping duties operate to impose a double remedy in respect of dumped goods. To provide a double remedy is to cross the line of equilibrium at which point something undesirable is counteracted or removed, and to create a new situation requiring redress or relief. By its very nature, a double remedy to "affected domestic producers" is adverse to dumped goods.

44. According to Australia, the Panel did not err in considering that the CDSOA's "legislative history" confirmed that the CDSOA constitutes "specific action against dumping". The Panel's review of the intent of United States Congress after it had already concluded that the CDSOA bears adversely on dumping and therefore acts against dumping, cannot be considered to be reliance on the intent of United States Congress to reach a finding. It is not an error *per se* for a panel to review whether the stated purpose or intent of a law concurs with its own findings.

45. Australia maintains that the Panel did not err when it concluded that the Appellate Body's interpretation of the provisions of the *Anti-Dumping Agreement* in *US – 1916 Act* applies equally to the provisions of the *SCM Agreement*. For Australia, the Panel correctly concluded that the only remedies permitted by the GATT 1994, as interpreted by the *SCM Agreement*, were countervailing duties, provisional measures, undertakings and countermeasures, and that to the extent that the CDSOA may be regarded as a specific action against a subsidy, but not a permissible remedy, it would be inconsistent with Article 32.1 of the *SCM Agreement*. Textual differences between Article VI:2 of the GATT 1994 and Article 1 of the *Anti-Dumping Agreement*, on the one hand, and Article VI:3 of the GATT 1994 and Article 10 of the *SCM Agreement*, on the other hand, do not render the Panel's conclusion invalid.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

46. Australia submits that the Panel reached its finding in respect of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* on the basis of the text of the relevant provisions. Thus, the Panel did not confuse violations of Articles 5.4 and 11.4 with a non-violation claim of nullification and impairment under Article XXIII:1(b) of the GATT 1994. Australia submits that the Panel expressly stated that "the first consequence" of the CDSOA's operation is that it renders the quantitative tests established by those Articles irrelevant, and that it was on this basis that the Panel found a violation of those Articles.

47. Australia endorses the Panel's application of the principle of good faith in its analysis of claims made in relation to Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. According to Australia, the Panel's finding is consistent with the general rule of treaty interpretation set out

in Article 31 of the *Vienna Convention* and the Appellate Body's findings in *US – Gasoline* and *US – Hot-Rolled Steel*. Adopting a measure that renders meaningless a WTO Member's application of these provisions cannot be consistent with the principle of good faith that informs them.

48. Australia endorses the Panel's conclusion that the CDSOA creates a financial incentive for domestic producers to initiate and support petitions. According to Australia, it was not an error for the Panel to use that conclusion as a basis for its finding that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.[44]

3. The Combination of Duties and CDSOA Offset Payments

49. Australia argues that the Panel did not exceed its terms of reference by examining claims concerning the CDSOA in combination with other United States laws and regulations. Australia agrees with the United States that the Complaining Parties' panel request did not include a challenge to provisions of United States laws or regulations relating to the imposition of anti-dumping or countervailing duties, or a challenge to the CDSOA in conjunction with provisions of United States laws or regulations relating to the imposition of anti-dumping or countervailing duties. However, according to Australia, "[t]he Panel's reference to 'the combination of anti-dumping duties and offset subsidies' is not a finding concerning the CDSOA in combination with other anti-dumping laws and regulations of the United States as such."[45] Rather, it is, and "should properly be seen, as a general reference to 'anti-dumping duties' as a permissible remedy within the meaning of the *Anti-Dumping Agreement*."[46]

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

50. Australia submits that the Panel correctly found that the CDSOA violates Articles 5.4 and 18.1 of the *Anti-Dumping Agreement* and Articles 11.4 and 32.1 of the *SCM Agreement*. Accordingly, the Panel's finding that the CDSOA is inconsistent with Article 18.4 of the *Anti-Dumping Agreement*, Article 32.5 of the *SCM Agreement* and Article XVI:4 of the *WTO Agreement* is also correct. Australia goes on to argue that, under Article 3.8 of the DSU, such violations constitute a *prima facie* case of nullification or impairment. Because the United States did not present to the Panel any evidence to rebut such presumption of nullification and impairment, the CDSOA constitutes a violation of Article 3.8 of the DSU as well.

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[44] Australia's appellee's submission, para. 61.
[45] Australia's appellee's submission, para. 72, quoting Panel Report, para. 7.36.
[46] Australia's appellee's submission, para. 72.

5. The "Advisory Opinion"

51. Australia submits that the Panel did not exceed its terms of reference by clarifying the scope of its finding in the first sentence of paragraph 7.22. Australia notes that, in arguing that the Panel erred in issuing an advisory opinion on a measure outside its terms of reference, the United States has not entered any argument in relation to the first sentence of paragraph 7.22; rather, the United States' argument relates strictly to the second sentence of the Panel's statement at paragraph 7.22 of its Report.

C. Brazil – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

52. Brazil submits that the Panel did not err in finding that CDSOA payments violate Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. For Brazil, there can be no question that entitlement to the remedy provided for in the CDSOA is an action which is taken in response to situations presenting the constituent elements of dumping, precisely the situation addressed by the Appellate Body in *US – 1916 Act.* The specific action—distribution of duties assessed under anti-dumping duty orders to affected domestic producers—is permitted only when the constituent elements of dumping have been demonstrated. Brazil argues that it is not the expenditure of the collected anti-dumping duties in a vacuum that constitutes the response to dumping, but the disbursement to the petitioning parties that make up the industry producing the product covered by the anti-dumping order.

53. Brazil refers to the United States' argument that, because CDSOA payments can and do occur at points in time when an order no longer exists and there is no finding that dumping is currently occurring, they cannot be considered against, or in response to, dumping or subsidization.[47] Brazil disagrees with this argument. For Brazil, this apparently addresses the delay in disbursement, which would be more a function of the retrospective nature of the anti-dumping regime in the United States and the logistics of liquidation and payment, rather than some disconnect between the payments and a finding of the constituent elements of dumping. The more appropriate question to ask is whether the payments can be made before a finding of the constituent elements of dumping. According to Brazil, the answer is no.

54. For Brazil, it is indisputable that CDSOA payments constitute specific action against dumping. This is discerned from a review of Article VI of the GATT 1994, the premise behind the CDSOA, the actual effect of CDSOA payments, as well as the comparisons to be drawn from the measure at issue in *US – 1916 Act*, which the Appellate Body has already found to be a specific action against dumping. The measure, which the panel and Appellate Body found in *US – 1916 Act* to be inconsistent with Article VI of the GATT 1994 and

[47] United States' appellant's submission, para. 22.

Article 18.1 of the *Anti-Dumping Agreement*, included the very same remedy that the Panel in these proceedings found invalid, namely the awarding of monetary damages to parties that have been found to be injured by dumping. Both the damages awarded by the CDSOA and the damages awarded under the measure at issue in *US – 1916 Act* are based on a demonstration of the constituent elements of dumping. Brazil adds that the CDSOA is not simply a decision by the United States government on how to spend revenues generated by anti-dumping duties. It is, rather, intended to have the effect of providing an additional remedy for dumping. It provides additional deterrence in that monies paid in the form of dumping duties by importing parties are distributed in the form of monetary damages to competitors. It also provides an additional incentive to United States' domestic industries to pursue anti-dumping actions in that it rewards them with monetary damages.

55. Brazil supports the conclusion of the Panel that an action "against" dumping must have some adverse bearing on dumping. The term "against" is best understood in the context of Article VI:2 of the GATT 1994, which states that anti-dumping duties are to be imposed in order to "offset or prevent dumping". Brazil sees no inconsistency in the Panel's treatment of the term "against" and the object and purpose of anti-dumping duties. In respect of the United States' contention that the Panel established a new "conditions of competition" test under Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, Brazil contends that Article 18.1 of the *Anti-Dumping Agreement* refers only to measures that act against "dumping" as a practice; there is no express requirement in the provision that the measure must act against the imported dumped product, or entities connected to, or responsible for, the dumped good.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

56. Brazil endorses the Panel's conclusion that the CDSOA violates Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. Brazil maintains that the CDSOA operates in such a manner that United States' investigating authorities are unable to conduct an objective and impartial examination of the level of support for an application. As a consequence, the Panel correctly concluded that the CDSOA has undermined the value of provisions of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* and that the United States "may be regarded as not having acted in good faith in promoting this outcome."[48] According to Brazil, the incentive to file or support anti-dumping and countervailing duty petitions created by CDSOA payments raises the potential for a minority of domestic producers to be able to control and initiate anti-dumping and/or countervailing duty proceedings. The numerical thresholds under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* have, as their object and purpose, to prevent

[48] Brazil's appellee's submission, para. 27.

this from happening. According to Brazil, "[i]t is this return to the situation that existed before the Uruguay Round Agreements that implicates and violates the provisions of Article 5.4 of the *AD Agreement* and Article 11.4 of the *SCM Agreement*."[49]

3. The Combination of Duties and CDSOA Offset Payments

57. Brazil argues that the Panel did not exceed its terms of reference by examining claims concerning the CDSOA in combination with other United States laws and regulations. According to Brazil, the Complaining Parties raise no claims against United States laws or regulations relating to the imposition of anti-dumping or countervailing duties, because they are not the subject of this dispute. Rather, Brazil argues, the relationship of those laws and regulations to the claims that the CDSOA violates Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* is incidental to the dispute. Brazil submits that the Complaining Parties do not dispute that, in as much as they are permitted specific actions, anti-dumping and countervailing duties are presumably valid under the *Anti-Dumping Agreement* and the *SCM Agreement*. Instead, Brazil claims that the Complaining Parties are disputing the CDSOA payments because they clearly do not qualify as permissible measures under Article 18.1 and Article 32.1.

D. Canada – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

58. Canada submits that the CDSOA is a specific action against dumping or subsidization within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. According to Canada, neither the text nor context of Article 18.1 or the Appellate Body's interpretation of that provision in *US – 1916 Act* indicates that the constituent elements of dumping must be built into a measure for it to constitute "specific action." A measure is "specific action" where its operation is contingent upon the existence of constituent elements of dumping or a subsidy. A WTO Member may not escape its obligations by calling dumping or a subsidy something else, or by not incorporating the definition of dumping or a subsidy into the measure itself. Where a practice is clearly defined in national laws, it is not necessary for each and every law targeting that practice to specifically incorporate the constituent elements of that practice. Requiring that the constituent elements of dumping or of a subsidy be built into the measure for it to constitute "specific action", would eviscerate Articles 18.1 and 32.1. This would create a loophole for measures that have no other purpose and effect than to act against dumping or a subsidy, solely because they do not, in themselves, contain the elements of these practices.

[49] Brazil's appellee's submission, para. 30.

59. Canada maintains that, in fact, the CDSOA does incorporate the constituent elements of dumping and a subsidy. Offset subsidies are possible only where there is an anti-dumping or countervailing duty order. Such orders are imposed once there has been a determination of injurious dumping or a subsidy. Offset subsidies are therefore possible only where there is already a determination of dumping or a subsidy, and in no other circumstance. As well, offset subsidies are paid out to "affected domestic producers". These are not domestic producers generally affected by imports. Rather, they are producers that produce like domestic products and that initiate or support an anti-dumping or countervailing investigation. Finally, offset subsidies reimburse certain "qualifying expenditures"; qualifying expenditures must relate to a product covered by an order. Thus, for Canada, every element of the CDSOA depends, for its operation, on a finding of dumping or subsidization.

60. Canada argues that the "trigger" for the operation of the CDSOA is, by design, an anti-dumping or countervailing duty order, not simply status as an "affected domestic producer". The very notion of "affected domestic producer" in this context does not exist separate from, or without the presence of, dumping or subsidization.

61. Canada contends that the Panel did not need to examine whether the CDSOA was an "action" within footnotes 24 and 56, because it had already found it was "specific action" within the meaning of Articles 18.1 and 32.1. "Specific action" is to be distinguished from "action" within the meaning of the footnotes. A measure is a "specific action" against dumping where the objective reason for the imposition of the measure is dumping itself. Action triggered by something other than dumping (like a safeguard based on a serious increase in imports that could have been caused by dumping by foreign exporters) that nevertheless has an incidental impact on dumping is "action" within the meaning of footnote 24. In that event, the basis for the imposition of a measure would not objectively be dumping, but its causes or effects. Canada adds that a measure does not escape the requirements of Article 18.1 of the *Anti-Dumping Agreement* on the sole ground that it is otherwise consistent with the GATT 1994.

62. Canada submits that the Panel decided correctly that the CDSOA is "against" dumping or a subsidy. The Panel's interpretation of the term "against" is in accordance with the principles of treaty interpretation. For Canada, a measure that is in some way related to dumping may have but one of three possible effects on the practice: it may encourage it; be neutral to it; or, discourage it. A measure is against dumping when it is structured in a way as to discourage the practice of dumping exports. This interpretation of "against" is supported by the context of Article 18.1. The provisions of the *Anti-Dumping Agreement* regulate not only what measures WTO Members may impose in response to dumping, but also the modalities of that imposition. The *Anti-Dumping Agreement* specifically permits duties, provisional duties and undertakings, and prohibits all specific action, direct or indirect, against dumping that is not one of those remedies. This limitation on specific action is in keeping with the object and purpose of the *Anti-Dumping Agreement* to further the substantial reduction of tariffs and other barriers to trade, to eliminate

discriminatory treatment in international trade relations and to develop a more viable and durable multilateral trading system.

63. Canada further maintains that, in finding adverse bearing in respect of the CDSOA, the Panel relied on traditional concepts employed by panels: an examination of conditions of competition. In this regard, the Panel was not reading words into the text of the treaty or proposing a new test. In fact, the Panel considered "conditions of competition" in giving substance to the proposed definition that a measure is "against dumping" where it "burdens" imports.

64. Canada contends that the United States' arguments concerning the alleged "remoteness" of the consequences of the CDSOA or the "speculative" nature of the Panel's analysis, are without merit. The CDSOA is mandatory legislation that is being challenged as such. The direct and necessary consequences of the CDSOA are apparent from its design, architecture and underlying structure. Based on the design, architecture and underlying structure of the CDSOA, the Panel determined that certain consequences necessarily follow from its operation that tied the offset payments to dumping and subsidies.

65. Canada submits that Article 32.1 of the *SCM Agreement* is identical in terminology, structure and intent to Article 18.1 of the *Anti-Dumping Agreement*, except for the reference to subsidy instead of dumping. This identical wording gives rise to a strong interpretative presumption that the two provisions set out the same obligation or prohibition. In the view of Canada, footnote 35 to Article 10 of the *SCM Agreement* expressly confirms this presumption. It provides that there are two sets of "specific action" consistent with the *WTO Agreement*, and requires that Members may choose one or the other specific action against a subsidy: countermeasures under Part II or III and countervailing duties, undertakings and provisional measures under Part V. For Canada, no other remedies are contemplated. Article 32.1 is identical in scope to Article 18.1 of the *Anti-Dumping Agreement*. Remedies against subsidies are restricted to the three measures governed by Part V of the *SCM Agreement*, and to multilaterally-sanctioned countermeasures.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

66. Canada endorses the Panel's finding that the CDSOA violates Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

67. Canada emphasizes that Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* require an investigating authority to determine that an application has the support of the domestic industry, based on an examination of the level of support for an application in the domestic industry. Canada argues that "[t]his determination and examination is not a mechanical exercise of toting up the number of producers and their share of domestic production."[50] The requirement is, rather, for an objective and impartial

[50] Canada's appellee's submission, para. 96.

assessment of evidence on the record that indicates that requisite support exists to initiate an investigation.

68. Canada submits that, under the CDSOA, "the United States pays domestic producers either to bring or to support applications."[51] According to Canada, providing such a "monetary reward for producers to support an antidumping application … precludes the possibility of an objective and impartial determination … of industry support."[52] Canada submits that the CDSOA violates Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* precisely because it prevents the United States from complying with its obligations under those Agreements.

69. Canada takes the view that, in arguing for a literal reading of the texts of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, the United States ignores the fact that those provisions "expressly require an authority to *examine* (enquire into the nature, look closely or analytically) the evidence as to those thresholds and *determine* (establish precisely) industry support."[53] According to Canada, this is "manifestly at variance with the apparent U.S. position that the sole obligation of a member is to tally up numbers presented by applicants."[54]

70. Canada further submits that the Panel's reference to good faith and object and purpose was not meant to replace the text of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* with either of these principles; but "rather to give a full and effective meaning to the text in the light of these interpretative principles."[55] Good faith and object and purpose are elements to be considered in the elaboration of an obligation by virtue of Article 31 of the *Vienna Convention*. According to Canada, "[t]his necessarily means that the obligation under Article 5.4 and 11.4 cannot be met where a Member vitiates its own capacity to make a 'determination', or to undertake an 'examination', by offering inducements that influence the basis for that determination."[56] Such an inducement, Canada argues, would render the determination partial and subjective.

3. The Combination of Duties and CDSOA Offset Payments

71. Canada argues that the Panel made no findings with regard to United States anti-dumping and countervailing duty laws outside of the CDSOA; rather, the statement of the Panel is clearly with regard to the operation and effect of the CDSOA in the context of the United States trade remedies system. According to Canada, when the Panel stated that the combination of anti-dumping duties and offset subsidies is not merely to level the playing field, but to transfer the competitive advantage to affected domestic producers, it was referencing the

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[51] *Ibid*., para. 106.
[52] *Ibid*.
[53] *Ibid*., para. 109. (original emphasis)
[54] *Ibid*.
[55] Canada's appellee's submission, para. 115.
[56] *Ibid*., para. 117.

impact of offset payments in addition to duties that would also exist. Canada further states that the CDSOA does not operate in a vacuum, and it constitutes a second remedy against dumped imports.

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

72. Canada agrees with the Panel that the CDSOA is inconsistent with Article XVI:4 of the *WTO Agreement*, Article 18.4 of the *Anti-Dumping Agreement* and Article 32.5 of the *SCM Agreement* because it violates Articles 18.1 and 5.4 of the *Anti-Dumping Agreement*, Articles 32.1 and 11.4 of the *SCM Agreement*, and Articles VI:2 and VI:3 of the GATT 1994. Based on these findings, Canada also agrees with the Panel's conclusion that the CDSOA constitutes a breach of Article 3.8 of the DSU, because it nullifies and impairs benefits accruing to the complainants under the covered agreements.

5. The "Advisory Opinion"

73. Canada takes the view that the Panel did not render an advisory opinion. Instead, it made a statement in support of its overall argument concerning the operation of the CDSOA. According to Canada, the Panel did not arrive at a legal conclusion in respect of the payment of duties from the United States Treasury itself, and so could not have been in legal error. Nor did the Panel offer an "advisory opinion" on that issue. Canada also points out that, in stating that "[e]ven if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion … that offset payments may be made only in situations presenting the constituent elements of dumping"[57], the Panel was merely responding to specific arguments raised by the United States in the course of the proceedings.

6. Article 9.2 of the DSU

74. Canada argues that Article 9.2 should be interpreted in the context of the other provisions of the DSU and in the light of the overall object and purpose of that Agreement. Canada refers, in particular, to Articles 3.2 and 3.3 of the DSU.

75. Canada argues that to interpret Article 9.2 in a manner that permits a WTO Member to ask for separate reports at any time, including at the end of the panel process, would undermine the prompt settlement of disputes. Canada submits that such a reading of Article 9.2 would also violate procedural fairness and impose an additional burden on the rights of parties. Canada concludes that Article 9.2 of the DSU does not grant an unfettered right to Members to ask for separate reports at any point in time; rather, where the exercise of such a right

[57] Panel Report, para. 7.22.

amounts to a potential *abus de droit*, a panel must have the discretion to refuse to grant the request.

E. European Communities, India, Indonesia and Thailand – Appellees

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

76. The European Communities, India, Indonesia and Thailand, as joint appellees, submit that the Panel correctly applied the test enunciated by the Appellate Body in *US – 1916 Act* in determining that the CDSOA is a specific action against dumping or a subsidy. According to them, this test does not require the Panel to establish whether the constituent elements of dumping are "explicitly built into" the CDSOA, but, rather, whether the offset payments are actions that may be taken only when the constituent elements of dumping are present. This test is met not only when the constituent elements of dumping are "explicitly built into" the action at issue, but also where they are implicit in the express conditions for taking the action concerned. They maintain that the CDSOA offset payments meet this test for the following reasons. First, the offset payments are not made to all United States' enterprises, or even to all United States' producers "affected" by imports, but only and exclusively to the United States' producers "affected" by an instance of dumping or subsidization which has been previously the subject of an anti-dumping or a countervailing duty order, respectively. Second, the offset payments are paid for "qualifying expenses" incurred by the affected domestic producers "after" the issuance of an anti-dumping or a countervailing duty order and prior to the termination of the order. Third, the "qualifying expenses" must be related to the production of a product that has been the subject of an anti-dumping or countervailing duty order.

77. The European Communities, India, Indonesia and Thailand argue that, to determine whether the CDSOA is specific, the Panel was not required to examine footnote 24 of the *Anti-Dumping Agreement* and footnote 56 of the *SCM Agreement*. According to them, the scope of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* and that of the footnotes are mutually exclusive. Therefore, once it is established that an action is "specific action against dumping", it is not necessary to make a finding to the effect that such action is not covered by the footnote. They add that, in any event, offset payments do not constitute "action" under other relevant provisions of the GATT 1994 within the meaning of footnotes 24 and 56 and that the CDSOA is not an action taken "under other relevant provisions" of the GATT 1994.

78. The European Communities, India, Indonesia and Thailand contend that the Panel was not required to further consider whether the CDSOA was action "against" dumping or a subsidy because, in the light of the test enunciated by the Appellate Body in *US – 1916 Act*, a conclusion that the CDSOA offset payments constitute specific action against dumping or a subsidy stems from the

establishment that the offset payments are an action that may be taken only when the constituent elements of dumping, or of a subsidy, are present. In any event, they submit that the Panel's interpretation of the term "against", which encompasses action that has an "indirect" adverse bearing on dumping or subsidization, is in accordance with the rules of treaty interpretation. According to them, the Panel's interpretation is consistent with the ordinary meaning of the term "against" as it corresponds to definitions such as "in competition with", "to the disadvantage of", "in resistance to" and "as protection from"; it would also be borne out by the immediate context of the term "against", in particular by the surrounding language of Articles 18.1 and 32.1, which does not prohibit specific action against dumped or subsidized imports, or against the importers of dumped or subsidized products, but rather against "dumping" and against "a subsidy". Also, they point out that the *SCM Agreement* authorizes indirect action in the form of "countermeasures".

79. The European Communities, India, Indonesia and Thailand support the conclusion of the Panel that the CDSOA has an adverse bearing on dumping and subsidization because it puts dumped/subsidized imports at a competitive disadvantage. According to the European Communities, India, Indonesia and Thailand, this conclusion is based exclusively on the interpretation of Articles 18.1 and 32.1, more specifically of the term "against".

80. The European Communities, India, Indonesia and Thailand submit that the CDSOA operates "against" dumping/a subsidy because the offset payments are objectively apt to have an "adverse bearing" on dumping or subsidization. In this vein, they point out that the qualifying expenses under the CDSOA are costs incurred "in competing with" the dumped/subsidized imports. They add that the offset payments allow the domestic producers to improve their competitive position *vis-à-vis* dumped and subsidized imports, and it is reasonable to expect that, in practice, they will use them for that purpose.

81. The European Communities, India, Indonesia and Thailand support the Panel's conclusion that the stated purpose of the CDSOA confirms that it is specific action against dumping. They are of the view that the stated purpose of the CDSOA is relevant for its interpretation, and they assert that Section 1002 is an integral part of the terms of the CDSOA.

82. The European Communities, India, Indonesia and Thailand submit that countervailing measures and countermeasures are the only permitted responses to subsidization. According to them, the Appellate Body's finding in *US – 1916 Act*—that the only specific actions against dumping allowed by Article VI of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*, are definitive duties, provisional measures and price undertakings—was not based exclusively on the presence of the term "measure" in Article 1 of the *Anti-Dumping Agreement*. They add that footnote 35 to Article 10 of the *SCM Agreement* provides contextual confirmation that the *SCM Agreement* does not allow the application of other measures against a subsidy. They contend that, as the wording of Article 32.1 mirrors that of Article 18.1, it is reasonable to assume that both provisions have a similar object and purpose; consequently, they should

have a similar scope. Furthermore, they submit that the United States' interpretation of Article 32.1 would reduce that provision to redundancy.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

83. The European Communities, India, Indonesia and Thailand endorse the finding of the Panel that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. They assert that, contrary to what the United States maintains, the Panel reached its conclusion based on the text of those provisions.

84. The European Communities, India, Indonesia and Thailand submit that the examination of the relevant facts for establishing whether an application is made "by or on behalf of the domestic industry" must be conducted in an "objective" manner. This is not stated expressly in Articles 5.4 or 11.4, but it is a corollary of the principle of good faith which informs all the covered agreements. According to them, the CDSOA is incompatible with the obligation to make an "objective" examination required by Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* because, through the offset payments, the United States authorities are "unduly influencing the very facts which they are required to 'examine'."[58]

85. The European Communities, India, Indonesia and Thailand argue that the United States' reading of Articles 5.4 and 11.4 would lead to absurd and unacceptable results and cannot be correct. If it did not matter whether an application or an expression of support is "genuine", the authorities could take any action within their reach in order to coerce or induce the domestic producers to make or support applications, so as to ensure that the quantitative thresholds of Articles 5.4 and 11.4 are reached.

86. The European Communities, India, Indonesia and Thailand emphasize that they are not suggesting that an investigating authority is to ascertain actively in each case the subjective motivations of a producer in expressing support for an application; but they argue that if there is evidence calling into question the credibility of a declaration of support, the administrative authorities cannot ignore such evidence without violating Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

87. The European Communities, India, Indonesia and Thailand endorse the Panel's conclusion that the CDSOA defeats the object and purpose of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* because it encourages the initiation of investigations in cases where the domestic industry has no genuine interest in the imposition of anti-dumping or countervailing duties. The consequence is that United States investigating authorities are prevented from reaching a proper determination of support before initiating an investigation.

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[58] European Communities', India's, Indonesia's and Thailand's appellees' submission, para. 127.

88. The European Communities, India, Indonesia and Thailand submit that Members must observe the general principle of good faith, recognized by the Appellate Body as a pervasive principle that informs the covered agreements, in the application and interpretation of the *Anti-Dumping Agreement* and the *SCM Agreement*. They submit that the obligation to perform a treaty obligation in good faith means that such obligations "must not be evaded by a merely literal interpretation".[59] It means also that the parties "must abstain from acts that are calculated to frustrate the object and purpose of the treaty".[60]

89. The European Communities, India, Indonesia and Thailand emphasize that the Panel's finding that the CDSOA provides a financial incentive to file or support applications is a question of fact, and not a question of law. They add that the United States has not claimed that, by finding that the CDSOA provides a financial incentive to file or support applications, the Panel has acted inconsistently with Article 11 of the DSU; accordingly, in their view, this finding is beyond the scope of appellate review.

90. In any event, the European Communities, India, Indonesia and Thailand submit that the Panel correctly concluded that the CDSOA provides a financial incentive to file or support applications. They submit that the reason why the evidence of "actual effects" of the CDSOA cannot be shown is because, as a result of the CDSOA, "it has become impossible, both for the U.S. authorities and for the complainants, to tell whether a domestic producer supports the imposition of measures as such or the distribution of the offset. The appropriate consequence to be drawn from this is not that the CDSOA can have no effects on the degree of support, but rather that the U.S. authorities are no longer in a position to make a proper determination of support, whether positive or negative."[61]

91. The European Communities, India, Indonesia and Thailand emphasize that they "have not claimed that the CDSOA affects the standing determination in each and every case."[62] Rather, their claim is that "there is a risk that the offset payments will influence the decision of the domestic producers in an indeterminate number of cases"[63] and that by creating that risk, the United States has acted inconsistently with the obligation to conduct an objective examination of the level of support. They submit that "[t]he existence of such risk can be reasonably inferred, as the Panel did, from the potential amount of the payments made under the CDSOA, as compared to the costs of filing or supporting applications."[64]

92. The European Communities, India, Indonesia and Thailand note that the United States argues that the declarations of support for the purposes of the distribution of the offset payments can be made to the USITC after the initiation

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[59] European Communities', India's, Indonesia's and Thailand's appellees' submission, para. 148.
[60] *Ibid*.
[61] *Ibid*., para. 163.
[62] *Ibid*., para. 164.
[63] *Ibid*.
[64] *Ibid*.

of the investigation. They stress that it remains true, however, that the CDSOA provides an incentive for filing applications or for supporting them before the initiation of the investigation because domestic producers cannot be sure that the other domestic producers will file or support an application, and thus whether the thresholds set out in Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* will be met.

3. The Combination of Duties and CDSOA Offset Payments

93. The European Communities, India, Indonesia and Thailand argue that the Panel did not exceed its terms of reference in the manner alleged by the United States. According to them, the Panel made findings and recommendations exclusively with respect to the CDSOA. They argue that the Panel made no finding or recommendation with respect to the WTO-consistency of the United States laws or regulations relating to the imposition of anti-dumping duties or countervailing duties. Rather, the European Communities, India, Indonesia and Thailand submit that the Panel treated the duties imposed pursuant to those laws and regulations as a fact when assessing the WTO-consistency of the CDSOA. They argue that the Panel correctly took into account those facts when assessing whether the offset payments had an adverse bearing on dumping and subsidization. According to them, by doing so, the Panel was merely assessing the effects of the CDSOA against the relevant factual background, and thus the Panel did not exceed its terms of reference.

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

94. The European Communities, India, Indonesia and Thailand argue that the CDSOA is inconsistent with Article XVI:4 of the *WTO Agreement* and nullifies or impairs benefits accruing to the complainants under Article 3.8 of the DSU because the CDSOA is inconsistent with the *Anti-Dumping Agreement* and the *SCM Agreement*.

5. The "Advisory Opinion"

95. The European Communities, India, Indonesia and Thailand note that the statement at issue was provided in response to a United States' argument. They argue that paragraph 7.22, where the statement in question appears, is part of the Panel's reasoning, and is pertinent and useful in order to understand the Panel's rationale for considering why the CDSOA constitutes "specific action" against dumping or a subsidy. Thus, they argue that the statement in question is not beyond the Panel's terms of reference.

6. Article 9.2 of the DSU

96. The European Communities, India, Indonesia and Thailand argue that, even though Article 9.2 of the DSU does not set any deadline for requesting a separate panel report, this does not mean that the parties to a dispute may request a separate report at any time of the proceedings. Citing the Appellate Body's statement in *US – FSC*, they argue that WTO Members are under a positive duty to exercise their procedural rights under the DSU in good faith and may forfeit those rights if they fail to do so. In the same way as the principle of good faith requires a defendant to raise its objections "seasonably and promptly"[65], it requires also that the right to a separate report under Article 9.2 of the DSU be exercised in a timely manner. They conclude that, because the United States clearly failed to request the report in a timely manner, the Panel was correct in rejecting the United States' request.

F. Japan and Chile – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

97. Japan and Chile, as joint appellees, submit that the CDSOA constitutes a violation of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. They argue that the United States' assertion that a Members' sovereign power over fiscal matters is totally unconstrained by its WTO obligations is an overstatement. WTO Members agreed to impose many limitations on their sovereign powers to promulgate and enforce domestic laws and regulations, even in fiscal matters. For example, Article III of the GATT 1994 limits the power of Members with regard to taxation. Article VI of the GATT 1994 and the *SCM Agreement* restrain the otherwise sovereign power of Members to provide subsidies. Specifically relevant to this dispute, the United States has committed not to adopt measures that would constitute specific action against dumping or subsidization except in accordance with the provisions of the GATT 1994, as interpreted by the *Anti-Dumping Agreement* and the *SCM Agreement*.

98. Japan and Chile contend that the presence of the constituent elements of dumping, as determined by the United States investigating authorities themselves, is a condition *sine qua non* of the application of the CDSOA. This is supported by the text of the law itself, which provides that duties assessed pursuant to anti-dumping or countervailing duty orders shall be distributed to affected domestic producers. In *US – 1916 Act*, the Appellate Body stated that a measure constitutes a specific action if it is taken *only* in situations presenting the constituent elements of dumping. They contend that the CDSOA meets this test, as the CDSOA refers explicitly to the requirement of an anti-dumping order. Thus, the "constituent elements of dumping" can be found in the CDSOA's textual reference to the prerequisite of an anti-dumping order.

[65] European Communities's, India's, Indonesia's and Thailand's appellees' submission, para. 188, quoting Appellate Body Report, *US – FSC*, para. 166.

According to Japan and Chile, the CDSOA addresses dumping and subsidization as such. As the title of the CDSOA and the Congressional findings in Section 1002 of the CDSOA make clear, the distribution of duties to the affected domestic producers offsets continued dumping and subsidization. The CDSOA acts specifically against dumping because it addresses dumping and subsidization as such, since dumping or subsidization are its cause and trigger, and because it will apply only when the constituent elements of dumping or subsidization are present. They add that, in their view, there is a clear connection between the determination of dumping and CDSOA offset payments.

99. Japan and Chile argue that the text of the CDSOA refutes the United States' claim that the link between the CDSOA and dumping or subsidization is remote. The findings listed in Section 1002 of the CDSOA reveal an immediate and clear link between dumping or subsidization and the offset payments. According to them, the link is evident from the title of the CDSOA—*the Continued Dumping and Subsidy Offset Act*.

100. According to Japan and Chile, the Panel correctly found that the CDSOA acts "against" dumping, in the sense that it has an adverse bearing on dumping. For them, there is no textual basis in either Article 18.1 or 32.1 for the interpretation of the word "against" as requiring a direct contact or impact on the dumped good or on the entity responsible for it. Therefore, the United States' argument that action "against" dumping must operate directly on the imported goods or entities responsible for them is not supported by the ordinary meaning of the phrase "specific action against dumping" in its context and in the light of the object and purpose of the *Anti-Dumping Agreement* or the *SCM Agreement*. They add that the very rationale underpinning Articles 18.1 and 32.1 is that Members should not be allowed to modify the conditions of competition between imported and domestic products that are in a competitive relationship, except to the extent necessary to counteract dumping and subsidization. They submit that the issue is not whether the CDSOA gives the affected domestic producers the incentive to use offset payments to bolster their competitive position, or whether it guarantees that producers will be successful in any attempts to bolster their competitive positions. The CDSOA gives the affected domestic producers the resources to improve their competitive positions *vis-à-vis* dumped imports, and it does so only because the imports are dumped—not as the United States' argument implies—regardless of the fact that they are dumped. That is precisely the element that, according to Japan and Chile, renders the CDSOA action against dumping. They also submit that the CDSOA creates an incentive to file or support applications for anti-dumping or countervailing investigations, and that a measure that leads to an increased number of investigations and orders is a measure "against" dumping/a subsidy.

101. According to Japan and Chile, the Panel correctly interpreted and gave full meaning to footnote 24 of the *Anti-Dumping Agreement* and footnote 56 of the *SCM Agreement*. The Panel explained, in accordance with the decision of the Appellate Body in the *US – 1916 Act* case, that "specific action" under Articles 18.1 and 32.1 must be distinguished from "action" under footnotes 24 and 56. Article 18.1 covers "specific action" against dumping. Footnote 24, by contrast,

addresses non-specific action, and clarifies that the prohibition in Article 18.1 does not cover non-specific action under "other relevant provisions of the GATT", that is, provisions not interpreted by the *Anti-Dumping Agreement*. Footnote 24 covers action that addresses the "causes or effects of dumping", but not action that addresses dumping *as such*, or which makes dumping the cause for its imposition. Footnote 56 also refers exclusively to non-specific action.

102. Japan and Chile maintain that the Panel treated the stated purpose of the CDSOA as confirming evidence of the fact that the CDSOA acts against dumping, a conclusion it had already reached based on other considerations. According to them, reliance on municipal law as evidence of facts is accepted under WTO law and general public international law.

103. Japan and Chile argue that the minor textual differences between the text in the *Anti-Dumping Agreement* and the *SCM Agreement* do not undermine the Panel's conclusions regarding the applicability of the Appellate Body's interpretation of Article 18.1 of the *Anti-Dumping Agreement* in the *US – 1916 Act* to Article 32.1 of the *SCM Agreement*. They point to footnote 35 of the *SCM Agreement*, and note that it expressly states that, in certain circumstances, "only one form of relief" against subsidization may be available. Thus, according to them, the text of the *SCM Agreement* makes plain that Article VI of the GATT 1994 applies to more than one type of action against subsidization. They add that, if Article VI of the GATT 1994 and the *SCM Agreement* governed only countervailing duties, as the United States alleges, then the prohibition in Article 32.1 would not prohibit effectively specific action against a subsidy and would be rendered meaningless. The meaning and effectiveness of Article 32.1, like Article 18.1, lie in the fact that it prohibits *all* types of specific action against a subsidy, except for the specific actions that are permitted under Article VI of the GATT 1994 and the *SCM Agreement*. Japan and Chile also note that Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* are virtually identical, and that, in *US – 1916 Act*, the Appellate Body stated that Article 18.1 supports a conclusion that Article VI of the GATT 1994 is applicable to any "specific action against dumping" of exports. They argue that, by the same logic, Article 32.1 means that Article VI of the GATT 1994 is applicable to any specific action against a subsidy.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

104. Japan and Chile maintain that the language of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* reflects the intention of WTO Members to ensure that anti-dumping and countervailing duty petitions have a specified level of support before investigations based on those petitions are initiated. According to them, the CDSOA distorts the proper expression and measure of this support by providing a financial incentive to members of an industry to express their views one way rather than another.

105. Japan and Chile refer to the report of the Appellate Body in *US – FSC*, and in *EC – Sardines*, to maintain that WTO Members are required to fulfill,

perform and execute their treaty obligations in accordance with the "pervasive" principle of good faith. According to them, the Panel correctly found that the United States ignored its good faith obligations when it adopted the CDSOA.

106. Japan and Chile find support for their conclusion in other provisions of the *Anti-Dumping Agreement* and the *SCM Agreement*. They see, implicit in those provisions, a recognition that even a properly initiated investigation can impose a severe burden on the parties required to respond. According to them, those provisions, as well as Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, seek to limit that burden. The object and purpose of Articles 5.4 and 11.4 was thus to place disciplines on the initiation of burdensome anti-dumping and countervailing duty investigations and to require that support, within the meaning of those provisions, be "freely-expressed".[66]

107. Japan and Chile agree with the United States that the motives of domestic producers in deciding whether to support or file an application are not relevant under Articles 5.4 and 11.4. They submit, however, that the action by the United States to influence those motives through a payment is relevant.

3. The Combination of Duties and CDSOA Offset Payments

108. Japan and Chile argue that the Panel's finding that the CDSOA has an adverse bearing on the conditions of competition of dumped or subsidized goods is not based on, nor does it question, the consistency of the United States laws or regulations relating to the imposition of anti-dumping or countervailing duties. According to them, the CDSOA was the only measure whose consistency with the GATT 1994, the *Anti-Dumping Agreement* and the *SCM Agreement* was examined by the Panel. In examining whether the CDSOA constitutes a specific action against dumping/a subsidy, and whether it is consistent with Articles 18.1 and 32.1, they claim it was necessary for the Panel to consider other relevant United States trade laws in its examination of the CDSOA, since the terms of the CDSOA incorporate those laws by direct reference to anti-dumping and countervailing duty orders and to findings under the Antidumping Act of 1921. Nevertheless, none of the Panel's conclusions depends on any finding regarding the text of laws other than the CDSOA.

109. Japan and Chile also note the United States' reference to footnote 334 of the Panel Report (referring to the combination of anti-dumping duties and offset payment subsidies in the particular circumstances of the CDSOA). According to them, the purpose of footnote 334 is to reiterate the Panel's statement in paragraph 7.52, which makes clear that the Panel did not make findings regarding anti-dumping and countervailing duty orders under the respective United States trade laws that were outside its terms of reference. They argue that it is inaccurate to assert that the Panel examined other provisions of United States law in order to find a WTO violation. Rather, they argue that the Panel made an objective assessment of the facts of the case, which included anti-

[66] Japan's and Chile's appellees' submission, para. 101.

dumping and countervailing duty orders issued under applicable United States laws.

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

110. Japan and Chile argue that, because the CDSOA is inconsistent with Articles 18.1 and 5.4 of the *Anti-Dumping Agreement*, Articles 32.1 and 11.4 of the *SCM Agreement*, and Articles VI:2 and VI:3 of the GATT 1994, it is also in violation of Article XVI:4 of the *WTO Agreement*, Article 18.4 of the *Anti-Dumping Agreement* and Article 32.5 of the *SCM Agreement*.

5. The "Advisory Opinion"

111. Japan and Chile submit that the Panel's observations contained in paragraph 7.22 of the Panel Report are not, as the United States claims, an "advisory opinion." They point out that the Panel was merely clarifying the factual basis for its finding that the offset payments under the CDSOA can be made only in situations where the constituent elements of dumping are present. By stating that it would have reached the same conclusion had the payments been funded directly from the United States Treasury, and in an amount unrelated to the collected anti-dumping duties, the Panel, according to them, was emphasizing that the connection between the offset payments and the determination of dumping was so clear, direct and unavoidable, that it would remain even if the payments were funded from another source.

6. Article 9.2 of the DSU

112. Japan and Chile argue that the Panel's decision not to accept the United States' request for separate panel reports was justified by the right of the Complaining Parties to a prompt settlement of the dispute and the need to prevent an untimely and abusive exercise of rights on the part of the United States, which would have prejudiced the complainants. According to them, it is inherent in every legal precept that confers rights to a party in a proceeding that such rights, either procedural or substantive, must be exercised in a reasonable and timely manner.

113. Japan and Chile submit that, by rejecting the request for separate panel reports, the Panel did not diminish the United States' rights under Article 9.2 of the DSU; rather, it protected the complainants' right under Article 3.3 of the DSU to a prompt settlement of the dispute and also protected them from an abusive exercise of the United States' rights. They also claim that the Panel properly determined that acceptance of the United States' request would have delayed the issuance of the final report and would have prolonged the nullification and impairment of the rights of the complainants under the covered agreements caused by the CDSOA. Thus, they conclude, that the Panel maintained the proper balance between the procedural right of the United States to separate

panel reports and its obligations not to nullify and impair the benefits accruing to the complainants under the covered agreements.

G. Korea – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

114. Korea submits that the CDSOA is a specific action in response to dumping. According to Korea, the Panel carefully analyzed the structure and design of the CDSOA, and found that the CDSOA requires the constituent elements of dumping for its application. It was only on that basis that the Panel concluded that there is a clear, direct and unavoidable connection between the determination of dumping and CDSOA offset payments, and that the CDSOA is "specific action" related to dumping.

115. Korea contends that the Panel's definition of "against" was in line with the rules of treaty interpretation. Korea notes the United States' assertion that "against" implies that an action must come into contact directly with the imported or subsidized good or importer, exporter or foreign producer. Korea argues that "in contact with" is an ordinary meaning of "against" when it is used to describe physical contact, and that it cannot be the ordinary meaning of "against" as it is used in relevant WTO provisions. Korea adds that the proper context in which the term "against" is used is "against dumping". It is neither against dumped imports nor against entities connected to the dumped good.

116. Korea submits that the Panel fully explained why the "conditions of competition" test is applicable to Article 18.1 and Article 32.1. The Panel found, from the ordinary meaning of "against", that a measure will act "against" dumping if it has an adverse bearing on the practice of dumping. The Panel then took note of the fact that "against" is not qualified in any way in Article 18.1, and thus found that the ordinary meaning of "against" encompasses any form of adverse bearing, be it direct or indirect. The Panel then proceeded to analyze the structure and design of the CDSOA to see how the CDSOA distorts the conditions of competition between dumped and domestic products. From this, the Panel found that the CDSOA distorts the conditions of competition between domestic and dumped products, which it found to be a *form* of adverse bearing on dumping.

117. Korea supports the Panel's finding that the CDSOA has an adverse impact on the conditions of competition. Korea disagrees with the United States that this finding of the Panel is based on mere suppositions, and argues that it results rather from an analysis of the structure and design of the CDSOA. Korea contends that the Panel correctly referred to the stated purpose of the CDSOA to confirm this finding. Korea notes that in *Chile – Alcoholic Beverages*, the Appellate Body made a distinction between *subjective* intentions inhabiting the minds of individual legislators, and the purpose or objective *objectively* expressed in the statute itself. According to Korea, although it is not necessary for the panel to sort through the *subjective* intentions of legislators, the Appellate

Body found that the purpose or objective *objectively* expressed in the statute itself are pertinent. The Appellate Body added that this *objective* expression can be discerned from the design, the architecture and the structure of a measure.[67] Korea submits that the Panel's analysis was in full compliance with such guidance from the Appellate Body.

118. Korea maintains that the Panel correctly found that its findings on claims under Article 18.1 of the *Anti-Dumping Agreement* apply equally in respect of the claims under Article 32.1 of the *SCM Agreement*. According to Korea, the Appellate Body's analysis in *US – 1916 Act* was not based on any particular provisions of the *Anti-Dumping Agreement* in isolation, but on the *Anti-Dumping Agreement* as a whole. Also, Korea notes that the Panel stated that it is important to have regard to the fact that the types of remedies foreseen by the *SCM Agreement* are broad, including countervailing duties and countermeasures.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

119. Korea endorses the Panel's finding that the CDSOA constitutes a violation of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

120. According to Korea, the peculiarity of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* is that the object and purpose of those provisions is explicitly contained in the provisions themselves. Korea concludes that a violation of the "object and purpose" of those provisions is a violation of the explicit terms of those provisions as well.

121. Korea notes the assertion by the United States that the Panel's finding is not based on a violation of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, but rather on a violation of the principle of good faith. According to Korea, the United States seems thereby to assert that, even though "good faith implementation of a treaty provision is a substantive obligation arising from the *Vienna Convention on the Law of Treaties*"[68], it is not "part of the WTO law."[69]

122. Korea submits that WTO Members must observe the general principle of good faith, recognized by the Appellate Body as a pervasive principle that informs the covered agreements, in the application and interpretation of the *Anti-Dumping Agreement* and the *SCM Agreement*.

123. Korea endorses the Panel's finding that the CDSOA provides a financial inducement to domestic producers to file or support applications for the initiation of anti-dumping and countervailing duty investigations, because CDSOA payments are made only to those producers that file or support such applications and because the financial rewards for doing so are significant. Korea submits that the Panel's findings to this effect were based on a careful examination of the

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[67] Appellate Body Report, *Chile – Alcoholic Beverages*, para. 62.
[68] Korea's appellee's submission, para. 50.
[69] *Ibid*.

structure and operation of the CDSOA and not on speculation, as the United States asserts.

3. The Combination of Duties and CDSOA Offset Payments

124. Korea notes that the United States, in making the claim that the Panel exceeded its terms of reference by examining the CDSOA in combination with United States laws, does not make any reference to the Panel Report. Korea argues that the absence of any reference is not because of inadvertence, but because the Panel did not make such an examination.

125. According to Korea, the CDSOA and anti-dumping (or countervailing) duties are not bifurcated and independent from each other. On the contrary, the presence of anti-dumping duties is a *sine qua non* for the disbursement of CDSOA offset payments. Korea submits that all of the relevant findings of the Panel were made in relation to the analysis of the CDSOA alone, without any reference to United States laws on the imposition of anti-dumping (or countervailing) duties.

H. Mexico – Appellee

1. Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement

126. Mexico submits that the Panel interpreted Articles 18.1 and 32.1 properly. The Panel applied the analysis of "constituent elements" used by the Appellate Body in *US – 1916 Act* and determined that the CDSOA offset payments acted specifically in response to dumping. The Panel interpreted the meaning of "against dumping" as "an adverse bearing on dumping" and applied its legal interpretation to the facts of the dispute in order to determine that the CDSOA was a non-permissible "specific action against dumping". The Panel also applied its analysis in relation to Article 18.1 of the *Anti-Dumping Agreement* to the argument on Article 32.1 of the *SCM Agreement*, and found that the CDSOA was a non-permissible "specific action against a subsidy".

127. Mexico contends that it is not necessary for the "constituent elements" of dumping or of a subsidy to be expressed in the language of the law. Interpreting Article 18.1 as requiring that a law must explicitly establish the constituent elements of dumping opens up the possibility of circumventing this provision. Such an interpretation should, therefore, be avoided.

128. Mexico argues that the distribution of CDSOA offset payments is directly related to, and caused by, the imposition of anti-dumping or countervailing duties, which legally can be imposed only when the elements of dumping and subsidy are present. According to Mexico, the Panel correctly found that there is a clear, direct and unavoidable connection between the determination of dumping and CDSOA offset payments.

129. Mexico adds that there is nothing in the "constituent elements" test that specifies that the payments and the dumping must occur at the same time. Even

though, under certain circumstances, CDSOA payments may be retrospective, this does not alter the fact that there is an unavoidable connection between the payments and the dumping or subsidization. By their very structure and design, CDSOA payments occur after the collection of anti-dumping and countervailing duties.

130. Mexico maintains that the scope of Articles 18.1 and 32.1 on the one hand, and footnotes 24 and 56 on the other, are mutually exclusive. Action prohibited by an article cannot be permitted by a footnote to that article. According to Mexico, even though the footnotes are relevant to this dispute, the United States has not established that the CDSOA is action "under other relevant provisions of GATT 1994". The fact that the measures are not inconsistent with the GATT 1994 does not mean that they are taken under other relevant provisions of the GATT 1994.

131. Mexico submits that there is no basis for interpreting the word "against" as meaning that action must have an adverse bearing on imports or persons "directly" related to the imports. There is no mention in any part of Articles 18.1 or 32.1 of actions taken "directly" against dumped or subsidized imports and there is no text or context that imposes this requirement. Those Articles simply refer to "action against", which may include direct or indirect action. The reference in Article 18.1 to "dumping of exports" instead of "dumped exports" and the reference in Article 32.1 to "a subsidy of another Member" instead of "subsidized imports" or "subsidized exports" confirms this. For Mexico, if those who drafted the two Agreements had wanted to follow the limited interpretation given by the United States, they would have used other words instead of "dumping of exports" or "a subsidy of another Member".

132. Mexico contends that the Panel did not interpret Articles 18.1 and 32.1 to include a "conditions of competition" test. The Panel's reference to conditions of competition was in the context of evaluating the relevant facts and circumstances of the CDSOA, and whether the CDSOA has "an adverse bearing" on dumping. For Mexico, the Panel was not creating a new legal test. Mexico maintains that the distortion of competition between the dumped product and the domestic product is proof of an adverse bearing on dumping.

133. Mexico submits that the conclusions of the Panel that the CDSOA has a specific adverse impact on the competitive relationship between domestic products and dumped imports, and that such dissuasive effect means that the CDSOA bears adversely on dumping, and therefore acts against dumping, are not the result of speculation and are not based on assumptions or hypothetical examples. Rather, they are the result of the Panel's analysis of the structure and design of the CDSOA. The real impact of the CDSOA is shown in the Panel's finding that "[e]xporters/foreign producers know that if they dump products in the United States, and if those products are subject to an anti-dumping order, not only will anti-dumping duties be levied, but those duties will be transferred to at least some of their US competitors in the form of CDSOA offset payments."[70]

[70] Panel Report, para. 7.39.

134. Mexico argues that the Panel is empowered to examine the legislative history of a law when examining its significance. In *US – 1916 Act*, the panel considered the text of the measure at issue in that dispute in the context of its enactment, including the legislative history.[71] In *US – Countervailing Measures on Certain EC Products*, the panel indicated that "when examining internal legislation, a Panel must look to all the elements that establish its meaning, not just the statutory language. Therefore, it is also necessary to look at other domestic interpretive tools such as the legislative history …".[72] In *US – Section 110(5) Copyright Act*, the panel stated that "we also observed that stated public policy purposes could be of subsidiary relevance for drawing inferences about the scope of an exemption and the clarity of its definition. In our view, the statements from the legislative history indicate an intention of establishing an exception with a narrow scope."[73] Mexico adds that the Panel in this case did not base its finding that the CDSOA constitutes "specific action against dumping" on the legislative history. Rather, it looked to the legislative history of the CDSOA to confirm its finding.

135. Mexico maintains that the Panel correctly interpreted Article 32.1 of the *SCM Agreement*. As noted by the Panel, Article 18.1 and Article 32.1 contain essentially identical language. The Panel acknowledged the differences between Article 1 of the *Anti-Dumping Agreement* and Article 10 of the *SCM Agreement*, but did not see why a different approach should apply in respect of the permissible responses to subsidization. In the case of the *Anti-Dumping Agreement*, the permitted responses to dumping are provisional anti-dumping duties, definitive anti-dumping duties and price undertakings. In the case of the *SCM Agreement*, the permitted responses to a subsidy are provisional and definitive countervailing duties, price undertakings, and countermeasures.

2. Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement

136. Mexico supports the finding of the Panel that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, because it operates in such a way that the investigating authorities cannot carry out an objective and impartial examination of the degree of support for the application.

137. Mexico submits that, contrary to the United States' claim, the wording of these provisions interpreted in good faith and taking into account their context and object and purpose, does not mean that the only thing WTO Members have to do is to examine whether the statistical thresholds in Articles 5.4 and 11.4 have been met prior to initiating an investigation. Rather, Articles 5.4 and 11.4 require a positive determination based on the degree of support for an application

[71] Panel Report, *US – 1916 Act (EC)*, paras. 6.120-6.133 and 6.228; Panel Report, *US – 1916 Act (Japan)*, paras. 6.141-6.151 and 6.289.
[72] Panel Report, *US – Countervailing Measures on Certain EC Products*, para. 7.139.
[73] Panel Report, *US – Section 110(5) Copyright Act*, para. 6.157.

"by or on behalf of the domestic industry". Such a determination must be objective and must comply with the principle of good faith.

138. Mexico submits that, for the thresholds set out in Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* to be meaningful, a WTO Member may not distort the degree of support for, or opposition to, any particular application. In order to comply with this obligation, it is not necessary to enquire into the motives or intent of producers that elect to support an application. Members of the WTO must ensure, however, that no measure increases (or decreases) the possibility that the domestic industry meets the prescribed threshold, and that the investigating authority's decision regarding the degree of support is objective and unbiased.

139. Mexico concludes that, "[b]y giving applicants or those supporting applications economic advantages, the CDSOA prevents the United States investigating authorities from making an objective and unbiased finding regarding the degree of support for any application."[74] In itself, the CDSOA "invariably distorts the degree of support for an application"[75] and is therefore inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

140. Mexico further submits that the Panel's analysis of whether or not the CDSOA creates a financial incentive to support anti-dumping or countervailing duty investigations is relevant with respect to addressing the issue of whether the United States has maintained measures which prevent investigating authorities from conducting an objective examination of whether or not an application has been made "by or on behalf of the domestic industry" within the meaning of Articles 5.4 and 11.4.

3. The Combination of Duties and CDSOA Offset Payments

141. Mexico argues that the Panel did not exceed its terms of reference by examining the claims concerning the CDSOA in combination with other laws and regulations. According to Mexico, the CDSOA is within the Panel's terms of reference. In addition, the complainants did not contest the consistency of United States legislation on anti-dumping and countervailing duties, so it is not necessary for this legislation to be identified as the actual measure in dispute in this case. At the same time, however, the Panel had the authority to examine the context of the CDSOA, which includes other United States legislation. Mexico also claims that the panel report in *US – Section 129(c)(1) URAA*, cited by the United States, does not support the United States' position, but is rather contrary to it.

[74] Mexico's appellee's submission, para. 54.
[75] *Ibid*.

4. Article XVI:4 of the WTO Agreement, Article 18.4 of the Anti-Dumping Agreement, Article 32.5 of the SCM Agreement and Article 3.8 of the DSU

142. Mexico argues that the Panel correctly found that the CDSOA is inconsistent with Articles 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement*, Articles 11.4, 32.1 and 32.5 of the *SCM Agreement*, and Articles VI.2 and VI.3 of the GATT 1994. Therefore, the CDSOA is inconsistent with Article XVI.4 of the *WTO Agreement*. It also nullifies or impairs the benefits accruing to the Complaining Parties under these agreements.

5. The "Advisory Opinion"

143. Mexico argues that paragraph 7.22 of the Panel Report is *obiter dictum* and not a legal finding by the Panel that has to be upheld, modified or reversed by the Appellate Body.

I. Arguments of the Third Participants

1. Argentina

(a) Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*

144. Argentina supports the conclusion of the Panel that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, because it induces United States producers to file or to support applications for the petition for the initiation of anti-dumping and countervailing duty investigations.

145. Argentina emphasizes that the object and purpose of Articles 5.4 and 11.4 should be considered "just as valid"[76] as the text of those provisions. According to Argentina, Articles 5.4 and 11.4 seek to ensure not only that WTO Members comply with the threshold tests set out in those provisions, but also that investigations are initiated in proper form and that "unjustified proliferation of investigations"[77] is avoided. According to Argentina, this "object and purpose" is also reflected in the requirement contained in those provisions not to initiate investigations when domestic producers expressly supporting the application account for less than 25 per cent of the domestic industry.

146. Argentina notes that the mere initiation of an investigation brings with it the possibility of provisional measures being introduced in accordance with Article 7 of the *Anti-Dumping Agreement* and Article 12.12 of the *SCM Agreement*. Argentina submits that a proliferation of investigations could entail injury to a large number of exporters to the United States' market and disrupt normal trade flows among WTO Members.

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[76] Argentina's third participant's submission, para. 7.
[77] *Ibid*., para. 8.

(b) Article XVI:4 of the *WTO Agreement*, Article 18.4 of the *Anti-Dumping Agreement*, Article 32.5 of the *SCM Agreement* and Article 3.8 of the DSU

147. Argentina argues that, because the CDSOA is inconsistent with the United States' WTO obligations under the *Anti-Dumping Agreement* and the *SCM Agreement*, it also violates Article XVI:4 of the *WTO Agreement*.

2. Hong Kong, China

(a) Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*

148. Hong Kong, China submits that the mandated distribution of offsets under the CDSOA constitutes specific action against dumping and subsidization under Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. Although the constituent elements of dumping are not referred to in the CDSOA, no payments under the CDSOA can be made unless anti-dumping duties are collected. Anti-dumping duties cannot be collected unless an anti-dumping order is imposed. An anti-dumping order cannot be imposed unless the constituent elements of dumping exist. The same is true for subsidization. Notwithstanding the fact that the CDSOA does not refer to the constituent elements of dumping or subsidization, actions under the CDSOA can be taken only if the constituent elements of dumping and/or subsidization are found. Thus, actions under the CDSOA are clearly "in response" to the constituent elements of dumping and/or subsidization.

149. Hong Kong, China adds that the CDSOA is a specific action against dumping or subsidization because it places imported goods at a competitive disadvantage relative to domestically-produced goods, and brings about an adverse impact on the imported goods. The additional burden is a direct result of the domestic producers of the United States having an increased cash flow that, in turn, is the result of distribution of funds directly stemming from the existence of an anti-dumping or countervailing duty order. The mere fact that the United States producers receive a distribution because an anti-dumping or countervailing duty order is in place is sufficient to render the CDSOA inconsistent with the *Anti-Dumping Agreement* and the *SCM Agreement*.

150. Hong Kong, China says that the Panel has not concluded that there exists a test for conditions of competition or competitive advantage in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. Rather, according to Hong Kong, China, the Panel has used this analysis only to demonstrate that the CDSOA is a direct burden on imported goods. By offsetting the effects of dumping and subsidization in addition to the anti-dumping and countervailing duty order, payments under the CDSOA impermissibly alter the competitive conditions in favour of domestic producers. According to Hong Kong, China, if anti-dumping and countervailing duties level the playing field, the CDSOA payments tilt the field back in favour of the domestic producers in the United States. By definition, CDSOA payments would improve the

recipients' competitive position. Hong Kong, China says that it is, therefore, established, through the conditions of competition analysis, that the CDSOA results in a "direct" burden on imported goods.

151. Hong Kong, China notes that in the dispute concerning the *US – 1916 Act*, the Appellate Body unequivocally restricted permissible responses to dumping to definitive anti-dumping duties, provisional measures or price undertakings. The Appellate Body's analysis was not based on any particular provisions in the *Anti-Dumping Agreement* in isolation, but rather on the *Anti-Dumping Agreement* as a whole. In that case, the Appellate Body looked at the overall purpose and meaning of the *Anti-Dumping Agreement* and found that only those measures expressly provided for in the *Anti-Dumping Agreement* are permissible specific actions against dumping. As far as the present case on the CDSOA is concerned, Hong Kong, China says that it sees no reason why the same analysis of examining the overall purpose and meaning of the whole Agreement should not be adopted in order to decide whether any action that is not expressly provided for in the Agreement is permissible.

(b) Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*

152. Hong Kong, China submits that the object and purpose of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* is to limit the initiation of investigations to those instances where the domestic industry has a genuine interest in the adoption of measures against dumping or subsidization. Hong Kong, China maintains that the CDSOA provides domestic producers who have not been adversely affected by dumped/subsidized imports with an incentive to file or to support anti-dumping and countervailing actions, and in doing so, renders the quantitative thresholds in Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* meaningless.

3. Israel

(a) Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*

153. Israel submits that the CDSOA is a specific action against dumping and subsidization within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, because it awards monetary damages to parties that have been found to be injured by dumping or subsidization.

(b) Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*

154. Israel endorses the Panel's finding that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, because it operates in such a way that the investigating authorities are unable to conduct an objective and impartial examination of the level of support that exists for an application.

4. Norway

(a) Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*

155. Norway submits that the Panel correctly concluded that the CDSOA is a non-permissible specific action against dumping contrary to Article 18.1 of the *Anti-Dumping Agreement* and that it is a non-permissible specific action against a subsidy contrary to Article 32.1 of the *SCM Agreement*. As Article 32.1 of the *SCM Agreement* contains parallel language to Article 18.1 of the *Anti-Dumping Agreement*, Norway says it agrees with the Panel that the phrase "specific action against a subsidy" must be understood similarly to encompass, at a minimum, action that may be taken only when the constituent elements of a subsidy are present. Norway adds that a Member's actions with respect to subsidies are spelled out in Articles VI and XVI of the GATT 1994, as interpreted by the *SCM Agreement*, and limited to one of the following three types of action against subsidization: "countervailing measures" imposed in accordance with Part V of the *SCM Agreement*; "countermeasures" against a "prohibited subsidy" imposed in accordance with Part II of the *SCM Agreement*; or, "countermeasures" against subsidies that cause "adverse effects" to the interests of the Member concerned, according to Part III of the *SCM Agreement*. The "specific measures" available to a WTO Member to meet subsidization are thus limited to the above-mentioned measures.

156. Norway notes that the United States has argued in *US – Norwegian Salmon AD* that limits exist with respect to the actions a Member State may take in response to unfair trade practices.

157. Norway contends that the legislative history of the CDSOA is a relevant and important factor to be taken into account when demonstrating that the CDSOA was aimed at creating an additional specific measure as a response to foreign dumping and subsidization.

(b) Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*

158. Norway expresses agreement with the Panel that the CDSOA, by mandating offset payments to affected domestic producers, provides a strong financial incentive to domestic producers to file applications for the imposition of anti-dumping or countervailing measures, or to support such applications made by other domestic producers. In Norway's submission, a domestic producer cannot be considered to have made an "application", or to have "supported" it, within the meaning of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, if it does so in order to qualify for offset payments provided under the CDSOA.

159. Norway submits that the CDSOA has the effect of stimulating the filing of applications and making it easier for applicants to obtain the support of other domestic producers, so as to meet the quantitative thresholds laid down in Article 5.4 of the *Anti-Dumping Agreement* and in Article 11.4 of the *SCM Agreement*.

In doing so, the CDSOA operates in a way which prevents the United States' authorities from conducting an objective examination of whether an application is made "by or on behalf of the domestic industry" as required by Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

(c) Article XVI:4 of the *WTO Agreement*, Article 18.4 of the *Anti-Dumping Agreement*, Article 32.5 of the *SCM Agreement* and Article 3.8 of the DSU

160. Norway argues that the CDSOA is inconsistent with Article XVI:4 of the *WTO Agreement* and nullifies and impairs benefits accruing to the complainants because it is inconsistent with Articles 18.1 and 5.4 of the *Anti-Dumping Agreement*, and with Articles 32.1 and 11.4 of the *SCM Agreement*.

IV. PROCEDURAL MATTERS: ARGUMENTS OF THE PARTICIPANTS AND THE THIRD PARTICIPANTS

A. Allegation of Flaws in the Notice of Appeal

1. Canada

161. In a letter dated 5 November 2002, Canada requested the Appellate Body to issue a preliminary ruling that the United States is in breach of Rule 20(2)(d) of the *Working Procedures*, because the United States' appellant's submission contains certain arguments, allegations and requests for ruling that the United States did not include in the Notice of Appeal dated 18 October 2002. Canada refers explicitly to paragraph 40 of the United States' appellant's submission, in which the United States argues that the Panel failed to set out "the basic rationale behind" its finding as required by Article 12.7 of the DSU (by not explaining why it examined the burden the measure creates on the conditions of competition under which imports compete), and that the Panel failed to conduct an "objective assessment of the matter before it" as required by Article 11 of the DSU.

162. Canada also refers to Sections IV and VI of the United States' appellant's submission, where the United States alleges that the Panel exceeded its terms of reference, by examining claims concerning the CDSOA in combination with other United States laws and regulations, and by issuing an advisory opinion on a measure outside its terms of reference. According to Canada, these claims relate to the exercise of jurisdiction by the Panel under Article 7 of the DSU, and the United States should have included them in its Notice of Appeal.

163. Canada concludes that the United States' claims, concerning violations by the Panel of Articles 7, 11 and 12 of the DSU, are outside the scope of appellate review, because the United States failed to include them in its Notice of Appeal.

2. United States

164. Responding to the arguments raised by Canada in its request for a preliminary ruling, the United States argues that its Notice of Appeal "is more

than sufficient in setting out the 'findings or legal interpretations of the Panel' from which the United States is appealing."[78] The United States submits that, in the first numbered paragraph of its Notice of Appeal, it appeals as erroneous the Panel's findings that the CDSOA is inconsistent with Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*; and that such findings are based on "erroneous findings of issues of law and related legal interpretations."[79] According to the United States, each of its arguments alleged by Canada to be outside the scope of the appeal falls within the matters raised in this first numbered paragraph of the United States' Notice of Appeal.

165. As regards paragraph 40 of the United States' appellant's submission, the United States notes that one of the legal bases for the Panel's findings on Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* is the "conditions of competition" test. Because the United States' claim at issue in paragraph 40 concerns the "conditions of competition" test, it relates to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. The United States' Notice of Appeal covers the Panel's findings and related legal interpretations regarding Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, and, therefore, the matters addressed in paragraph 40 "fall squarely within the matters raised in the first numbered paragraph of the U.S. notice."[80] The United States also argues that Canada's claim that the United States' Notice of Appeal should have specifically cited Articles 11 and 12.7 of the DSU is contrary to the Appellate Body's interpretation of Rule 20 of the *Working Procedures*. The United States submits that, under the interpretation of this rule set out by the Appellate Body in *US – Shrimp*, the Notice of Appeal need only identify the findings or legal interpretations of the Panel which are being appealed as erroneous; the Notice of Appeal is not designed to be a summary or outline of the arguments to be made by the appellant. The United States clarified at the oral hearing that it does not request the Appellate Body to make a specific finding that the Panel has failed to comply with Articles 11 or 12.7 of the DSU; the comments on these Articles found in paragraph 40 are simply supportive of the United States' argument that the Panel erred in interpreting Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.

166. Turning next to Canada's contentions regarding Section IV of the United States' appellant's submission, the United States submits that the Panel's findings on Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* were based in part on the Panel's findings concerning the CDSOA in combination with other United States laws. Because the United States' claim at issue in Section IV concerns the combination issue, it relates to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. The United States' Notice of Appeal covers the Panel's findings and related legal interpretations regarding Article 18.1 of the *Anti-Dumping Agreement* and

[78] United States' letter of 8 November 2002.
[79] *Ibid*.
[80] *Ibid*.

Article 32.1 of the *SCM Agreement*, and, therefore, the matters addressed in Section IV "are plainly covered" by the Notice of Appeal.[81]

167. As to Canada's contentions on Section VI of the United States' appellant's submission, the United States submits that the Panel's advisory opinion was made in the context of its findings on Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. Section VI concerns the advisory opinion issue and, therefore, relates to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. Because the United States' Notice of Appeal covers the Panel's findings and related legal interpretations regarding Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, the matters addressed in Section VI "are well within the scope"[82] of the Notice of Appeal.

168. The United States also argues that Canada's arguments alleging that due process mandates that these issues should be included in the Notice of Appeal are without merit. The United States points out that there is no "notice of appeal" preceding an "other appellant's" submission under the *Working Procedures*. Furthermore, an appellee has 15 days to respond to an appellant's submission (which is preceded by a notice of appeal), but only 10 days to respond to an "other appellant's" submission (which is not preceded by a notice of appeal). Thus, the United States argues, Canada's logic regarding due process would suggest that all appeals to date under the WTO in which there has been an "other appellant's" submission have violated the "fundamental requirements of due process".

3. Australia

169. Australia contends that some allegations of errors by the United States are not properly before the Appellate Body by reason of insufficiencies of the Notice of Appeal. Australia submits that the Notice of Appeal does not include any reference to the fact that the Panel may have violated Articles 11 and 12.7 of the DSU. Nor does it include any reference that the Panel may have exceeded its terms of reference.

4. Brazil

170. According to Brazil, the United States' claim that the Panel exceeded its terms of reference by examining claims concerning the CDSOA in combination with other United States laws is not properly before the Appellate Body, because the United States failed to include this claim in its Notice of Appeal.

5. European Communities, India, Indonesia and Thailand

171. The European Communities, India, Indonesia and Thailand argue that, only if the allegations of error are adequately identified in the Notice of Appeal,

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[81] United States' letter of 8 November 2002.
[82] *Ibid*.

are the other parties to the proceedings in a position to exercise their rights under the DSU and the *Working Procedures*. They also recall the Appellate Body's recognition that Article 3.10 of the DSU commits WTO Members to engage in the dispute settlement procedures "in good faith" and that the procedural rights under the DSU must be exercised in a manner that does not prevent other Members from exercising their own rights. According to the European Communities, India, Indonesia and Thailand, withholding a claim of error until the filing of the appellant's submission is inconsistent with the requirements of good faith and due process. Thus, the European Communities, India, Indonesia and Thailand conclude that the claims identified in Canada's letter dated 5 November 2002 should be excluded from the scope of this appeal.

6. Japan

172. Japan argues that the claims identified in Canada's letter dated 5 November 2002 as new claims of error made by the United States cannot be characterized simply as grounds for the current appeal, as legal arguments in support of an allegation included in the Notice of Appeal, or as statements of a provision of the covered agreements. Therefore, Japan concludes that the United States contravened Rule 20(2)(d) of the *Working Procedures* by including these new allegations in its appellant's submission.

7. Korea

173. Korea submits that the United States included in its appellant's submission several points not raised in the Notice of Appeal. According to Korea, this is in violation of Rule 20(2)(d) of the *Working Procedures*.

8. Norway

174. Norway contends that some of the allegations in the United States' appellant's submission are not mentioned in the Notice of Appeal and, therefore, should be excluded from the scope of appellate review.

B. Allegations Regarding the Scope of Appellate Review

1. Canada

175. Canada further argues in its request for a preliminary ruling and in its appellee's submission that the United States' appellant's submission is "inconsistent with Article 17.6 of the DSU, because it purports to adduce new evidence … and that consideration of such new evidence is outside the scope of appellate review."[83] According to Canada, Article 17.6 of the DSU prohibits the Appellate Body from receiving and examining evidence that was not before the Panel in order to impugn the factual findings of the Panel.

[83] Canada's letter dated 5 November 2002.

176. Canada submits that in paragraphs 120-121 of the United States' appellant's submission, the United States purports to impugn evidence on which the Panel relied, namely two letters submitted to the Panel by Canada. For Canada, this attempt by the United States to impugn the "credibility and weight"[84] the Panel attached to the two letters is inconsistent with Article 17.6 of the DSU. Canada also stresses that the United States does so even though it did not comment on this evidence when the evidence was first brought before the Panel, and even though the Panel gave the United States ample opportunity to comment on the letters.

177. In addition, Canada submits that in footnotes 148-149 of the United States' appellant's submission, the United States adduces new evidence that it characterizes as being "available on the public record". Canada argues that consideration by the Appellate Body of such new evidence would be contrary to Article 17.6 of the DSU and that such new evidence "should be struck from the record".[85]

2. United States

178. The United States argues that nothing in its appellant's submission requests, or in any way indicates, that the Appellate Body should do anything but examine the issues of law underlying the Panel's findings and the associated legal interpretations. According to the United States, paragraphs 120 and 121 of its appellant's submission, cited by Canada, "go to the core of one of the legal errors committed by the Panel"[86], namely that the Panel assumed, as a matter of law, without sufficient basis, that the statute would necessarily result in the initiation of anti-dumping and subsidy cases with less than the level of support required under the *WTO Agreement*. The United States argues that the Panel's erroneous conclusions resulted, in part, from the Panel's "misunderstanding of two letters"[87], and that paragraphs 120 and 121 of the appellant's submission seek to clarify the contents of these letters. The United States claims that, in showing that the Panel lacked a basis for its finding that the CDSOA amounts to a *prima facie* violation of the *WTO Agreement*, the arguments in paragraphs 120 and 121 are entirely appropriate and "well within the scope of the matters to be examined in this appeal."[88]

179. As to footnotes 148 and 149 of its appellant's submission, the United States submits that the appeal involves a *prima facie* challenge to the CDSOA and that the issue turns on whether or not the Panel had a sufficient basis for its legal conclusions. Thus, the United States argues, it "cited to [the public documents in these footnotes] to provide the Appellate Body with a greater

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84 Canada's appellee's submission, para. 155.
85 Canada's letter dated 5 November 2002.
86 United States' letter dated 8 November 2002.
87 *Ibid.*
88 *Ibid.*

understanding of the facts involved in the dispute and to reinforce the point that the panel lacked a sufficient basis for its findings."[89]

3. Australia

180. Australia submits that, under Article 17.6 of the DSU, paragraphs 120 and 121 of the United States' appellant's submission, and footnotes 148 and 149 thereto, should be disregarded, as the United States may not contest the accuracy of, or introduce, factual evidence for the first time in appeal proceedings.

4. European Communities, India, Indonesia and Thailand

181. The appellees argue that the new factual arguments and the new factual evidence adduced by the United States at paragraphs 120 and 121 of its appellant's submission, and in the accompanying footnotes, should be disregarded by the Appellate Body. The new factual arguments in paragraphs 120 and 121 were not raised during the Panel proceedings. In addition, the footnotes refer to documents that were not part of the record of the Panel proceedings.

5. Japan

182. Japan first recalls that in *Canada – Aircraft*, the Appellate Body declined to rule on a new argument made by Brazil on appeal. According to Japan, the Appellate Body's decision was based on the ground that in order to rule on the new argument, it would have to solicit, receive and review new facts that were not before the Panel, and that were not considered by it, a scenario excluded by Article 17.6 of the DSU. Therefore, Japan argues that the new argument and the new evidence brought by the United States should be rejected.

6. Korea

183. Korea contends that the United States' appellant's submission is inconsistent with Article 17.6 of the DSU because it adduces new evidence that had not been presented to the Panel.

7. Norway

184. Norway argues that the United States has adduced new factual arguments and new factual evidence in its appellant's submission that are outside the scope of appellate review.

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[89] *Ibid.*

V. PROCEDURAL MATTERS AND RULING

185. We turn first to the procedural matters raised in this appeal. As we indicated earlier in this Report[90], Canada, supported by other appellees[91] and one third participant[92], argues that the United States is in breach of Rule 20(2)(d) of the *Working Procedures*, because the United States' appellant's submission allegedly includes claims, allegations and requests for ruling that were not included in the United States' Notice of Appeal.[93] Canada requests that these claims be struck from the appeal. In addition, Canada objects, with support from other appellees[94] and one third participant[95], to the inclusion in the United States' appellant's submission of arguments that, in Canada's view, impugn certain evidence relied upon by the Panel, and to the inclusion of what Canada regards as new evidence that was not before the Panel. Canada submits that these arguments and the alleged new evidence are outside the scope of appellate review by virtue of Article 17.6 of the DSU.

186. Canada requested a preliminary ruling on these issues[96], to which the United States objected on the grounds that Canada's claims are "meritless"[97] and because neither the DSU nor the *Working Procedures* permits such rulings.[98] We denied the request for a preliminary ruling[99] without ruling on the substance of the issues. We will address them here in turn.

A. Allegations of Flaws in the Notice of Appeal

187. Canada, supported by other participants, argues that the United States refers in its appellant's submission to four issues that were not included in the Notice of Appeal:

- the United States' contention in paragraph 40 of its appellant's submission that the Panel failed to meet its obligations under Article 11 of the DSU[100] because the Panel did not undertake an objective assessment of the matter before it;

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90 *Supra*, paras. 161-163.

91 Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand join Canada in respect of allegations regarding the non-inclusion of claims under DSU Articles 7, 11 and 12.7. In addition, Brazil joins Canada in respect of allegations regarding the non-inclusion of claims under Article 7 of the DSU.

92 Norway.

93 The Notice of Appeal is attached as Annex I to this Report.

94 Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.

95 Norway.

96 Letter dated 5 November 2002 from the Permanent Representative of Canada to the Presiding Member (hereinafter, Canada's letter dated 5 November 2002). A letter was submitted jointly on 8 November 2002 by the European Communities, India, Indonesia and Thailand, in support of Canada's request for a preliminary ruling. Japan also filed a letter on 8 November 2002 in support of Canada's request for a preliminary ruling.

97 United States' letter dated 8 November 2002.

98 *Ibid*.

99 Letter from the Director of the Appellate Body Secretariat dated 8 November 2002.

100 Article 11 states in relevant part:

- the United States' contention in paragraph 40 of its appellant's submission that the Panel failed to meet its obligations under Article 12.7 of the DSU[101] because the Panel did not explain why it examined the burden that the measure creates on conditions of competition;
- the United States' contention in Section IV of its appellant's submission that the Panel exceeded its terms of reference[102] by examining claims concerning the CDSOA "in combination" with other United States laws and regulations; and
- the United States' contention in Section VI of its appellant's submission that the Panel exceeded its terms of reference by issuing an "advisory opinion" on a measure that was not before it.

188. Canada submits that these "claims, allegations and requests for ruling"[103] are not properly before us because they were not included in the Notice of Appeal. According to Canada, Rule 20(2)(d) of the *Working Procedures* "requires a Notice of Appeal to include 'a brief statement of the nature of the appeal, including allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel.'"[104] Canada argues that these requirements, "as well as the requirements of due process, mandate[ ] the United States to include in its Notice of Appeal all *claims* of error that the United States intends to raise."[105] Canada submits that "[b]y failing to include any reference to claims that the Panel violated Articles 7, 11 and 12.7 of the DSU, the United States is in breach of these requirements."[106] Canada asserts that these claims of error are very serious allegations that must not be made without proper notification to the appellees in the Notice of Appeal.[107] Finally,

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> … a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements.

101 Article 12.7 states in relevant part:

> … the report of a panel shall set out the findings of fact, the applicability of relevant provisions and the *basic rationale behind any findings and recommendations* that it makes." (emphasis added)

102 Article 7.1 of the DSU sets out the standard terms of reference for panels:

> Panels shall have the following terms of reference unless the parties to the dispute agree otherwise within 20 days from the establishment of the panel:
>
> "To examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)."

103 Canada's appellee's submission, para. 139.

104 *Ibid*.

105 *Ibid*. (original emphasis)

106 *Ibid*.

107 Canada's letter dated 5 November 2002.

Canada requests that the claims with respect to Articles 7, 11 and 12.7 be struck from this appeal.

189. The United States clarified at the oral hearing that it is not requesting a finding that the Panel failed to act consistently with Articles 11 and 12.7 of the DSU. The United States explained that the reference in paragraph 40 of its appellant's submission to the Panel's failure to meet its obligations under Articles 11 and 12.7 of the DSU is merely an argument in support of its claim that the Panel erred in interpreting Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.

190. As we have not been asked to make findings under Articles 11 and 12.7, we make no such findings. However, we observe that paragraph 40 of the United States' appellant's submission refers explicitly to the Panel's failure to meet its obligations under those provisions. The clear implication is that the United States was indeed making claims under Articles 11 and 12.7 of the DSU. We also note that the United States did not suggest in its letter of 8 November 2002, objecting to Canada's request for a preliminary ruling on the scope of appeal, that it was not requesting findings under those provisions. In our view, Canada and the other appellees were therefore justified in interpreting the United States' appellant's submission as if such claims were indeed being made by the United States. However, given the United States' explanation at the oral hearing that it was not pursuing such claims, the issue of whether they were notified in the Notice of Appeal has become moot.

191. We look next to the other two matters raised by Canada and other participants as not being in the Notice of Appeal and hence not properly before us, namely the United States' arguments in Sections IV and VI of its appellant's submission that the Panel exceeded its terms of reference. The United States contends [108] that its Notice of Appeal is in accordance with Rule 20(2)(d) and relies on our interpretation of that Rule in *US – Shrimp*, where we said:

> The *Working Procedures for Appellate Review* enjoin the appellant to be *brief* in its notice of appeal in setting out "the nature of the appeal, including the allegations of errors". We believe that, in principle, the "nature of the appeal" and "the allegations of errors" are sufficiently set out where the notice of appeal adequately identifies the findings or legal interpretations of the Panel which are being appealed as erroneous. The notice of appeal is not expected to contain the reasons why the appellant regards those findings or interpretations as erroneous. The notice of appeal is not designed to be a summary or outline of the arguments to be made by the appellant. The legal arguments in support of the allegations of error are, of course, to be set out and developed in the appellant's submission. [109] (original emphasis)

[108] United States' letter dated 8 November 2002.
[109] Appellate Body Report, *US – Shrimp*, para. 95.

192. According to the United States, its Notice of Appeal "is more than sufficient in setting out the 'findings or legal interpretations of the Panel' from which the United States is appealing."[110] The United States contends that the claims regarding the Panel's exceeding its terms of reference are included in the Notice of Appeal because they fall within the United States' claim set out in the Notice that the Panel erred in its interpretation of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. In any event, the United States stated at the oral hearing that, as a question of jurisdiction, it is open to the Appellate Body to examine whether a panel exceeded its terms of reference even if no such claim is included in the Notice of Appeal.

193. In examining these submissions, we look first to Rule 20(2) of the *Working Procedures*, which prescribes what is to be included in the Notice of Appeal. In addition to the title of the panel report under appeal, the name of the appellant, and the service address, paragraph (d) states that a Notice of Appeal shall include:

> … a brief statement of the nature of the appeal, including the allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel.

194. We have examined this provision in previous appeals.[111] Most recently, in *US – Countervailing Measures on Certain EC Products*, we said:

> [O]ur previous rulings have underscored the important balance that must be maintained between the right of Members to exercise the right of appeal meaningfully and effectively, and the right of appellees to receive notice through the Notice of Appeal of the findings under appeal, so that they may exercise their right of defence effectively. …[The] requirements under Rule 20(2) serve to ensure that the appellee also receives notice, albeit brief, of the "nature of the appeal" and the "allegations of errors" by the panel.[112]

195. The underlying rationale of Rule 20(2)(d) is thus to require the appellant to provide notice of the claims of error that the appellant intends to argue on appeal.[113]

196. Turning to the Notice of Appeal filed in this case, the United States maintains that "[e]ach of the U.S. arguments claimed by Canada to be outside the

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[110] United States' letter dated 8 November 2002.

[111] Appellate Body Report, *US – Shrimp*, paras. 92-97; Appellate Body Report, *EC – Bananas III*, paras. 151-152; Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, paras. 50-75.

[112] *US – Countervailing Measures on Certain EC Products*, para. 62.

[113] In its letter dated 8 November 2002, the United States points out that, under the *Working Procedures*, there is no "notice of appeal" preceding an "other appellant's" submission and therefore Canada's arguments regarding due process are without merit. In our view, the United States' argument is inapposite because the *Working Procedures* do not require an other appellant to file a Notice of Appeal. In this respect, we refer to para. 62 of our Report in *US – Countervailing Measures on Certain EC Products* and footnote 142 thereto.

scope of the appeal fall squarely within the matters raised in the first numbered paragraph of the U.S. notice."[114]

197. We examine first the arguments in Section IV of the United States' appellant's submission, which is entitled "The Panel Exceeded Its Terms of Reference By Examining Claims Concerning The CDSOA In Combination With Other U.S. Laws And Regulations." In that Section, the United States submits that the Panel exceeded its terms of reference by examining whether the CDSOA, in combination with United States laws on the imposition of anti-dumping duties (or countervailing duties), violate Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.[115] The United States argues that the Panel's terms of reference are limited to examining whether the CDSOA, *as such*, is WTO-consistent, and do not permit an examination of whether the CDSOA, *in combination* with any other United States law or regulation, violates United States obligations' under the *WTO Agreement*.

198. Canada, supported by other appellees[116] and one third participant[117], alleges that Section IV of the United States' appellant's submission relates to a claim as to "the exercise of jurisdiction by the Panel under Article 7 of the DSU"[118], and that such claim was not included in the Notice of Appeal. Canada asks us to exclude this claim from the scope of appeal. The United States responds that "[b]ecause the U.S. notice of appeal covers the Panel's findings and related legal interpretations regarding Antidumping Agreement Article 18.1 and SCM Agreement 13.2 [*sic*], the matters addressed in Section IV are plainly covered by the notice of appeal."[119]

199. A plain reading of the first numbered paragraph of the United States' Notice of Appeal, which the United States submits includes the claim that the Panel exceeded its terms of reference by ruling on the CDSOA in combination with other laws, reveals that there is no explicit reference to Article 7 of the DSU. Nor is there any allegation, explicit or implied, that the Panel exceeded its terms of reference with respect to any of its findings. Indeed, no such claim is apparent in any of the paragraphs of the Notice of Appeal.

200. We do not agree with the United States' contention that the first numbered paragraph of the United States' Notice of Appeal, referring generally to the Panel's failure properly to interpret Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, "plainly covers" a claim that the Panel exceeded its terms of reference. As we have said, the Notice of Appeal "serve[s] to ensure that the appellee also receives notice, albeit brief, of the 'nature of the appeal' and the 'allegations of errors' by the panel."[120] Generic statements such as

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[114] United States' letter dated 8 November 2002. For the full text of the United States' Notice of Appeal, see Annex 1 to this Report.
[115] United States' appellant's submission, para. 131.
[116] Australia, Brazil, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.
[117] Norway.
[118] Canada's letter dated 5 November 2002.
[119] United States' letter dated 8 November 2002.
[120] Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 62.

that relied upon by the United States cannot serve to give the appellees adequate notice that they will be required to defend against a claim that the Panel exceeded its terms of reference. This is particularly so for procedural errors; it can be especially difficult to discern a claim of procedural error by a panel from general references to panel findings or from extracts of a panel report, because allegations of procedural error by a panel may not necessarily be raised until the appellate stage.

201. Therefore, we agree with Canada and other participants that the Notice of Appeal does not provide adequate notice that a claim that the Panel exceeded its terms of reference in ruling on the CDSOA in combination with other laws would be argued by the United States on appeal.

202. Canada, supported by other appellees [121] and one third participant [122], also challenges the United States' arguments set out in Section VI of the United States' appellant's submission as being outside the scope of appeal because they were not included in the Notice of Appeal. Section VI of the United States' appellant's submission is entitled "The Panel Erred in Issuing an Advisory Opinion on a Measure Outside of Its Terms of Reference." The United States contends in that Section that the Panel rendered an "advisory opinion" by making a finding on a measure that was not before it, when it said:

> Even if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion – for the reasons set forth in the preceding paragraph - that offset payments may be made only in situations presenting the constituent elements of dumping. [123]

203. The United States argues that because there was no measure before the Panel regarding payments funded directly from the United States Treasury, the Panel had no authority to make this finding.

204. Canada, supported by other participants, alleges that Section VI of the United States' appellant's submission relates to a claim as to "the exercise of jurisdiction by the Panel under Article 7 of the DSU" [124], which was not in the Notice of Appeal. Canada requests us to rule that this claim of the United States is outside the scope of appellate review. The United States responds that "[b]ecause the U.S. notice of appeal covers the Panel's findings and related legal interpretations regarding Antidumping Agreement Article 18.1 and SCM Agreement Article 13.2 [*sic*], the matters addressed in Section VI are well within the scope of the notice of appeal." [125]

205. We have already explained that we see no reference, explicit or implicit, in the Notice of Appeal regarding the Panel's exceeding its terms of reference.

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[121] Australia, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico and Thailand.
[122] Norway.
[123] Panel Report, para. 7.22.
[124] Canada's letter dated 5 November 2002.
[125] United States' letter of 8 November 2002.

Therefore, our reasoning above applies equally to the United States' claim regarding the alleged advisory opinion in the Panel Report.

206. Having concluded that the Notice of Appeal does not provide notice to the appellees that the United States intended to make claims that the Panel exceeded its terms of reference, the next question is whether we are precluded from examining these claims on appeal. As we have explained, if an appellee has not received sufficient notice in the Notice of Appeal that a particular claim will be advanced by the appellant, that claim normally will be excluded from the appeal. However, we observe that the United States has argued in this appeal that we are entitled to examine questions of jurisdiction in any event, even if not included in the Notice of Appeal.[126]

207. We agree with the United States' position. We have stated previously, in relation to a panel's obligation to address issues related to its jurisdiction, that:

> … panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. In this regard, we have previously observed that "[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings." For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed.[127] (footnote omitted)

208. In our view, the same reasoning applies in this case. As we have said, "[a]n objection to jurisdiction should be raised as early as possible"[128] and it would be preferable, in the interests of due process, for the appellant to raise such issues in the Notice of Appeal, so that appellees will be aware that this claim will be advanced on appeal. However, in our view, the issue of a panel's jurisdiction is so fundamental that it is appropriate to consider claims that a panel has exceeded its jurisdiction even if such claims were not raised in the Notice of Appeal.

209. It is convenient to proceed now with a consideration of the United States' claims that the Panel exceeded its terms of reference "by examining claims concerning the CDSOA in combination with other U.S. laws and regulations" and "in issuing an advisory opinion on a measure outside of its terms of reference."[129]

210. Turning to the first of the United States' contentions, the Panel stated, in connection with its discussion on whether the CDSOA operates "against" dumping or a subsidy, that:

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126 United States' response to questioning at the oral hearing.
127 Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36.
128 Appellate Body Report, *US – 1916 Act*, para. 54.
129 United States' appellant's submission, Sections IV and VI.

> We agree that dumping over time may be evidence of a competitive advantage. However, the *combination* of anti-dumping duties and offset subsidies is not merely to level the playing field, but to transfer that competitive advantage to "affected domestic producer".[130] (emphasis added; footnote omitted)

211. In addition, the Panel said in a footnote:

> Although our finding that the CDSOA constitutes "specific action against dumping" and subsidy rests on the adverse impact of the CDSOA on exporters/foreign producers engaged in dumping, that adverse impact does not result exclusively from the provision of offset payment subsidies (or the use of a subsidy). The adverse impact results from the *combination* of anti-dumping duties and offset payment subsidies in the particular circumstances of the CDSOA.[131] (original underlining)

212. In our view, these statements do not constitute a finding by the Panel that was outside its terms of reference. The Panel was merely reflecting in its reasoning the fact that the CDSOA does not operate in a vacuum but, rather, operates in a context that includes other laws and regulations. The Panel's view was that the combination of anti-dumping duties (or countervailing duties) and CDSOA offset payments distorts the competitive relationship between dumped (subsidized) and domestic products, to the detriment of dumped (subsidized) products. This led the Panel to find that the CDSOA—alone—has an adverse bearing on dumping (subsidization) and, therefore, operates "against" dumping (subsidies) within the meaning of Article 18.1 of the *Anti-Dumping Agreement* (and Article 32.1 of the *SCM Agreement*). Therefore, we *dismiss* the claim of the United States that the Panel exceeded its terms of reference by examining claims concerning the CDSOA "in combination" with other United States laws and regulations.

213. We turn next to the United States' contention that the Panel erred in issuing an "advisory opinion" on a measure outside of its terms of reference. The United States takes issue with the following statement by the Panel:

> Even if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion – for the reasons set forth in the preceding paragraph - that offset payments may be made only in situations presenting the constituent elements of dumping.[132]

214. We note that the Panel made this observation in response to the United States' argument that the fact that CDSOA distributions are funded by proceeds from anti-dumping and countervailing duties does not render the CDSOA a

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[130] Panel Report, para. 7.36.
[131] *Ibid*., para. 7.119 and footnote 334 thereto.
[132] Panel Report, para. 7.22.

"specific action against dumping."[133] The Panel reasoned that, even if the offset payments were funded directly from the United States Treasury, and in an amount unrelated to the collected duties, it would still "reach the conclusion … that offset payments may be made only in situations presenting the constituent elements of dumping."[134] We do not agree with the United States that, in making this statement, the Panel was making a finding on a matter that was outside the Panel's terms of reference. In our view, the Panel was simply making an observation to make it abundantly clear that its finding was in no way based on the fact that offset payments are funded from collected anti-dumping duties. Therefore, we *dismiss* the United States' claim that the Panel issued an "advisory opinion" exceeding its terms of reference.[135]

B. Allegations Regarding the Scope of Appellate Review Under Article 17.6 of the DSU

215. We turn next to the second procedural issue raised by Canada[136], supported by other appellees[137] and one third participant[138], namely the issue whether the United States included arguments and evidence in its appellant's submission that are outside the scope of appellate review by virtue of Article 17.6 of the DSU. Specifically, Canada points to the comments in paragraphs 120 and 121 of the United States' appellant's submission regarding two letters referred to in paragraphs 7.62 and 7.45 of the Panel Report. In addition, Canada contends that footnotes 148 and 149 of the United States' appellant's submission refer to evidence that was not before the Panel.

216. In examining these questions, we recall first that Article 17.6 of the DSU provides:

> An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.

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[133] *Ibid*., para. 7.20. See also Panel Report, para. 4.504, which sets out, in relevant part, the United States' contention in its first oral statement, that "the complaining parties' primary argument is that because the source of the funds for the distributions under CDSOA are AD/CVD duties, the CDSOA is, on its face, inconsistent with the Antidumping and SCM Agreements. The reality is that, because money is fungible, the only real connection between the funds distributed under CDSOA and the orders is that the duties collected serve to cap or limit the amount of the annual distributions."

[134] Panel Report, para. 7.22.

[135] We observe that the concept of "advisory opinion" has a special meaning in the context of international adjudication. A number of international courts and tribunals, including the International Court of Justice and the European Court of Justice, provide in their statutes or rules for the provision of such opinions upon the request of States or of certain authorized bodies.

[136] Canada's letter dated 5 November 2002; Canada's appellee's submission, paras. 149-157.

[137] Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.

[138] Norway.

1. The United States' Comments About Letters Before the Panel

217. In paragraphs 7.45 and 7.62 of the Panel Report, the Panel refers to a letter from a United States producer[139] which, according to the Panel, demonstrates that that producer changed its position concerning an application after initiation of the investigation, and decided to express support for the application to impose anti-dumping and countervailing duties in order to remain eligible for possible offset payment subsidies.[140] In the same paragraphs, the Panel also referred to a letter from a lawyer dated 8 January 2001[141], which, according to the Panel, illustrates the potential for the CDSOA to encourage domestic producers to support applications for the imposition of dumping or countervailing duties.[142] The Panel referred to those letters in paragraph 7.62 to support its finding that the United States failed to comply with its obligations under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* (more specifically, as regards the issue that the CDSOA operates as an incentive for domestic producers to support applications for imposition of anti-dumping and countervailing duties). These letters were also cited in paragraph 7.45 in relation to the finding that the CDSOA is contrary to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* (more specifically, as regards the question whether the CDSOA operates "against" dumping or subsidies within the meaning of those provisions).

218. The United States makes the following comments on the letters in paragraphs 120 and 121 of its appellant's submission:

> Moreover, the examination of the letter reveals that the letter is not what the Panel claimed it to be. It is neither a letter from a "domestic producer" nor a letter changing positions. In fact, the company that authored the letter states therein that it is expressing its "continuing" support for the petitions (*i.e.*, it is not expressing a change in position), citing a letter it submitted to the ITC over a month earlier in which the producer had already expressed support for the petition. Moreover, the company had entered an appearances before the ITC and Commerce as a "foreign manufacturer, producer, or exporter, or the United States importer, of subject merchandise" - not a domestic producer. Thus, the letter is irrelevant to the issue for which the Panel cited it. Contrary to the claim of the Panel, the company did not change its position.[143] (footnotes omitted)

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[139] Brief of Fred Tebb & Sons, Inc., dated 22 March 2002, filed by Canada on 27 March 2002 in the Panel proceedings. (Exhibit CDA-20)

[140] Panel Report, para. 7.62.

[141] Letter from J. Ragosta, Dewey Ballantine, dated 8 January 2001, p. 2, attached to a letter from R. Wood, Chairman of the Coalition for Fair Lumber Imports, regarding an "Important Legal Request on Subsidized Canadian Lumber Imports", dated 8 January 2001.

[142] Panel Report, para. 7.45.

[143] United States' appellant's submission, para. 120.

> The Panel also cited a letter in which a U.S. producer purportedly urged other domestic producers to support a petition against Canadian softwood lumber imports by citing the CDSOA. Examination of the letter referencing the CDSOA, however, shows that it was not written by a domestic producer, but instead by a law firm *informing* domestic producers of the merits and circumstances of their case, as well as various provisions of U.S. law including the CDSOA. Importantly, the letter counsels that petitioners/supporters cannot count on obtaining funds under the CDSOA. The letter does not try to use the CDSOA to induce other domestic producers to support a petition. It certainly does not promise CDSOA disbursements if domestic producers support the petition. Furthermore, there is no indication that the letter actually had the effect of influencing any domestic producers to support the petition, much less to support a petition it otherwise would not but for the potential to become eligible for CDSOA offsets.[144] (original emphasis; footnotes omitted)

219. Canada agrees that the two letters referred in paragraphs 120-121 of the United States appellant's submission were in evidence before the Panel. Canada's objection is that the United States is prohibited by virtue of Article 17.6 of the DSU from challenging the "credibility and weight the Panel attached to the two letters."[145] Canada argues that the Panel's statements about the letters did not form part of its legal reasoning. Therefore, according to Canada, we cannot consider the United States' explanations about the nature of the letters because there is "no question of legal characterisation by the Panel of facts before it in respect of the two letters".[146]

220. We do not regard the United States' comments in paragraphs 120-121 as impugning the Panel's factual findings on the two letters. In our view, the United States' comments form part of its challenge to the Panel's legal conclusions that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, as well as with Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. Whether such findings are supported by those letters is an issue of law, properly raised by the United States in its Notice of Appeal, on which we have the authority to decide under Article 17.6 of the DSU.

2. Allegations of New Evidence in Footnotes 148 and 149

221. In footnotes 148 and 149 of the United States' appellant's submission, the United States cites various documents in connection with its challenge to the Panel's conclusions about the import of the two letters referred to above, noting that they are "available on the public record".[147] According to Canada[148],

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144 United States' appellant's submission, para. 121.
145 Canada's appellee's submission, para. 155.
146 *Ibid*.
147 United States' appellant's submission, footnotes 148 and 149.

supported by other participants[149], the documents constitute new evidence that was not before the Panel and, consequently, our consideration of that evidence is beyond the scope of appellate review by virtue of Article 17.6 of the DSU.

222. We agree with the submission of Canada. It is not disputed that footnotes 148 and 149 of the United States' appellant's submission refer to documents that were not part of the Panel record. The United States submits that it referred to the documents "to provide the Appellate Body with a greater understanding of the facts involved in the dispute".[150] However, Article 17.6 is clear in limiting our jurisdiction to issues of law covered in panel reports and legal interpretations developed by panels. We have no authority to consider new facts on appeal. The fact that the documents are "available on the public record" does not excuse us from the limitations imposed by Article 17.6. We note that the other participants have not had an opportunity to comment on those documents and, in order to do so, may feel required to adduce yet more evidence. We would also be precluded from considering such evidence. We *find*, therefore, that the documents referred to in footnotes 148 and 149 of the United States' appellant's submission that were not part of the Panel record, constitute new evidence. Consequently, by virtue of Article 17.6 of the DSU, we are precluded from taking those documents into account in deciding this appeal.

VI. ISSUES RAISED IN THIS APPEAL

223. The following issues are raised in this appeal:

(a) whether the Panel erred in finding, in paragraphs 7.51 and 8.1 of the Panel Report, that the Continued Dumping and Subsidy Offset Act of 2000 ("CDSOA") is a non-permissible specific action against dumping or a subsidy, contrary to Article 18.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*") and Article 32.1 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*");

(b) whether the Panel erred in finding, in paragraphs 7.66 and 8.1 of the Panel Report, that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*;

(c) whether the Panel erred in finding, in paragraphs 7.93 and 8.1 of the Panel Report, that the CDSOA is inconsistent with certain provisions of the *Anti-Dumping Agreement* and the *SCM Agreement* and that, therefore, the United States has failed to comply with Article 18.4 of the *Anti-Dumping Agreement*,

[148] Canada's letter dated 5 November 2002; Canada's appellee's submission, paras. 149-157.
[149] Australia, Chile, the European Communities, India, Indonesia, Japan, Korea, Norway and Thailand.
[150] United States' letter dated 8 November 2002.

Article 32.5 of the *SCM Agreement* and Article XVI.4 of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*");

(d) whether the Panel erred in finding, in paragraph 8.4 of the Panel Report, that, pursuant to Article 3.8 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), the CDSOA nullifies or impairs benefits accruing to the Complaining Parties under those Agreements; and

(e) whether the Panel acted inconsistently with Article 9.2 of the DSU by rejecting, in paragraph 7.6 of the Panel Report, the request by the United States for a separate panel report on the dispute brought by Mexico.

VII. ARTICLE 18.1 OF THE *ANTI-DUMPING AGREEMENT* AND ARTICLE 32.1 OF THE *SCM AGREEMENT*

224. We turn now to the United States' appeal of the Panel's conclusion that the CDSOA is a non-permissible specific action against dumping, contrary to Article 18.1 of the *Anti-Dumping Agreement*, and a non-permissible specific action against a subsidy, contrary to Article 32.1 of the *SCM Agreement*.[151] We will start by reviewing briefly the Panel's analysis of this issue.

225. The Panel began its analysis by referring to our ruling in *US – 1916 Act*, where we said:

> In our view, the ordinary meaning of the phrase "specific action against dumping" of exports within the meaning of Article 18.1 is action that is taken in response to situations presenting the constituent elements of "dumping". "Specific action against dumping" of exports must, at a minimum, encompass action that may be taken *only* when the constituent elements of "dumping" are present.[152] (original emphasis; footnote omitted)

226. The Panel decided that this ruling is not conclusive of whether the CDSOA is a specific action against dumping or a subsidy for three reasons. *First*, the Panel observed that, in *US – 1916 Act*, we were not interpreting Article 18.1 of the *Anti-Dumping Agreement*, as such, but were rather referring to that Article in order to clarify the scope of application of Article VI of the *General Agreement on Tariffs and Trade* (the "GATT 1994").[153] *Second*, the Panel noted that we were not required to consider, in deciding that appeal, the meaning of the word "against" as used in Article 18.1 of the *Anti-Dumping Agreement*, because there was no disagreement between the participants in that dispute that the measure at issue, which imposed criminal and civil liabilities on importers

[151] Panel Report, para. 7.51.
[152] Appellate Body Report, *US – 1916 Act*, para. 122.
[153] Panel Report, para. 7.15.

engaged in dumping, constituted action "against" dumping.[154] *Third*, the Panel opined that the category of action "in response to" dumping is broader than the category of action "against" dumping.[155]

227. Having decided that our ruling in *US – 1916 Act* was not dispositive of the issues in the present case, the Panel developed the following standard to determine whether a measure is a specific action against dumping or a subsidy: a measure will constitute specific action against dumping or a subsidy if: (1) it acts "specifically" in response to dumping or a subsidy, in the sense that the measure may be taken *only* in situations presenting the constituent elements of dumping or a subsidy; and (2) it acts "against" dumping or a subsidy, in the sense that the measure has an *adverse bearing* on the practice of dumping or on the practice of subsidization.[156]

228. Applying this standard to the CDSOA, the Panel, as a preliminary matter, determined that the CDSOA is a "specific action related to"[157] dumping or a subsidy. According to the Panel, the CDSOA meets the first condition of the standard because CDSOA payments may be made *only* in situations where the constituent elements of dumping (or of a subsidy) are present. The Panel also pointed out that CDSOA offset payments follow automatically from the collection of anti-dumping (or countervailing) duties, which in turn may be collected only following the imposition of anti-dumping (or countervailing duty) orders, which in turn may be imposed only following a determination of dumping (or subsidization). The Panel thus determined that the CDSOA is a specific action related to dumping (or subsidization) because there is a "clear, direct and unavoidable connection"[158] between the determination of dumping (or subsidization) and CDSOA offset payments.

229. Moving to the question whether the CDSOA acts "against" dumping or a subsidy, in the sense that it has an adverse bearing on dumping or a subsidy, the Panel affirmed that Article 18.1 of the *Anti-Dumping Agreement* (and Article 32.1 of the *SCM Agreement*) concerns measures that act against dumping as a practice (or subsidization as a practice), and do not require that the measure at issue must act against the imported dumped (or subsidized) product, or entities connected to, or responsible for, the dumped (or subsidized) product, such as the importer, exporter, or foreign producer.[159] The Panel added that the term "against" in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* encompasses measures having a direct, as well as indirect, adverse bearing on the practice of dumping (or subsidization).[160]

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[154] Panel Report, para. 7.16.
[155] *Ibid*., para. 7.17.
[156] *Ibid*., para. 7.18. In para. 7.18, the Panel refers only to dumping. We understand, however, that, in the light of the conclusion the Panel reached in para. 7.51, the two conditions set out in para. 7.18 extend *mutatis mutandis* to Article 32.1 of the *SCM Agreement*, which deals with subsidies.
[157] Panel Report, para. 7.23.
[158] Panel Report, para. 7.21.
[159] *Ibid*., para. 7.33.
[160] *Ibid*.

230. Two considerations led the Panel to find that the CDSOA operates "against" dumping (or a subsidy), in the sense that it has an adverse bearing on dumping (or a subsidy). First, according to the Panel, the CDSOA acts against dumping (or a subsidy) by conferring on affected domestic producers, which incur qualifying expenses, an offset payment subsidy that would allow them to establish a competitive advantage over dumped (or subsidized) imports. Second, the Panel was of the view that the CDSOA has an adverse bearing on dumping (or a subsidy) because it provides a financial incentive for domestic producers to file anti-dumping (or countervail) applications, or at least to support such applications, in order to establish their eligibility for offset payments.

231. The Panel noted that, in our Report in *US – 1916 Act*, we found that Article VI of the GATT 1994, in particular Article VI:2, read in conjunction with the *Anti-Dumping Agreement*, limits the permissible responses to dumping to definitive anti-dumping duties, provisional measures and price undertakings.[161] The Panel took the view that a similar approach should apply in respect of the permissible responses to subsidization.[162] The Panel observed that Part V of the *SCM Agreement* foresees definitive countervailing duties, provisional measures and undertakings, whereas Part III foresees countermeasures. According to the Panel, these are the permissible responses to subsidization.[163] Because the CDSOA does not fall within the range of the permissible responses to dumping under Article VI of the GATT 1994 and the *Anti-Dumping Agreement*, or within the range of the permissible responses to subsidization under the GATT 1994 and the *SCM Agreement*, the Panel concluded that the CDSOA constitutes a non-permissible specific action against dumping, contrary to Article 18.1 of the *Anti-Dumping Agreement*, and a non-permissible specific action against a subsidy, contrary to Article 32.1 of the *SCM Agreement*.

232. In addition, the Panel rejected the United States' argument that the CDSOA is an action permitted by virtue of footnote 24 to Article 18.1 of the *Anti-Dumping Agreement* and footnote 56 to Article 32.1 of the *SCM Agreement*. According to the Panel, a measure that has been characterized as "specific" under Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement* cannot be permitted under those footnotes, because the footnotes cover *non-specific* actions against dumping or a subsidy. In other words, the "actions" covered in the provisions and the "actions" covered in the footnotes are mutually exclusive.

233. On appeal, the United States contends that the Panel erred in finding that the CDSOA constitutes specific action against dumping within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and specific action against a subsidy within the meaning of Article 32.1 of the *SCM Agreement*, and asks us to reverse the Panel's finding that the CDSOA is inconsistent with Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.

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[161] Panel Report, para. 7.7.
[162] *Ibid*.
[163] *Ibid*.

234. We begin our analysis with a review of the relevant provisions. Article 18.1 of the *Anti-Dumping Agreement* reads as follows:

> *Final Provisions*
>
> No specific action against dumping of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.[24]
>
> ———————
>
> [24] This is not intended to preclude action under other relevant provisions of GATT 1994, as appropriate.

235. Article 32.1 of the *SCM Agreement* reads as follows:

> *Other Final Provisions*
>
> No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.[56]
>
> ———————
>
> [56] This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

236. Looking to the ordinary meaning of the words used in these provisions, we read them as establishing two conditions precedent that must be met in order for a measure to be governed by them. The first is that a measure must be "specific" to dumping or subsidization. The second is that a measure must be "against" dumping or subsidization. These two conditions operate together and complement each other. If they are not met, the measure will not be governed by Article 18.1 of the *Anti-Dumping Agreement* or by Article 32.1 of the *SCM Agreement*. If, however, it is established that a measure meets these two conditions, and thus falls within the scope of the prohibitions in those provisions, it would then be necessary to move to a further step in the analysis and to determine whether the measure has been "taken in accordance with the provisions of GATT 1994", as interpreted by the *Anti-Dumping Agreement* or the *SCM Agreement*. If it is determined that this is not the case, the measure would be inconsistent with Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement*.

A. The Term "Specific" in the Phrase "Specific Action Against" Dumping or a Subsidy

237. We observe that Article 18.1 of the *Anti-Dumping Agreement* is identical in language, terminology and structure to Article 32.1 of the *SCM Agreement*, except for the reference to dumping instead of subsidy. The Panel analyzed the terms "specific" and "against" in Article 18.1 in the same manner as it did with respect to their use in Article 32.1. We agree with the Panel's approach. We also note that the United States does not challenge such approach and that, at the oral

hearing, none of the appellees or third participants expressed the view that the terms, as used in Article 18.1 should have a different meaning as used in Article 32.1.

238. As mentioned above, in *US – 1916 Act*, we interpreted the phrase "specific action against dumping" in Article 18.1 of the *Anti-Dumping Agreement*. We said:[164]

> In our view, the ordinary meaning of the phrase "specific action against dumping" of exports within the meaning of Article 18.1 is action that is taken in response to situations presenting the constituent elements of "dumping". "Specific action against dumping" of exports must, at a minimum, encompass action that may be taken *only* when the constituent elements of "dumping" are present.[66]
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>
> [66] We do not find it necessary, in the present cases, to decide whether the concept of "specific action against dumping" may be broader.

Given that Article 18.1 of the *Anti-Dumping Agreement* and 32.1 of the *SCM Agreement* are identical except for the reference in the former to dumping, and in the latter to a subsidy, we are of the view that this finding is pertinent for both provisions.

239. We recall that, in *US – 1916 Act*, the United States argued that the 1916 Act did not fall within the scope of Article VI of the GATT 1994 because it targeted predatory pricing, as opposed to dumping. We disagreed, and determined that the 1916 Act was a "specific action against dumping" because the constituent elements of dumping were "built into"[165] the essential elements of civil and criminal liability under the 1916 Act. We also found that the "wording of the 1916 Act … makes clear that these actions can be taken *only* with respect to conduct which presents the constituent elements of 'dumping'."[166] Accordingly, a measure that may be taken only when the constituent elements of dumping or a subsidy are present, is a "specific action" in response to dumping within the meaning of Article 18.1 of the *Anti-Dumping Agreement* or a "specific action" in response to subsidization within the meaning of Article 32.1 of the *SCM Agreement*. In other words, the measure must be inextricably linked to, or have a strong correlation with, the constituent elements of dumping or of a subsidy. Such link or correlation may, as in the 1916 Act, be derived from the text of the measure itself.

240. This leads to the question of how to determine what are the constituent elements of dumping or a subsidy. We recall that, in *US – 1916 Act*, we said the constituent elements of dumping are found in the definition of dumping in Article VI:1 of the GATT 1994, as elaborated in Article 2 of the *Anti-Dumping*

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[164] Appellate Body Report, *US – 1916 Act*, para. 122.
[165] Appellate Body Report, *US – 1916 Act*, para. 130.
[166] *Ibid*. (original emphasis)

Agreement.[167] As regards the constituent elements of a subsidy, we are of the view that they are set out in the definition of a subsidy found in Article 1 of the *SCM Agreement*.[168]

241. We turn now to determine whether the CDSOA is a "specific action" against dumping or subsidization within the meaning of Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement*.

242. In our view, the Panel was correct in finding that the CDSOA is a specific action related to dumping or a subsidy within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.[169] It is clear from the text of the CDSOA, in particular from Section 754(a) of the Tariff Act[170], that the CDSOA offset payments are inextricably linked to, and strongly correlated with, a determination of dumping, as defined in Article VI:1 of the GATT 1994 and in the *Anti-Dumping Agreement*, or a determination of a subsidy, as defined in the *SCM Agreement*. The language of the CDSOA is unequivocal. *First*, CDSOA offset payments can be made *only* if anti-dumping duties or countervailing duties have been collected. *Second*, such duties can be collected *only* pursuant to an anti-dumping duty order or countervailing duty order. *Third*, an anti-dumping duty order can be imposed *only* following a determination of dumping, as defined in Article VI:1 of the GATT 1994 and in the *Anti-Dumping Agreement*. *Fourth*, a countervailing duty order can be imposed only following a determination that exports have been subsidized, according to the definition of a subsidy in the *SCM Agreement*. In the light of the above elements, we agree with the Panel that "there is a clear, direct and unavoidable connection between the determination of dumping and CDSOA offset payments"[171], and we believe the same to be true for subsidization. In other words, it seems to us unassailable that CDSOA offset payments can be made only following a determination that the constituent elements of dumping or subsidization are present. Therefore, consistent with the test established in *US – 1916 Act*, we find that the CDSOA is "specific action" related to dumping or a subsidy within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*.

243. In its appellant's submission, the United States argues that the CDSOA is not specific action related to dumping or to a subsidy because, contrary to the 1916 Act examined in a previous appeal, the language of the CDSOA does not

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[167] Appellate Body Report, *US – 1916 Act*, paras. 105-106 and 130.

[168] In response to questioning at the oral hearing, the participants did not dispute that the constituent elements of dumping refer to the definition of dumping in Article VI:1 of the GATT 1994, as elaborated in Article 2 of the *Anti-Dumping Agreement*, and that the constituent elements of a subsidy refer to the definition of a subsidy found in Article 1 of the *SCM Agreement*.

[169] Panel Report, para. 7.23.

[170] Section 754(a) of the Tariff Act provides:

> Duties assessed pursuant to a countervailing duty order, an anti-dumping duty order, or a finding under the Antidumping Act of 1921 shall be distributed on an annual basis under this section to the affected domestic producers for qualifying expenditures. Such distribution shall be known as the "continued dumping and subsidy offset".

[171] Panel Report, para. 7.21.

refer to the constituent elements of dumping (or of a subsidy), and dumping (or subsidization) is not the trigger for application of the CDSOA.[172] The United States suggested at the oral hearing that the CDSOA is not "specific" because the constituent elements of dumping or of a subsidy do not form part of the essential components of the CDSOA. In addition, the United States submits that, according to the Panel's reasoning, *any* expenditure of collected anti-dumping (or countervailing) duties, including expenditure for international emergency relief, would be characterized as specific action against dumping (or a subsidy). For the United States, the Panel's approach "cannot withstand scrutiny."[173]

244. We disagree with these arguments. The criterion we set out in *US – 1916 Act* for specific action in response to dumping is not whether the constituent elements of dumping or of a subsidy are explicitly referred to in the measure at issue, nor whether dumping or subsidization triggers the application of the action, nor whether the constituent elements of dumping or of a subsidy form part of the essential components of the measure at issue. Our analysis in *US – 1916 Act* focused on the strength of the link between the measure and the elements of dumping or a subsidy. In other words, we focused on the degree of correlation between the scope of application of the measure and the constituent elements of dumping or of a subsidy. In noting that the "wording of the 1916 Act also makes clear that these actions can be taken *only* with respect to conduct which presents the constituent elements of 'dumping'"[174], we did not *require* that the language of the measure include the constituent elements of dumping or of a subsidy. This is clear from our use of the word "also", which suggests that this aspect of the 1916 Act was a supplementary reason for our finding, and not the basis for it. Indeed, we required that the constituent elements of dumping (or of a subsidy) be "present"[175], which in our view can include cases where the constituent elements of dumping and of a subsidy are implicit in the measure. Thus, we agree with the European Communities, India, Indonesia and Thailand that the "test"[176] established in *US – 1916 Act* "is met not only when the constituent elements of dumping are 'explicitly built into' the action at issue, but also where … they are implicit in the express conditions for taking such action."[177] In fact, the presence of the constituent elements of dumping and of a subsidy is implied by the very words of the CDSOA, which refer to "[d]uties assessed pursuant to a countervailing duty order, an antidumping duty order, or a finding under the Antidumping Act of 1921 …".[178]

245. We also disagree with the submission of the United States that, under the Panel's reasoning, any expenditure of the collected anti-dumping (or countervailing) duties would be characterized as a specific action against dumping (or a subsidy). This submission does not take into account the express

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[172] United States' appellant's submission, para. 18.
[173] *Ibid*., para. 20.
[174] Appellate Body Report, *US – 1916 Act*, para. 130. (original emphasis)
[175] *Ibid*., para. 122.
[176] European Communities', India's, Indonesia's and Thailand's appellees' submission, para. 14.
[177] *Ibid*.
[178] Section 754(a) of the Tariff Act.

terms of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, which, as we said earlier, contain two conditions precedent, namely that the action be "specific" to dumping or a subsidy, and that it be "against" dumping or a subsidy. To refer to the example given by the United States, international emergency relief financed from collected anti-dumping or countervailing duties would not, in our opinion, be subject to the prohibitions of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, because such action would have no effect whatsoever on dumping or subsidization and, therefore, could not be characterized as operating "against" dumping or a subsidy. As the Panel noted, we did not focus on the word "against" in our ruling in *US – 1916 Act*, because there was no dispute there that the measure (imposing civil and criminal liabilities on importers) was indeed "against" something—the question there was whether the action was against dumping, or some other conduct (predatory pricing).[179]

B. The Term "Against" in the Phrase "Specific Action Against" Dumping or a Subsidy

246. We move now to an analysis of the term "against" as used in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. As mentioned above, Article 18.1 of the *Anti-Dumping Agreement* is identical in language, terminology and structure to Article 32.1 of the *SCM Agreement*, except for the reference to dumping instead of subsidy, and therefore we will proceed, as the Panel did, with an analysis of the word "against" on the basis that it has the same meaning in both provisions. We note that neither the United States nor any of the appellees objects to this approach.

247. We agree with the Panel that our statement in *US – 1916 Act*—to the effect that "the ordinary meaning of the phrase 'specific action against dumping' of exports within the meaning of Article 18.1 is action that is taken in response to situations presenting the constituent elements of 'dumping'"[180]—is not conclusive as to the nature of the condition flowing from the term "against". The Panel took the position that an action operates "against" dumping or a subsidy within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* if it has an *adverse bearing* on dumping or subsidization.[181] The United States criticizes this approach, contending that an action is "against" dumping or a subsidy if it is "in hostile/active opposition" to dumping or a subsidy.[182] The United States puts emphasis on the argument that an action, in order to be characterized as being "against" dumping or a subsidy, must "come into contact with"[183] dumping or a subsidy, in the sense of "operating directly"[184] on the imported good, or the entity responsible for the

[179] Panel Report, para. 7.16.
[180] Appellate Body Report, *US – 1916 Act*, para. 122.
[181] Panel Report, para. 7.18 and footnote 271 thereto.
[182] United States' appellant's submission, para. 31.
[183] *Ibid*., para. 32.
[184] *Ibid*., para. 33.

dumped or subsidized good.[185] In the view of the United States, the Panel erred by finding that the term "against" in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* encompasses any form of adverse bearing, whether it be direct or indirect, and by finding that this term does not imply a requirement that the action applies directly to the imported good or an entity responsible for it, and is burdensome.[186] The United States contends that such a requirement derives from the ordinary meaning of the term "against". Specifically, the United States relies on a definition found in the *New Shorter Oxford English Dictionary*, according to which "against" means "in contact with".[187] In order to identify the ordinary meaning of the term "against" as used in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, the United States posits three definitions of that term: (1) "of motion or action in opposition"; (2) "in hostility or active opposition to"; and (3) "in contact with".[188]

248. In our view, the first and second definitions invoked by the United States could, arguably, have some relevance in identifying the ordinary meaning of the term "against" as used in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement.* However, we do not believe the third definition is appropriate given the substance of Articles 18.1 and 32.1. Indeed, the third definition refers to physical contact between two objects and, thus, in our view, is irrelevant to the idea of opposition, hostility or adverse effect that is conveyed by the word "against" as used in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. It should be remembered that dictionaries are important guides to, not dispositive statements of, definitions of words appearing in agreements and legal documents.

249. We also note that the third dictionary definition cited by the United States is incomplete; not only does that dictionary definition refer to "in contact with", it also refers to "supported by". This latter element is difficult to reconcile with any idea of opposition, hostility or adverse bearing.[189]

250. Therefore, as the definition "in contact with" cannot be used to ascertain the ordinary meaning of "against" as used in Article 18.1 of the *Anti-Dumping Agreement* and in Article 32.1 of the *SCM Agreement*, we do not believe the United States is justified in using that definition to support its view that an action against dumping or a subsidy must have direct contact with the imported good, or the entity responsible for the dumped or subsidized good. More generally, we fail to see how such a meaning can be given to the term "against", which, given the substance of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of

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[185] *Ibid*.
[186] Panel Report, para. 7.33.
[187] United States' appellant's submission, para. 31.
[188] *Ibid*.
[189] Further support for our view is found in the examples given by the *New Shorter Oxford English Dictionary* in relation to this definition:

> 17. W. OWEN Under his helmet, up against his pack, . . Sleep took him by the brow and laid him back. R. CHANDLER There was a bar against the right hand wall.

the *SCM Agreement*, must relate to an idea of opposition, hostility or adverse effect.

251. A textual analysis of Articles 18.1 and 32.1 supports, rather than defeats, the finding of the Panel that these provisions are applicable to measures that do not come into direct contact with the imported good, or entities responsible for the dumped or subsidized good. We note that Article 18.1 refers only to measures that act against "dumping", and that there is no express requirement that the measure must act against the imported dumped product, or entities responsible for that product. Likewise, Article 32.1 of the *SCM Agreement* refers to specific action against "a subsidy", not action against the imported subsidized product or a responsible entity. The United States' contention is further contradicted by the contextual consideration that the *SCM Agreement* authorizes multilaterally-sanctioned countermeasures "against" a subsidy, which may consist of indirect action affecting other products.

252. Turning to considerations of object and purpose, we do not consider that the object and purpose of the *Anti-Dumping Agreement* and of the *SCM Agreement*, as reflected in Article 18.1 of the *Anti-Dumping Agreement* and in Article 32.1 of the *SCM Agreement*, support the incorporation into these provisions, through the term "against", of a requirement that the measure must come into direct contact with the imported good, or the entity responsible for it. Both provisions fulfil a function of limiting the range of actions that a Member may take unilaterally to counter dumping or subsidization.[190] Excluding from Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* actions that do not come into direct contact with the imported good or the entity responsible for the dumped or subsidized good, would undermine that function.

253. We, therefore, agree with the Panel that in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, there is no requirement that the measure must come into direct contact with the imported product, or entities connected to, or responsible for, the imported good such as the importer, exporter, or foreign producer. We also agree with the Panel that the test should focus on dumping or subsidization as *practices*.[191] Article 18.1 refers only to measures that act against "dumping"; there is no express requirement that the measure must act against the imported dumped product, or entities responsible for that product. Likewise, Article 32.1 of the *SCM Agreement* refers to specific action against "a subsidy", not to action against the imported subsidized product or a responsible entity.

254. Recalling the other two elements of the definition of "against" from the *New Shorter Oxford Dictionary* relied upon by the United States, namely "of motion or action in opposition" and "in hostility or active opposition to", to determine whether a measure is "against" dumping or a subsidy, we believe it is necessary to assess whether the design and structure of a measure is such that the measure is "opposed to", has an adverse bearing on, or, more specifically, has the

[190] See *supra*, para. 231.
[191] Panel Report, para. 7.33.

effect of dissuading the practice of dumping or the practice of subsidization, or creates an incentive to terminate such practices. In our view, the CDSOA has exactly those effects because of its design and structure.

255. The CDSOA effects a transfer of financial resources from the producers/exporters of dumped or subsidized goods to their domestic competitors. This is demonstrated by the following elements of the CDSOA regime. *First*, the CDSOA offset payments are financed from the anti-dumping or countervailing duties paid by the foreign producers/exporters. *Second*, the CDSOA offset payments are made to an "affected domestic producer", defined in Section 754(b) of the Tariff Act as "a petitioner or interested party in support of the petition with respect to which an anti-dumping duty order, a finding under the Antidumping Act of 1921, or a countervailing duty order has been entered" and that "remains in operation". In response to our questioning at the oral hearing, the United States confirmed that the "affected domestic producers" which are eligible to receive payments under the CDSOA, are necessarily competitors of the foreign producers/exporters subject to an anti-dumping or countervail order. *Third*, under the implementing regulations issued by the United States Commissioner of Customs ("Customs") on 21 September 2001, the "qualifying expenditures" of the affected domestic producers, for which the CDSOA offset payments are made, "must be related to the production of the same product that is the subject of the related order or finding, with the exception of expenses incurred by associations which must relate to a specific case."[192] *Fourth*, Customs has confirmed that there is no statutory or regulatory requirement as to how a CDSOA offset payment to an affected domestic producer is to be spent[193], thus indicating that the recipients of CDSOA offset payments are entitled to use this money to bolster their competitive position *vis-à-vis* their competitors, including the foreign competitors subject to anti-dumping or countervailing duties.

256. All these elements lead us to conclude that the CDSOA has an adverse bearing on the foreign producers/exporters in that the imports into the United States of the dumped or subsidized products (besides being subject to anti-dumping or countervailing duties) result in the financing of United States competitors—producers of like products—through the transfer to the latter of the duties collected on those exports. Thus, foreign producers/exporters have an incentive not to engage in the practice of exporting dumped or subsidized products or to terminate such practices. Because the CDSOA has an adverse bearing on, and, more specifically, is designed and structured so that it dissuades the practice of dumping or the practice of subsidization, and because it creates an incentive to terminate such practices, the CDSOA is undoubtedly an action "against" dumping or a subsidy, within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*.

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[192] 19 C.F.R. § 159.61(c).

[193] "Distribution of Continued Dumping and Subsidy Offset to Affected Domestic Producers", United States Federal Register, 21 September 2001 (Volume 66, Number 184), p. 48549.

257. We note that the United States challenges what it views as the Panel's incorporation of a "conditions of competition test" in Article 18.1 of the *Anti-Dumping Agreement* and in Article 32.1 of the *SCM Agreement*.[194] In our view, in order to determine whether the CDSOA is "against" dumping or subsidization, it was not necessary, nor relevant, for the Panel to examine the conditions of competition under which domestic products and dumped/subsidized imports compete, and to assess the impact of the measure on the competitive relationship between them. An analysis of the term "against", in our view, is more appropriately centred on the design and structure of the measure; such an analysis does not mandate an economic assessment of the implications of the measure on the conditions of competition under which domestic product and dumped/subsidized imports compete.

258. As mentioned above[195], the finding of the Panel that the CDSOA is a measure against dumping or a subsidy is also based on the view that the CDSOA provides a financial incentive for domestic producers to file or support applications for the initiation of anti-dumping and countervailing duty investigations, and that such an incentive will likely result in a greater number of applications, investigations and orders.[196] We agree with the United States that this consideration is not a proper basis for a finding that the CDSOA is "against" dumping or a subsidy; a measure cannot be against dumping or a subsidy simply because it facilitates or induces the exercise of rights that are WTO-consistent. The Panel's reasoning would give Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement* a scope of application that is overly broad. For example, the Panel's reasoning would imply that a legal aid program destined to support domestic small-size producers in anti-dumping or countervailing duty investigations should be considered a measure against dumping or a subsidy within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*, because it could be argued that such legal aid is a financial incentive likely to result in a greater number or applications, investigations and orders.

259. The United States also argues that the Panel erred in relying on the stated purpose of the CDSOA, as expressed in the "Findings of Congress" set forth in Section 1002 of the CDSOA, to support its finding that the CDSOA is a measure against dumping or a subsidy.[197] We note that the Panel referred to the "Findings of Congress", not as a *basis* for its conclusion that the CDSOA constitutes a

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[194] United States' appellant's submission, para. 41. The Panel found that the CDSOA is a measure against dumping or a subsidy because it "has a specific adverse impact on the competitive relationship between domestic products and dumped [or subsidized] imports". (Panel Report, para. 7.39) According to the Panel, the CDSOA is against dumping or a subsidy because it affects competition between, on the one hand, dumped or subsidized products, and, on the other hand, domestic products, to the detriment of the imported products.

[195] See *supra*, para. 230.

[196] Panel Report, para. 7.42.

[197] United States' appellant's submission, paras. 80-83. The United States, viewing the statutory provision entitled "Findings of Congress" as legislative history, stated at the oral hearing that a United States' court will not look to the legislative history of a statute unless that statute is ambiguous.

specific action against dumping or subsidies, but rather as a consideration confirming that conclusion.[198] We agree with the Panel that the intent, stated or otherwise, of the legislators is not conclusive as to whether a measure is "against" dumping or subsidies under Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement*. Thus, it was not necessary for the Panel to inquire into the intent pursued by United States legislators in enacting the CDSOA and to take this into account in the analysis. The text of the CDSOA provides sufficient information on the structure and design of the CDSOA, that is to say, on the manner in which it operates, to permit an analysis whether the measure is "against" dumping or a subsidy. Specifically, the text of the CDSOA establishes clearly that, by virtue of that statute, a transfer of financial resources is effected from the producers/exporters of dumped or subsidized goods to their domestic competitors. This essential feature of the CDSOA constitutes, in itself, the decisive basis for concluding that the CDSOA is "against" dumping or a subsidy—because it creates the "opposition" to dumping or subsidization, such that it dissuades such practices, or creates an incentive to terminate them. Therefore, there was no need to examine the intent pursued by the legislators in enacting the CDSOA.[199] In our view, however, the Panel did not err in simply noting that the stated legislative intent, which appears in the statute itself, confirms the conclusion it had reached as to the scope of the measure.

C. Footnote 24 of the Anti-Dumping Agreement and Footnote 56 of the SCM Agreement

260. The United States challenges the way the Panel addressed footnote 24 of the *Anti-Dumping Agreement* and footnote 56 of the *SCM Agreement*, arguing that the Panel erred in declining to examine the import of the footnotes because it had already determined that the CDSOA was a "specific action" under Article 18.1 of the *Anti-Dumping Agreement* and under Article 32.1 of the *SCM Agreement*. The United States contends that these footnotes permit actions involving dumping or subsidies consistent with GATT 1994 provisions and not

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[198] Panel Report, para. 7.41.

[199] We discussed the role of the legislative or regulatory intent in *Japan – Alcoholic Beverages II*, where we examined whether a measure is consistent with Article III:2 of the GATT 1994. We said:

> This third inquiry under Article III:2, second sentence, must determine whether "directly competitive or substitutable products" are "not similarly taxed" in a way that affords protection. This is not an issue of intent. *It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent*. If the measure is applied to imported or domestic products so as to afford protection to domestic production, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislators or the regulators who imposed the measure. It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, "*applied* to imported or domestic products so as to afford protection to domestic production". This is an issue of how the measure in question is *applied*. (original emphasis; underlining added)

(Appellate Body Report, *Japan – Alcoholic Beverages II*, at 119)

addressed by Article VI of the GATT 1994, and that these actions are not encompassed by the prohibitions against "specific action" in Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*. In other words, according to the United States, an action that falls within footnotes 24 and 56 cannot be characterized as a "specific action" within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, and such action would, therefore, not be WTO-inconsistent. [200]

261. We disagree with this argument. We note, first, that, in *US – 1916 Act*, we commented on footnote 24 as follows:

> Footnote 24 to Article 18.1 of the *Anti-Dumping Agreement* states:
>
> > This is not intended to preclude action under other relevant provisions of GATT 1994, as appropriate.
>
> We note that footnote 24 refers generally to "action" and not, as does Article 18.1, to "specific action against dumping" of exports. "Action" within the meaning of footnote 24 is to be distinguished from "specific action against dumping" of exports, which is governed by Article 18.1 itself. [201]

262. The United States' reasoning is tantamount to treating footnotes 24 and 56 as the primary provisions, while according Articles 18.1 and 32.1 residual status. This not only turns the normal approach to interpretation on its head, but it also runs counter to our finding in *US – 1916 Act*. In that case, we provided guidance for determining whether an action is specific to dumping (or to a subsidy): an action is specific to dumping (or a subsidy) when it may be taken *only* when the constituent elements of dumping (or a subsidy) are present, or, put another way, when the measure is inextricably linked to, or strongly correlates with, the constituent elements of dumping (or of a subsidy). This approach is based on the *texts* of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*, and not on the accessory footnotes. Footnotes 24 and 56 are clarifications of the main provisions, added to avoid ambiguity; they confirm what is implicit in Article 18.1 of the *Anti-Dumping Agreement* and in Article 32.1 of the *SCM Agreement*, namely, that an action that is *not* "specific" within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*, but is nevertheless related to dumping or subsidization, is not prohibited by Article 18.1 of the *Anti-Dumping Agreement* or Article 32.1 of the *SCM Agreement*.

D. Whether the CDSOA is in Accordance with the WTO Agreement

263. Having determined that the CDSOA is a "specific action against" dumping or a subsidy within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, we move to the next step of

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[200] United States' appellant's submission, paras. 25-29.
[201] Appellate Body Report, *US – 1916 Act*, para. 123.

our analysis, which is to determine whether the action is "in accordance with the provisions of the GATT 1994, as interpreted by" the *Anti-Dumping Agreement* or the *SCM Agreement*.

1. The Anti-Dumping Agreement

264. We interpreted "provisions of GATT 1994" as referred to in Article 18.1 of the *Anti-Dumping Agreement* in *US – 1916 Act*. In particular, we stated that the "provisions" are, in fact, the provisions of Article VI of the GATT 1994 concerning dumping:

> We recall that footnote 24 to Article 18.1 refers to "*other* relevant provisions of GATT 1994". These terms can only refer to provisions other than the provisions of Article VI concerning dumping. Footnote 24 thus confirms that the "provisions of GATT 1994" referred to in Article 18.1 are in fact the provisions of Article VI of the GATT 1994 concerning dumping.[202] (original emphasis)

265. We also stated in that appeal that "Article VI, and, in particular, Article VI:2, read in conjunction with the *Anti-Dumping Agreement*, limit the permissible responses to dumping to definitive anti-dumping duties, provisional measures and price undertakings."[203] As CDSOA offset payments are not definitive anti-dumping duties, provisional measures or price undertakings, we conclude, in the light of our finding in *US – 1916 Act*, that the CDSOA is not "in accordance with the provisions of the GATT 1994, as interpreted by" the *Anti-Dumping Agreement.* It follows that the CDSOA is inconsistent with Article 18.1 of that Agreement.

2. The SCM Agreement

266. As regards subsidization, the United States argues that Article VI:3 of the GATT 1994, read in conjunction with Article 10 of the *SCM Agreement*, does not limit the permissible remedies for subsidies to duties. The United States submits that the legal regime governing permissible responses to dumping is different from that governing the permissible responses to subsidization. Therefore, it is inappropriate to rely on the reasoning from *US – 1916 Act* to determine what is meant by "in accordance with the provisions of the GATT 1994" as that phrase relates to permissible responses to subsidies.

267. The United States also submits that the CDSOA is in accordance with Article VI:3 of the GATT 1994 and the provisions of Part V of the *SCM Agreement*, because those provisions do not encompass *all* measures taken against subsidization; they contemplate *only* countervailing duties (and by implication, provisional measures and price undertakings).[204] Thus, it cannot

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[202] Appellate Body Report, *US – 1916 Act*, para. 125.
[203] *Ibid*., para. 137.
[204] United States' appellant's submission, paras. 84-92.

properly be concluded that the CDSOA violates Article VI:3 of the GATT 1994 or the provisions of Part V of the *SCM Agreement*, because the CDSOA offset payments are *not* countervailing duties (or provisional measures or price undertakings), and, therefore, do not constitute an action covered by these provisions. In support of its submissions, the United States contrasts the language of Article VI:2 of the GATT 1994 and Article 1 of the *Anti-Dumping Agreement* with Article VI:3 of the GATT 1994 and Article 10 of the *SCM Agreement*.[205] The United States argues, on the basis of textual differences, that the conclusion we reached in *US – 1916 Act* that Article VI of the GATT 1994 encompasses all measures taken against dumping, was based on the specific language of Article VI:2 of the GATT 1994 and Article 1 of the *Anti-Dumping Agreement*. Therefore, according to the United States, such a conclusion should not be extended to the textually different subsidy provisions of Article VI of the GATT 1994 and of Part V of the *SCM Agreement*, which are limited to the imposition of countervailing duties (and by implication, provisional duties and price undertakings). In particular, the United States argues that the permissible responses to dumping are limited to definitive anti-dumping duties, provisional measures and price undertakings, because Article 1 of the *Anti-Dumping Agreement* refers to anti-dumping *measures*, a generic expression that encompasses *all* measures taken against dumping, and not only duties. Article 10 of the *SCM Agreement*, by contrast, refers to countervailing *duties*, and thus only countervailing duties (and, by implication, provisional duties and price undertakings) are governed by Article VI:3 of the GATT 1994 and Part V of the *SCM Agreement*.

268. We disagree with these submissions for the following reasons. As the Panel noted, our analysis in *US – 1916 Act* "was not based on any particular AD provision in isolation, but on the AD Agreement as a whole."[206] We agree with the Panel that:

> Since the Appellate Body's analysis [in *US – 1916 Act*] was not based exclusively on AD Article 1, we fail to see why a different approach should apply in respect of the permissible responses to subsidization, simply because of a difference between the text of AD Article 1 and SCM Article 10. *In identifying the permissible responses to subsidization, we consider it important to have regard to the type of remedies foreseen by the SCM Agreement.*[207] (emphasis added)

As pointed out above, Article 32.1 of the *SCM Agreement* is identical in terminology and structure to Article 18.1 of the *Anti-Dumping Agreement*,

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[205] The United States contrasts the terms "may levy … an anti-dumping duty" in Article VI:2 with "[n]o countervailing duty shall be levied" in Article VI:3; the United States also contrasts the reference to an "antidumping measure" and to "action … taken under anti-dumping legislation or regulations" in Article 1 of the *Anti-Dumping Agreement* with the use of the expression "countervailing duty" and "countervailing duties" in Article 10 of the *SCM Agreement*. (United States' appellant's submission, para. 87)

[206] Panel Report, para. 7.7.

[207] *Ibid*.

except for the reference to subsidy instead of dumping. We endorse Canada's contention that "[t]his identical wording gives rise to a strong interpretative presumption that the two provisions set out the same obligation or prohibition." [208]

269. Article VI of the GATT 1994 and the *Anti-Dumping Agreement* identify three responses to dumping, namely, definitive anti-dumping duties, provisional measures and price undertakings. No other response is envisaged in the text of Article VI of the GATT 1994, or the text of the *Anti-Dumping Agreement*. Therefore, to be in accordance with Article VI of the GATT 1994, as interpreted by the *Anti-Dumping Agreement*, a response to dumping must be in one of these three forms. We confirmed this in *US – 1916 Act*. We fail to see why similar reasoning should not apply to subsidization. The GATT 1994 and the *SCM Agreement* provide four responses to a countervailable subsidy: (i) definitive countervailing duties; (ii) provisional measures; (iii) price undertakings; and (iv) multilaterally-sanctioned countermeasures under the dispute settlement system. No other response to subsidization is envisaged in the text of the GATT 1994, or in the text of the *SCM Agreement*. Therefore, to be "in accordance with the GATT 1994, as interpreted by" the *SCM Agreement*, a response to subsidization must be in one of those four forms.

270. We note that interpreting these provisions as limiting the permissible responses to a countervailable subsidy to the four remedies envisaged in the *SCM Agreement* and the GATT 1994 is consistent with footnote 35 to Article 10 of the *SCM Agreement*, and with the function of Article 32.1 of the *SCM Agreement*. Footnote 35 reads as follows:

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

It is appropriate to emphasize the phrase "only one form of relief (either a countervailing duty, if the requirements of Part V are met, or a countermeasure

[208] Canada's appellee's submission, para. 78.

under Articles 4 or 7) shall be available." It expressly sets out two forms of specific action, and provides that WTO Members may choose to apply one or the other against a subsidy. The assumption underlying the requirements of footnote 35 is that remedies under the *SCM Agreement* are limited to countervailing duties (and, by implication, provisional measures and price undertakings), explicitly envisaged in Part V of the *SCM Agreement*, and to countermeasures under Articles 4 and 7 of the *SCM Agreement*. Footnote 35 requires WTO Members to choose between two forms of remedy; such a requirement would be meaningless if responses to a countervailable subsidy, other than definitive countervailing duties, provisional measures, price undertakings and multilaterally-sanctioned countermeasures, were permitted under the GATT 1994 and the *SCM Agreement*.

271. Moreover, Article 32.1 of the *SCM Agreement* limits the range of actions a WTO Member may take unilaterally to counter subsidization. Restricting available unilateral actions against subsidization to those expressly provided for in the GATT 1994 and in the *SCM Agreement* is consistent with this function. The United States' reasoning would deprive Article 32.1 of the *SCM Agreement* of effectiveness. As we have stated on many occasions, the internationally recognized interpretive principle of effectiveness should guide the interpretation of the *WTO Agreement*[209], and, under this principle, provisions of the *WTO Agreement* should not be interpreted in such a manner that whole clauses or paragraphs of a treaty would be reduced to redundancy or inutility.[210] Accepting the United States' contention that Article VI:3 of the GATT 1994 and Part V of the *SCM Agreement* cover only countervailing duties would render Article 32.1 of the *SCM Agreement* redundant or inutile, because, under the United States' approach, Article 32.1 of the *SCM Agreement* would not provide additional discipline. Thus, a violation of Article 32.1 would flow only from a violation of another provision; violating Article 32.1 would be only a mechanical consequence of a violation of another provision.

272. Furthermore, Article 32.1 of the *SCM Agreement* would be inutile with respect to "specific action[s] against a subsidy" other than countervailing duties, as it would be impossible, in such case, to find a violation of Article 32.1. Given that Article VI:3 of the GATT 1994 and Part V of the *SCM Agreement* would, under the United States' reasoning, be limited to countervailing duties, such specific actions would always be in accordance with Article VI:3 of the GATT 1994 and Part V of the *SCM Agreement* and, therefore, consistent with Article 32.1. Consequently, we reject the United States' contention that Article

[209] See Appellate Body Report, *US – Gasoline*, at 21; Appellate Body Report, *Japan – Alcoholic Beverages II*, at 106; Appellate Body Report, *US – Underwear*, at 24; Appellate Body Report, *US – Shrimp*, para. 131 (referencing various authors); Appellate Body Report, *Korea – Dairy*, para. 81; Appellate Body Report, *Canada – Dairy*, para. 133; and Appellate Body Report, *Argentina – Footwear (EC)*, para. 88.

[210] See Appellate Body Report, *US – Gasoline*, at 21; Appellate Body Report, *Japan – Alcoholic Beverages II*, at 106; Appellate Body Report, *Korea – Dairy*, para. 80; Appellate Body Report, *Canada – Dairy*, para. 133; Appellate Body Report, *Argentina – Footwear (EC)*, para. 88; and Appellate Body Report, *US – Section 211 Appropriations Act*, paras. 161 and 338.

VI:3 of the GATT 1994 and Part V of the *SCM Agreement* encompass only countervailing duties.

273. In our view, Article VI:3 of the GATT 1994 and Part V of the *SCM Agreement* encompass *all* measures taken against subsidization. To be in accordance with the GATT 1994, as interpreted by the *SCM Agreement*, a response to subsidization must be either in the form of definitive countervailing duties, provisional measures or price undertakings, or in the form of multilaterally-sanctioned countermeasures resulting from resort to the dispute settlement system. As the CDSOA does not correspond to any of the responses to subsidization envisaged by the GATT 1994 and the *SCM Agreement*, we conclude that it is not in accordance with the provisions of the GATT 1994, as interpreted by the *SCM Agreement*, and that, therefore, the CDSOA is inconsistent with Article 32.1 of the *SCM Agreement*.

274. Accordingly, we uphold, albeit for different reasons, the finding of the Panel that the CDSOA is a non-permissible specific action against dumping or a subsidy, contrary to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*.

VIII. ARTICLE 5.4 OF THE *ANTI-DUMPING AGREEMENT* AND ARTICLE 11.4 OF THE *SCM AGREEMENT*

275. We turn now to examine whether the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

276. First, we consider the Panel's findings under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, and then we examine whether the Panel's interpretation of those provisions is consistent with the customary rules of interpretation codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*"). In doing so, we begin with the words of Articles 5.4 and Article 11.4 and then turn to the object and purpose of the *Anti-Dumping Agreement* and the *SCM Agreement*. As a separate matter, we address the Panel's application of the principle of good faith.

A. The Panel's Findings on the Interpretation of Articles 5.4 and 11.4

277. The Panel's findings under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* may be summarized as follows. The Panel found that the CDSOA provides a financial incentive for domestic producers to file or support applications for the initiation of anti-dumping or countervailing duty investigations, because offset payments are made only to producers that file or support such applications. According to the Panel, the CDSOA will result in more applications having the required level of support from domestic industry than would have been the case without the CDSOA, and that "given the low costs of supporting a petition, and the strong likelihood that all producers will feel obliged to keep open their eligibility for offset payments

for reasons of competitive parity, … the majority of petitions will achieve the levels of support required"[211] under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. In reaching its conclusion, the Panel relied, *inter alia*, on a letter in which a "US producer seeks support from other producers for a proposed countervail application ... and states that 'if the [CDSOA] is … applicable here, the total amount available to US lumber producers could be very large – easily running into hundreds of millions of dollars a year.'"[212] The Panel also referred to another letter in which a domestic producer indicates, according to the Panel, that it changed its position concerning an application by deciding to express support for that application "in order to remain eligible for possible offset payment subsidies".[213] In the Panel's view, "these letters are evidence of the inevitable impact of the CDSOA on the position of the domestic industry vis-à-vis anti-dumping/countervail applications."[214]

278. Notwithstanding these findings, the Panel agreed with the United States' argument that Article 5.4 of the *Anti-Dumping Agreement* "requires only that the statistical thresholds be met, and imposes no requirement that the investigating authorities inquire into the motives or intent of a domestic producer in electing to support a petition".[215] The Panel went on to conclude, however, that this argument did not "address the matter at issue" because "the operation of the CDSOA … is [such] that it renders the quantitative tests included in [Articles 5.4 and 11.4] irrelevant"[216] and "den[ies] parties potentially subject to the investigation a meaningful test of whether the petition has the required support of the industry."[217] According to the Panel, in doing so, the CDSOA "recreates the spectre of an investigation being pursued where only a few domestic producers have been affected by the alleged dumping, but industry support is forthcoming because of the prospect of offset payments being distributed."[218] The Panel concluded that the CDSOA "may be regarded as having undermined the value of AD Article 5.4/SCM Article 11.4 to the countries with whom the United States trades, and the United States may be regarded as not having acted in good faith in promoting this outcome."[219]

279. Turning to what it identified as the "object and purpose" of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, the Panel found that those provisions require investigating authorities "to examine the degree of support which exists for an application and to determine whether the application was thus filed by or on behalf of the domestic industry."[220] The Panel appears to have found that the CDSOA "defeats this object and purpose"[221] by

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[211] Panel Report, para. 7.62.
[212] *Ibid*., para. 7.45 and footnote 304 thereto.
[213] Panel Report, para. 7.62.
[214] *Ibid*.
[215] *Ibid*., para. 7.63.
[216] *Ibid*.
[217] *Ibid*.
[218] *Ibid*.
[219] *Ibid*.
[220] *Ibid*., para. 7.64.
[221] *Ibid*., paras. 7.64-7.65.

implying a return to the situation which existed before the introduction of Articles 5.4 and 11.4. According to the Panel, those Articles were "introduced precisely to ensure that support was not just assumed to exist but actually existed, and that the support expressed by domestic producers was evidence of the industry-wide concern of injury being caused by dumped or subsidized imports."[222]

280. The Panel went on to conclude that the CDSOA "in effect mandates"[223] domestic producers to support applications for the initiation of anti-dumping and countervailing duties by making such support "a prerequisite for receiving offset payments"[224] and thus renders the threshold test of Articles 5.4 and 11.4 "completely meaningless".[225] Accordingly, the Panel found that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

B. The Meaning of Articles 5.4 and 11.4

281. At the outset, we express our concern with the Panel's approach in interpreting Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. Specifically, we fail to see how the Panel's interpretation of those provisions may be said to be based on the ordinary meaning of the words found in those provisions, and hence we do not believe the Panel properly applied the principles of interpretation codified in the *Vienna Convention*. It is well settled that Article 3.2 of the DSU requires the application of those principles.[226] Article 31(1) of the *Vienna Convention* provides in relevant part 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.

Thus, the task of interpreting a treaty provision must begin with the specific words of that provision. Accordingly, we turn first to the texts of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. Those provisions are identical and provide, in relevant part, that:

> An investigation shall not be initiated … unless the authorities have determined … that the application has been made by or on behalf of the domestic industry. The application shall be considered to have been made "by or on behalf of the domestic industry" if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the

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[222] *Ibid*., para. 7.65.
[223] Panel Report, para. 7.66.
[224] *Ibid*.
[225] *Ibid*.
[226] Similarly, Article 17.6 (ii) of the *Anti-Dumping Agreement* provides that "the panel shall interpret the relevant provisions of the Agreement in accordance with the customary rules of interpretation of public international law."

> domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry. (footnotes omitted)

282. Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* thus require investigating authorities to "determine" whether an application for the initiation of an investigation has been "made by or on behalf of the domestic industry". If a sufficient number of domestic producers has "expressed support" and the thresholds set out in Articles 5.4 and 11.4 have therefore been met, the "application shall be considered to have been made by or on behalf of the domestic industry". In such circumstances, an investigation may be initiated.

283. A textual examination of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* reveals that those provisions contain no requirement that an investigating authority examine the motives of domestic producers that elect to support an investigation.[227] Nor do they contain any explicit requirement that support be based on certain motives, rather than on others. The use of the terms "expressing support" and "expressly supporting" clarify that Articles 5.4 and 11.4 require only that authorities "determine" that support has been "expressed" by a sufficient number of domestic producers. Thus, in our view, an "examination" of the "degree" of support, and not the "nature" of support is required. In other words, it is the "quantity", rather than the "quality", of support that is the issue.

284. We observe that the Panel appears to have arrived at the same conclusion when it conducted its examination of the *texts* of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. Specifically, the Panel concluded that the United States was correct in arguing that Article 5.4 of the *Anti-Dumping Agreement* "requires only that the statistical thresholds be met, and imposes no requirement that the investigating authorities inquire into the motives or intent of a domestic producer in electing to support a petition".[228] Thus, it seems that, on the basis of a textual analysis of Articles 5.4 and 11.4, the Panel did not find that the CDSOA constitutes a violation of those provisions. The Panel went on to note, however, that this was not the "matter at issue".[229] Instead, according to the Panel, the question was whether the CDSOA "defeats" what it identified as the object and purpose of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.[230]

285. As mentioned above, we have difficulty with the Panel's approach. Clearly, the matter at issue before the Panel included whether the CDSOA is inconsistent with the *Anti-Dumping Agreement* and the *SCM Agreement* in the light of their object and purpose, since interpreting Articles 5.4 and 11.4 involves

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[227] We note that the parties' submissions do not suggest otherwise.
[228] Panel Report, para. 7.63.
[229] *Ibid*.
[230] *Ibid*., para. 7.64.

an inquiry into the object and purpose of those Agreements. In our view, however, the Panel dismissed all too quickly the textual analysis of those provisions as irrelevant.

286. We conclude, therefore, that the texts of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* do not support the reasoning of the Panel. By their terms, those provisions require no more than a formal examination of whether a sufficient number of domestic producers have expressed support for an application.

287. Having said this, we turn next to examine what the Panel identified as the "object and purpose" of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

288. According to the Panel, Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* have as their "object and purpose" to require investigating authorities "to examine the degree of support which exists for an application and to determine whether the application was thus filed by or on behalf of the domestic industry".[231] The Panel appears to have found that the CDSOA defeats this "object and purpose" because it "in fact implies a return to the situation which existed before the introduction of [Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*]."[232] We understand the Panel to have suggested that the CDSOA "implies a return" to the situation in which an application could be "presumed" to have been made by or on behalf of the domestic industry.[233]

289. We do not agree with the Panel's analysis. By their terms, Articles 5.4 and 11.4 do not permit investigating authorities to "presume" that industry support for an application exists. For the thresholds set out in Articles 5.4 and 11.4 to be met, a sufficient number of domestic producers must have "expressed support" for an application. The CDSOA does not change the fact that investigating authorities are required to examine the "degree of support" that exists for an application and that an application shall be considered to have been made "by or on behalf of the domestic industry" only if sufficient support has been "expressed".[234] Hence, we do not agree with the Panel that the CDSOA has "defeated" the object and purpose of Articles 5.4 and 11.4, even if we were to

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[231] *Ibid*.

[232] *Ibid*., para. 7.65.

[233] The Panel notes in this respect the argument advanced by the European Communities, India, Indonesia and Thailand that Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* "were introduced in response to the controversial practice of the United States authorities of *presuming* that an application was made by or on behalf of the domestic industry unless a major proportion of the domestic industry expressed active opposition to the petition." (Panel Report, para. 7.61, referring to the European Communities', India's, Indonesia's and Thailand's first written submission to the Panel, footnote 49; underlining added). In our view, this is not, in itself, sufficient evidence of the "object and purpose" of Articles 5.4 and 11.4.

[234] In this respect, we note that the United States does not contest that it continues to be bound by the obligation set out in Articles 5.4 and 11.4 to ensure that anti-dumping and countervailing duty cases are not initiated unless the levels of support set out in Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* are met. (See United States' second written submission before the Panel, para. 81)

assume that the Panel's understanding of such object and purpose was correct. For the same reason, we also do not agree with the Panel that the CDSOA renders the quantitative threshold tests included in Articles 5.4 and 11.4 "irrelevant"[235] and "completely meaningless."[236]

290. The Panel also took the view that Articles 5.4 and Article 11.4 "[were] introduced precisely to *ensure* … that support expressed by domestic producers was *evidence of industry-wide concern of injury*".[237] Although we agree with the Panel that support expressed by domestic producers *may* be evidence of an "industry-wide concern of injury", we do not agree that such support may be taken to be evidence of such concern alone. Nor do we see anything in Articles 5.4 or 11.4 that would require support to be based on that concern *alone*. Indeed, there may be a number of reasons why a domestic producer could choose to support an investigation. For example, it may do so in the expectation that the protection afforded by future anti-dumping or countervailing duties would improve its competitive position in relation to importers of like foreign products. The Panel appears, however, to have considered that certain motives to support an application would be WTO-consistent, whereas others would not. We see no basis in Articles 5.4 and 11.4 for such an approach.

291. As we have noted, Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement* contain no requirement for investigating authorities to examine the motives of producers that elect to support (or to oppose) an application. Indeed, it would be difficult, if not impossible, as a practical matter, to engage in that exercise.

292. The Panel found that the CDSOA "will result"[238] in more applications having the required level of support from domestic industry than would have been the case without the CDSOA and stated that "given the low costs of supporting a petition, and the strong likelihood that all producers will feel obliged to keep open their eligibility for offset payments for reasons of competitive parity", it "could conclude that the *majority of petitions will achieve the levels of support required* under AD Article 5.4/ SCM Article 11.4."[239] The evidence contained in the Panel record, however, does not support the overreaching conclusion that "the majority of petitions will achieve the levels of support required" under Articles 5.4 and 11.4 as a *result* of the CDSOA. Indeed, we note that, in its first written submission to the Panel, the United States explained that "it is rare for domestic producers in the United States not to have sufficient industry support in filing antidumping or countervailing duty petitions."[240] In support of its statement, the United States submitted to the Panel a survey[241] that shows, for example, that during the year prior to the enactment

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235 Panel Report, para. 7.63.
236 *Ibid*., para. 7.66.
237 *Ibid*., para. 7.65. (emphasis added)
238 Panel Report, para. 7.62.
239 *Ibid*. (emphasis added)
240 United States' first written submission to the Panel, para. 125.
241 Exhibit US-6 before the Panel.

of the CDSOA, *all* of the applications that were filed met the legal thresholds for support.[242]

293. We also believe that the Panel had no basis for stating that the CDSOA as such "in effect *mandates* domestic producers to support the application."[243] Even assuming that the CDSOA may create a financial incentive for domestic producers to file or to support an application[244], it would not be correct to say that the CDSOA as such "mandates" or "obliges" producers to do so. The fact that a measure provides an "incentive" to act in a certain way, does not mean that it "in effect mandates" or "requires" a certain form of action. Indeed, we are not considering here a measure that would "coerce" or "require" domestic producers to support an application. Such a measure might well be found to be WTO-inconsistent. It could be considered, *inter alia*, to circumvent the obligations contained in Article 5.6 of the *Anti-Dumping Agreement* and Article 11.6 of the *SCM Agreement* not to initiate an investigation without a written application "by or on behalf of the domestic industry" except when the conditions set out in those provisions have been met. However, the CDSOA is not such a measure.

294. For all these reasons, we reverse the Panel's finding that the CDSOA, *as such*, is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*.

C. The Panel's Conclusion on Good Faith

295. We address now the Panel's conclusion, in paragraph 7.63 of the Panel Report, that "the United States may be regarded as not having acted in good faith" with respect to its obligations under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*. However, given our conclusion that the CDSOA does not constitute a violation of Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*, the issue of whether the United States "may be regarded as not having acted in good faith" in enacting the CDSOA does not have the relevance it had for the Panel.

296. On appeal, the United States maintains that there is "no basis or justification in the WTO Agreement for a WTO dispute settlement panel to conclude that a Member has not acted in good faith, or to enforce a principle of

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[242] In para. 116 of its appellant's submission, the United States also relies on the argument that a domestic producer can qualify for receipt of possible offset payments by expressing support as late as "the final injury investigation questionnaire, which can be issued more than 200 days after a petition is filed." Although we note that support, for purposes of qualifying for CDSOA distributions, need not necessarily be expressed *prior to* initiation of the investigation, the incentive to express support may well exist at the stage of the initiation of the investigation. This is because if an investigation is not initiated, for example, due to lack of support, that investigation cannot, by definition, lead to a finding of dumping or subsidization and later to CDSOA distributions. This, however, does not affect our conclusion that Articles 5.4 and 11.4 do not require investigating authorities to determine the motivations of producers that choose to support an anti-dumping or countervailing duty investigation (or indeed the motivations of producers that choose to oppose such investigations).

[243] Panel Report, para. 7.66. (emphasis added)

[244] We consider this to be a factual finding of the Panel.

good faith as a substantive obligation agreed to by WTO Members."[245] We observe that Article 31(1) of the *Vienna Convention* directs a treaty interpreter to interpret a treaty 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 the treaty's object and purpose. The principle of good faith may therefore be said to inform a treaty interpreter's task. Moreover, performance of treaties is also governed by good faith. Hence, Article 26 of the *Vienna Convention*, entitled *Pacta Sunt Servanda*, to which several appellees referred in their submissions[246], provides that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[247] The United States itself affirmed "that WTO Members must uphold their obligations under the covered agreements in good faith".[248]

297. We have recognized the relevance of the principle of good faith in a number of cases. Thus, in *US – Shrimp*, we stated that:

> The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states.[249]

In *US – Hot-Rolled Steel*, we found that:

> … the principle of good faith … informs the provisions of the *Anti-Dumping Agreement*, as well as the other covered agreements.[250]

Clearly, therefore, there is a basis for a dispute settlement panel to determine, in an appropriate case, whether a Member has not acted in good faith.

298. Nothing, however, in the covered agreements supports the conclusion that simply because a WTO Member is found to have violated a substantive treaty provision, it has therefore not acted in good faith. In our view, it would be necessary to prove more than mere violation to support such a conclusion.

299. The evidence in the Panel record does not, in our view, support the Panel's statement that the United States "may be regarded as not having acted in good faith". We are of the view that the Panel's conclusion is erroneous and, therefore, we reject it.

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[245] United States' appellant's submission, para. 105.

[246] Canada's appellee's submission, para. 101; the European Communities', India's, Indonesia's and Thailand's appellees' submission, para. 146; Japan's and Chile's appellee's submission, para. 96.

[247] The United States said, in response to questioning at the oral hearing, that it has no difficulty with the notion that Article 26 of the *Vienna Convention* expresses a customary international law principle.

[248] United States' second written submission before the Panel, para. 81. The United States reiterated this point in response to questioning at the oral hearing. See also, Appellate Body Report, *EC – Sardines*, para. 278.

[249] Appellate Body Report, *US – Shrimp*, para. 158. See also, Appellate Body Report, *US – FSC*, para. 166.

[250] Appellate Body Report, *US – Hot-Rolled Steel*, para. 101.

IX. ARTICLE XVI:4 OF THE *WTO AGREEMENT*, ARTICLE 18.4 OF THE *ANTI-DUMPING AGREEMENT*, ARTICLE 32.5 OF THE *SCM AGREEMENT* AND ARTICLE 3.8 OF THE DSU

300. The United States asks that we reverse the Panel's finding that the CDSOA violates Article XVI:4 of the *WTO Agreement* on the grounds that the CDSOA is consistent with Articles VI:2 and VI:3 of the GATT 1994, Articles 5.4, 18.1 and 18.4 of the *Anti-Dumping Agreement*, and Articles 11.4, 32.1 and 32.5 of the *SCM Agreement*. For the same reason, the United States requests that we reverse the Panel's finding that the benefits accruing to the appellees under the *WTO Agreement* have been nullified or impaired.[251]

301. Article 18.4 of the *Anti-Dumping Agreement* and Article 32.5 of the *SCM Agreement* provide that "[e]ach Member shall take all necessary steps, of a general or particular character, to ensure … the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement". Similarly, Article XVI:4 of the *WTO Agreement* provides that "[e]ach Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements", which include the *Anti-Dumping Agreement* and the *SCM Agreement*.

302. As a consequence of our finding that the United States has acted inconsistently with Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, we uphold the Panel's finding that the United States has failed to comply with Article 18.4 of the *Anti-Dumping Agreement*, Article 32.5 of the *SCM Agreement* and Article XVI:4 of the *WTO Agreement*.

303. Article 3.8 of the DSU provides, in relevant part, that:

> In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment.

304. We conclude that, to the extent we have found that the CDSOA is inconsistent with Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*, the CDSOA nullifies or impairs benefits accruing to the appellees in this dispute under those Agreements.

X. ARTICLE 9.2 OF THE DSU

305. The United States claims on appeal that the Panel acted inconsistently with Article 9.2 of the DSU by denying the United States' request for a separate panel report on the dispute brought by Mexico.

306. The Panel took the view that, although Article 9.2 of the DSU provides a general right to WTO Members to request a separate report, such requests "should be made in a timely manner, since any need to prepare separate reports

[251] United States' appellant's submission, para. 133.

may affect the manner in which a panel organises its proceedings."[252] The Panel added that, in its view, "such requests should be made at an early juncture in the panel process, preferably at the time that a panel is established."[253] Turning to the case at hand, the Panel observed that "the US request was received on 10 June 2002, approximately two months after issuance of the descriptive part of the Panel's report"[254] and that the United States had provided "no explanation of why it was unable to submit its request at an earlier date".[255] The Panel also noted that the United States had not referred to any prejudice that it would suffer if the Panel were not to issue a separate report on the dispute brought by Mexico.

307. Based on these considerations, the Panel concluded:

> … that the preparation of a separate report on the dispute brought by Mexico would delay issuance of the Panel's interim report. Although the United States only requested a separate *final* report, we are not prepared to issue a separate final report without also issuing a separate interim report. This is because we are not entitled to issue a final report on the dispute brought by Mexico without first having issued an interim report on that dispute. Otherwise Mexico would be denied its right to request a review of precise aspects of its interim report (DSU Article 15.2).[256] (original underlining)

Accordingly, the Panel rejected the United States' request.[257]

308. The United States appeals this finding of the Panel. The United States submits that Article 9.2 of the DSU gives WTO Members an "unqualified right to the issuance of separate panel reports upon request".[258] According to the United States, Article 9.2 contains no requirement for a party to make its request for a separate panel report by any particular time in the panel proceeding. Nor does it require any party to demonstrate that it would suffer prejudice if its request is not accepted.

309. In our analysis of this issue, we begin by examining the ordinary meaning of the text of Article 9.2 of the DSU which provides, in relevant part, that:

> The [ ] panel shall organize its examination and present its findings to the DSB in such a manner that the rights which the parties to the dispute would have enjoyed had separate panels examined the complaints are in no way impaired. *If one of the parties to the dispute so requests, the panel shall submit separate reports on the dispute concerned.* (emphasis added)

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[252] Panel Report, para. 7.4.
[253] *Ibid*.
[254] *Ibid*.
[255] *Ibid*.
[256] *Ibid*., para. 7.5.
[257] *Ibid*., para. 7.6. In para.s 6.3-6.5 of its Report, the Panel provides further argumentation for why it rejected the United States' request.
[258] United States' appellant's submission, para. 140.

310. By its terms, Article 9.2 accords to the requesting party a broad right to request a separate report. The *text* of Article 9.2 does not make this right dependent on any conditions. Rather, Article 9.2 explicitly provides that a panel "shall" submit separate reports "if one of the parties to the dispute so requests". Thus the text of Article 9.2 of the DSU contains no requirement for the request for a separate panel report to be made *by a certain time*. We observe, however, that the text does not explicitly provide that such requests may be made *at any time*.

311. Having made these observations, we note that Article 9.2 must not be read in isolation from other provisions of the DSU, and without taking into account the overall object and purpose of that Agreement. The overall object and purpose of the DSU is expressed in Article 3.3 of that Agreement which provides, relevantly, that the "prompt settlement" of disputes is "essential to the effective functioning of the WTO." If the right to a separate panel report under Article 9.2 were "unqualified", this would mean that a panel would have the obligation to submit a separate panel report, pursuant to the request of a party to the dispute, *at any time during the panel proceedings*. Moreover, a request for such a report could be made for whatever reason—or indeed, *without any reason*—even on the day that immediately precedes the day the panel report is due to be circulated to WTO Members at large. Such an interpretation would clearly undermine the overall object and purpose of the DSU to ensure the "prompt settlement" of disputes.

312. In support of its argument, the United States relied on *EC – Bananas III (US)* where the panel granted the European Communities' request for "four separate panel reports". We note, however, as did the Panel, that the European Communities' request was made at the meeting at which the DSB established the panel.[259] *EC – Bananas III (US)* is therefore distinguishable from the present case. Thus, we cannot agree with the United States that the right contained in Article 9.2 is "unqualified".[260]

313. Our view is supported by our decision in *US – FSC*, where we observed that:

> The procedural rules of WTO dispute settlement are designed to promote … the fair, *prompt and effective* resolution of trade disputes.[261] (emphasis added)

In the somewhat different context of the *time* by which procedural objections must be raised, we stated in *Mexico – Corn Syrup (Article 21.5 – US)*, that:

> When a Member wishes to raise an objection in dispute settlement proceedings, it is always incumbent on that Member to do so promptly. A Member that fails to raise its objections in a *timely manner, notwithstanding one or more opportunities to do so*, may

[259] Panel Report, para. 6.3.
[260] United States appellant's submission, para. 138, referring to the Panel Report in *EC – Bananas III (US)*, para. 7.55.
[261] Appellate Body Report, *US – FSC*, para. 166.

> be deemed to have waived its right to have a panel consider such objections.[262] (emphasis added; footnote omitted)

314. In the case at hand, the United States made its request under Article 9.2 "approximately two months after the issuance of the descriptive part of the Panel's report"[263] and more than seven months after the Panel had been composed.[264] It therefore cannot be said that the United States made its request "promptly" or in a "timely manner, notwithstanding one or more opportunities to do so".

315. Finally we note that the first sentence in Article 9.2 provides that it is for the panel to "organize its examination and present its findings in such a manner that the rights which the parties to the dispute would have enjoyed had separate panels examined the complaints are in no way impaired." Our comments in *EC – Hormones* about panels' discretion in dealing with procedural issues are pertinent here:

> … the DSU and in particular its Appendix 3, leave panels a *margin of discretion* to deal, always in accordance with due process, with specific situations that may arise in a particular case and that are not explicitly regulated. Within this context, an appellant requesting the Appellate Body to reverse a panel's ruling on matters of procedure must demonstrate the prejudice generated by such legal ruling.[265] (emphasis added)

316. In our view, the Panel acted within its "margin of discretion" by denying the United States' request for a separate panel report. We do not believe that we should lightly disturb panels' decisions on their procedure, particularly in cases such as the one at hand, in which the Panel's decision appears to have been reasonable and in accordance with due process. We observe that, on appeal, the United States is not claiming that it suffered any prejudice from the denial of its request for a separate panel report.[266] We also note that the first sentence of Article 9.2 refers to the rights of all the parties to the dispute. The Panel correctly based its decision on an assessment of the rights of all the parties, and not of one alone.

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[262] Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 50. The Appellate Body also emphasized the need for procedural objections to be made in a timely manner in *US – 1916 Act*, para. 54.

[263] Panel Report, para. 7.4.

[264] The Panel was composed on 25 October 2001. See Panel Report, para. 1.7.

[265] Appellate Body Report, *EC – Hormones*, footnote 138 to para.152.

[266] The United States submits that a showing of prejudice is not required by the text of Article 9.2. In response to questioning at the oral hearing, the United States added that, although it was not aware of any prejudice that it would have suffered in this case, prejudice could have resulted if, for example, Mexico had chosen to cross-appeal the claim related to Article 5 of the *SCM Agreement*, which only Mexico raised before the Panel.

317. Accordingly, we reject the United States' claim that the Panel acted inconsistently with Article 9.2 of the DSU by not issuing a separate panel report in the dispute brought by Mexico.[267]

XI. FINDINGS AND CONCLUSIONS

318. For the reasons set out in this Report, the Appellate Body:

(a) *upholds* the finding of the Panel, in paragraphs 7.51 and 8.1 of the Panel Report, that the CDSOA is a non-permissible specific action against dumping or a subsidy, contrary to Article 18.1 of the *Anti-Dumping Agreement* and Article 32.1 of the *SCM Agreement*;

(b) *consequently upholds* the Panel's finding, in paragraphs 7.93 and 8.1 of the Panel Report, that the CDSOA is inconsistent with certain provisions of the *Anti-Dumping Agreement* and the *SCM Agreement* and that, therefore, the United States has failed to comply with Article 18.4 of the *Anti-Dumping Agreement*, Article 32.5 of the *SCM Agreement* and Article XVI:4 of the *WTO Agreement*;

(c) *upholds* the Panel's finding, in paragraph 8.4 of the Panel Report, that, pursuant to Article 3.8 of the DSU, to the extent that the CDSOA is inconsistent with provisions of the *Anti-Dumping Agreement* and the *SCM Agreement*, the CDSOA nullifies or impairs benefits accruing to the Complaining Parties under those Agreements;

(d) *reverses* the Panel's findings, in paragraphs 7.66 and 8.1 of the Panel Report, that the CDSOA is inconsistent with Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*;

(e) *rejects* the Panel's conclusion, in paragraph 7.63 of the Panel Report, that the United States may be regarded as not having acted in good faith with respect to its obligations under Article 5.4 of the *Anti-Dumping Agreement* and Article 11.4 of the *SCM Agreement*; and

(f) *rejects* the claim of the United States that the Panel acted inconsistently with Article 9.2 of the DSU by not issuing a separate panel report in the dispute brought by Mexico.

319. The Appellate Body *recommends* that the DSB request the United States bring the CDSOA into conformity with its obligations under the *Anti-Dumping Agreement*, the *SCM Agreement*, and the GATT 1994.

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[267] We express no view on the question whether the Panel was correct in concluding, in para. 7.5 of the Panel Report, that it was "not entitled to issue a final report on the dispute brought by Mexico without first having issued an interim report on that dispute". In this respect, we note moreover that the United States has not requested a finding with respect to whether the Panel erred in its interpretation of Article 15.2 of the DSU.

ANNEX 1

WORLD TRADE ORGANIZATION

WT/DS217/8
WT/DS234/16
22 October 2002

(02-5747)

Original: English

UNITED STATES – CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

Notification of an Appeal by the United States under paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)

The following notification, dated 18 October 2002, sent by the United States to the Dispute Settlement Body (DSB), is circulated to Members. This notification also constitutes the Notice of Appeal, filed on the same day with the Appellate Body, pursuant to the *Working Procedures for Appellate Review*.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the Working Procedures for Appellate Review, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the report of the single panel established in response to the requests of Australia, Brazil, Canada, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico, and Thailand in the disputes *United States – Continued Dumping and Subsidy Offset Act of 2000* ("*CDSOA*") (WT/DS217/R and WT/DS234/R) and legal interpretations developed by the Panel.

1. The United States seeks review by the Appellate Body of the Panel's legal conclusion that the Continued Dumping and Subsidy Offset Act of 2000 ("CDSOA") is inconsistent with Articles VI:2 and VI:3 of the *General Agreement on Tariffs and Trade* 1994 ("GATT 1994"), Article 18.1 of the *Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ("Antidumping Agreement") and Article 32.1 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

These findings are in error, and are based on erroneous findings on issues of law and related legal interpretations with respect to Articles VI:2 and VI:3 of GATT 1994, Article 18.1 of the Antidumping Agreement and Article 32.1 of the SCM Agreement, including, for example:

(a) the Panel's legal conclusions that the CDSOA acts specifically in response to dumping, the CDSOA has an adverse bearing on dumping, the CDSOA operates against dumping, actions objectively capable of offsetting or preventing dumping or subsidization constitute action against dumping or subsidization, and Article 18.1 of the Antidumping Agreement and Article 32.1 of the SCM Agreement apply to the CDSOA or to specific actions that have an adverse bearing on the practice of dumping or the practice of subsidization;

(b) the Panel's legal conclusion that Article 18.1 of the Antidumping Agreement and Article 32.1 of the SCM Agreement include a conditions of competition or competitive advantage test;

(c) the Panel's legal conclusions that the Appellate Body's interpretation of GATT Article VI:2 and the Antidumping Agreement in *US – 1916 Act* applies equally to GATT Article VI:3 and the SCM Agreement, and that Part III and Part V of the SCM Agreement contain the only permissible remedies for subsidization;

(d) the Panel's legal conclusion that the CDSOA constitutes specific action against the practice of dumping and specific action against the practice of subsidization;

(e) the Panel's legal conclusion that the CDSOA acts "against" dumping and/or a subsidy because of a claimed adverse impact on the competitive relationship between dumped/subsidized imports and the goods produced by "affected domestic producers," and the improper shifting of the burden of proof to the United States to prove that the CDSOA does not have an adverse bearing on the competitive relationship between dumped/subsidized imports and the goods produced by "affected domestic producers;"

(f) the Panel's legal conclusion that it need not examine footnote 24 of the Antidumping Agreement and footnote 56 of the SCM Agreement because it had already concluded that the CDSOA constitutes "specific action" against dumping and subsidization;

(g) the Panel's legal conclusion that the legislative intent of the CDSOA is relevant to determining whether the CDSOA is consistent with WTO obligations; and

(h) the Panel's legal conclusion that the CDSOA creates a "financial incentive" to file or support dumping/countervail petitions and therefore acts "against" dumping and/or a subsidy.

2. The United States seeks review by the Appellate Body of the Panel's legal conclusion that the CDSOA is inconsistent with Article 5.4 of the Antidumping Agreement and Article 11.4 of the SCM Agreement. These findings are in error, and are based on erroneous findings on issues of law and on related legal interpretations with respect to Article 5.4 of the Antidumping Agreement and Article 11.4 of the SCM Agreement, including, for example:

(a) the Panel's legal conclusion that the CDSOA violates Article 5.4 of the Antidumping Agreement and Article 11.4 of the SCM Agreement despite its findings that the U.S. has implemented these obligations under various provisions of U.S. law, that the CDSOA does not amend these laws and that U.S. investigating authorities observe the quantitative thresholds;

(b) the Panel's legal conclusion that the CDSOA renders the quantitative thresholds in Article 5.4 of Antidumping Agreement and 11.4 of the SCM Agreement meaningless;

(c) the Panel's legal conclusion that the CDSOA violates Article 5.4 of the Antidumping Agreement and Article 11.4 of the SCM Agreement because it " in effect mandates" domestic producers to support the initiation of dumping/countervail investigations and/or creates a financial incentive for domestic producers to support the initiation of dumping/countervail investigations; and

(d) the Panel's legal conclusion that the United States has not acted in good faith in enacting the CDSOA.

3. The United States seeks review by the Appellate Body of the Panel's legal conclusion that the CDSOA violates Article 18.4 of Antidumping Agreement, Article 32.5 of the SCM Agreement, and Article XVI:4 of the Marrakesh Agreement Establishing the World Trade Organization.

4. The United States seeks review by the Appellate Body of the Panel's legal conclusion that the benefits accruing to the Complaining Parties under the WTO Agreement have been nullified or impaired.

5. The United States seeks review by the Appellate Body of the Panel's legal conclusion that the Panel has the discretion under Article 9.2 to reject a party's request for the Panel to submit separate reports.

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