

**AUSTRALIA – SUBSIDIES PROVIDED TO  
PRODUCERS AND EXPORTERS OF  
AUTOMOTIVE LEATHER -**

**RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE  
UNITED STATES**

**REPORT OF THE PANEL**

The report of the Panel on Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 21 January 2000 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

Note by the Secretariat: This Panel Report shall be adopted by the Dispute Settlement Body (DSB) within 30 days after the date of its circulation unless a party to the dispute decides to appeal or the DSB decides by consensus not to adopt the report. If the Panel Report is appealed to the Appellate Body, it shall not be considered for adoption by the DSB until after the completion of the appeal. Information on the current status of the Panel Report is available from the WTO Secretariat.



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## I. INTRODUCTION AND FACTUAL BACKGROUND

1.1 On 16 June 1999, the Dispute Settlement Body (“the DSB”) adopted the report and recommendations of the Panel in the dispute *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather* (WT/DS126/R) (“*Australia – Automotive Leather*”). In that report, the Panel found that payments under a grant contract between the Government of Australia, and Howe and Company Proprietary Ltd. (“Howe”) and Howe’s parent company Australia Leather Holdings, Ltd. (“ALH”) were subsidies within the meaning of Article 1 of the Agreement on Subsidies and Countervailing Measures (“the SCM Agreement”) contingent upon export performance within the meaning of Article 3.1(a) of that Agreement.<sup>3</sup> The Panel accordingly recommended, pursuant to Article 4.7 of the SCM Agreement, that Australia withdraw those subsidies without delay, which the Panel specified to be within 90 days.<sup>4</sup>

1.2 On 6 July 1999 Australia submitted a communication to the Chairman of the DSB pursuant to Article 21.3 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”), regarding “surveillance of implementation of recommendations and rulings – time-period for implementation” (WT/DS126/6). In that communication, Australia stated that the United States had been informed at a bilateral meeting in Canberra on 25 June 1999 that Australia intended to implement the DSB recommendations, and that Australia intended to implement the DSB recommendations within the time-frame provided for in the panel report.

1.3 On 17 September 1999, Australia submitted to the Chairman of the DSB a “status report by Australia” to inform the DSB of Australia’s progress in implementing the recommendations and rulings in the dispute (WT/DS126/7). In that communication, Australia stated that on 14 September 1999, Howe had repaid the Australian Government \$A8.065 million, an amount which covered any remaining inconsistent portion of the grants made under the grant contract. Australia further stated that the Australian Government had also terminated all subsisting obligations under the grant contract. Australia concluded that this implemented the recommendations and rulings in the dispute to withdraw the measures within 90 days.

1.4 On 4 October 1999, the United States submitted a communication seeking recourse to Article 21.5 of the DSU (WT/DS126/8). In that communication, the United States indicated its view that the measures taken by Australia to comply with the recommendations and rulings of the DSB were not consistent with the SCM Agreement and the DSU. In particular, in the view of the United States, Australia’s withdrawal of only \$A8.065 million of the \$A30 million grant, and Australia’s provision of a new \$A13.65 million loan on non-commercial terms to Howe’s parent company, ALH, were inconsistent with the recommendations and rulings of the DSB and Article 3 of the SCM Agreement. The United States further stated that because there was “a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB” between the United States and Australia, within the terms of Article 21.5 of the DSU, the United States sought recourse to Article 21.5 in the matter and requested that the DSB refer the disagreement to the original panel, if possible, pursuant to Article 21.5.

1.5 At its meeting on 14 October 1999, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by the United States in document WT/DS126/8. The DSB further decided 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/DS126/8, the matter referred to the DSB by the

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<sup>3</sup> *Australia – Automotive Leather* at para. 10.1(b).

<sup>4</sup> *Australia – Automotive Leather* at paras. 10.3, 10.7

United States in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.6 The Panel was composed as follows:

Chairperson: H.E. Carmen Luz Guarda

Members: Mr. Jean-François Bellis  
Mr. Wieslaw Karsz

1.7 The European Communities ("the EC") and Mexico reserved their rights to participate in the Panel proceedings as third parties.

1.8 The Panel met with the parties on 23-24 November 1999, and with the third parties on 23 November 1999.

1.9 The parties having agreed to dispense with the interim review stage, the Panel submitted its report to the parties on 14 January 2000.

## II. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

2.1 The **United States** requests the Panel to "determine that Australia has not withdrawn its illegal subsidy without delay, and thus has not complied with Article 4.7 of the SCM [Agreement] and the Panel's recommendations".

2.2 The United States also requests the Panel to make a preliminary ruling that Australia produce by 29 October 1999 authentic copies of certain documents, as well as certain information, for review by the Panel and the United States.

2.3 **Australia** requests the Panel to "find that in withdrawing \$8.065 m. from Howe by 14 September 1999: Australia has fully implemented the recommendation of the DSB of 16 June 1999 (WT/DS126/5)".

## III. PROCEDURAL MATTERS

### A. WORKING PROCEDURES CONCERNING THE DESCRIPTIVE PART OF THE PANEL REPORT

3.1 The Panel adopted its working procedures for this dispute after consulting with the parties. With the agreement of the parties, these procedures provide that, in lieu of the traditional descriptive part of the Panel report setting forth the arguments of the parties, the parties' submissions will be annexed in full to the Panel's report. Accordingly, the submissions of the United States are set forth in Annex 1, and the submissions of Australia are set forth in Annex 2. The third party oral statement and the written submission of the EC containing answers to questions posed by the Panel are set forth in Annex 3. Mexico, the other third party, did not make a written submission nor did it present a written version of its oral remarks made at the third party session.<sup>5</sup>

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<sup>5</sup> See para. 4.2 for a summary of Mexico's oral remarks.

## B. PROCEDURES GOVERNING BUSINESS CONFIDENTIAL INFORMATION

3.2 As part of its working procedures, the Panel established, in consultation with the parties, additional procedures governing business confidential information “(BCI)”. The BCI procedures are set forth in Annex 4. In the original dispute, the Panel had adopted similar procedures.

3.3 Under the BCI procedures, either party may designate as “business confidential” information that it submits. Only “approved persons” may have access to such information. “Approved persons” are those who have provided a signed “Declaration of Non-Disclosure” to the Chair of the Panel, and have thereby agreed to abide by the established BCI procedures. A party submitting business confidential information also must submit a non-confidential version or summary thereof, which can be disclosed to the public.

3.4 In a letter to the Panel dated 8 November 1999, the EC objected to the BCI procedures established by the Panel. In particular, the EC noted that the procedures provide that certain portions of the parties’ written submissions can be withheld if they are considered to contain business confidential information, and if the relevant officials of the third party have not signed a Declaration of Non-Disclosure. In the view of the EC, this requirement is not in conformity with the DSU. The EC argued that EC officials are not allowed to enter into personal commitments to third country governments concerning the conduct of dispute settlement proceedings, and that such obligations may only be undertaken by the EC. The EC further argued that EC officials are bound by the EC Treaty and their terms of employment not to disclose confidential information, including business confidential information, and that the EC is bound to protect the confidentiality of such information under the DSU. The EC therefore requested that the Panel ensure that the EC received complete copies of the parties’ written submissions, as requested by the DSU.

3.5 In a response to the EC dated 11 November 1999, the Panel noted that Australia had already submitted business confidential information, expressly on the basis of the procedures established by the Panel concerning such information (*see* para. 5.9, *infra.*), and that Australia also had submitted, and the EC had been provided with a copy of, a non-business confidential letter describing that information. The Panel recalled that the BCI procedures had been adopted by the Panel in consultation with the parties, in recognition of the parties’ concerns over the protection of business confidential information, and that similar procedures had been adopted in the original dispute. The Panel indicated that, while respecting the obligations undertaken by EC officials with respect to confidentiality, it continued to conclude that in this case special procedures for the submission and handling of business confidential information were appropriate. The Panel concluded therefore that to obtain access to any business confidential information in this dispute, the EC would need to provide signed Declarations of Non-Disclosure, in accordance with the relevant procedures established by the Panel.

3.6 At the third party session, the EC reiterated its objection to this aspect of the Panel’s working procedures.<sup>6</sup>

## C. WORKING PROCEDURES AS REGARDS THIRD PARTIES

3.7 The working procedures adopted by the Panel provide, *inter alia*, for only one meeting with the parties, in conjunction with which the third party session was held. The procedures also provide for third parties to receive only the first submissions, and not the rebuttal submissions, of the parties.

3.8 In its 8 November 1999 letter to the Panel, the EC objected to this aspect of the Panel’s working procedures. The EC recalled that Article 10.3 of the DSU provides that:

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<sup>6</sup> Annex 3-1 at paras. 9-10.

“Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel”.

The EC stated that since in this case there was to be only one meeting of the Panel, at which the Panel would be considering both submissions of each party, the EC should, in accordance with Article 10.3 of the DSU, receive all of the parties' submissions. The EC claimed that it is only in this way that it would be able to make known its views on the issues that the Panel was actually considering at its meeting, rather than having to express views on the incomplete positions of the parties that would have been developed and might have changed in the further submissions that the Panel would have before it at the meeting. The EC therefore asked the Panel to clarify the working procedures so as to ensure that the EC received all written submissions made before the meeting of the Panel.

3.9 In its 11 November 1999 response to the EC, the Panel indicated that it had decided not to change the existing working procedures which provide for third parties to receive the first written submissions of the parties, but not the rebuttals. The Panel stated that if it had decided to hold two meetings with the parties, as is the normal situation envisioned in Appendix 3 of the DSU, third parties would have received only the written submissions made prior to the first meeting, but not rebuttals or other submissions made subsequently. Thus, in the more usual case, third parties would be in the same position as they were in this case with respect to their ability to present views to the panel. In the view of the Panel, the procedure it had established conformed more closely with the usual practice than would be the case if third parties received the rebuttals, and was in keeping with Article 10.3 of the DSU in a case where the Panel holds only one meeting.

3.10 At the third party session, the EC reiterated its objection to this aspect of the Panel's working procedures.<sup>7</sup>

#### **IV. THIRD PARTY STATEMENTS**

4.1 As indicated, the full text of the EC's oral statement is attached at Annex 3. In addition, the Panel had invited third parties to answer several questions, should they choose to do so. The EC's written answers to those questions are also attached at Annex 3.

4.2 In its oral remarks at the third party session, **Mexico** regretted that there had been no translation of the submissions and stated that the lack of translation made it impossible for Mexico to react in a prompt manner to the parties' arguments, and that Mexico was therefore not in a position to make a submission. Mexico noted that under the Panel's working procedures, Mexico had no further opportunity to present its views. Mexico had a systemic interest in how Article 21.5 panels are carried out in practice. Mexico stated that it had sent the Panel's written questions to its capital, but noted that the Chair had recalled that third parties are not obliged to answer such questions.

#### **V. REQUEST BY THE UNITED STATES FOR PRELIMINARY RULING CONCERNING INFORMATION FROM AUSTRALIA**

5.1 In its first written submission,<sup>8</sup> the United States asked the Panel to request that Australia produce, by 29 October 1999, authentic copies of the following documents, as well as the following information, for review by the Panel and the United States:

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<sup>7</sup> Annex 3-1 at paras. 2-8.

<sup>8</sup> Annex 1-1 at para. 54.



- "1. Any agreement, whether by formal agreement or by correspondence with Howe or its related entities, under which Howe agreed to repay, or repaid, \$A8.065 million of the \$A30 million provided in 1997 and/or 1998.
2. Any correspondence between the Government of Australia and Howe or its related entities that refers to the agreement to repay, or to the repayment of, the \$A8.065 million referred to in request 1 above.
3. (a) Any written calculation of the \$A8.065 million communicated to or by Howe or its related entities to or by the Australian Government.  
(b) An explanation of how the \$A8.065 million was calculated.
4. Any document by which the Grant Contract was terminated and any document terminating any performance requirements by Howe pursuant to that Grant Contract.
5. The loan contract between the Australian Government and Australia Leather Holdings providing for the "additional loan of \$13.65 million" to Australia Leather Holdings referred to in Australia's Joint Media Release 99/291, dated September 15, 1999.
6. Any documents referring to or related to the loan contract or the loan referenced in request 5 above, including but not limited to any correspondence between Howe or its related entities and the Australian Government.
7. (a) Any written calculation of the amount of the \$A13.65 million loan communicated to or by Howe or its related entities to or by the Australian Government.  
(b) An explanation of how the \$A13.65 million was calculated or determined.
8. Any documents created by the Australian Government related to the authorization of the Australian Government to (a) issue a new \$A13.65 million loan referenced in request 5 above, and/or (b) terminate the Grant Contract and request repayment of \$A8.065 million of the subsidy".

5.2 The United States argued that this information and documentation were crucial to the Panel's determination under Article 21.5 of the DSU. The United States had relied in its first submission on published statements and submissions of the Australian Government to establish that (a) Australia's method of determining the prospective portion of the grant was arbitrary and resulted in inappropriately putting most of the grant beyond the reach of the SCM Agreement remedies; and (b) the loan was simply a reimbursement on non-commercial terms of the purported withdrawal of the \$A8.065 million repaid by Howe.

5.3 According to the United States, the information and documents requested contained facts and information with a direct bearing on the issues in this proceeding; they should reveal in detail the circumstances under which the repayment by Howe was made, how that amount was agreed to or calculated, and whether there was any reimbursement or *quid pro quo* for the repayment. Similarly, given that the loan was obviously linked to the partial repayment of the grant, documentation and information pertaining to the loan were critical to a clear understanding of its relationship to the grant and grant repayment at issue. In addition, the exact terms of the loan, and the conditions for its issuance, were

highly relevant to whether, and the extent to which, Australia was simply funding Howe's reimbursement out of its own pocket.

5.4 The United States recalled that it had requested these documents and information of Australia at the first organizational meeting of the Panel, on 18 October 1999, but had received nothing as of the filing deadline for the United States' first submission. In the view of the United States, therefore, the request should have come as no surprise to Australia, and Australia should have no trouble meeting the deadline proposed by the United States. It was important that these documents and information be provided on this schedule to permit the United States to review them prior to Australia's first submission, so that relevant information could be incorporated into the United States' second submission.

5.5 The **Panel** sought the views of Australia with regard to the United States' request for preliminary ruling concerning its information request. The Panel stated that if Australia did not object to providing some or all of that information, it should so indicate, and that in that case, the Panel would request that any such documents be submitted no later than the deadline for Australia's first written submission. If Australia objected to the United States' request or any part thereof, its response should set forth the basis for any such objection.

5.6 **Australia** replied that, as a general point, the United States had laid no foundation for most of the putative material, in particular about the 1999 loan, sought in its request for a preliminary ruling. However, according to Australia, most of the material did not exist. Australia noted that it had informed the United States orally about the details of both the withdrawal and the loan prior to 14 September 1999 and had told the United States that a media release was being issued on the matter. Nonetheless, during the six weeks between 14 September and the 18 October organizational meeting of the Panel, the United States had not requested any documents or any further explanation or details. While, at the behest of the United States, Australia had waived the normal requirement for consultations prior to establishment of the Panel, the United States had had plenty of time and opportunity to approach Australia about the matter, but had chosen not to. As a normal procedure, Australia considered that the United States should have to lay some foundation for requiring specific information, rather than launching such a request through seeking an immediate ruling by the Panel.

5.7 Regarding the withdrawal of subsidies required by the DSB, Australia indicated, in response to the United States' requests 1 and 4, that it would include the Deed of Release and confirmation of payment of the \$A8.065 million in the context of Australia's first submission. In response to request 2, Australia indicated that the letter from the Government to ALH could be provided, although no foundation had been laid about its relevance to the dispute. In response to request 3 (a), Australia stated that there was no written calculation of the \$A8.065 million communicated to or by Howe or its related entities to or by the Australian Government, and that the issue had been resolved at meetings. In response to request 3 (b), Australia indicated that the explanation of how the \$A8.065 million had been calculated would be provided in its first submission.

5.8 Regarding the 1999 loan generally, Australia indicated that the Australian Government was entitled to provide new subsidies, including in the form of an unconditional concessional loan to ALH, and was not constrained in this by the DSB recommendation on automotive leather. Australia therefore considered that the matter was not before the Panel and that the United States had not laid the necessary foundation for using this Panel process for seeking such information. Australia stated that, based on the argument at paragraph 50 of the US first submission,<sup>9</sup> the United States was not arguing that the loan was WTO inconsistent, which it could hardly do given the Panel's finding on the 1997 loan, which was for automotive leather purposes, while the 1999 loan was unconditional to ALH. According to Australia,

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<sup>9</sup> Annex 1-1 at para. 50.

there was nothing covert about the 1999 loan except that it dealt with the business of a single, small company. Rather than going on a fishing expedition, the United States should first have to establish the need for such additional information to argue its case, which appeared on the basis of its first submission to be one of trade effect rather than WTO rules.

5.9 Regarding the United States' request 5, Australia indicated that, if the Panel considered that it needed to see the Loan Agreement, Australia was willing to provide it, so long as there was an assurance from other parties that the BCI procedures set out by the Panel would be adhered to. In this regard, Australia requested the Panel to inform the United States and the third parties that, as a condition for receiving business confidential information, consistent with paragraph XII:1(i) of the BCI procedures, Australia required that all business confidential information, including notes taken under paragraph VII:2 of the BCI procedures, be returned promptly to Australia.

5.10 Regarding the United States' request 6, Australia indicated that the letter from the Government to ALH could be provided. Regarding request 7, Australia indicated that there was no written calculation of the amount of the \$A13.65 million loan communicated to or by Howe or its related entities to or by the Australian Government, and that there were lengthy consultations with ALH about the size of a new concessional loan. A wide range of options in respect of ALH and its shareholders had been considered. The decision in favour of a loan had been based solely on the Panel's finding in favour of the 1997 loan to ALH and Howe for automotive leather purposes. The terms of the loan had been derived from those in the 1997 loan, but without any connection to automotive leather. The final amount had been accepted by ALH in the context of its assessment of all factors, including resolving the case, the effect on ALH's balance sheet, tax implications for ALH, and ALH's judgement of future interest rates. Regarding request 8, Australia indicated that these documents were referred to in its response concerning requests 1 and 6.

5.11 The **Panel** concluded that, based on Australia's comments on the United States' request, Australia was willing to submit all of the information either on its own, or in the event that the Panel considered it necessary, to the extent that documents existed and subject to proper handling in accordance with the BCI procedures. The Panel observed that it had every expectation that parties and third parties would abide by the relevant procedures established by the Panel, if they wished to have access to such information. In this regard, the Panel had requested the United States and the third parties to sign and return to the Panel Secretary the non-disclosure forms, so that a list of approved persons could be established to enable the parties and third parties to provide only approved persons with copies of business confidential information. The Panel informed Australia that it did consider necessary the submission of all of the information requested by the United States, and therefore expected Australia to submit all relevant information in conjunction with Australia's first written submission.

5.12 In conjunction with its first submission, Australia submitted certain documents and information requested by the United States.

## **VI. FINDINGS**

### **A. IS THE 1999 LOAN WITHIN THE PANEL'S TERMS OF REFERENCE?**

6.1 Australia argues that the 1999 loan is not within the scope of the Panel's terms of reference. In this regard, Australia argues that the 1999 loan is not part of the implementation of the DSB's ruling and recommendation, noting that it was not notified to the DSB in the document submitted in this regard by

Australia (WT/DS126/7). In Australia's view, the Panel's terms of reference "relate to the implementation of the recommendation of the Report, i.e. to withdraw the grant payments from Howe".<sup>10</sup>

6.2 The United States argues that, under Article 21.5 of the DSU, the Panel's task is to determine the existence or consistency of measures taken to comply with the DSB's ruling. In the United States' view, it is clear that if the Panel can determine the "existence" of measures taken to comply with the ruling, it can consider whether the measures purportedly taken to comply were effectively rendered non-existent.<sup>11</sup>

6.3 We note that this Panel is operating under standard terms of reference, which authorize the Panel

"To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS126/8, the matter referred to the DSB by the United States 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".<sup>12</sup>

Consequently, as in the original dispute, the Panel's terms of reference are defined by the "request for establishment", that is, document WT/DS126/8. That document provides, in pertinent part:

"On 15 September 1999, the Australian government announced in a media release that it had implemented the Panel report's recommendation by terminating the grant contract with Howe and that Howe had repaid \$A8.065 million of the \$A30 million grant. Australia stated that this repayment constituted the "prospective element" of the grant because it was "the proportion of grant monies found to be applied to the sales performance targets contained in the Grant Contract for the period from 14 September 1999 until the end of the Grant Contract on 30 June 2000".

Australia further stated in the same media release that it was providing a new loan of \$A13.65 million to Howe's parent company, Australian Leather Holdings Ltd. The United States understands that this loan was granted on non-commercial terms.

The United States believes that **these measures** taken by Australia to comply with the recommendations and rulings of the DSB are not consistent with the SCM Agreement and the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). In particular, **Australia's withdrawal of only \$A8.065 million** of the \$A30 million grant, and **Australia's provision of a new \$A13.65 million loan** on non-commercial terms to Howe's parent company, are inconsistent with the recommendations and rulings of the DSB and Article 3 of the SCM Agreement". (emphasis added).

6.4 In general, it is the complaining Member in WTO dispute settlement which establishes the scope of the measures before a panel. A "matter" before a panel consists of the "measure(s)" at issue, and the claims relating to those measures, as set out in the request for establishment.<sup>13</sup> In this case, the United States' request for establishment clearly identifies both the repayment by Howe and the 1999 loan as the measures at issue. For us to rule, as suggested by Australia, that we are precluded from considering the 1999 loan, would allow Australia to establish the scope of our terms of reference by choosing what

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<sup>10</sup> Annex 2-1 at para. 51.

<sup>11</sup> Annex 1-2 at para. 30

<sup>12</sup> WT/DS126/9 (1 November 1999).

<sup>13</sup> See, *Guatemala - Anti-Dumping Investigation regarding Portland Cement from Mexico (Guatemala-Cement)*, WT/DS60/AB/R (*Guatemala-Cement AB Report*), adopted 25 November 1998, para. 76.

measure or measures it will notify, or not notify, to the DSB in connection with its implementation of the DSB's ruling. Australia has not made any argument or advanced any reasoning to support its position beyond stating its own view that the 1999 loan is not relevant to this dispute.

6.5 Even assuming that a panel may conclude that a measure specifically identified in the request for establishment is not properly before it in a proceeding under Article 21.5, a question we do not here decide, in this case we see no basis for such a conclusion. The 1999 loan is inextricably linked to the steps taken by Australia in response to the DSB's ruling in this dispute, in view of both its timing and its nature. In our view, the 1999 loan cannot be excluded from our consideration without severely limiting our ability to judge, on the basis of the United States' request, whether Australia has taken measures to comply with the DSB's ruling. In the absence of any compelling reason to do so, we decline to conclude that a measure specifically identified in the request for establishment is not within our terms of reference.

6.6 We note that this view is consistent with the conclusion of the Panel in *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*.<sup>14</sup> In that case, the Panel observed that its terms of reference comprised the measures and claims specified by Ecuador in requesting the Panel's establishment.<sup>15</sup>

6.7 Therefore, we find that the 1999 loan is within our terms of reference, and we may consider it in determining the existence or consistency of measures taken by Australia to comply with the DSB's ruling in this dispute.

**B. EXISTENCE OR CONSISTENCY OF MEASURES TAKEN TO COMPLY WITH THE RECOMMENDATION OF THE DISPUTE SETTLEMENT BODY**

**1. Arguments of the United States**

6.8 The United States asserts that Australia has failed to take measures to comply with the recommendation and ruling in this dispute, that is, that Australia has failed to withdraw the subsidies determined to be inconsistent with Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). In addition, the United States asserts that the measures taken by Australia are not consistent with the SCM Agreement and the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

6.9 In the United States' view, in order to comply with the recommendation to "withdraw the subsidy" in this dispute, Australia was required to withdraw the "prospective portion" of the prohibited subsidies found to have been provided to Howe. The United States notes that in our original determination, we found that the payments under the grant contract constituted prohibited subsidies, recommended that Australia withdraw the subsidies, and that the measures be withdrawn within 90 days. The United States observes that Article 1.1 of the SCM Agreement provides that a subsidy exists if there is a direct transfer of funds from the government and a benefit is thereby conferred. Therefore, the United States asserts that what must be withdrawn, in order to comply with the recommendation, is that portion of the funds provided by the Government of Australia that continues to confer a benefit to Howe after the adoption of the Report in this dispute, that is, after 16 June 1999.

6.10 The United States calculates what it refers to as the "prospective portion" of the subsidy to be withdrawn by allocating the amount of the grant payments over the useful life of Howe's production

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<sup>14</sup> WT/DS27/RW/ECU (12 April 1999).

<sup>15</sup> *Id.* para. 6.7. See also paras. 6.8-6.10, where the Panel concluded that Article 21.5 did not establish any limitations on the measures that might be brought before a panel under that provision.

assets, and calculating the amount allocable to the period following adoption of the report on 16 June 1999. To the amount thus calculated as the "prospective portion" of the subsidy, the United States adds interest accruing after the date of adoption of the report.<sup>16</sup> The United States finds support for its approach to this calculation in the practice of Members, in particular its own practice and that of the EC, in calculating subsidy amounts under Part V of the SCM Agreement, which provides for countervailing measures as a unilateral remedy in cases of injurious subsidies, and also points to the Report of the Informal Group of Experts.<sup>17</sup> That report, which concerned recommendations for calculating the *ad valorem* rate of subsidization in the context of certain serious prejudice cases under Part III of the SCM Agreement, recommends that large non-recurring subsidies should normally be allocated over the useful life of the recipient's assets.

6.11 The United States argues that large non-recurring grants can be used to purchase productive assets, or free up other funds to purchase assets, and thus provide benefits which last a long time – generally, over the life of those assets. In the absence of an allocation, the United States argues that a subsidy would have to be attributed to some shorter period of time, which would ignore economic reality, and would, in many cases, place subsidies in the form of large, non-recurring grants beyond the reach of panel recommendations under Article 4.7 of the SCM Agreement.

6.12 A fundamental principle underlying the United States' approach is that the recommendation required under Article 4.7 of the SCM Agreement "that the subsidizing Member withdraw the subsidy without delay," calls only for prospective corrective action, and therefore requires the withdrawal only of the "prospective portion" of a prohibited subsidy. In this regard, the United States refers to Article 19.1 of the DSU which provides that "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement". In the United States' view, this recommendation requires only prospective corrective action by Members, not retrospective action. The United States also notes the decision of the Appellate Body in *Guatemala-Cement*, which states that "It is, therefore, only in the specific circumstance where a provision of the DSU and a special or additional provision of another covered agreement are mutually inconsistent that the special or additional provision may be read to *prevail* over the provision of the DSU".<sup>18</sup> In the United States' view, there is no inconsistency between withdrawal without delay of the prospective portion of a subsidy under Article 4.7 of the SCM Agreement and bringing the subsidy into conformity with a Member's obligations under Article 19 of the DSU.

6.13 Moreover, the United States argues that, to the extent Australia may be considered to have withdrawn part of the subsidy, any such withdrawal is vitiated by the simultaneous provision of the 1999 loan, conditioned upon the repayment by Howe of \$A8.065 million. The United States argues that the 1999 loan amount was sufficient to enable Howe to repay \$A8.065 million, invest the remainder, and have sufficient funds at the end of the loan period to repay the outstanding amount. The United States also argues that the 1999 loan "steps into the shoes" of the prohibited subsidy Australia was required to withdraw, and is therefore itself inconsistent with Article 3.1(a) of the SCM Agreement.

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<sup>16</sup> The result of this calculation, that is, the amount that the United States argues should be withdrawn in order to withdraw the "prospective portion" of the prohibited subsidy, is \$A26,346,154.

<sup>17</sup> Informal Group of Experts on Calculation Issues Related to Annex IV of the Agreement on Subsidies and Countervailing Measures, Report to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415/Rev.2, 15 May 1998.

<sup>18</sup> *Guatemala – Cement AB Report*, para. 66 (emphasis in original).

## 2. Arguments of Australia

6.14 Australia, like the United States, contends that only a “prospective” remedy is envisioned under Article 4.7 of the SCM Agreement. In this regard, Australia considers that terminating all subsisting obligations under the grant contract, thus terminating the sales performance requirements on Howe under that contract, would be sufficient to implement the recommendation to withdraw the subsidy in this dispute. Australia maintains that it is not the provision of money that was found to be prohibited, but the combination of the provision of the money and the export contingency. Therefore, Australia argues that, by terminating the grant contract and all obligations on Howe under that contract, in particular with respect to the sales performance targets, it has brought the subsidy into conformity with Article 3.1(a) of the SCM Agreement by eliminating the prohibited export contingency.

6.15 Australia argues that elimination of the tie to the sales performance targets transforms the payments under the grant contract from prohibited subsidies to subsidies consistent with the requirements of Article 3.1(a) of the SCM Agreement. In Australia's view, a prohibited subsidy that is "brought into conformity" with Article 3.1(a) has been withdrawn in the sense of Article 4.7 of the SCM Agreement. Australia acknowledges that in some circumstances, "it is difficult to see how the subsidy could be withdrawn...without withdrawing money",<sup>19</sup> but contends that this case does not present such circumstances.

6.16 While Australia maintains, in the first instance, that no repayment is necessary in order to comply with the recommendation in this dispute, it decided, in order to "ensure an end to this dispute",<sup>20</sup> to require Howe to pay \$A8.065 million. Australia calculated this amount as the portion of the subsidy allocable to the period after the end of implementation period (*i.e.*, 14 September 1999), until the end of the sales performance targets under the grant contract (*i.e.*, 30 June 2000). Australia's argument in the alternative appears to be based on the same principle as that underlying the United States' position, namely that any repayment need only be of the "prospective portion" of the subsidy. However, Australia differs from the United States with respect to the calculation of the amount to be repaid in order to effectuate repayment of the "prospective portion" of the subsidy. Australia's view is that, in this case, the payments under the grant contract must be allocated over the period for which the sales performance targets set forth in the grant contract were to be in effect, that is, to the period 1 April 1997 to 30 June 2000, less any amounts allocable to sales other than exports of automotive leather. Australia bases this view on its understanding that the grant payments were found to be prohibited subsidies because they were tied to the sales performance targets, which the Panel considered to be, effectively, export performance targets. The amount to be repaid under Australia's calculation is the amount allocable to export sales of automotive leather during the period from 14 September 1999, the end of the implementation period, to 30 June 2000, the end of the performance targets under the grant contract.<sup>21</sup>

6.17 With respect to the 1999 loan, Australia argues that it is not part of the implementation of the recommendation in this dispute. Moreover, Australia asserts that the 1999 loan is not inconsistent with Article 3.1(a) of the SCM Agreement.

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<sup>19</sup> Annex 2-5, answer to question 13(b) from the Panel.

<sup>20</sup> Annex 2-1 at para. 20.

<sup>21</sup> Australia presents two alternative calculations, depending on whether the allocation is based on the aggregate sales performance target, or the interim targets set forth in the grant contract. The first basis yields an amount of \$A6.602 million to be withdrawn, and the second yields an amount of \$A8.065 million. (Annex 2-1 at paras. 46-49, footnotes 22-24, and Attachment A.) Australia considers the lower amount to be based on the appropriate approach (*id.* at para. 47), but required the repayment of the higher amount.

### 3. The meaning of “withdraw the subsidy” in Article 4.7 of the SCM Agreement

6.18 We are required to determine whether Australia has taken measures to comply with the recommendation and ruling of the DSB in this dispute. Our recommendation and ruling, adopted by the DSB, was made pursuant to Article 4.7 of the SCM Agreement, and called upon Australia to "withdraw the subsidies identified in paragraph 10.1(b)" of the Report within 90 days. The "subsidies identified in paragraph 10.1(b)" of the Report are "the payments under the grant contract [which we had determined] are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement". The question before us is the existence or consistency with a covered agreement of measures taken to comply with that recommendation. In order to resolve this question, it is in our view imperative to know what that recommendation means, which in turn requires interpretation of the phrase "withdraw the subsidy" in Article 4.7.

6.19 Both parties, and the EC as third party, appear to be of the view that our task in this dispute is to choose between the parties' respective positions and either conclude, as Australia argues, that Australia has fully complied with the DSB's ruling, or conclude, as the United States argues, that **because** Australia did not withdraw from Howe the sum that the United States calculates should have been withdrawn, it has failed to take measures to comply with the DSB's ruling. In response to a question from the Panel, both parties argue that the possibility that "withdraw the subsidy" under Article 4.7 of the SCM Agreement should be interpreted to mean "repay in full" the financial contribution to the recipient was not an issue in dispute between the parties, and therefore is not an issue which we need to address.<sup>22</sup> Our view differs. That neither party has argued a particular interpretation before us, and indeed, that both have argued that we should not reach issues of interpretation that they have not raised, cannot, in our view, preclude us from considering such issues if we find this to be necessary to resolve the dispute that is before us. A panel's interpretation of the text of a relevant WTO Agreement cannot be limited by the particular arguments of the parties to a dispute.

(a) Recommendation of a remedy having exclusively "prospective" effect

6.20 The parties have gone to some lengths to argue that "withdraw the subsidy" is a recommendation with exclusively "prospective" effect. The United States argues that "withdraw the subsidy" requires some repayment in this case, but that the repayment can only be "prospective".<sup>23</sup> The United States argues that the "prospective portion" of a one-time subsidy paid in the past can be identified by allocating the subsidy over the useful life of the recipient's productive assets and then drawing a line at the date of adoption of the panel report finding the subsidy to be prohibited. According to the United States, repayment is a prospective remedy with no retrospective effect if it is limited to that portion of the subsidy benefit allocated to the period following adoption of the panel report, plus interest accruing between the date of adoption of the panel report and the end of the implementation period.

6.21 Australia also argues, in the alternative to its primary argument (*see* para. 6.46 *infra.*), that repayment of the "prospective portion" of the subsidy is a prospective remedy. Australia calculates the prospective portion as that portion of the subsidy allocated to the period from the end of the implementation period to the end of the period covered by the sales performance targets under the grant contract. Australia argues that in this case, the subsidies must be allocated in full to the sales performance targets set forth in the grant contract, that is, to the period 1 April 1997 to 30 June 2000, less any amounts allocable to sales other than exports of automotive leather. Australia bases this position on its understanding that the Panel itself so allocated the grant payments by ruling that those payments were

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<sup>22</sup> Annex 1-5 (United States) and Annex 2-5 (Australia), answer to question no. 2 for both parties.

<sup>23</sup> It is supported in this view by the EC. (Annex 3-2, answer to Panel questions 1 and 2.)



prohibited subsidies because they were tied to the sales performance targets, which the Panel considered to be, effectively, export performance targets.<sup>24</sup>

6.22 While we understand the conceptual framework advanced by the United States,<sup>25</sup> as well as that underlying Australia's alternative position, we do not find meaningful the distinction proposed by the parties between repayment of "prospective" and "retrospective" portions of past subsidies in the context of Article 4.7 of the SCM Agreement. We do not agree that it is possible to conclude that repayment of the "prospective portion" of prohibited subsidies paid in the past is a remedy having only prospective effect. In our view, where any repayment of any amount of a past subsidy is required or made, this by its very nature is **not** a purely prospective remedy. No theoretical construct allocating the subsidy over time can alter this fact. In our view, if the term "withdraw the subsidy" can properly be understood to encompass repayment of **any** portion of a prohibited subsidy, "retroactive effect" exists.

6.23 The EC, as third party, argues that there can be no obligation on a Member to remedy violations with retroactive effect. In the EC's view, any such obligation would be ineffective, since it would result in interference with private rights, giving rise to domestic legal claims. However, this concern would equally arise if repayment of a putative "prospective portion" of a subsidy is required, as the United States proposes, with the support of the EC. Indeed, even the cessation of subsidy payments in the future, a remedy more clearly "prospective" in effect, may interfere with private rights and give rise to domestic legal claims. Many situations can be envisioned, and not only in the subsidies area, in which a Member's actions to implement a ruling of the DSB might result in some interference with private rights, and result in domestic legal claims. This possibility does not, in our view, limit our interpretation of the text of the SCM Agreement.

(b) May "withdraw the subsidy" be understood to encompass repayment?

6.24 In this case, we must consider whether the recommendation to "withdraw the subsidy" in Article 4.7 of the SCM Agreement can properly be understood to encompass repayment. In order to answer that question, we must first determine what is meant by the term "withdraw the subsidy" as used in Article 4.7 of the SCM Agreement. In particular, we must consider whether that term is limited to a recommendation with purely prospective effect, or whether it also encompasses repayment.

6.25 The Appellate Body has repeatedly observed that, in interpreting the provisions of the WTO Agreement, including the SCM Agreement, panels are to apply the general rules of treaty interpretation

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<sup>24</sup> Australia's calculation methodology is based on a fundamental misunderstanding of our original determination finding the payments under the grant contract to be prohibited subsidies. Contrary to Australia's understanding, we did not conclude that the subsidies in question were "tied to" particular export sales during a particular period, specifically, the sales performance targets in the grant contract. Rather, we concluded that the subsidy payments under the grant contract "are in fact tied to Howe's actual or anticipated exportation or export earnings. These payments are conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets". *Australia – Automotive Leather*, para 9.71. The sales performance targets were an important factual element in our finding, but as we stated, it was our consideration of **all** of the facts that led us to the conclusion that the payments under the grant contract were prohibited subsidies. The specific details of the factual evidence underlying the conclusion that the subsidies were in fact contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement and therefore prohibited do not, in our view, determine what is required in order to "withdraw the subsidy" within the meaning of Article 4.7 of the SCM Agreement.

<sup>25</sup> We note that the concept of allocation of certain subsidies over time has been used and/or recommended in the context of countervailing measures and serious prejudice, because in those contexts, particular subsidy amounts must be attributed to particular sales of particular goods at particular moments in time for calculation of per unit or *ad valorem* subsidization of specific products to be possible. In our view, these issues simply do not arise where the question is what is meant by "withdrawal" of prohibited subsidies.

set out in the Vienna Convention on the Law of Treaties. These rules call, in the first place, for the treaty interpreter to attempt to ascertain the ordinary meaning of the terms of the treaty in their context and in the light of the object and purpose of the treaty, in accordance with Article 31(1) of the Vienna Convention. The Appellate Body has also recalled that the task of the treaty interpreter is to ascertain and give effect to a legally operative meaning for the terms of the treaty. The applicable fundamental principle of *effet utile* is that a treaty interpreter is not free to adopt a meaning that would reduce parts of a treaty to redundancy or inutility.<sup>26</sup>

6.26 Article 4.7 of the SCM Agreement sets forth the recommendation that a panel is to make in a dispute involving a prohibited subsidy:

"If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay".

In order to ascertain the meaning of "withdraw the subsidy" in Article 4.7, we will consider first the ordinary meaning of the term. We will then consider the meaning of the term in its context, and in the light of the object and purpose of the SCM Agreement. Finally, we will consider whether an interpretation of "withdraw the subsidy" as providing exclusively a prospective remedy would render the recommendation and remedy in prohibited subsidy cases ineffective.

(i) *Textual analysis*

6.27 Turning first to the ordinary meaning of the term, the word "withdraw" has been defined as: "pull aside or back (withdraw curtain, one's hand); take away, remove (child from school, coins from circulation, money from bank, horse from race, troops from position, favour etc. from person); retract (offer, statement, promise)".<sup>27</sup> This definition does not suggest that "withdraw the subsidy" necessarily requires only some prospective action. To the contrary, it suggests that the ordinary meaning of "withdraw the subsidy" may encompass "taking away" or "removing" the financial contribution found to give rise to a prohibited subsidy. Consequently, an interpretation of "withdraw the subsidy" that encompasses repayment of the prohibited subsidy seems a straightforward reading of the text of the provision.

(ii) *Context*

6.28 As regards the context of Article 4.7, we note that the term "withdraw the subsidy" appears elsewhere in the SCM Agreement. We consider these references to "withdrawal" of subsidies to be relevant for our understanding of the term. In the case of "actionable" subsidies, Members whose trade interests are adversely affected may, under Part III of the SCM Agreement, pursue multilateral dispute settlement in order to establish whether the subsidy in question has resulted in adverse effects to the interests of the complaining Member. If such a finding is made, the subsidizing Member "shall take appropriate steps to remove the adverse effects **or shall withdraw the subsidy**".<sup>28</sup> Alternatively, a Member whose domestic industry is injured by subsidized imports may impose a countervailing measure under Part V of the SCM Agreement, "**unless the subsidy or subsidies are withdrawn**".<sup>29</sup> In both cases, withdrawal of the subsidy is an alternative, available to the subsidizing Member, to some other action.

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<sup>26</sup> *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 23; *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 12.

<sup>27</sup> Concise Oxford Dictionary, sixth edition, (1976).

<sup>28</sup> SCM Agreement Article 7.8 (emphasis added).

<sup>29</sup> SCM Agreement Article 19.1 (emphasis added).

Repayment of the subsidy would certainly effectuate withdrawal of the subsidy by a subsidizing Member so as to allow it to avoid action by the complaining Member. In the practice of at least one Member, the United States, "withdraw the subsidy" as used in Article 19.1 of the SCM Agreement encompasses repayment.<sup>30</sup> Thus, the use of the term "withdraw" elsewhere in the SCM Agreement further supports the suggestion that it may encompass repayment.

6.29 The United States, Australia, and the EC as third party all argue that an interpretation of Article 4.7 of the SCM Agreement which would allow a retroactive remedy is inconsistent with Article 19 of the DSU and customary practice under the GATT 1947 and the WTO. We note also Article 3.7 of the DSU, which provides in pertinent part:

" The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred. **In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements**". (emphasis added).<sup>31</sup>

6.30 It might be argued that because Article 3.7 of the DSU appears to equate "bring the measure into conformity", the recommendation provided for in Article 19.1 of the DSU, with withdrawal of the inconsistent measure, "withdraw the subsidy", the recommendation provided for in Article 4.7 of the SCM Agreement, should also be equated with "bring the subsidy into conformity".<sup>32</sup> As the parties have argued, the recommendation to "bring the measure into conformity" under Article 19.1 is generally understood to require a Member found to have violated a provision of the WTO Agreements to "withdraw the measure" in a prospective sense. Thus, it might be argued that "withdraw the subsidy" should also require a Member to do so only in a prospective sense.

6.31 However, we do not believe that Article 19.1 of the DSU, even in conjunction with Article 3.7 of the DSU, requires the limitation of the specific remedy provided for in Article 4.7 of the SCM Agreement to purely prospective action. An interpretation of Article 4.7 of the SCM Agreement which would allow exclusively "prospective" action would make the recommendation to "withdraw the subsidy" under Article 4.7 indistinguishable from the recommendation to "bring the measure into conformity" under Article 19.1 of the DSU, thus rendering Article 4.7 redundant.

6.32 Finally, to argue, as the United States and Australia do, that the customary practice under the GATT/WTO has been to recommend prospective remedies, does not address, much less resolve, the question of what is meant by the term "withdraw the subsidy", a special or additional rule of dispute settlement which is new to the SCM Agreement and has not before been interpreted by a panel. Indeed, Article XVI.1 of the Marrakesh Agreement provides that the WTO, including dispute settlement panels

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<sup>30</sup> *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/R, circulated 23 December 1999, pp.248-249 (Second Submission of the United States, 30 June 1999, paras. 40-49). We recognize that the United States' position in that case is consistent with its position concerning repayment of the "prospective portion" of a subsidy, being based on allocation of the subsidy over time, and repayment of the "net present value of the outstanding benefit stream" *Id.* at p. 249, para. 49. However, this does not alter the fact that US practice acknowledges that "withdraw the subsidy" in Article 19.1 of the SCM Agreement encompasses repayment.

<sup>31</sup> In contrast, Article 26.1 of the DSU provides that after a finding of non-violation nullification or impairment, "there is no obligation to withdraw the measure. However, in such cases, the panel or the Appellate Body shall recommend that the Member concerned make a mutually satisfactory adjustment".

<sup>32</sup> This appears to be Australia's position, as it repeatedly referred to "bringing the subsidy into conformity with Article 3.1(a)" in its arguments before us.

interpreting the terms of WTO Agreements, "shall be guided" by the customary practice of the GATT 1947 **"Except as otherwise provided under this Agreement or the Multilateral Trade Agreements"** (emphasis added). We are of the view that "withdraw the subsidy" in Article 4.7 of the SCM Agreement is a provision that "otherwise provides", and therefore customary practice under GATT 1947 and the WTO Agreement does not require us to conclude that "withdraw the subsidy" must be read to allow prospective action only.

(iii) *Object and purpose*

6.33 Turning to the object and purpose of Article 4.7 of the SCM Agreement, we observe that the SCM Agreement as a whole establishes disciplines on subsidies. The SCM Agreement categorises subsidies as non-actionable, actionable, or prohibited.<sup>33</sup> In the case of non-actionable and actionable subsidies, Members are only allowed to take certain prescribed steps in the event that their trade interests are harmed by another Member's subsidies. Part II of the SCM Agreement, however, establishes an absolute prohibition on certain types of subsidies: Members are obligated, under Article 3.2 of the SCM Agreement, to "neither grant nor maintain" such subsidies. While the trade effects of prohibited subsidies may be countered under Parts III and V of the SCM Agreement, Part II of the SCM Agreement establishes special and additional rules for rapid dispute settlement in cases involving such subsidies. Article 4.7 of the SCM Agreement establishes a specific remedy to be recommended in the case of a violation - withdrawal of the subsidy.

6.34 In our view, the architecture of the SCM Agreement discussed above provides further support for the conclusion that the remedy provided for prohibited subsidies, withdrawal, encompasses repayment. This specific remedy, withdrawal of the prohibited subsidy, does not merely counteract adverse trade effects, but is intended to enforce the absolute prohibition on the grant or maintenance of such subsidies. In our view, terminating a programme found to be a prohibited subsidy, or not providing, in the future, a prohibited subsidy, may constitute withdrawal in some cases. However, such actions have no impact, and consequently no enforcement effect, in the case of prohibited subsidies granted in the past. Thus, an interpretation of "withdraw the subsidy" which encompasses repayment is consistent with the overall structure of the SCM Agreement, as well as with the explicit prohibition of certain subsidies and special dispute settlement procedures provided for in such cases. In this regard, we recall that repayment is a means of "withdrawing" a subsidy by which the possibility of an importing Member imposing countervailing measure on imported subsidized goods can be avoided.

(iv) *Effectiveness of the remedy*

6.35 We believe it is incumbent upon us to interpret "withdraw the subsidy" so as to give it effective meaning. A finding that the term "withdraw the subsidy" may not encompass repayment would give rise to serious questions regarding the efficacy of the remedy in prohibited subsidy cases involving one-time subsidies paid in the past whose retention is not contingent upon future export performance. For instance, Australia argues in this case that no repayment is required, and that elimination of the export contingency in the grant contract would have been sufficient to withdraw the subsidy. Under Australia's approach, the only effect of a panel recommendation to "withdraw the subsidy" would be a prospective change in the terms of the subsidy. As a result, prohibited export subsidies paid in the past, and for which there is no continuing export contingency, would be beyond the effective reach of a recommendation to "withdraw the subsidy", no matter how clear the violation of Article 3.1(a) of the SCM Agreement might be.

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<sup>33</sup> We note that, pursuant to Article 31 of the SCM Agreement, the provisions of Articles 6.1 (presumption of serious prejudice), and 8 and 9 (non-actionable subsidies) shall apply for five years from the date of entry into force of the WTO Agreement unless extended for a further period.

6.36 Under Article 1.1 of the SCM Agreement, a subsidy is deemed to exist if there is a financial contribution by a government, and a benefit is thereby conferred. A subsidy may take the form of a one-time financial contribution conferring a benefit, or it may take the form of a programme or practice pursuant to which financial contributions conferring a benefit are provided on a recurrent basis.<sup>34</sup> For "withdraw the subsidy" to be a meaningful remedy, that is, for it to effectuate the prohibition on the grant or maintenance of certain types of subsidies, it must be effective regardless of the form in which a prohibited subsidy is found to exist. An interpretation of Article 4.7 which would provide an effective remedy only in some cases would not, in our view, be appropriate.

6.37 We note that the EC, as third party, has argued that the absence of a remedy for past and consummated violations is and has always been a well-known feature of the GATT/WTO system, under which in some cases there is no remedy at all for a complaining party. The EC cites the Panel decision in the *Trondheim Toll Equipment* dispute, in which a government contract was awarded in violation of provisions of the Government Procurement Agreement.<sup>35</sup> The panel in that dispute realized that the "usual" GATT remedy of "bring the measure into conformity" was less than satisfactory, but declined to recommend an alternative remedy.<sup>36</sup> However, unlike the Panel in *Trondheim*, in this case we are considering a specific recommendation to "withdraw the subsidy", which is a special provision unique to the SCM Agreement. We decline to read "withdraw the subsidy" in a manner that does not give it an effective meaning merely because in some cases under other WTO Agreements, the general remedy under Article 19.1 of the DSU of bringing the measure into conformity may not be effective.

6.38 If we were to accept the conclusion that "withdraw the subsidy" does not encompass repayment, then that recommendation, far from providing a remedy for violations of Article 3.1(a) of the SCM Agreement, would grant full absolution to Members who grant export subsidies that are fully disbursed to the recipient before a recommendation to withdraw the subsidy is issued in dispute settlement, and for which the export contingency is entirely in the past. We do not believe that the drafters of the SCM Agreement would have established in Article 3.1(a) the strict prohibition against subsidies contingent on export performance, including one-time subsidies contingent in fact on export performance, only to undermine that prohibition by providing a remedy which is ineffective in the case of such subsidies.

(v) *Conclusion*

6.39 Based on the ordinary meaning of the term "withdraw the subsidy", read in context, and in light of its object and purpose, and in order to give it effective meaning, we conclude that the recommendation to "withdraw the subsidy" provided for in Article 4.7 of the SCM Agreement is **not** limited to prospective action only but may encompass repayment of the prohibited subsidy.

6.40 The United States and Australia both look to Article 19.1 of the DSU as a principal element to be considered in interpreting Article 4.7 of the SCM Agreement, arguing that Article 4.7 of the SCM Agreement should be read consistently with Article 19.1 of the DSU.

6.41 However, Article 19.1 of the DSU is not the basis of the recommendation in a case involving prohibited subsidies, such as this one. Rather, the recommendation to "withdraw the subsidy" is required by Article 4.7 of the SCM Agreement, which is a special or additional rule or procedure on dispute

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<sup>34</sup> See *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted as modified by WT/DS46/AB/R, 20 August 1999, paras. 7.1-7.3.

<sup>35</sup> *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*, GPR/DS.2/R, adopted 13 May 1992.

<sup>36</sup> *Id.* at paras. 4.21-4.25.

settlement, identified in Appendix 2 to the DSU. It is Article 4.7 which we must interpret and apply in this dispute. In this respect, we note Article 1.2 of the DSU, which provides:

"The rules and procedures of this Understanding shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to this Understanding. **To the extent that there is a difference between the rules and procedures of this Understanding and the special or additional rules and procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail...**". (emphasis added).

Thus, to the extent that "withdraw the subsidy" requires some action that is different from "bring the measure into conformity", it is that different action which prevails.<sup>37</sup>

6.42 "Withdraw the subsidy" is, as discussed above, different from "bring the measure into conformity", the recommendation required under Article 19.1 of the DSU. This conclusion is consistent with the observation of the Appellate Body in *Brazil – Aircraft*:

"Article 4.7 [of the SCM Agreement] contains several elements which are different from the provisions of Articles 19 and 21 of the DSU with respect to recommendations by a panel and implementation of rulings and recommendations of the DSB. For example, Article 19 of the DSU requires a panel to recommend that the Member concerned bring its measure "into conformity" with the covered agreements. In contrast, Article 4.7 of the *SCM Agreement* requires a panel to recommend that the subsidizing Member *withdraw* the subsidy".<sup>38</sup>

That a "retrospective" remedy might not be permissible under Article 19.1 of the DSU (a question which we do not here decide) does not preclude us from concluding, on the basis of the text of Article 4.7 of the SCM Agreement, that "withdraw the subsidy" is **not** limited to purely prospective action, but may encompass repayment of prohibited subsidies.

(c) If repayment is necessary to "withdraw the subsidy", can partial repayment be sufficient?

6.43 Having concluded that the recommendation to "withdraw the subsidy" in Article 4.7 of the SCM Agreement encompasses repayment, we must further consider whether such repayment must be of the full amount of the prohibited subsidy, or whether a lesser amount, a partial repayment, may suffice.

6.44 As discussed above, we do not view the distinction drawn by the parties between the "prospective" and past portions of a subsidy to be meaningful. Thus, this distinction provides no basis for a conclusion that repayment of less than the full amount of the prohibited subsidy would suffice to satisfy a recommendation to withdraw the subsidy. In this regard, we note that the United States' line of reasoning in calculating the "prospective" benefit of past subsidies raises a number of questions. In the first place, taking back the full amount of the prohibited subsidy necessarily eliminates the benefit conferred. Moreover, as is evident in this dispute, the valuation of the benefit of a subsidy, its allocation over time, and the calculation of the "prospective portion" thereof, are complicated questions, for which

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<sup>37</sup> See *Guatemala-Cement AB Report*, para. 65.

<sup>38</sup> *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999, para. 191 (emphasis in original).

there are no guidelines in the SCM Agreement.<sup>39</sup> It seems to us unlikely that the negotiators of the SCM Agreement intended "withdraw the subsidy" to involve these complex questions of allocation over time without some indication in the text of the Agreement to that effect. The parties have made no other arguments which would support a conclusion that anything less than full repayment would satisfy the requirements of Article 4.7.

6.45 Having concluded that Article 4.7 of the SCM Agreement encompasses repayment, we can find no basis for concluding that anything less than full repayment would suffice to satisfy the requirement to "withdraw the subsidy" in a case where repayment is necessary.

(d) Is repayment in full of the prohibited subsidy necessary in this case?

6.46 Australia argues in the first instance that no repayment is required in this case, and that it could have fully complied with the recommendation to withdraw the subsidy in this case by releasing Howe from the remaining obligations under the grant contract. In Australia's view, this action would have eliminated the export contingency on which was based the determination that the subsidies granted to Howe were prohibited, and would bring the prohibited subsidies into conformity with Article 3.1(a) of the SCM Agreement, thus "withdrawing" the prohibited subsidies.

6.47 We are not persuaded by Australia's argument that it is possible to change, *ex post facto*, the export contingency associated with the prohibited subsidy in this case. Our determination of the existence of in fact export contingency was based on the "facts that existed at the time the contract establishing the conditions for the grant payments was entered into".<sup>40</sup> Where, as here, the prohibited subsidy is a one-time, past event, and its retention is not contingent upon export performance yet to be achieved, it is a logical impossibility to change the facts and circumstances surrounding the decision to provide the subsidy which led to the conclusion that the subsidy was prohibited. While in this case, the period covered by the sales performance targets has not yet ended, releasing Howe from any obligations with respect to those targets cannot change the fact that there was a close tie between anticipated exportation and the grant of the subsidies **at the time the subsidies were provided**. We noted in our original determination that the fact that anticipated exports did not come to pass in the volumes anticipated did not affect the conclusion that the subsidies were contingent upon export performance. Similarly, the removal of the sales performance targets today cannot change the fact that, at the time the subsidies were provided, they were contingent upon anticipated export performance. The purely prospective remedy proposed by Australia of changing after the fact the conditions on which the subsidy was provided, essentially by erasing the sales performance targets from the grant contract, in our view would be completely ineffective in this case.

6.48 Thus, we conclude that, in the circumstances of this case, repayment is necessary in order to "withdraw" the prohibited subsidies found to exist. As discussed above, we do not find any basis for repayment of anything less than the full subsidy. We therefore conclude that repayment in full of the prohibited subsidy is necessary in order to "withdraw the subsidy" in this case.

6.49 In our view, the required repayment does not include any interest component. We believe that withdrawal of the subsidy was intended by the drafters of the SCM Agreement to be a specific and effective remedy for violations of the prohibition in Article 3.1(a). However, we do not understand it to be a remedy intended to fully restore the *status quo ante* by depriving the recipient of the prohibited

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<sup>39</sup> While some Members have developed methodologies for the valuation of subsidy benefits in the context of countervailing duty procedures, these are not universally accepted or consistent. Moreover, their relevance and applicability in the context of the Article 4.7 recommendation is not apparent.

<sup>40</sup> *Australia - Leather*, para. 9.68.

subsidy of the benefits it may have enjoyed in the past. Nor do we consider it to be a remedy intended to provide reparation or compensation in any sense. A requirement of interest would go beyond the requirement of repayment encompassed by the term "withdraw the subsidy", and is therefore, we believe, beyond any reasonable understanding of that term.

#### 4. Has Australia withdrawn the prohibited subsidies in this case?

6.50 Australia withdrew A\$8.065 million from Howe on 14 September 1999. On the same date, Australia provided a loan of A\$13.65 million on non-commercial terms (the 1999 loan) to Howe's parent company, ALH.<sup>41</sup> In light of the facts and circumstances surrounding the provision of the 1999 loan and the repayment by Howe, we find that they are inextricably linked elements of a single transaction. The documents concerning the loan make clear that the repayment and the provision of funds pursuant to the loan occurred at the same time, and that the provision of the loan funds was **specifically conditioned** on the repayment.<sup>42</sup> Moreover, the total loan amount was sufficient to fund the repayment, with enough left over to invest, at an unexceptional rate of return, so as to yield a sufficient sum to allow repayment in full of the loan on the due date.<sup>43</sup> In our view, in the particular circumstances of this case, the provision of the 1999 loan nullifies the repayment by Howe of \$A8.065 million.

6.51 We emphasise that we do **not** determine that the 1999 loan is inconsistent with Article 3.1(a) of the SCM Agreement. Nor do we consider that Australia is precluded from providing subsidies to Howe simply because it has been determined that the payments under the grant contract are prohibited subsidies. We simply find that because of the loan, in the circumstances of this case, no repayment, and consequently, no withdrawal of the prohibited subsidies, has effectively taken place.

## VII. CONCLUSION

7.1 Based on the foregoing, we determine that Australia has failed to withdraw the prohibited subsidies within 90 days, and thus has not taken measures to comply with the DSB's recommendation in this dispute.

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<sup>41</sup> While the specific terms of the 1999 loan are business confidential information, Australia has acknowledged that it is a subsidy. Annex 2-2, para. 8.

<sup>42</sup> We note Australia's argument that the 1999 loan was provided to ALH, Howe's parent company, while the repayment was made by Howe. However, the provision of the 1999 loan by Australia was expressly conditioned on repayment. In these circumstances, we do not believe the distinction between the two corporate entities insisted upon by Australia undermines our conclusion that the provision of the 1999 loan vitiates the repayment. Moreover, the entire history of transactions between the Government of Australia, ALH, and Howe in connection with this matter indicates that the legal distinctions between the two corporate entities do not preclude the conclusion that cooperative behaviour between the two with respect to the repayment and the use of the 1999 loan is likely and expected.

<sup>43</sup> This conclusion is based on the United States' calculations concerning the loan amount and the repayment amount in this regard. Australia did not dispute either the calculation or the interest rate relied on by the United States in those calculations. We therefore conclude that the interest rate derived by the United States was one which would be obtainable on the investment of the funds remaining after repayment of the \$8.065 million.



**ANNEX 1-1**

**FIRST SUBMISSION OF THE UNITED STATES**

(27 October 1999)

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**I. INTRODUCTION**

1. This Panel already decided that Australia has provided a prohibited A\$30 million export subsidy to its sole automotive leather company, and recommended that the subsidy be withdrawn without delay. Such a decision is meaningless unless Australia complies with the Panel’s recommendations. Under Article 21.5 of the Dispute Settlement Understanding (“DSU”) the Panel’s task is to determine whether Australia has taken measures to comply with the Panel’s recommendations and rulings and whether those measures are consistent with the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”). The answer in this case is clearly no.

2. Purporting to withdraw the subsidy, Australia agreed to accept a repayment of only a modest prospective portion of the grant. In so doing, Australia has arbitrarily and unreasonably relegated the lion’s share of its substantial and illegal capital infusion to the past, declaring it out of the reach of this Panel and the SCM Agreement. But that is not all. Australia has reimbursed even this modest repayment with an even larger, non-commercial loan.

3. In its submission to the Dispute Settlement Body (“DSB”) on recourse to Article 21.5 (document WT/DS126/8), the United States cited the actions noted above, and stated:

The United States believes that these measures taken by Australia to comply with the recommendations and rulings of the DSB are not consistent with the SCM Agreement and the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). In particular, Australia's withdrawal of only \$A8.065 million of the \$A30 million grant, and Australia's provision of a new \$A13.65 million loan on non-commercial terms to Howe's parent company, are inconsistent with the recommendations and rulings of the DSB and Article 3 of the SCM Agreement.

Accordingly, because "there is 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 the United States and Australia, within the terms of Article 21.5 of the DSU, the United States seeks recourse to Article 21.5 in this matter and requests that the DSB refer the disagreement to the original panel, if possible, pursuant to Article 21.5.

4. The terms of reference for this Panel are standard terms of reference as provided in Article 7. As the panel found in Ecuador's recourse to Article 21.5 of the DSU on the EC's banana regime, even in an Article 21.5 proceeding, the panel's terms of reference are defined by the measures and claims specified by the complaining party in its request for establishment of a panel<sup>1</sup> Moreover, both of the measures cited by the United States in WT/DS126/8 were clearly "taken to comply" with the DSB's recommendations, as they both concern the subsidies received by the sole Australian automotive leather producer and exporter, Howe and Company Proprietary, Ltd. ("Howe"). In addition, a Panel determination concerning the consistency with the SCM Agreement of both of these measures will promote the prompt settlement of disputes, as noted by the panel in the Ecuador 21.5 proceeding<sup>2</sup>

5. Thus, the task that faces this Panel is to determine whether Australia has taken measures to comply with the DSB's recommendations and rulings, and whether the measures listed in WT/DS126/8 are consistent with the SCM Agreement. The answer to these questions no.

6. This Panel's findings on these points are critical if its Panel Report is to have any practical meaning. The United States urges the Panel to find that Australia has not withdrawn its illegal subsidy and thus has not complied with the Panel's recommendations.

## II. PROCEDURAL HISTORY

7. The United States requests that this Panel, established pursuant to Article 21.5 of the Dispute Settlement Understanding ("DSU"), review whether Australia has implemented the Panel's recommendations in Australia – Subsidies Provided to Producers and Exporters of Automotive Leather, WT/DS126/R, Report of the Panel, Adopted 16 June 1999 ("Panel Report"). The parties have agreed that they will unconditionally accept this Panel's report and that there will be no appeal of this report. Both parties have also agreed to cooperate to ensure that this Panel can circulate its report within 90 days of its establishment. See Exhibit US-1.

8. This is a dispute with a long and troubling history<sup>3</sup> In October 1996 - over three years ago - the United States requested consultations with the Australian Government regarding export subsidies made available to the Australian automotive leather industry under two programmes, the Australian Textiles, Clothing and Footwear Import Credit Scheme and the Export Facilitation Scheme. As a result of these

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<sup>1</sup>European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Article 21.5 by Ecuador, WT/DS27/RW/ECU, para. 6.7.

<sup>2</sup>*Id.* at para. 6.9.

<sup>3</sup>The facts of the procedural history are recounted in the Panel Report, paras 2.1-3.2.

consultations, the Australian Government agreed to remove automotive leather from eligibility for these export subsidy programmes, effective 1 April 1997.

9. On 9 March 1997, however, the Australian Government replaced these subsidy programmes with a A\$30 million grant, also contingent on export performance<sup>4</sup> to Howe, the sole Australian automotive leather producer and exporter. The United States once again requested consultations, this time with respect to the grant. Unable to reach a satisfactory resolution with Australia, the United States requested the establishment of a panel on 11 June 1998, to examine the consistency of Australia's grant with the SCM Agreement.

10. On 25 May 1999, the Panel issued a report sustaining the US view that Australia had bestowed a prohibited export subsidy – the A\$30 million grant – on Howe in 1997-1998. In accordance with the SCM Agreement, the Panel recommended that Australia withdraw the subsidy without delay. The Panel gave Australia 90 days to comply. The Panel Report was adopted by the DSB on 16 June 1999, and was not appealed.

11. In a 20 September 1999, communication to the Chairman of the DSB, Australia claimed to have implemented the Panel recommendation by arranging for Howe to repay A\$8.065 million of the A\$30 million grant -- just under 27 per cent -- which Australia contended "covered any remaining inconsistent portion of the grants made under the Grant Contract"<sup>5</sup> Exhibit US-2. According to an Australian Government media release issued on 15 September 1999, the repayment amount covered what Australia considered to be the "prospective element" of the grant -- namely, the "proportion of the grant monies found to be applied to the sales performance targets contained in the Grant Contract for the period from 14 September 1999 until the end of the Grant contract on 30 June 2000". Exhibit US-3.

12. In the very same press release, however, Australia announced that it intended to provide a new, A\$13.65 million loan to Howe's parent holding company. This loan, which the United States understands is on non-commercial terms, effectively reimburses Howe and its parent for the grant repayment and, to this extent, turns Australia's purported withdrawal of the subsidy into a sham.

13. The United States submits to the Panel that Australia has not complied with the Panel's recommendations, in that (1) the A\$8.065 million repayment, which accounts for less than 27 per cent of the prohibited export subsidy, does not amount to a full withdrawal of the subsidy; and (2) this small amount was not even a partial withdrawal of the subsidy, to the extent it was reimbursed by the Australian Government through a loan on non-commercial terms.

### **III. AUSTRALIA HAS NOT WITHDRAWN THE SUBSIDY WITHIN 90 DAYS.**

#### **A. THE AMOUNT THAT HOWE REPAID IS NOT A FULL WITHDRAWAL OF THE SUBSIDY.**

##### **1. To comply with Article 4.7 of the SCM Agreement and the Panel's recommendation, Australia should have recovered the full, prospective portion of the subsidy.**

14. This Panel found that "[t]he payments under the grant contract are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of

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<sup>4</sup>Australia also provided a loan to the company in 1997, which is not relevant to this Article 21.5 compliance proceeding.

<sup>5</sup>WT/DS126/7

Article 3.1(a) of that Agreement.<sup>6</sup> Article 3.1(a) of the SCM Agreement provides that such subsidies “shall be prohibited”; Article 3.2 provides that “[a] Member shall neither grant nor maintain subsidies referred to [Article 3.1].” This Panel recommended, in accordance with Article 4.7 of the SCM Agreement, that Australia withdraw the prohibited subsidies – i.e., the “payments under the grant contract” – without delay<sup>7</sup>

15. There is no disagreement between the parties that the provisions of Article 4.7 of the SCM Agreement and the recommendations in the Panel Report call for Australia to withdraw only the prospective portion of the illegal subsidy. And indeed, this position is supported by the SCM Agreement and the DSU. Article 4.7 of the SCM Agreement provides that “if the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay.” However, Article 19 of the DSU provides that “Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement.” The use of the phrase “bring the measure into conformity” indicates that the recommendations contemplated by Article 19 of the DSU include only recommendations calling for prospective corrective action by Members, not retrospective action. As the Appellate Body has stated in its decision in the Guatemala Cement dispute, “It is . . . only in the specific circumstance where a provision of the DSU and a special or additional provision of another covered agreement are mutually inconsistent that the special or additional provision may be read to prevail over the provision of the DSU.<sup>8</sup> There is no inconsistency between withdrawal without delay of the prospective portion of a subsidy under Article 4.7 of the SCM Agreement, and bringing the subsidy into conformity with the obligations of Australia under Article 19 of the DSU.

16. Where there is considerable disagreement, however, is over Australia’s claim that Howe’s partial A\$8.065 million repayment should be viewed as a complete withdrawal of the prospective portion of the subsidy. It was only 18 to 30 months ago that Howe received the full A\$30 million capital infusion. The benefit to Howe – and the resulting distortion to trade – will be felt in a substantial way for many years to come.

17. Australia has arbitrarily assigned the lion’s share of its prohibited subsidy to the past, in an effort to declare it out of reach of the Panel and the SCM Agreement. It is worth recalling that in 1997 Australia sought to deal with US complaints regarding its blatantly illegal export subsidy by engaging in consultations, agreeing to remove the export subsidy from the automotive leather industry, and then simply swapping it for another equally illegal export subsidy. Now that the United States has proceeded through a full round of additional consultations and panel proceedings, and now that the Panel has ruled that the A\$30 million grant is a prohibited export subsidy, Australia is seeking the Panel’s permission to declare its illegal subsidy largely irremediable.

18. This cannot be permitted. The great bulk of Australia’s A\$30 million subsidy is attributable to the period after the adoption of the Panel Report. It is that amount that Australia must withdraw.

## **2. The prospective portion of the subsidy must be determined on a reasonable economic basis.**

19. The Panel Report, at paras. 10.1(b) and 10.1(3), identifies the subsidies to be withdrawn “without delay” as “[t]he grant payments under the grant contract”. Article 1.1 states, in parts relevant to this

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<sup>6</sup>Panel Report, para. 10.1(b).

<sup>7</sup>Panel Report, para. 10.3.

<sup>8</sup>*Guatemala – Anti-dumping Investigation Regarding Portland Cement From Mexico*, WT/DS60/AB/R, para. 66.

discussion, that a subsidy exists if (a) a government practice involves a direct transfer of funds (e.g., grants) and (b) a benefit is thereby conferred.

20. What should be withdrawn, therefore, is that portion of the Australian Government funds that continues to benefit the recipient after the adoption of the Panel Report. As discussed below, the SCM Agreement recognizes that significant, non-recurring grants must be allocated over time - generally over the useful life of production assets. A significant grant, which is available to purchase production assets (or to free up other funds to purchase such assets), provides a benefit that lasts over the life of those assets. Attributing all of such a grant entirely to the year of receipt, or to some other, arbitrarily short period, ignores economic reality<sup>9</sup> It also would have the unintended result in many cases of placing such grants beyond the reach of panel recommendations under SCM Article 4.7. It could thus reduce SCM Articles 3 and 4 to inutility in the case of grants, and would convey the message to subsidizing Members that they can bestow any amount of subsidies, even explicitly conditioned on exports, with virtual impunity as long as the subsidies are in grant form.

21. The “prospective” portion of the benefits that Australia provided to Howe are those that are attributable to the period after the adoption of the Panel Report, which is the date on which Australia was to have withdrawn the subsidy “without delay”. The United States submits that those benefits should be determined by allocating the grant over the useful life of Howe’s production assets and by adding interest, which is also a benefit conferred with the grants, for the period 16 June 1999, to the date of repayment.

22. There is considerable support under the SCM Agreement for this approach. The practice of certain Members, including the United States, in calculating subsidy amounts under Part V (Countervailing Measures) of the SCM Agreement is instructive<sup>10</sup> In calculating the amount of the subsidies in investigations conducted under Part V, the United States regulations require the allocation of significant, non-recurring grants over the number of years corresponding to the average useful life of the renewable physical assets. 19 CFR 351.11

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<sup>9</sup>By contrast, on-going, recurring subsidies provide only current benefits that are not allocated to future production. In the terminology of subsidy calculations, such recurring subsidies are “expensed” – attributed entirely to the period in which they are received – and are not allocated forward in time. See *infra*, note 11.

<sup>10</sup>Although the export subsidies in this proceeding were not pursued under Part V, Part V does provide that Members are to calculate the “amount of the subsidy” and impose countervailing duties that do not exceed the amount of the subsidy. Article 19 of the SCM Agreement. Where the same terms and concepts are used throughout the SCM Agreement, they should be interpreted consistently throughout the Agreement. The Appellate Body in *Canada – Measures Affecting The Export Of Civilian Aircraft*, WT/DS70/AB/R, Report of the Appellate Body, (2 August 1999), adopted September 1999 (para. 158), in considering whether certain measures were prohibited export subsidies, used principles set out in Part V, Article 14, to determine whether the measures constituted a subsidy under Article 1.1, describing Article 14 as “relevant context in interpreting Article 1.1(b).”

In particular, where Members have set out detailed rules for calculating the amount and duration of the subsidy, pursuant to Article 14 of the SCM Agreement, such rules should be taken into account by the Panel in determining the prospective portion of the subsidy that should be withdrawn.

<sup>11</sup>G/SCM/N/1/USA/1/Suppl. 4 (29 March 1999), pages 129-131. For the sake of consistency, the United States uses the same assumptions regarding asset lives in the subsidies context as for other purposes such as the Federal income tax. The average useful life used is presumptively that listed in the US Internal Revenue Service’s 1977 Class Life Asset Depreciation Range System (Rev. Proc. 77-10, 1977-1 C.B. 548 (RR-38)), as updated by the Department of Treasury. 19 CFR 351.524 (d)(2)

By contrast, 19CFR 351.524(a) provides that the Department of Commerce “will allocate (expense) a recurring benefit to the year in which the benefit is received.”

23. Similarly, the EC recently notified its “Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations”, G/SCM/N/1/EEC/2/Suppl.2 (8 January 1999), in which it states, at 9:

For non-recurring subsidies, which can be linked to the acquisition of fixed assets, the total value of the subsidy has to be spread over the normal life of the assets (Article 7(3)(of Regulation 2.26/97). Therefore the amount of the subsidy from, for example, a grant (for which it is assumed that it is used by the beneficiary to improve its competitiveness in the long term, and thus to purchase product assets of one kind or another), can be spread over the normal period used in the industry involved for the depreciation of assets. (Latter emphasis added).

24. The consequence of this approach is that “[a]s many subsidies have effects for a number of years, subsidies granted before the investigation period should also be investigated in order to determine what portion of such subsidy is attributable to the investigation period.” Id.

25. Of note, under these approaches, is the fact that in applying the general principle that a significant, non-recurring grant should be allocated over the useful life of production assets, neither the EC nor the United States inquires whether the grant was actually used to purchase such assets. Rather, it is presumed that the grant is used to enhance the long-term competitiveness of the company, either because it is in fact applied to the purchase of such assets, or because the grant money frees up other corporate money for such purposes. Given the fungibility of money, it is unproductive and unrealistic to attempt to trace the use of grants in order to determine how they should be allocated.

26. The principles that Members have developed to calculate the amount of the subsidy (and its allocation over time) are revealing, not only because they recognize that grantees can reap long-term competitive benefits from significant, non-recurring grants, but also because these principles address a concern similar to that present in this proceeding. If significant grants can be allocated purely to the year in which they are bestowed (or on some other arbitrarily short period), Members would be precluded from imposing countervailing duties “in the amount of the subsidy” for any grant provided prior to the investigation period.

27. Similarly, if this Panel were to countenance the allocation of Australia’s illegal A\$30 million export subsidy over an arbitrarily short period of time, most of it in the past, as urged by Australia, the remedy of “withdrawal of the subsidy” would be severely undercut.

28. The SCM Agreement itself recognizes the principle that grants should be allocated to take account of their future effects. Paragraph 7 of Annex IV of the SCM Agreement (which provides guidance on the calculation of ad valorem subsidies in the context of determining the 5 per cent “serious prejudice” benchmark in cases of actionable subsidies (Part III)) provides that “[s]ubsidies granted prior to the date of entry into force of the WTO Agreement, the benefits of which are allocated to future production, shall be included in the overall rate of subsidization.”

29. The Informal Group of Experts (“IGE”), charged with recommending clarifications to Annex IV, stated, at para. 11 of their 1997 report, that large non-recurring subsidies should be allocated over time because such subsidies continue to have an impact beyond the year of bestowal: they will either be used to purchase fixed assets, or will free up company funds to do the same. The IGE recommendations continue, at para. 13.

As a general matter, it is recommended that the average useful life of all of the recipient's operational assets should be used as the allocation period for all types of subsidies except long-term loans, and possibly equity infusions.

30. In short, there is a consistent and well-accepted view under the SCM, both in the text of the Agreement and in Member practice, that significant non-recurring grants should be allocated over time based on the useful life of the production assets. When the grant at issue in this case is so allocated, it is apparent that most of the subsidy is attributable to the future. This is the portion of the grant that Australia must withdraw.

31. Howe received three payments in 1997 and 1998 worth A\$30 million -- one-time, non-recurring grants that amounted to approximately one-third of Howe's 1997 sales<sup>12</sup>. With this money, Howe was able to construct a new tannery and a new finishing plant, increasing its efficiency and export capacity<sup>13</sup>. Howe used the grant to more than double its production capacity<sup>14</sup> and to install state-of-the-art equipment. According to Howe's managing director, "[t]he [Rosedale] plant has been built around the latest computerized equipment, which gives us complete control over every step in in the production process.<sup>15</sup> The new finishing facility at Thomastown was also completely automated, with new patterns fed into the computer and cut on the same day<sup>16</sup>. Howe's parent corporation predicted that the new processing facility "will enable [Howe] to make considerable savings in labour, raw materials, and working capital, and to have fewer rejects and re-works which will give higher yields.<sup>17</sup>

32. Plainly, the benefit of this significant A\$30 million export subsidy – and, indeed, the distortive impact it has on trade – extends at least over the life of Howe's production assets.

33. Available information for Howe suggests that the useful life of its assets is 13 years. Exhibit US-10. The useful life of production assets in the leather industry, according to US Internal Revenue depreciation tables used by the US Department of Commerce to estimate useful life for the purpose of allocating subsidies, is consistent with this estimate, at 9-13 years. Exhibit US-11. Because Howe received A\$17.5 million in July 1997 and A\$12.5 million in July 1998<sup>18</sup> the prospective portion as of July 1999 (the month following the adoption of the Panel Report) can be calculated based on the ratio of 11/13 of the A\$17.5 million (since two years have now elapsed, and 11 remain) – or A\$14,807,692 – plus 12/13 of the second grant of A\$12.5 million, or A\$11,538,462 – for a total of A\$26,346,154.

34. Under a reasonable allocation of these grants, therefore, A\$26,346,154, represents the "prospective portion" of the subsidy as of July 1999 that Australia must withdraw. To this amount should be added interest, at Howe's 1997 borrowing cost of 11.6 per cent for the period from July 1999 until

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<sup>12</sup>"Sacred Cows vs The Hide of Howe," *The Weekend Australian*, 20-21 Sept. 1997 (reporting that Howe's sales in 1997 were expected to be A\$88.6 million). Exhibit US-4.

<sup>13</sup>Panel Report, para. 2.3 n.4.

<sup>14</sup>Australian Leather Holdings Ltd., *Australian Leather Holdings* (c. 1995) ("Howe Leather turns out more than 10,000 premium quality hides every week for market throughout Australasia, Asia, the United States and Europe"); Howe, *Howe Leather*, Dec. 1994, at 2 (noting a total automotive capacity of 600,000 hides per year, or 11,538 hides per week); "Picking Winners," *Business Review* 1997, 13 Oct. 1997 ("The new facility will allow the value of exports to increase to nearly \$200 million and the company will be able to process 1.1 million cattle hides. ..."). Exhibits US-5, US-6, and US-7.

<sup>15</sup>"Howe Impressive", *Leather*, Aug. 1998, at 29, Exhibit US-8.

<sup>16</sup>*Id.* The plant utilized 14 different types of new equipment, as well as an automatic conditioning system which sprayed fine droplets of moisture into the atmosphere when the relative humidity fell below requisite levels.

<sup>17</sup>Schaffer Corporation, Ltd., Chairman's Address, 19 Nov. 1997, Exhibit US-9.

<sup>18</sup>These are approximate dates, relying on the facts as set forth in Panel Report, para. 2.3.

Australia complies with the Panel's recommendation<sup>19</sup>. Six months' interest, for instance, assuming Australia complies by the end of this year, would be A\$1,528,077 (11.6 per cent of A\$26,346,154 divided by two, to account for the half year) for a total of A\$27,874,231.

35. By contrast to this reasonable allocation, Australia has entered into an agreement with Howe that requires Howe to repay a mere A\$8.065 million.

### 3. Howe's partial repayment does not amount to a withdrawal of the subsidy.

36. Australia informed the DSB on 20 September 1999, that it had implemented the Panel's recommendation ("to withdraw the measures within 90 days") by accepting a repayment from Howe of A\$8.065 million, which, according to Australia, "covered any remaining inconsistent portion or the grants made under the Grant Contract." The Australian Government also stated that it had "terminated all subsisting obligations under the Grant Contract."<sup>20</sup>

37. Although there was no explanation whatsoever in the 20 September communication of how the amount of repayment was determined, a media release issued on 15 September 1999, explained that A\$8.065 million is the amount that Howe agreed to pay, and elaborated that:

This amount reflects the prospective element of the grant payment. It is the proportion of the grant monies found to be applied to the sales performance targets contained in the Grant Contract for the period from 14 September 1999 until the end of the Grant Contract on 30 June 2000. Exhibit US-3.

38. The US understands from this explanation that, because the grants were contingent on Howe's best efforts to achieve certain performance targets, including sales performance targets for the periods 1 April 1997, through 30 June 2000, the Australian Government deemed the subsidy to be in effect only during the roughly three-year period that the performance targets were in place, and then "withdrew" that proportion of the subsidy attributable to the period 14 September 1999 to 30 June 2000.

39. Australia's explanation confuses two legally distinct concepts: the elements of a subsidy and the duration or allocation of the subsidy. The Panel correctly found that the grants were an export subsidy because, *inter alia*, "[t]he sales performance targets set out in the grant contract, in conjunction with the other facts enumerated above, therefore [led the Panel] to the conclusion that the grant of the subsidies was conditioned on anticipated exportation".<sup>21</sup>

40. The grants amounted to an export subsidy because they were contingent on export performance. The export-contingent feature of the subsidy, however, is not a useful tool for measuring how the subsidy should be allocated.

41. In particular, the time period established in a grant contract for performance requirements is not a reasonable measure of how long the benefits conferred by the subsidy lasts or for calculating the "prospective" portion. First, there is no necessary relationship between the criteria for an export subsidy - - such as export performance requirements -- and the actual duration of the benefit. Inventing such a relationship makes export subsidies open to manipulation. For instance, a Member could bestow a

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<sup>19</sup>Howe's borrowing cost is derived from the 1997 financial statements of Australia Leather Holdings, Ltd., at pages 7 and 9. Total interest and financial charges divided by borrowings is A\$3,647,000/A\$31,373,000 = 11.6 per cent interest rate. Exhibit US-12.

<sup>20</sup>WT/DS126/7, dated 20 September 1999 (Exhibit US-2).

<sup>21</sup>Panel Report, para. 9.71.



significant prohibited subsidy – sufficient for the recipient to build a large manufacturing facility with a useful life of 25 years – contingent on exports for a two-year period. By the time a dispute settlement panel could recommend that the subsidy be withdrawn, the two-year period could have lapsed. Yet the benefit of the subsidy would persist for over two decades. Under Australia’s approach, there would be no “prospective portion” to withdraw. Members could structure their export subsidies in just this way, or through a series of smaller short-term subsidies, thus evading the disciplines imposed by the SCM Agreement.

42. Second, with respect to the grants at issue here, the Panel found that the sales (i.e., export) performance targets, “in conjunction with the other facts enumerated above” led the Panel to conclude that the subsidy was conditioned on anticipated exportation.<sup>22</sup> The “other facts” included that the expanded production resulting from the grants and from the “required capital investments” would translate into increased exports.<sup>23</sup> Plainly, such increased exports resulting from the required capital investments are not limited to the period of the sales performance targets. In addition, the grants were contingent on “best endeavours” to achieve the sales performance targets, and not purely on the achievement of those target.<sup>24</sup> Both of these factors, specific to this case, militate against Australia’s allocation of the grants over the sales performance targets.

43. In sum, the benefit to a recipient of receiving a significant grant cannot be calculated with reference to the criteria for qualifying for the grant. The “prospective” portion of the subsidy must be calculated in an economically reasonable manner that more accurately reflects the extent to which the subsidy persists over time. The subsidy should be allocated over the useful life of Howe’s production assets, and the portion of that allocation that is subsequent to the adoption of the Panel Report should be repaid.

**4. The “prospective” element of the subsidy withdrawn should be calculated as of the date of adoption of the Panel Report.**

44. Article 4.7 of the SCM Agreement provides that if a prohibited subsidy is found, the subsidy should be withdrawn “without delay”. The Panel Report, recommending that the subsidy be withdrawn without delay, was adopted on 16 June 1999. The Panel gave Australia 90 days to “withdraw the measures”<sup>25</sup> On that date, the DSB declared Australia’s grants to be a prohibited export subsidy for purposes of the SCM Agreement.

45. Although the Panel accorded Australia 90 days in which to comply, Australia was free to comply at any time within that period. Instead, Australia used the entire 90-day period, waiting until 14 September to put its remedy in place and then claiming that its withdrawal would be effective from that day forward.

46. The United States submits that the 90-day compliance period did not provide Australia with an additional three months during which it could continue to provide the prohibited export subsidy with impunity. Such an interpretation would reward -- and encourage -- delay in carrying out the Panel’s recommendations. Rather, the date from which the prospective element of the subsidy should be derived is the date of the Panel Report. This approach, which would not discourage early compliance, would give

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<sup>22</sup>Panel Report, para 9.71.

<sup>23</sup>Id., para. 9.67.

<sup>24</sup>Id., para. 2.3.

<sup>25</sup>Panel Report, para. 10.7.

effect to the express intent of Article 4.7, which calls for panels to recommend that the Member concerned withdraw the prohibited subsidy “without delay.”

47. Consequently, any calculation of the so-called “prospective period” of the subsidy should start on 16 June 1999, the date of adoption of the Panel Report.

**B. HOWE’S REPAYMENT WAS NOT A WITHDRAWAL OF THE SUBSIDY TO THE EXTENT IT WAS REIMBURSED BY A NON-COMMERCIAL LOAN.**

48. By recouping from Howe a small fraction of the grant monies, Australia claims that it has now fully withdrawn the prohibited subsidy. But the small sum which Australia collected with one hand it immediately reimbursed with the other, through the extension of loan to Howe’s parent holding company, Australia Leather Holdings, Ltd. (“ALH”), for a far greater amount.

49. The United States understand that this loan was provided on non-commercial terms, which is not surprising, given the history of Australia’s actions in this dispute, as well as the governmental, as opposed to commercial, source of the funds. Under these circumstances, Australia cannot be credited with having “withdrawn” any portion of its prohibited export subsidy. It has simply restructured a small portion of the subsidy by providing a loan with concessionary repayment terms. Australia’s actions defeat the purpose of Article 4.7, which calls for prohibited subsidies to be withdrawn in order to ensure that subsidy recipients no longer enjoy their benefits. In this instance, Australia has not so much removed the any part of the benefits it provided through its A\$30 million grants as modified part of them through the replacement of one form of subsidy by another: Article 1.1 of the SCM Agreement defines subsidies to include loans, as well as grants, that confer a benefit.

50. Australia asserts in its media release that its earlier loan to ALH “was not found in breach of the WTO”, presumably implying that this new loan is not contrary to the SCM Agreement. However, the issue is not whether the loan itself should be condemned as a prohibited subsidy, but whether its bestowal nullifies Australia’s purported withdrawal of the subsidy that this Panel found to be inconsistent with the SCM Agreement. The simultaneous announcement of both the partial repayment by Howe and the much larger loan back to Howe’s parent holding company, tied together in the same media announcement, demonstrates that the non-commercial loan is linked to -- indeed, intended to -- offset the so-called “withdrawal”.

51. Australia’s lame declaration in its media announcement that the loan has no “link” to automotive leather is difficult to credit. The recipient of the loan is none other than Howe’s holding company parent, which, since it is a holding company, does not produce anything itself. It bears repeating that Howe is not just any Australian manufacturer randomly selected to receive government largess. Howe became a major automotive leather exporter precisely because of a series of blatantly SCM-illegal subsidy programmes.

52. Moreover, the link to Howe’s illegal subsidy is made plain by the fact that Australia announced the loan in the same document, indeed on the same page, as its announcement of the partial subsidy repayment. Tellingly, Australia provided no independent reason for the loan, leaving little doubt that it was intended to offset the partial grant repayment.

53. Together, these facts and circumstances dictate the conclusion that Australia has not fully complied with its obligation to “withdraw” its subsidy. Australia’s non-commercial loan to ALH should be seen for what it is – a partial or complete perpetuation of the prohibited subsidy that this Panel condemned.

#### **IV. REQUEST FOR PRELIMINARY RULING THAT THE PANEL SEEK INFORMATION FROM AUSTRALIA**

54. The United States requests, pursuant to paragraph 17 of the working procedures in this proceeding and Article 13 of the DSU, that the Panel request Australia to produce authentic copies of the following documents and the following information for review by the Panel and the United States, no later than Friday, 29 October 1999:

1. Any agreement, whether by formal agreement or by correspondence with Howe or its related entities, under which Howe agreed to repay, or repaid, A\$8.065 million of the A\$30 million provided in 1997 and/or 1998.
2. Any correspondence between the Government of Australia and Howe or its related entities that refers to the agreement to repay, or to the repayment of, the A\$8.065 million referred to in request 1. above.
- 3.(a) Any written calculation of the \$A8.065 million communicated to or by Howe or its related entities to or by the Australian Government.
  - (b) An explanation of how the \$8.065 million was calculated.
4. Any document by which the Grant Contract was terminated and any document terminating any performance requirements by Howe pursuant to that Grant Contract.
5. The loan contract between the Australian Government and Australia Leather Holdings providing for the "additional loan of \$13.65 million" to Australia Leather Holdings referred to in Australia's Joint Media Release 99/291, dated 15 September 1999.
6. Any documents referring to or related to the loan contract or the loan referenced in request 5 above, including but not limited to any correspondence between Howe or its related entities and the Australian Government.
- 7.(a) Any written calculation of the amount of the \$A13.65 million loan communicated to or by Howe or its related entities to or by the Australian Government.
  - (b) An explanation of how the \$A13.65 million was calculated or determined.
8. Any documents created by the Australian Government related to the authorization of the Australian Government to (a) issue a new A\$13.65 million loan referenced in request 5 above, and/or (b) terminate the Grant Contract and request repayment of A\$8.065 million of the subsidy.

55. This information and documentation are crucial to the Panel's determination under Article 21.5 of the DSU. The United States has relied in this first submission on published statements and submissions of the Australian Government to establish that (a) Australia's method of determining the prospective portion of the grant is arbitrary and results in inappropriately putting most of the grant beyond the reach of the SCM Agreement remedies; and (b) the loan was simply a reimbursement on non-commercial terms of the purported withdrawal of the A\$8.065 million repaid by Howe.

56. The information and documents listed above contain facts and information that have a direct bearing on the issues in this proceeding. The information and documents should reveal in detail the

circumstances under which the repayment by Howe was made, how that amount was agreed to or calculated, and whether there was any reimbursement or quid pro quo for the repayment. Similarly, given that the loan is obviously linked to the partial repayment of the grant, documentation and information pertaining to this loan are critical to a clear understanding of its relationship to the grant and grant repayment at issue. In addition, the exact terms of the loan, and the conditions for its issuance, are highly relevant to whether, and the extent to which, Australia is simply funding Howe's reimbursement out of its own pocket.

57. The United States requested these documents and information of Australia at the first organizational meeting of the Panel, on 18 October 1999, but has received nothing as yet, despite today's deadline for the filing of the US first submission. Therefore, this request should come as no surprise to Australia, and Australia should have no trouble meeting a Friday, 27 October 1999, deadline. It is important that these documents and information be provided on this schedule, to permit the United States to review them prior to Australia's first submission, so that relevant information can be incorporated into the United States' second submission.

## **V. CONCLUSION**

58. The United States urges this Panel to determine that Australia has not withdrawn its illegal subsidy without delay, and thus has not complied with Article 4.7 of the SCM and the Panel's recommendations.

59. The United States further urges the Panel to request that Australia provide the information and documents described in section III above by Friday, 27 October 1999.

**LIST OF EXHIBITS**

- Exhibit US-1 Agreement Between US And Australia On Article 21.5 Procedures, WT/DS/126/8, 4 October 1999
- Exhibit US-2 Status Report By Australia, WT/DS/126/7, 20 September 1999
- Exhibit US-3 Media Release: “Automotive Leather Dispute”, 15 September 1999
- Exhibit US-4 “Sacred Cows vs The Hide of Howe,” The Weekend Australian, 20-21Sept. 1997
- Exhibit US-5 Australian Leather Holdings Ltd., *Australian Leather Holdings* (c. 1995)
- Exhibit US-6 Howe, *Howe Leather*, Dec. 1994
- Exhibit US-7 “Picking Winners,” *Business Review* 1997, 13 Oct. 1997
- Exhibit US-8 “Howe Impressive”, *Leather*, Aug. 1998
- Exhibit US-9 Schaffer Corporation, Ltd., Chairman’s Address, 19 Nov. 1997
- Exhibit US-10 Calculation of Average Useful Life Of Assets for Howe
- Exhibit US-11 US Internal Revenue Service’s 1977 Class Life Asset Depreciation Range System (Rev. Proc. 77-10, 1977-1 C.B. 548 (RR-38)), as updated by the Department of Treasury
- Exhibit US-12 Australia Leather Holdings Ltd, 1997 Financial Statement (exerpt)

**ANNEX 1-2**

**REBUTTAL SUBMISSION OF THE UNITED STATES**

(15 November 1999)

**REDACTED AUSTRALIAN BUSINESS CONFIDENTIAL INFORMATION INDICATED BY  
DOUBLE BRACKETS – [[ ]]**

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## I. INTRODUCTION

1. The first submission of the United States demonstrated that Australia failed to withdraw its export subsidy, as recommended by this Panel. Instead, Australia recovered only a modest repayment of the grant from the beneficiary, Howe and Company Proprietary, Ltd. (“Howe”), and then immediately reimbursed even that meager sum. In response, Australia argues that the minor repayment that Howe made was both unnecessary and more than sufficient to withdraw the subsidy. Australia also argues that only the repayment, but not its reimbursement by the Government of Australia, was part of the implementation of the recommendations, so that the reimbursement is not “covered by the Panel’s terms of reference.” Australia is wrong on both counts.

2. Australia's interpretation raises fundamental questions about the continued viability of the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”). Australia's position could, if sustained, effectively render the obligations in Article 4.7 of the SCM Agreement meaningless. Australia’s interpretation means that Members who provide significant illegal, prohibited export subsidy grants can easily relegate most or all of those grants to the past, declaring them outside the reach of the SCM Agreement remedies. Further, such Members are, according to Australia, free to “comply” with the requirement that such subsidies be withdrawn by engaging in any number of bookkeeping manoeuvres to which panels would be required to turn a blind eye. For example, under Australia's approach, Members in breach of their export subsidy obligations may “comply” with those obligations by having the recipient of the subsidy repay an arbitrary part of the subsidy, at least on paper, while the government simultaneously pays the recipient the same or greater amounts of money. This new payment may even be expressly linked to the repayment of the subsidy, according to Australia, but panels must ignore this linkage.

3. Australia’s interpretation is not supported by the SCM Agreement and should not be endorsed by this Panel. This Panel should determine that Australia has not complied with the SCM Agreement and the recommendations of the Dispute Settlement Body (“DSB”).

## II. THE \$8.065 MILLION REPAYMENT IS NOT A WITHDRAWAL OF THE SUBSIDY.

4. The first submission of the United States, filed 27 October 1999, explained that (1) Howe should repay the entire amount of the \$30 million grant that is prospective as of the date of adoption of the Panel report and that (2) to determine the prospective portion of the grant, the grant should be allocated in an economically reasonable manner, such as over the useful life of Howe’s production assets. This means that most of the \$30 million grant remains prospective and must be repaid.<sup>1</sup> The amount that should be repaid, as calculated in the US first submission, is \$26,346,154, plus interest.<sup>2</sup>

5. In contrast, Australia claims that, less than two years after providing \$30 million in illegal export subsidy grants to Howe, it has fully withdrawn the subsidy by recouping just one quarter of the amount it provided.

6. In fact, Australia also claims, at para. 20, but does not seriously argue, that it need not have recovered a single dollar, since, according to Australia, merely terminating Howe’s sales performance requirements under the Grant Contract would have been sufficient to implement the DSB’s recommendations. This view is wrong, and not even Australia seems to credit it, since Australia’s submission then proceeds to determine what Australia itself calls the “required” repayment amount.<sup>3</sup> Nonetheless, to prevent any confusion, the United States responds to Australia’s assertion in the footnote below.<sup>4</sup> Australia suggests that for purposes of calculating how much it was required to

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<sup>1</sup>See US First Submission, paras 19 - 35. For the sake of brevity, these explanations will not be restated here.

<sup>2</sup>*Id.*, paras. 34 - 35. All dollar amounts in this submission are in Australian dollars.

<sup>3</sup>*E.g.*, Australian First Submission, paras. 38, 42.

<sup>4</sup> Australia states, at para. 20 of its first submission, that

“the termination of all subsisting obligations under the Grant Contract, and hence the termination of any sales performance requirement on Howe, would have been sufficient for Australia to implement the recommendations adopted by the DSB, given that there is now no obligation on Howe in respect of sales.”

This assertion is illogical and contrary to the SCM Agreement. First, the DSB’s recommendation under Article 4.7 of the SCM Agreement was that Australia should withdraw the subsidy — which the Panel defined as the grant — without delay. *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, Report of the Panel, Adopted 16 June 1999 (“Panel Report” ), paras. 10.1(b) and 10.3. On its face, this calls for Australia to remove the subsidy itself, not certain of the export-related elements associated with the subsidy.

Australia’s assertion, in addition to being contrary to the plain language of the SCM Agreement and the DSB’s recommendation, would produce a perverse result. If Australia’s view were to be credited, not only would the recipient of an illegal non-recurring subsidy be entitled to retain the entire benefit conferred by the subsidy, it would be able to enjoy a further benefit -- namely, relief from any obligations imposed as a condition of the subsidy. Such a result is plainly at variance with the notion of “withdrawal” of the subsidy, which necessarily contemplates the removal of benefits, not the conferral of further benefits.

Second, as this Panel has recognized, the decision whether a grant is contingent on export performance, and therefore is an export subsidy, must be made on the basis of the facts that existed at the time that the contract establishing the conditions for the grant payments was concluded. Panel Report, para. 9.68. The \$30 million grant is an export subsidy because the grant was contingent, at the time it was provided, on export performance. The prospective “termination of any sales performance requirements on Howe” cannot change the fact that, when the \$30 million was provided, it was contingent upon export performance, and therefore illegal. Attempting to change some of the obligations now does not affect the nature of the illegal subsidy, and it does not, by itself, withdraw the subsidy. This conclusion is reinforced by the fact that, regardless of what Australia says about sales performance requirements, Howe has already used the illegal export subsidy to make significant capital improvements that will benefit Howe’s exports for many years to come.

Moreover, even if it were possible to withdraw the prohibited export subsidy by removing, ex post facto, the export-contingent features of the subsidy, Australia has not succeeded in doing so in this case. The \$30 million grant was contingent on exports, not based solely on the sales performance requirements of the grant contract, but also based on various other facts, “weighed together”. Panel Report, para. 9.71. The Panel also noted the capital investment performance requirements that Australia imposed on Howe, observing that the expanded production resulting from the grants and from the “required capital investments” necessarily translated into increased exports. Howe apparently completed most of these required capital investments -- aimed at promoting exports -- before the Panel Report was adopted. Panel Report, para. 2.3 n.4. These investments, required by the illegal export subsidy grant, will continue to support exports regardless of what happens to Howe’s sales performance requirements.

In addition, the Panel also found that:

(1) Howe had earned significant benefits from its exports of automotive leather pursuant to two automotive and textile export incentive programmes -- programmes from which Howe was excluded following a US request under the SCM Agreement for consultations regarding the programs -- and that the \$30 million was to compensate Howe for these lost benefits (Panel Report, para.9.65);

(2) Australia was aware that the overwhelming majority of Howe’s sales were for export, thanks to the benefits of the export incentive programs, and sought, through the provision of the grant, to ensure that Howe remained in business after its exclusion from the export incentive programs (this point alone made it clear to the Panel that “continued exports, that is, anticipated exportation, was an important condition in the provision of the assistance”) (Panel Report, para. 9.66); and

(3) The grant money was provided to the one Australian leather company that exported, while other Australian leather producers were excluded (Panel Report, para. 9.69).

Howe’s sales performance targets under the grant contract were, therefore, only one of several factors that led the Panel to conclude that the \$30 million subsidy is “in fact tied to Howe’s actual or anticipated



recoup from Howe, the \$30 million grant should be allocated exclusively over the period that the performance requirements were to be in effect. Based on Australia's view, only the portion of the \$30 million that is attributable to the period that the performance requirements were to remain in effect after the end of Australia's compliance period has to be withdrawn.<sup>5</sup> Australia calculates that amount as either \$8.065 million or \$6.602 million, depending on whether the allocation is weighted by the sales target quantities set in the Grant Contract.<sup>6</sup> Not surprisingly, under Australia's theory, the requisite withdrawal amount is quite modest, since most of the sales performance period fell prior to the 14 September 1999, compliance deadline.

7. Australia supports its view by stating that the Panel itself made a "finding that the allocation of the grant payments was in respect of sales performance targets and hence applied over the period 1 April 1997 to 30 June 2000."<sup>7</sup> Australia states that "the Report explicitly linked the grant payments to the sales performance targets<sup>8</sup> and "[t]he Report considered that the grant payments were tied to export performance in the period 1 April 1997 to 30 June 2000 because of the sales performance targets, and were to be used, i.e., expensed, in achieving those targets."<sup>9</sup>

8. In fact, however, the Panel made no findings whatsoever on how the export subsidy should be allocated and never addressed how the grants should be expensed. Plainly, the sales performance requirements were an important factor — one among several — that led the Panel to find that the \$30 million grant was a prohibited export subsidy. Only in this sense did the Panel "link" the sales performance targets to the \$30 million subsidy. The Panel did not say, however, that this link should be the basis on which to determine how the grant should be allocated for purposes of calculating the amount that Australia was required to withdraw.

9. In fact, it appears that Australia draws its conclusion, not from any finding of the Panel, but purely through semantic confusion and the inappropriate melding of two distinct concepts. The core of Australia's argument appears in paragraph 29 of its First submission:

[I]t is illogical to claim that the allocation of the subsidy can be done in two different ways for the same case. The USA is saying that the conditions on which a subsidy is provided are critical to determining whether it is in breach [*sic.*] SCM Article 3.1(a), but that, once that subsidy has been found to be in breach, the conditions and nature of the subsidy suddenly change when the issue of remedy is addressed . . . Either subsidies are "tied to" exports or they are not. If they are subsidies contingent upon

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exportation or export earnings." Panel Report, para. 9.71. Even if Australia could somehow withdraw the subsidy by removing its export contingent nature, Australia has not achieved that result simply by relieving Howe of its sales performance requirements. Australia did nothing to address the other factors that led to the Panel's conclusion.

Finally, Howe's obligation under the Grant Contract was to make "best endeavours" to achieve the sales targets. Panel Report, para. 2.3. In other words, Howe did not have to achieve the sales targets in order to receive the grant money, but only had to try to achieve them. Further, Australia itself conceded that "the grant funds cannot be taken back by the government once the payments are made" and that "a change in Howe's level of exports would not affect the disbursement of the funds". Panel Report, para. 9.70. In light of these facts, Australia has not "implemented" anything by terminating "the sales performance requirements on Howe," so that "there is now no obligation on Howe in respect of sales." Under the Grant Contract, Howe could apparently keep the \$30 million regardless of its actual sales performance. The situation after Australia's so-called implementation is unchanged.

<sup>5</sup>E.g., Australian First Submission, paras. 20, 37 - 49.

<sup>6</sup>Id., paras 37 - 49.

<sup>7</sup>Id., para. 20.

<sup>8</sup>Id., para. 21.

<sup>9</sup>Id., para. 25.

export performance (i.e. prohibited export subsidies in law or in fact), then they are expensed in achieving the contingent export sales.

10. As the United States stated in its First submission, at para. 39, the Australian position confuses two legally distinct concepts: the elements of an export subsidy and the duration or allocation of the subsidy. If, in the words of the Panel, a subsidy is conditioned on anticipated exportation, it is an illegal export subsidy. That legal conclusion does not address the wholly separate question of how the subsidy is allocated over time, which is at issue in this Article 21.5 proceeding but was not relevant in the earlier proceeding. Australia has provided no basis for its assertion that the allocation of the illegal export subsidy – which is the key question in determining how much of this subsidy must be withdrawn – can be determined solely on the basis of one of the export elements associated with the subsidy.

11. Because Australia's paragraph 29, quoted above, appears to encapsulate Australia's argument in this proceeding, the United States responds below to each of the points in that paragraph.

**“[I]t is illogical to claim that the allocation of the subsidy can be done in two different ways for the same case.”**

12. Contrary to Australia's characterization, the United States does not claim that there are two different ways to allocate the \$30 million grant at issue. The United States is presenting only one way of allocating this grant for withdrawal purposes, and that is the economically reasonable way explained by the United States in its first submission. What Australia deems a second allocation method in fact has nothing to do with allocation. Rather, it is the threshold inquiry into whether a grant is an export subsidy, based on whether it is provided because of actual or anticipated exportation.

**“Either subsidies are ‘tied to’ exports or they are not.”**

13. With this statement, Australia simply interjects semantic confusion. The Panel used the phrase “tied to” to analyze whether the grant at issue was an export subsidy (which was the only issue before it).<sup>10</sup> The Panel was not opining — and indeed there was no reason for it to opine — on whether the grant was to be allocated over the time-period associated with one of the performance targets established under the Grant Contract.

14. The nature of the Panel's enquiry, and of its findings, is obvious from the language of Article 3.1(a) itself. Article 3.1(a) defines prohibited export subsidies as those “contingent, in law or in fact, . . . upon export performance.” The “in fact” language is explained in footnote 4 to Article 3.1(a) as follows:

This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.

It is plain that the “tied to” language in Article 3.1(a) footnote 4 is directed at the issue of whether the subsidy is, in fact, “contingent” upon export performance, and, therefore, prohibited. It is not directed at the issue of how a subsidy should be allocated or expensed.<sup>11</sup>

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<sup>10</sup> E.g., Panel Report, para. 9.71.

<sup>11</sup> The Appellate Body has been very clear that “the legal standard expressed by the word ‘contingent’ is the same for both de jure or de facto contingency. There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent.” *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, Report of the Appellate Body, (2 August 1999), para 167. Indeed, the Appellate Body (in para. 171) has explicitly stated that the phrase “tied to” relates to whether the subsidy is contingent or conditioned upon exports: “The ordinary meaning of ‘tied to’ confirms the linkage of ‘contingency’ with

**“If they are subsidies contingent upon export performance (i.e. prohibited export subsidies in law or in fact), then they are expensed in achieving the contingent export sales.”**

15. There is no basis for the assertion that grants contingent upon export performance must be allocated over the period set for achieving those sales. Australia more fully articulates this argument, at para. 32, asserting that the prohibition on export subsidies arises

because the subsidies contingent upon export performance are presumed to be expensed on actual exports, paid either in advance or in arrears. The grant payments are necessarily allocated to the sales performance targets on which they were contingent, i.e. to the period 1 April 1997 to 30 June 2000.<sup>12</sup>

Once again, Australia points to no authority in the SCM Agreement or elsewhere for either its presumption or its conclusion. Nor can it, because, as discussed above, Australia continues to confuse the allocation of a grant with the conditions that make it an export subsidy. Yet, Australia immediately draws from its own, unfounded conclusion to assert that if an allocation based on sales performance targets is not appropriate in this case, it would never be appropriate, no matter how different the circumstances.<sup>13</sup>

16. Again, there is no basis for that conclusion. Some export subsidy programmes may pay small sums on a recurring basis. For such programmes, withdrawal might mean simply ceasing the export contingent payments, *i.e.*, withdrawing the subsidy programme. Under such a program, there may be no need for any allocation over time because the export subsidy may be expensed as the sales occur. There can be a wide variety of export subsidy programmes. For purposes of determining whether or how the subsidy is to be allocated over time in any particular case, WTO panels will need to undertake a fact-specific review of the subsidy’s structure and implementation, based on the specific facts and the specific programme before the panel. The purpose of this Article 21.5 proceeding is not to determine how all subsidies should be allocated or withdrawn, but simply to determine whether Australia’s non-recurring \$30 million grant to Howe has been withdrawn.

17. Indeed, Australia goes a step farther in arguing that export subsidies must be allocated over a specific sales period. Australia is apparently asserting that the only way a significant lump sum grant can be contingent upon export performance, in the sense of Article 3.1(a) of the SCM Agreement, is for it to be specifically contingent on particular export levels over a particular period of time. This is the only possible explanation for Australia’s assertion that an export grant has to be allocated or “expensed on actual exports.”<sup>14</sup> This position is clear from Australia’s unsupported claim, at para. 26, that

[I]f the money was not allocated over the period 1 April 1997 to 30 June 2000 on the basis of anticipated export in this period, then it would not have been in breach of SCM Article 3.1(a). Such subsidies would have been a case for Parts III or V of the SCM Agreement, not Part II.

18. Nowhere does the SCM Agreement impose such a requirement. Nor does the SCM Agreement suggest that an export subsidy remains illegal only for so long as any export sales

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‘conditionality’ in Article 3.1(a).” The phrase “tied to” exportations or export earnings means conditioned or contingent upon export performance, not allocated over specific anticipated exports.

<sup>12</sup>Australian First Submission, para. 32.

<sup>13</sup>Australia’s reference to the US Foreign Sales Corporation law in this regard is of course not relevant. The programme is not an export subsidy. Furthermore, not only are there no adopted DSB recommendations or rulings on this law, the United States has already indicated an intention to appeal the panel report in that dispute.

<sup>14</sup>Australian First Submission, para. 32.

performance goals associated with the subsidy subsist. Under the SCM Agreement, a measure is an illegal export subsidy if, at the time of its bestowal, it is contingent upon actual or anticipated export performance – which might or might not be directly and specifically linked to specific sales quantities or over a particular period of time.

19. Further, it is untrue that “but for” a purported allocation of the grant over the period April 1997-June 2000, there would have been no finding of an export subsidy. First, as stated above, there was no Panel finding that money was allocated over the performance period on the basis of anticipated exports in this case. Second, the sales performance targets were based on “best efforts” and were one of many facts which, weighed together, led the Panel to conclude that the \$30 million was an export subsidy.<sup>15</sup> Contrary to Australia’s claim, therefore, it was not just the sales performance requirements over a specific period of time that led the Panel to find an export subsidy. Several other facts were considered as well. Further, the Panel’s conclusion, stated at several points in its report, was that “the grant of the subsidies was conditioned on anticipated exportation,”<sup>16</sup> not conditioned directly and exclusively on exports in specific amounts through June 2000.

20. As the United States pointed out in its first submission, para. 41, there is no necessary relationship between the criteria for an export subsidy — such as export performance requirements — and the allocation of the subsidy for purposes of determining how it is to be withdrawn. Imposing such a relationship only invites abuse. A Member could grant a significant subsidy, sufficient to build a large manufacturing facility with a useful life of 25 years, but make it contingent on export increases over the first two years. The Member could be confident that it had “jump-started” long-term export increases over the useful life of the assets, but because it chose only to monitor the first two years of exports, it escapes the SCM Agreement entirely. By the time a dispute settlement panel could recommend that the subsidy be withdrawn, the two-year period would likely have lapsed.<sup>17</sup> Yet the subsidy — which the SCM Agreement prohibits in its entirety — would have a financial and economic impact for over two decades. Under Australia’s view, however, no portion of that subsidy would need to be withdrawn.

21. For these reasons, the subsidy that should be withdrawn in this case cannot be calculated with reference to the sales performance targets, which was only one of the facts that made the grant an export subsidy. Rather, the “prospective” portion of the subsidy must be calculated in an economically reasonable manner that accurately reflects the extent to which the subsidy persists over time. The subsidy should be allocated over the useful life of Howe’s production assets, and Howe should repay that portion attributable to the period after the adoption of the Panel Report.

22. Finally, although the United States does not wish to give any credence to the various creative allocation calculations advanced by Australia at paras. 37 - 49, it is plain that Australia’s suggestion that the amount of repayment can be reduced by 10 per cent, a figure representing assumed domestic sales, is completely unsupported. The Panel found that the domestic market could not expand, so that the \$30 million grant was contingent on export performance.<sup>18</sup> The Panel did not find that 90% of the \$30 million was an export subsidy; it found that 100 per cent of the \$30 million was an export subsidy. Therefore, there is no basis for claiming that only 90 per cent of the prospective amount of the export subsidy need be repaid.

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<sup>15</sup>See supra, note 4.

<sup>16</sup>Panel Report, para. 9.71.

<sup>17</sup>Australia’s position would also appear to be that if, during the period established by a panel pursuant to Article 4.7 of the SCM Agreement, the Member were to amend the export sales requirements so that they all expired before the end of that period, then the subsidy would have been “withdrawn,” an equally illogical result.

<sup>18</sup>Panel Report, para. 9.67.

### III. AUSTRALIA SHOULD WITHDRAW THE GRANT AS OF THE DATE OF ADOPTION OF THE PANEL REPORT.

23. Australia claims, at para. 33, that to require the repayment of the prospective portion of the grant as of the date of adoption of the Panel Report is to impose “retroactive action” and that

[t]he rationale for requiring the repayment of money is that that money has not been expensed at the time of implementation and so needs to be repaid to bring the Member into conformity at that date, not the date of adoption of the Panel Report. To interpret it otherwise, would be to make the concept of the implementation period meaningless.

24. Not at all. The Panel recommendation under the SCM Agreement was that the subsidy should be withdrawn “without delay”. It is reasonable, as Australia says, to allow some implementation period in which the offending Member can take the necessary measures to withdraw the subsidy. This does not, however, mean that, when considering what portion of the grant is “prospective”, the implementation period can “eat away” at the prospective portion that should be withdrawn.<sup>19</sup> Nor does it mean that, should the Panel agree in this Article 21.5 proceeding that the grant should be allocated over the useful life of production assets, the prospective portion would then be calculated as of the date of the Panel’s report in this proceeding. It is entirely reasonable to allow a Member time to implement its withdrawal. It is not reasonable to allow that time to reduce the amount of the subsidy that should be withdrawn.<sup>20</sup>

25. Further, it is reasonable to calculate the illegal subsidy that must be withdrawn as including interest on the amount that should be withdrawn starting on the date of adoption of the Panel report until the amount is repaid. Plainly, the subsidy that should be withdrawn is not only the face value of the subsidy, but also the interest that the company would otherwise have to pay – but did not – to obtain those funds in the market. Both of these elements are part of the prohibited benefit to Howe and are therefore part of the repayment of the prohibited benefit.

26. Withdrawing the grant as of the date of adoption of the Panel Report is not “retroactive action”. The amount withdrawn is prospective, in that it is the amount allocated to the time-period after the date of adoption of the Panel report. The amount is “retroactive” only in the sense that it is allocated in part to a period prior to the implementation deadline. The implementation period, however, is only a practical necessity to allow the party to take the necessary action to comply. It is not a “free pass” that allows even more of the subsidy to escape withdrawal.

27. Australia is wrong in arguing, at para. 35, that the US position – that the withdrawal amount should be calculated as of the date of adoption of the Panel Report – would apply to all other cases under the WTO, and would require, for instance, that illegal tariffs collected after the panel report adoption date be refunded. First, the SCM Agreement, unlike other agreements under the WTO, provides as a remedy that the offending Member should “withdraw the subsidy.” By contrast, disputes under other agreements require that the Member’s measure be brought into compliance, and do not require that anything be “withdrawn.”

28. Second, even with respect to disputes under the SCM Agreement, cases involving a significant, non-recurring export subsidy grant are different from cases involving recurring subsidies

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<sup>19</sup>Indeed, Australia’s approach implies that a Member would be free to continue to provide new subsidy amounts, or even to increase the amount of the subsidy, during this period of time. There is no basis for such an approach in the text of the SCM Agreement.

<sup>20</sup>The United States emphasizes that such decisions as to how particular subsidies should be withdrawn, and how the withdrawal amount should be calculated, are fact-specific. What might be appropriate in the case of one subsidy, such as the lump-sum grants at issue here, may be entirely inappropriate in other cases.

in which the subsidy might not be allocated over a period of time, but might be expensed when received.<sup>21</sup> In the latter case, it may be that a subsidy can be withdrawn fully by withdrawing the subsidy programme itself, *i.e.*, discontinuing the provision of subsidies.<sup>22</sup> In the case of significant, non-recurring grants, by contrast, simply promising not to provide more significant grants is not a withdrawal, because the grant already provided endures over a period of years. In such a case, “withdrawal” can be effected through the refund of the prospective portion of the grant. In this case, but not necessarily in the case of recurring subsidies, the issue arises of what event triggers the “prospective” portion. In the case of grants, this event is the adoption date of the Panel report.

#### IV. THE NEW LOAN NULLIFIED THE PARTIAL WITHDRAWAL OF \$8.065 MILLION.

29. Australia claims, at paras. 50-54, that the 1999 Loan was not part of the implementation of the Panel’s recommendations (because it was not notified to the DSB) and is not part of the Panel’s terms of reference, “which relate to the implementation” of the Panel’s recommendations. Australia also asserts that the 1999 Loan is simply a legal subsidy that replaced an illegal one, and must be considered on its “individual merits” without reference to the illegal subsidy.

30. Australia’s claims are wrong. The DSB’s recommendation, in accordance with SCM Agreement Article 4.7, was that Australia should withdraw the subsidy. Under Article 21.5, this Panel is to consider “the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings.” Plainly, if this Panel can determine the “existence” of measures taken to comply with the recommendations, it can consider whether the measures purportedly taken to comply were effectively rendered non-existent.

31. In this case, the repayment of the \$8.065 million was part of Australia’s implementation of the Panel’s recommendations, and the concessional 1999 Loan was a critical and necessary part of that repayment package. Without the 1999 Loan, there would have been no repayment, and without the repayment, there would have been no 1999 Loan.<sup>23</sup> That Australia chose to notify the DSB of only a part of its implementation package has no bearing on what, in fact, the full implementation package was.

32. The simple facts — hinted at in public statements but conspicuously omitted from the DSB notification — are that (1) Australia negotiated a modest repayment amount of \$8.065 million with Howe’s holding company parent, Australian Leather Holdings (“ALH”)<sup>24</sup> in a transaction in which ALH acknowledged receiving “valuable consideration” in exchange for the repayment<sup>25</sup> (2) on the very same day, and [[ ]], Australia agreed to provide a highly concessional \$13.654 million loan to that same company, ALH, [[ ]]<sup>26</sup> (3) the 1999 Loan Agreement makes specific that the \$13.654 million [[ ]]<sup>27</sup> and (4) these arrangements were made between the identical two parties: the Australian Government on the one hand, and ALH, on the other.<sup>28</sup>

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<sup>21</sup>This distinction between non-recurring and recurring subsidies is recognized, for instance in the practice of the United States and the EC in connection with subsidy investigations under SCM Agreement, Part V. See US First Submission, paras. 22 - 23.

<sup>22</sup>Given the wide variety of possible subsidy programmes, a determination of how such a subsidy should be withdrawn should be arrived at based on the particular facts at issue.

<sup>23</sup>Among other things, this is apparent from Australia’s Media Release on this subject, Exhibit US-3.

<sup>24</sup>Note that, although Australia makes much of the fact that the repayment was by Howe and the 1999 Loan was to ALH, the actual documents show that the agreement to repay was made by ALH as well as Howe. Exhibit AUS-1, page 5 (execution of repayment agreement by ALH).

<sup>25</sup>Exhibit AUS-1, para. 2.

<sup>26</sup>Exhibit AUS-BCI-3, [[ ]].

<sup>27</sup>Exhibit AUS-BCI-3, para. 2.3.

<sup>28</sup>Exhibits AUS-1, US-3.

33. Under these facts, it is plain that there was no repayment of \$8.065 million. In substance, on the day that the DSB recommendations and rulings were to be implemented by withdrawing the subsidy, ALH repaid \$8.065 million to the Australian Government, and, [[ ]], the Australian Government transferred \$8.065 million right back to ALH. Under these circumstances, for Australia to say that the \$8.065 repayment was part of Australia's implementation, but that the [[ ]] reimbursement was not, is specious. There would not have been one without the other. Both are part of Australia's so-called "implementation", and the reimbursement cancels out the repayment such that no part of the subsidy was withdrawn.

34. Australia claims that the 1999 Loan has to be considered on its own merits, citing Panel statements that "each subsidy has to be evaluated on its own terms in deciding consistency with the SCM Agreement" and the Panel's "agreement" that a prohibited subsidy can be replaced with a non-prohibited subsidy.<sup>29</sup> Australia also tries to "bootstrap" the 1999 Loan onto the 1997 Loan that the Panel had found not to be an export subsidy in the underlying proceeding.

35. Australia conveniently neglects to remind the Panel that, immediately following the language it cites, the Panel analyzes the totality of the circumstances surrounding the \$30 million export subsidy grant, including the fact that it was paid to compensate Howe for its exclusion from two previous export incentive programmes.<sup>30</sup> On the basis of all of these facts, the Panel determined that the \$30 million was an export subsidy. Plainly, in considering whether a subsidy is an illegal subsidy, the Panel may look, not just to the subsidy measure in isolation, but at the totality of the circumstances giving rise to the subsidy measure.

36. Similarly, it is not sufficient for Australia to say that the 1999 Loan was "modelled" on the 1997 Loan that the Panel found not to be an export subsidy, and that, therefore, the 1999 Loan is similarly "legal". First, the US does not believe that the Panel has to reach a conclusion that the 1999 Loan is, itself, an export subsidy in order to find that Australia has not complied with the Panel's recommendations. To comply with the Panel's recommendation that the subsidy be withdrawn, Australia should have required the repayment of the correct prospective portion of the subsidy. It did not do this: it set up a paper transaction under which ALH appeared to, but did not, repay part of the subsidy. This is plainly not compliance with the Panel's recommendations.

37. Second, neither in form nor in substance is the 1999 Loan similar to the 1997 Loan. [[ ]]. One crucial difference is that the 1999 Loan is [[ ]]. If the \$8.065 million portion of the \$30 million is contingent on export performance, and the \$13.654 million 1999 Loan [[ ]], it follows logically that the 1999 Loan is contingent on export performance and is, therefore, a prohibited export subsidy under SCM Article 3.1(a). In this sense, the 1999 Loan is very different from the 1997 Loan. The Panel found no direct links to export contingencies in the 1997 Loan; the 1999 Loan, by contrast, is directly contingent on export performance through the reimbursement of the export subsidy.

38. As noted above, under Article 21.5, this Panel is to consider "the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings." Plainly, as discussed above, the 1999 Loan was part and parcel of the measures taken to comply with the recommendations of the DSB. The question is therefore properly before the Panel whether the 1999 Loan itself is a prohibited export subsidy under SCM Article 3.1(a). Australia appears to admit - - as it must -- that the 1999 Loan is a subsidy.<sup>31</sup> This Panel has already determined that the \$30 million grant was a prohibited export subsidy, because it was "in fact tied to Howe's actual or anticipated exportation or export earnings".<sup>32</sup> The \$8.065 million repayment was part of that \$30

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<sup>29</sup>Australian First Submission at para. 53.

<sup>30</sup>See, e.g., Panel Report, para. 9.65, 9.71.

<sup>31</sup>Australia argues only that it is entitled to provide subsidies to ALH, and concedes that the 1999 Loan is "concessional". See, e.g., Australian First Submission, paras. 6 and 12. See also AUS-BCI-3, [[ ]].

<sup>32</sup>Panel Report, para. 9.71.

million. The \$13.065 million 1999 Loan, which Australia admits – as it must -- was a subsidy, is a direct replacement for the export subsidy, [[ ]]. That 1999 Loan, therefore, steps into the shoes of the export subsidy that the Panel has already analyzed and is itself a prohibited export subsidy.

39. In light of the above facts, this Panel should find that the 1999 Loan is part of the measures taken by Australia to comply with the DSB's recommendations, and that the 1999 Loan improperly nullifies Australia's purported withdrawal of \$8.065 million and itself provides a replacement export subsidy which is inconsistent with SCM Agreement Article 3.1(a).

## **V. CONCLUSION.**

40. For the above reasons, this Panel should conclude that the measures taken by Australia to comply with the DSB's recommendation are not in compliance with that recommendation and are inconsistent with the SCM Agreement.



## ANNEX 1-3

### ORAL STATEMENT OF THE UNITED STATES

(23 November 1999)

1. Good morning. My name is Dan Mullaney. I am Assistant General Counsel at the Office of the United States Trade Representative, and I am appearing today on behalf of the United States.

2. The Panel's task is to decide whether the requirement under SCM Article 4.7 to "withdraw the subsidy" means anything at all in the case of large, lump-sum grants. Australia says no. Australia says that after having provided a prohibited export subsidy – the worst and most trade-distorting form of subsidy there is – it can simply arrange for temporary repayment of a small portion of that subsidy and then immediately pay it back. That is why we are here: the United States urges the Panel to give real meaning to the Article 4.7 remedies in this case and to reject Australia's invitation to make it toothless.

#### **The Allocation of the Grant**

3. I'd like to turn to the question of how the \$30 million grant should be allocated for purposes of withdrawal. But first, I'd like to clear up one point. The issue of how the grant should be allocated is important because the remedy for an illegal export subsidy is that it has to be "withdrawn". Webster's Third New International Dictionary defines "withdraw" as "to take back or away (something bestowed or possessed)". The portion of a significant export subsidy grant that is allocated to prospective periods has to be removed, taken away, "withdrawn" from the recipient. It is only the prospective portion that has to be withdrawn, because the nature of the WTO remedies is prospective.

#### **"Withdrawal"**

4. Australia has done and argued everything conceivable to avoid this obvious and straightforward remedy of withdrawal of the subsidy. Australia has even argued, despite the specific remedy in the SCM Agreement, that the appropriate remedy is that the subsidy measure should be brought into conformity, and has specifically avoided talking about the only remedy at issue here: withdrawal, without delay, of the subsidy. Instead, virtually all of Australia's arguments are designed to show that the subsidy has somehow been brought into conformity with the agreement, not that it has been withdrawn.

5. Australia says that it does not matter that an Article 3.1(a) subsidy is irremediable. It says that remedies are not the issue, that the issue is only "conformity with a rule" and "how a Member can reconfigure assistance to be consistent with SCM Article 3.1(a)." Australia's position is wrong.

6. SCM Article 4 is entitled "Remedies". Article 4.7 specifically provides for the "remedy" of withdrawal of the subsidy without delay, not "reconfiguration of the assistance" and not "bringing the measure into conformity." Article 1.2 of the DSU is very clear that Article 4.7, as a special rule, prevails. Therefore, the normal DSU approach – that the measure be brought into conformity – is not the remedy in this case, and it is not what the Panel recommended. Article 4.7 could have, but did not, provide that the measure should be brought into conformity. Instead, it provides very specifically that the subsidy be withdrawn.

7. We understand why Australia wants to avoid the required SCM remedy of withdrawal of the subsidy. It is a strong remedy reserved for the most serious form of impermissible subsidy. Nevertheless, it is not a "punitive" measure imposed on an individual company. Under Article 1.1 of the SCM Agreement, by definition, a subsidy provides a benefit to a recipient. Plainly, then, what must be withdrawn is the benefit conferred on the recipient. This is not a punishment; the government is required to take back what should not have been bestowed in the first place. It is hard to conceive

of any company, particularly in this instance, having a legitimate expectation of being able to keep an illegal subsidy. ALH and Howe have been on notice, since at least October 1996, that the United States regarded the export benefits it was receiving as illegal export subsidies. It took the \$30 million subsidy anyway, obviously aware that it would come under scrutiny as an export subsidy.

8. In any case, the SCM Agreement says that the subsidy should be withdrawn, and this means effectively – not nominally – withdrawn from the recipient.

### **Allocation Period**

9. So, the subsidy must be withdrawn. The issue in this proceeding is exactly how much of the subsidy should be withdrawn. This is determined by how this grant is allocated over time, because only that portion of the grant attributable to prospective periods is withdrawn. The exercise is only to calculate the value of what the recipient still has. That is what needs to be withdrawn. To the extent that Australia admits that anything at all has to be withdrawn, this appears to be a principle on which both parties agree. The evolution of Australia's reasoning on the allocation issue in this case is interesting. In the original proceeding, Australia argued that there was no tie whatsoever between the \$30 million subsidy and export performance: I quote from Australia's argument in the Panel Report: "the money is gone and there is no connection with future sales, including sales for export". Now, Australia is asserting that the \$30 million grant is so specifically connected to export performance that each dollar of the \$30 million can be directly attributed to specific export sales. The truth is at neither extreme: the subsidy was contingent on export performance, and was therefore a prohibited export subsidy; but it was not attributed specifically to individual sales or to a particular time-period.

10. It is our position that, for these purposes, this grant must be allocated over the useful life of Howe's assets. Why? Because that is how long the benefit of the subsidy lasts. When a company purchases a significant capital asset, it does not charge the entire cost of that asset to its financial statement in the year of purchase. Rather, recognizing that the asset will last for a period of some years, the company depreciates the asset – that is, allocates the cost of the asset – generally, over its useful life. Similarly, when a company receives a grant significant enough to use in capital investments to enhance its long-term competitiveness, that grant continues to benefit the recipient over the life of those assets. In the absence of this grant, the company would have had to pay for the asset itself and depreciated that cost on its books over the life of the asset. Thus, from the point of view of the recipient, the subsidy lasts for the useful life of the asset.

11. This accounting treatment is common sense: The benefit of a subsidy that permits a company to make a significant capital investment, lasts, from the point of view of the recipient, for as long as the capital asset does. Further, Article 3.1(a) does not exist in a vacuum. The reason that export subsidies are prohibited is that they presumptively distort trade. An export subsidy that permits capital investments endures and distorts trade for as long as the resulting asset remains in use.

12. This key point distinguishes a significant grant from a smaller, recurring subsidy. When a government makes a small subsidy payment for each unit of exports, each such payment only distorts trade with respect to that particular unit: it does not necessarily impact other exported units at all, or extend into the future. Such a subsidy would not be allocated over time for purposes of withdrawal.

13. That is why, as we described in our First Submission, the expert opinion and Member practice under the SCM Agreement is that small recurring subsidies are not allocated, but that significant lump sum grants are allocated over the useful life of assets. Significant grants are allocated this way because such an allocation reflects the economic reality of how long such a subsidy lasts and how long it will affect exports. Conversely, a recent significant grant, if not allocated over the useful life of assets, could completely escape the SCM remedies, even though the recipient continues to benefit from it.

14. These are precisely the reasons for allocating the \$30 million grant at issue in this case in the same way.

15. Australia, in its second submission, articulates why it believes the \$30 million – which it once argued had no connection whatsoever to future sales – now is so directly linked with the sales performance targets that it is “expensed” in achieving those targets. Australia’s main argument appears to be that the \$30 million grant was a replacement, as of April 1, 1997, for the ICS export subsidy programme, which was scheduled to provide export subsidies through 30 June 2000. Australia also asks rhetorically why it should make a difference to the allocation whether Australia paid the export subsidy as a recurring subsidy, in each quarter through 30 June 2000, or paid the entire amount up front.

16. Let’s examine this argument. The \$30 million was provided in part to compensate Howe for being excluded from the ICS and EFS export subsidy programmes. The EFS programme lasts through 31 December 2000, and the ICS programme lasts through 30 June 2000. Nothing in the grant, however, says that, because the grant was given in part instead of ICS and EFS export subsidies, that the “duration” of the grant itself was somehow limited by those previous programmes. Indeed, Australia argues that the duration of the grant was limited by the duration of the ICS programme alone, but, curiously, not the EFS programme. The only conclusion one can draw from these facts, and the only conclusion this Panel reached, is that Howe was excluded from the ICS and EFS programmes, and that the \$30 million grant was provided to compensate Howe for this exclusion. Nothing in this conclusion limits the “duration ” of the \$30 million subsidy to 30 June 2000.

17. Finally, it is not helpful to speculate on what the result in this case would have been had Australia paid the \$30 million little by little instead of in lump sums. If the subsidy were structured differently the result in this case may well have been different. If Australia had decided to provide quarterly benefits based purely on export performance targets, Australia might have provided smaller quarterly benefits over a longer period of time than through 30 June 2000, and Howe might have received less grant money before the compliance deadline than the U.S. has calculated. Further, there might have been no capital investment performance requirements under such a hypothetical programme, since the payments would not have been large enough to justify such a requirement. The point is that, yes, if Australia had established a subsidy programme different from significant lump-sum payments, the manner in which a withdrawal of the subsidy could be effected under SCM Article 4.7 might be different. But that is not our situation.

18. In any case, taking Australia’s hypothetical at face value, there is a big difference to a recipient between receiving a lump sum payment today, which is immediately available to purchase major capital assets – in fact, earmarked for such capital assets – and receiving periodic payments of much smaller amounts over a longer period of time.

19. What else is wrong with Australia’s proposed allocation method? Because it is divorced from economic reality, it is subject to abuse. What if Australia had provided the \$30 million subsidy contingent on best efforts to achieve export and investment targets through 16 June 1999, instead of through 30 June 2000? The same \$30 million would have been provided; it plainly would have been, in its entirety, an export subsidy; the same amount would have been invested in capital assets, and Howe would have benefitted to the same extent as it has now. In terms of the prohibited benefit to Howe, that \$30 million export subsidy would be indistinguishable from the \$30 million export subsidy we are considering today. Yet, under Australia’s interpretation, there would be nothing whatsoever to withdraw in the former case, because it all would have been “expensed” as of 16 June 1999. The same prohibited subsidy, the same impact on Howe, but a completely different result from the point of view of Article 4.7 remedies.

20. Obviously, Australia’s position is a virtual blueprint for how to grant significant export subsidies without having to worry about the WTO consequences.

### **The Reimbursement Through The Subsidy of the 1999 Loan.**

21. Let's talk now about the 1999 Loan, which Australia admits is a subsidy. Picture, if you will, this scenario. ALH and the Australian Government meet in a conference room on 14 September to discuss how to comply with the Panel's recommendations. The Australian Government says: "We're sorry, but we have to take back part of the \$30 million grant, because the WTO Panel said we had to withdraw the subsidy". ALH protests, "but we don't want to repay this money, we need it for our automotive leather operations". The Australian Government replies, "don't worry, just hand the \$8 million to us, and we'll hand it right back to you. We'll even sign an agreement to that effect. ALH, quite rationally, agrees, and the deal is done.

22. When ALH and the Australian Government walk out of that conference room, would anyone seriously argue that ALH had repaid \$8 million of the subsidy, or that the Australian Government had withdrawn that portion of the subsidy? No. Yet, in substance, that is precisely what happened here.

23. I'm going to simplify the discussion by talking about round numbers. The Australian Government agreed to give ALH \$13 million, specifically conditioned on ALH giving the Australian Government \$8 million, and asks only that ALH pay back the \$13 million in 13 years, with no interest. ALH takes \$13 million, returns \$8 million to the Government, and invests the balance at a modest 7.5 per cent rate of return. In 2012, ALH has enough money to pay the Australian Government back in full. These transactions, which all happened on the same day, 14 September 1999, are the exact equivalent of the "conference room" scenario I just described.

24. Now, Australia will tell you that this is not what happened. They say that Howe received the \$30 million and paid back \$8 million of it, and that ALH, a completely different company with a broader product line, received the loan subsidy. They say that the \$13 million loan is a "separate measure" from the grant or its repayment. They say that the \$13 million loan is identical in conditions to the \$25 million loan in 1997 that the Panel found not to be an export subsidy, and is therefore perfectly WTO-consistent.

25. None of these assertions is accurate.

26. ALH is a common party throughout these transactions; it is a holding company, and Howe is its wholly-owned subsidiary. ALH received the original \$30 million grant to use for its automotive leather operations. ALH was the recipient of the \$13 million loan. ALH arranged for the repayment of the \$8 million grant, and it was ALH that agreed with the Australian Government that the 1999 Loan subsidy would be conditioned on the repayment. Technically, the \$8 million came out of Howe's funds (and was then immediately reimbursed), because that is where the subsidy went. Australia simply cannot credibly argue that the repayment and its reimbursement are two separate transactions involving two separate parties.

27. Second, the \$13 million non-commercial loan is plainly not a measure that is separate from the grant repayment. Far from it. This loan is directly and specifically contingent on the grant repayment. There would not have been one without the other. By Australia's logic, if the Panel saw me go to a restaurant for dinner tonight, it would have to conclude that I was receiving a free dinner. My payment to the restaurant at the end of the meal, by Australia's logic, would be a completely separate transaction that the Panel would be urged not to take into account.

28. Third, and finally, Australia cannot plausibly claim that the 1999 Loan is just like the 1997 Loan, and is, therefore, a separate WTO-consistent measure. As I have said, the 1999 Loan subsidy was a directly contingent reimbursement for the repayment of the \$8 million subsidy. This alone makes it very different from the 1997 Loan, because the 1999 Loan was intended to, and did, reimburse and therefore nullify the partial repayment.

29. In addition, however, since the \$13 million loan subsidy was a direct reimbursement of the \$8 million repayment, and was specifically contingent on the repayment that loan steps into the shoes of the \$8 million grant repayment. In the conference room scenario I described a few minutes ago, ALH repays \$8 million to the Australian Government, and the Australian Government, by prior arrangement, pays it back. Nothing has happened to the \$8 million portion of the export subsidy to make it any less of an export subsidy. It was an export subsidy when it was returned to Australia, and it remains an export subsidy when the Australian Government gives it back.

30. Australia would probably respond that, when the export subsidy was returned to ALH, it was returned (1) as a loan subsidy and (2) without the same export-related strings attached. This is the same, however, as Australia's argument that all it had to do to withdraw the subsidy was remove the sales performance obligations. Australia is attempting to "cleanse" the original subsidy by removing, *ex post facto*, the export conditions for that subsidy. This does not implement the Panel's recommendations because Article 4.7 says to withdraw the subsidy, not remove some of the features of the subsidy.

31. Another way of looking at this is that because the \$8 million portion of the export subsidy was contingent on export performance, the subsidy provided through the 1999 Loan is also contingent on export performance, because it is linked to, and, but for accounting differences, becomes the same as, the original export subsidy. In this respect, the subsidy provided through the 1999 Loan is, itself, an export subsidy.

32. In addition, Australia itself noted that the facts and circumstances surrounding the 1997 Loan examined in the underlying proceeding were identical to those surrounding the \$30 million grant, except for a specific link to export performance. This link to export performance, according to Australia, was the difference that made the \$30 million grant an illegal export subsidy and the 1997 Loan not. The 1999 Loan, unlike the 1997 Loan, has a direct link to export performance, in that it is linked specifically to the repayment of an export subsidy. Therefore, the 1999 Loan is itself inconsistent with Article 3.1(a).

33. Either way one looks at the reimbursement represented by the 1999 Loan subsidy, it is plain that Australia has not complied with the recommendation of this Panel and the DSB that the subsidy be withdrawn.

#### **Starting date for the "prospective portion"**

34. I want to turn now to the issue of the starting date for calculating the prospective portion of the grant – that portion that must be withdrawn. The SCM Agreement calls for withdrawal of the subsidy "without delay". The Panel Report making this recommendation in this case was adopted on 16 June 1999. In our view, in the case of the withdrawal of the prospective portion of a grant, this is the starting date for calculating the "prospective portion": grant monies allocated to periods on or after 16 June 1999, should be withdrawn. In this way, the entire prospective portion of the subsidy is withdrawn, and no Member benefits by delaying implementation.

35. Australia's response is instructive. Australia believes that, after a formal export subsidy finding is made, with every day that passes, more and more of the prohibited subsidy becomes untouchable by the SCM remedies. Revealingly, Australia says that the measure "comes into conformity" automatically at the end of the allocation period as a consequence of the monies having been expensed. In other words, even after the formal finding of a prohibited export subsidy, a Member can avoid withdrawing anything at all simply by delaying implementation and waiting out the clock.

36. There is no reason for this result under the SCM Agreement and it only rewards postponing implementation. In some cases, there is a practical need for some period of time in which a Member decides how to implement the withdrawal of an allocated grant. No matter how long that time-period

is, however, the prospective portion to withdraw should be calculated as of the date of adoption of the Panel Report. The obligation to withdraw the subsidy becomes effective on that date. There is no reason that the amount to be withdrawn should decline with every day that passes after the DSB adopts a Panel Report finding an export subsidy.

37. Australia protests that if the amount is never withdrawn, then at the end of the allocation period, the Member would still have to withdraw the original amount outstanding, together with interest. This is precisely true. If the Member does not withdraw the subsidy as recommended, that Member should not receive a credit against withdrawing the subsidy, simply because of the passage of time. In other words, the lapse of time does not excuse a Member from its obligation, which accrued on the adoption date of the Panel Report, to withdraw the subsidy. This is not “punitive action”, as Australia characterizes it. It is the remedy – that the subsidy be withdrawn without delay – that the SCM Agreement mandates.

38. As for Australia’s claim that, if the Member does not withdraw the subsidy, it would be subject to retaliation or compensation forever, this raises a question that is not at issue here. This proceeding is not under Article 22.6, and is not about appropriate countermeasures.

39. Australia also says that the withdrawal should not include interest, and disparages the use of ALH’s actual borrowing rate in 1997 to calculate this interest. This criticism is misplaced. Plainly, the subsidy that should be withdrawn prospectively includes not only the allocated portion of the grant, but also the interest that the company saved by not having to borrow the money. That is the total benefit to ALH that should be withdrawn. The 1997 borrowing cost is no accident: Since ALH received \$30 million in 1997 – 98 for free, in lieu of having to borrow it at its 1997 cost of borrowing, the interest saved currently is the interest that ALH would have incurred to borrow the funds in 1997.

### **Conclusion**

40. To sum up, this Panel is called upon to decide a very important issue, which is whether an export subsidy is effectively irremediable, which is the upshot of Australia’s arguments, or whether it has to be meaningfully withdrawn, as required by the SCM Agreement.

41. Thank you very much for your attention.

ANNEX 1-4

FINAL ORAL STATEMENT OF THE UNITED STATES

(24 November 1999)

1. As we said at the outset of this meeting yesterday, the Panel's task in this proceeding is to decide whether the requirement under SCM Article 4.7 to "withdraw the subsidy" means anything at all in the case of large, lump-sum grants. Under Australia's interpretation of the Agreements, it does not. Under Australia's interpretation, the issue is whether its previously bestowed grant can somehow be brought into conformity with the agreement, or reconfigured, or revised *ex post facto*, to remove the export contingency. Respectfully, none of these possible responses is appropriate. Article 4.7 simply and expressly requires that the subsidy be withdrawn. Further, the Member must really withdraw the subsidy, not simply go through the motions.
2. We submit that there are only a few key issues that the Panel need analyze in reviewing Australia's compliance in this proceeding.
3. First, Article 3.1(a) only provides that, if a subsidy is contingent on export performance, it is a prohibited export subsidy. Article 3.1(a) does not and cannot define how an export-contingent grant is allocated over time.
4. Second, a significant grant which is an export subsidy should be allocated over time on some reasonable economic basis that reflects the length of time that the subsidy, and its benefits to the recipient, last. This allocation period should be based on meaningful, objective criteria. The allocation period should not be defined by the subsidizing Member's own arbitrary view – contained in the grant contract or elsewhere – on how long the grant subsidy should be deemed to last. The allocation period certainly should not be defined by only one of the several conditions – the sales performance targets – that made the grant an export subsidy in this case. A large, lump-sum grant objectively provides a benefit to the recipient that lasts over the useful life of the recipient's production assets, and its allocation should reflect this.
5. Third, the 1999 Loan subsidy to ALH, which was directly contingent on ALH's arranging for the repayment of part of the export subsidy, effectively nullified any purported withdrawal of a small portion of the \$30 million export subsidy. It rendered what might have been a partial withdrawal completely non-existent.
6. Finally, the obligation to withdraw the subsidy accrued the day this Panel Report was adopted. On that day, Australia's obligation with respect to the prospective portion of the principal amount of the \$30 million grant was fixed, and on that day, the prospective portion of the subsidy to be withdrawn started to include the interest that the recipient saved by virtue of not having to borrow the principal amount. Delays in withdrawing the subsidy do not decrease the amount to be withdrawn; indeed, because of the interest component of the benefit, the prohibited benefit increases over time.
7. The answer to these few questions will determine whether an export subsidy is effectively irremediable, which is the upshot of Australia's arguments, or whether it has to be meaningfully withdrawn, as required by the SCM Agreement.

## ANNEX 1-5

### UNITED STATES' ANSWERS TO WRITTEN QUESTIONS OF THE PANEL

(1 December 1999)

#### ANSWERS TO QUESTIONS FROM THE PANEL TO THE UNITED STATES

##### Question 1

*The United States agreed, in the original dispute, that a Member is permitted to replace a prohibited subsidy with a non-prohibited subsidy, and that the consistency of the new subsidy would need to be judged on its own merits. How does the US reconcile this with its new argument that the 1999 loan should be judged on the basis of the Panel's original finding concerning the grant?*

##### Answer 1

This Panel, consistent with Article 4.7 of the SCM Agreement, recommended that Australia withdraw the subsidy -- the \$30 million grant. Under Article 21.5 of the DSU, this Panel is to review the existence or consistency with a covered agreement of measures taken by Australia to comply with the recommendation of the Panel that the subsidy be withdrawn. The 1999 Loan is a subsidy (because it was concessionary) that was provided contingent on the repayment of a portion of the \$30 million grant -- part of the measures purportedly taken by Australia to comply with the recommendation of the Panel. The question presented to the Panel is whether these measures taken by Australia -- the partial repayment and its simultaneous reimbursement -- withdrew the subsidy. These measures taken to comply have to be examined in connection with the grant the Australia is required to withdraw. Whether the \$8 million "repayment" implements the Panel's recommendations obviously can only be determined by considering the nature of the \$30 million export subsidy and Australia's obligation to withdraw it. In the same way, the impact of the 1999 Loan on Australia's implementation can only be understood through its connection with the \$8 million partial repayment and the original \$30 million grant. Therefore, in the context of an Article 21.5 proceeding, in which the Panel examines the "measures taken to comply" with its recommendations, the 1999 Loan subsidy must be analyzed as part of the set of measures taken to comply with Australia's obligation to withdraw the \$30 million subsidy. In this sense, analyzing the 1999 Loan subsidy in this Article 21.5 proceeding is different from analyzing it in the context of an original dispute. Australia is subject to different obligations in this Article 21.5 proceeding -- to withdraw the subsidy -- than it would be in a normal dispute, and the 1999 Loan must be analyzed in the light of these obligations. Specifically, Australia was obligated to take back part of the export subsidy, and, partially through the benefit of the 1999 Loan subsidy, did not.

In addition, even in the case of the original dispute, this Panel found that it was required to "examine all of the facts that actually surround the granting or maintenance of the subsidy in question, including the terms and structure of the subsidy, and the circumstances under which it was granted or maintained." Panel Report, para. 9.56. There is no reason that the Panel should turn a blind eye to the facts and circumstances surrounding a subsidy provided as part of a "measure taken to comply" in an Article 21.5 proceeding. In this case, the facts and circumstances include that the 1999 Loan subsidy was a direct and contingent replacement for the portion of the \$30 million that was withdrawn.

##### Question 2

*The US argues that the task facing the Panel is to determine whether Australia has taken measures to comply with the DSB's recommendations, and whether the measures are "consistent with the SCM Agreement". Is the US argument that the 1999 loan is inconsistent because it, like the grant,*



*is an export subsidy? Or, is the US arguing that the 1999 loan, because it cancels out the grant repayment, turns the repayment into a sham? If the US is making both of these arguments, are they arguments in the alternative?*

### Answer 2

Under either theory – whether the 1999 Loan subsidy is itself an export subsidy that replaces part of the \$30 million export subsidy or whether it nullifies and renders nonexistent Australia’s purported withdrawal – Australia has not complied with the recommendations of the Panel to withdraw the subsidy.

### Question 3

*Is the US arguing that there is a distinction between measures examined in an original dispute and all steps related to implementation in the context of Article 21.5 DSU? Please explain fully.*

### Answer 3

There is a distinction between the measures examined in an original dispute and all steps related to implementation in the context of Article 21.5 of the DSU. As a result of adoption of the Panel Report by the DSB in this Article 21.5 proceeding, Australia has an obligation that was not present in the original dispute: to withdraw the prohibited export subsidy. The Panel must examine all of the steps related to the implementation of this obligation taken by Australia to determine whether Australia has complied with the recommendations. In this case, Australia purported to withdraw only a small portion of the \$30 million grant, but even that modest transaction was in fact a sham, since the grant monies were immediately replaced by the contingent 1999 Loan subsidy.

### Question 4

*On what grounds does the US justify relying on its own and the EC’s countervail practice, and the Informal Group of Experts’ report which is not adopted and pertains to serious prejudice calculations, as the basis for its proposed methodology for determining the amount of the subsidy that should be “withdrawn” to comply with the DSB’s recommendation in this prohibited subsidy case? On what specific basis does the US argue that Article 14 of the SCM Agreement can give guidance regarding questions of subsidy allocation in general (as argued in footnote 10 of the US first submission), and regarding withdrawal of a subsidy in the context of Article 4 SCM?*

### Answer 4

One of the issues in this proceeding is how to determine what portion of the subsidy’s benefit remains as of the date of adoption of the Panel Report -- that is, how much of the benefit to the recipient is attributable to the time period after the date of adoption. That is the portion of the subsidy that should be withdrawn. The determination by Members and by recognized experts as to how grants are allocated over time is, therefore, directly relevant to the issue of how much of the grant should be withdrawn.

The SCM Agreement applies to subsidies, and contains a general “Definition of a Subsidy” in Article 1. The work of Members and of the Informal Group of Experts in interpreting such subsidies is instructive, regardless of the particular Part of the SCM Agreement being studied. The focus, both of the Members and of the Informal Group of Experts, is on an economically meaningful way of determining how long a significant lump-sum grant lasts, that is, the period over which it should be allocated. That this practice and expert advice has been applied in the context of actionable subsidies (Part III of the SCM Agreement) or countervailing measures (Part V of the SCM Agreement) does not

detract from its value: nothing about the nature of actionable subsidies or countervailing measures would make the allocation principles for grants specific to those situations, and inapplicable in the case of export subsidies. In fact, there are identical concerns with respect to the effectiveness of the SCM Agreement remedies: In each of the situations at issue -- prohibited export subsidies, actionable subsidies, and countervailing measures -- if the grant is not allocated on an economically reasonable basis, such as over the useful life of assets, it escapes the SCM Agreement remedies, because it can be relegated inappropriately to the past.

Further, the Informal Group of Experts was created by the Committee on Subsidies and Countervailing Measures to clarify the calculation of subsidies. The experts were chosen by the Committee based on their substantive experience in subsidy calculation methodology. Their status and expertise in subsidy calculations should therefore be carefully considered by the Panel. Further, although the Informal Group of Experts noted that there were grey areas of subsidy allocation that would have to be analyzed on a case-by-case basis, the Experts held a consistent view throughout the report about how large non-recurrent grants should be allocated. The general rule is as the United States has stated it: such grants should be allocated over time on an economically reasonable basis, such as over the useful life of assets.

With respect to the application of Article 14 of the SCM Agreement, that Article provides that Members shall determine the method of calculating the benefit to the recipient of subsidies. Under US and EC practice, determining the benefit conferred by a grant may involve an analysis of how long the benefit of the subsidy to the recipient lasts – *i.e.*, the allocation of the subsidy over time. This is because Part V provides that Members are to calculate the “amount of the subsidy” and to impose countervailing duties that do not exceed the amount of the subsidy. Article 19 of the SCM Agreement. Article 14 sheds light on the meaning of the term “benefit”.

Further, the Appellate Body has specifically used Article 14 to interpret Article 1 in a prohibited subsidy case. In *Canada – Measures Affecting The Export Of Civilian Aircraft*, WT/DS70/AB/R, Report of the Appellate Body (2 August 1999), adopted September 1999 (para. 158), in considering whether certain measures were prohibited export subsidies, the Appellate Body used principles set out in Part V, Article 14, to determine whether the measures constituted a subsidy under Article 1.1, describing Article 14 as “relevant context in interpreting Article 1.1(b).”

The United States emphasizes that, despite Australia’s complaints that it had relied on the Panel Report in determining how the grant was to be allocated, there was nothing in the Panel Report that suggested that the grant should be allocated over sales performance targets.<sup>1</sup> By contrast, the allocation of grants over the useful life of assets is an established and well-publicized method of allocation. Australia cannot, therefore, claim to have “relied” on the Panel Report in deciding on its implementation measures. Further, the United States rejects Australia’s claim that its allocation period can only be rejected if it is a “contrivance”. The issue is not whether a Member’s own self-designated allocation period is a contrivance; the issue is the proper allocation for significant grants.

#### Question 5

*Does the US agree with the following statement from para. 7 of Australia’s second submission: “the measure comes into conformity automatically at the end of the allocation period as a consequence of all of the monies having been expensed”; and with the following statement from para. 13 of that submission: “As time passes, the amount to be withdrawn becomes smaller and goes to zero at the end of the period over which the subsidy is allocated. [The existence of] compensation or retaliation rights until the measure comes into conformity cannot increase, or halt the reduction over time of, the amount of subsidy to be withdrawn to bring the measure into conformity”? If the US*

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<sup>1</sup>In any event, as the United States has noted in its submissions, Australia’s position ignores that there is a difference between the criteria for finding an export subsidy and its allocation over time.

*disagrees, how does it reconcile that disagreement with its proposed subsidy allocation methodology, which seems to involve definition of a finite period over which subsidy benefits exist and are “expensed” with the passage of time?*

Answer 5

The United States disagrees with the statement that the “measure comes into conformity automatically at the end of the allocation period.” It is not clear how such a measure “comes into conformity” simply through the passage of time; rather, it would seem that the subsidy remains a prohibited export subsidy, but is simply a past export subsidy. More important, however, the issue in this proceeding is not whether the measure comes into conformity. The issue in this proceeding is how much of the subsidy is allocated to the time following the date of adoption of the Panel Report, and whether Australia has withdrawn that portion of the subsidy, as required by Article 4.7. Once a significant grant is found to be a prohibited export subsidy in an adopted Panel Report, it should be withdrawn, and the amount to be withdrawn does not decrease simply because the Member has delayed implementation. Further, it is not accurate to say that the existence of “compensation or retaliation rights” halts the reduction over time of the amount of subsidy that should be withdrawn. It is the adoption by the DSB of a Panel Report finding a prohibited export subsidy grant that fixes the amount that must be withdrawn: at that point, the entire prospective amount of the significant grant must be withdrawn.<sup>2</sup> The amount to be withdrawn does not decline because a Member delays implementation.

Question 6

*In the view of the United States, would a subsidy in the form of a one-time grant to a company, contingent on exportation of a given product, still need to be “withdrawn” if the recipient company completely exited that product market and no new export contingency were established in respect of other products produced by that company? If so, how would the US propose that such a withdrawal would be effectuated?*

Answer 6

In the view of the United States, whether a significant grant is an export subsidy is determined based on the conditions in place at the time the subsidy was bestowed. Subsequent events would not impact this determination. See Panel Report, para. 9.68. If a Panel were requested to rule in such a situation, in which there are no exports, the subsidy would still have to be withdrawn; however, the specific means of effecting the withdrawal would depend on the facts of the case.

Question 7

*Does the US agree with Australia’s characterization of the US approach, reflected in para. 19 of Australia’s second submission:*

*“[I]f the USA’s punitive approach on interest were to be adopted, [the amount to be withdrawn would never decline, but rather] would increase. This would mean that at the end of the allocation period, even though there would no longer be any benefit to the company involved, the Member would still have to withdraw the original outstanding amount, together with interest, to bring the measure into conformity.”*

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<sup>2</sup>Of course, prior to the adoption of the Panel Report, the amount to be withdrawn does decline over time.

Answer 7

The United States agrees that, if a Member does not withdraw a significant grant after it has been found to be a prohibited export subsidy, the amount to be withdrawn does not decline over time. Further, after the grant is found to be a prohibited subsidy, if it is not withdrawn, the benefit includes the interest that the recipient saves by not having to borrow the funds from which it is benefitting. The United States does not agree that this is punitive. It is simply a withdrawal of the prohibited subsidy, as required by Article 4.7 of the SCM Agreement, that Member have agreed not to grant in the first place.

Question 8

*Put another way, if a dispute were not brought until after the end of an allocation period, and the US agreed that the allocation period used was the correct one, would any remedy still be available? That is, would the subsidizer have to take any action to “withdraw” the subsidy? Or, because under the US approach the benefits of the subsidy would have ceased by then, would it be the US view that no remedy was necessary?*

Answer 8

The United States does not rule out the possibility that, in a particular case, a country could delay bringing an action such that there might be little or no remaining subsidy to be withdrawn. This is not the case here. The United States has acted quickly in requesting that the DSB review prohibited export subsidies, and is entitled to a meaningful remedy of withdrawal. A Member that acts expeditiously should not be greeted with the response that most of the significant subsidy has been relegated to the past and is therefore untouchable by the SCM remedies, which is upshot of Australia's position.

Question 9

*How does the US respond to Australia's arguments at para. 25 in Australia's second submission that “to bring the grant payments into conformity, Australia did not have to impose a punitive measure on an individual company, be it Howe or ALH. This matter is about Australia's rights and obligations as a Member”; and in para. 26 of that submission that “[t]he impact on Howe or ALH or any other Australian company is irrelevant: they are not Members, Australia is”?*

Answer 9

The SCM Agreement requires that the subsidy be withdrawn. In this case, this means from the recipient who received the subsidies. Australia's argument is one that would apply to any type of WTO remedy, and has specifically been rejected. Arbitrator Beeby noted in the dispute concerning *Indonesian Automotive Measures*:

In virtually every case in which a measure has been found to be inconsistent with a Member's obligations under the GATT 1994 or any other covered agreement, and therefore, must be brought into conformity with that agreement, some degree of adjustment by the domestic industry of the Member concerned will be necessary.<sup>3</sup>

This does not make the required withdrawal punitive. First, given that Members have agreed not to provide prohibited export subsidies, it follows that their firms would not have a legitimate expectation of retaining such subsidies. This is particularly true here, where all those involved were

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<sup>3</sup>*Indonesia – Certain Measures Affecting the Automotive Industry*, WT/DS54/15 et al., Award of the Arbitrator (7 December 1998), para. 25.

on notice from the beginning that the \$30 million grant was potentially a prohibited export subsidy. Second, only the prospective portion of the prohibited export subsidy must be withdrawn, not the past portion. Such a withdrawal can hardly be said to be punitive. The recipient firm is no worse off after the withdrawal than before it received the subsidy; indeed, it is better off, since it retains some portion – the “retrospective portion” – of the prohibited export subsidy.

#### Question 10

*How does the United States reconcile its view that the remedy of “withdraw the subsidy” is prospective with the fact that it interprets that term to require repayment of some amount?*

#### Answer 10

The grant is paid in a lump sum, but for purposes of assessing how long the subsidy lasts, and how long it provides a benefit, it must be allocated on some reasonable economic basis, such as the useful life of production assets. In the U.S. view, Australia is required to withdraw that portion of the grant allocable to the period after the Panel Report is adopted by the DSB.

#### Question 11

*The United States argues that the Panel should calculate the remaining benefit to be withdrawn in an export subsidy case based on allocation methodology applied in countervailing duty cases to determine the amount of benefit that may be countervailed in any given period. However, if Australia were to have withdrawn A\$28 million in this case, there would still be a A\$2 million benefit to the company that could be countervailed under Part V of the SCM Agreement. It seems, therefore, that the only way to avoid the possibility that the recipient of the prohibited subsidy retains some benefit that could be countervailed, would be to withdraw the entire amount originally provided. Please comment.*

#### Answer 11

In the context of both countervailing measures and actionable subsidies, Members and experts have considered that significant lump-sum grants should be allocated over the useful life of the recipient’s production assets. This determination is based on an economically and financially reasonable assessment of how long the grant lasts. This assessment is no less pertinent in the context of prohibited export subsidies than in the context of countervailing measures and actionable subsidies. The inquiry is the same in all cases: how long does the significant grant last and continue to provide benefits to the recipient.

This is a different issue from whether the retrospective portion of the grant – a grant whose prospective portion has been withdrawn under SCM Part II -- is still potentially subject to countervailing measures under Part V. Nothing in the SCM Agreement precludes Members from determining that a withdrawal under Article 3.1(a) is a withdrawal under Part V, making countervailing duties unnecessary.<sup>4</sup> Therefore, it is unclear that the whole amount would have to be withdrawn in order to avoid countervailing duties.

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<sup>4</sup>See, e.g., Part V, Article 19 of the SCM Agreement, which provides that countervailing duties may be imposed unless the subsidy is withdrawn.

Question 12

*Is it the United States' position that an export subsidy, which the United States would consider to be non-allocable, granted prior to the adoption of the Panel's report, is beyond the reach of remedies under Part II of the SCM Agreement, and can only be reached under Parts III and V of that Agreement? If not, please explain.*

Answer 12

In general, the types of subsidies that the United States would view as “non-allocable” are those that are “recurring”. If a programme providing recurring subsidies was found to be a prohibited export subsidy programme, a possible remedy would be to change or withdraw the underlying programme itself. Thus, the export subsidy programme would not be beyond reach of the Part II remedies, even though the subsidies previously bestowed under the programme might not have to be repaid. It is possible, moreover, that a small grant, if provided on a one-time basis and not allocated to the period following the adoption of a panel report, would not have to be repaid. This is not the case here.

**ANSWERS TO QUESTIONS FROM THE PANEL TO BOTH PARTIES**Question 1

*Both parties have proposed a calculation methodology to determine what they refer to as the “prospective” amount of the subsidy to be repaid. Given that the subsidy itself was entirely paid before the Panel’s report was adopted, in what sense can any amount of repayment be considered “prospective”?*

Answer 1

The benefits conferred on a recipient by this significant lump sum grant continue to accrue over the average life of the production assets. The portion of the grant attributable to the period after the adopted panel report should be regarded as prospective in nature. In this sense, the repayment of that amount is “prospective”, even though the grant was paid before the Panel Report was adopted.

Question 2

*On what legal basis do the parties base the argument that the phrase “withdraw the subsidy” has “prospective” effect only. One interpretation of the phrase “withdraw the subsidy”, which is not argued by either party, would be that it means “repay in full” or “take back” the financial contribution to the recipient. Please comment on this possible interpretation, with specific reference to the text, context, and object and purpose of Part II of the SCM Agreement.*

Answer 2

The issue in this proceeding is whether Australia has implemented the Panel’s recommendation that the subsidy be withdrawn without delay. The United States submits that Australia has not done so. The question of whether Australia must withdraw the entire \$30 million grant, or only the \$26,346,154 prospective portion of that grant (plus interest), is less important than this Panel’s determination of whether -- irrespective of the method for calculating the prospective portion of the grant -- Australia has complied with the Panel’s recommendation. Neither the United States, nor Australia, nor any third party, has argued that the withdrawal should be retrospective and that the whole \$30 million should be withdrawn, and there is no need for the Panel to reach this issue. Since Australia has not even withdrawn the prospective portion of the subsidy, the

Panel does not have to decide whether Australia should withdraw the retrospective portion of the subsidy. The Panel need only decide whether or not Australia has complied with the recommendation of the Panel.

That WTO remedies are not retrospective, but only prospective, is reflected in several places in the DSU itself, which generally speaks in terms of the requirement that Members “bring a measure into conformity” with a covered agreement. e.g., DSU Articles 19 and 22.1. The specific rule in Article 4.7 of the SCM Agreement – that the subsidy be withdrawn – requires, in the context of a significant grant, that something be removed or taken back. Consistency with the prospective nature of DSU, however, means that what should be taken back is that portion of the subsidy that is attributable to prospective periods. Viewed in this way, the remedy prescribed by Article 4.7 would be both consistent with general prospective principles of the DSU and meaningful.

Given the prospective nature of WTO remedies, if there had been a contrary intention in Article 4.7 of the SCM Agreement – an intention to make the withdrawal retrospective instead of prospective – that intention would have been specified somewhere in the SCM Agreement, either in a preamble or in Article 4 itself. In the absence of a specific textual basis for reading the SCM Agreement to require a retrospective withdrawal the Panel should decline to so interpret the SCM Agreement.

#### Questions 3 & 4

*In European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, the Panel noted that “any assessment of the level of nullification or impairment presupposes an evaluation of consistency or inconsistency with WTO rules of the implementation measures taken by the European Communities, i.e. the revised banana regime, in relation to the panel and Appellate Body findings concerning the previous regime.” WT/DS27/ARB, 9 April 1999, at para. 4.3. The Panel further noted that both parties accepted that it was the consistency or inconsistency with WTO rules of the new EC bananas regime – and not of the previous regime – that had to be the basis for the assessment of the equivalence between the nullification suffered and the level of the proposed suspension, id. at para. 4.5, and that it would be the WTO-inconsistency of the revised EC regime that would be the root cause of any nullification or impairment suffered by the United States. Id. at para 4.8. Is there any relationship, or should there be, between the concept of “equivalence” of the nullification or impairment of benefits to the suspension of concessions under Article 22 of the DSU, and calculation of the relevant amounts, and the calculation of the amount to be withdrawn in accordance with Article 4.7 of the SCM Agreement?*

*Further to the preceding question, would your answer change in light of the provisions of Article 4.10 of the SCM Agreement? That is, Article 4.10 of the SCM Agreement provides for “appropriate countermeasures” in the event a recommendation of the DSB is not followed, that is, the subsidy found to be prohibited is not withdrawn. Article 9 provides that “appropriate” countermeasures does not allow countermeasures that are disproportionate in light of the fact that the subsidies in question are prohibited. Does or should this have any relation to or consequences for the calculation of the amount to be withdrawn?*

#### Answer 3 & 4

The United States submits that, at this stage, the Panel should focus on whether its recommendations were implemented, not on the “appropriate countermeasures” or on equivalence of nullification or impairment.

#### Question 5

*Australia has argued, based on the Panel's original decision, that it is entitled to replace a prohibited export subsidy with a WTO-consistent subsidy, and that the 1999 loan at most falls into this category of replacement. Assuming the 1999 loan is not inconsistent with the SCM Agreement, it might nonetheless be argued that once the DSB had adopted a decision that a subsidy was inconsistent, that ruling could not be implemented simply by replacing the inconsistent subsidy with a consistent one. To implement a recommendation to "withdraw the [prohibited] subsidy" by repayment, and then immediately replace it with a WTO-consistent subsidy has no remedial effect, because the harmful trade effects presumed to have been caused by the prohibited subsidy in the first instance will necessarily continue. Would the parties please comment on this proposition.*

Answer 5

The United States agrees that the directly contingent reimbursement of a withdrawal payment nullifies, and makes non-existent, the putative withdrawal measure. This is precisely what the 1999 Loan subsidy does, through its significant concessionary features. Therefore, regardless of whether the 1999 Loan subsidy is itself WTO-consistent, it nullifies the withdrawal. It is therefore directly relevant to the Panel's Article 21.5 task to review "the existence . . . of measures taken to comply with the recommendations" of the Panel.



**ANNEX 1-6**

UNITED STATES' COMMENTS ON NEW FACTUAL INFORMATION FROM AUSTRALIA

(3 December 1999)

1. The Panel's question 4 to Australia was as follows:

Australia, although arguing that Howe's interest rate is irrelevant to this dispute, criticizes the US's estimate of that rate, derived from 1997 financial statements of Howe Leather (Australia's second submission at para. 51). **What in Australia's view would be the commercial interest rate and loan terms that Howe would have been able to obtain on the market for long-term borrowing during each of the past three years? Please provide a full explanation and supporting documentation.**

2. In lieu of responding to the Panel's question, Australia repeats its criticism of the U.S. calculation of interest, which is based on the published audited consolidated financial statements of ALH (which includes Howe), and notes that ALH's interest rate for bills of exchange was 7.5 per cent and its overdraft rate 9.25 per cent. As "supporting documentation", ALH submitted two tables whose provenance and context were not identified.

3. This new information is not responsive. First, it is not the commercial interest rates and loan terms for long-term borrowing from Howe. To the contrary, rates for bills of exchange and overdrafts are a particular and very selective form of short-term borrowing and, since they are apparently reported with respect to ALH alone, they do not represent the cost of borrowing by Howe. Second, the "documentation" provides no support for how the interest rates were calculated, whether non-interest-bearing liabilities were excluded, or whether the rates were the actual rates paid, or simply rates available. In short, the Panel does not really know what these interest rates represent, except that they are plainly not long-term commercial interest rates and loan terms that Howe would have paid on the market, as requested by the Panel.

4. Australia states in its response that there is public information on the "full details" of all loans and the average interest rates for those loans. This is the information that the Panel requested with respect to Howe for each of the years 1997-99, and this is the information that should have been provided, but was not. The limited amount of information submitted by Australia, and its obvious inadequacy as a measure of Howe's long-term borrowing costs, cannot substitute for the interest rate information provided by the United States. The Appellate Body recently stated, in connection with Canada's refusal to provide information with respect to export subsidies:

Clearly, in our view, the Panel had the legal authority and the discretion to draw inferences from the facts before it – including the fact that Canada had refused to provide information sought by the Panel.

\* \* \*

The continued viability of [the dispute settlement] system depends, in substantial measure, on the willingness of panels to take all steps open to them to induce the parties to the dispute to comply with their duty to provide information necessary for dispute settlement. In particular, a panel should be willing expressly to remind parties – during the course of dispute settlement proceedings – that a refusal to

provide information requested by the panel may lead to inferences being drawn about the inculpatory character of the information withheld.<sup>1</sup>

5. The US method of calculating the interest rate is accurate. First, it is based on audited, published financial statements, which should be presumed to be correct. Second, it is based on a consolidated financial statement, meaning that (1) it specifically includes Howe's market costs of funds, and (2) it excludes any intra-company borrowing at non-market rates that might skew the true "market" cost of funds. Third, since it is based on actual interest expenses paid, the US method results in an actual, historical, and not a theoretical, cost of borrowing. Finally, although, in theory, a massive retirement of debt during the course of the fiscal year might influence this calculation, in the absence of any indication of such an extraordinary circumstance, the Panel should not assume it. This is particularly true here, since Australia was given an opportunity to provide what it considers to be more accurate information, but declined to do so.

6. In this connection, the United States notes that the 1997 interest rate calculation is corroborated by the 1999 consolidated financial statements of Schaeffer Corporation, ALH's parent company.<sup>2</sup> The 1999 interest rate is 11.36%, compared to the originally submitted 1997 interest rate of 11.6 per cent.

|  |              |
|--|--------------|
| Fiscal year "borrowing cost paid":             | \$ 1,884,000 |
| Fiscal year "non-current bank loan – secured": | \$16,583,000 |

$\$ 1,884,000 / \$16,583,000 = 11.36\%$

7. The consistency between this 1999 interest rate and the 1997 interest rate strongly suggests that, contrary to Australia's assertions, the 1997 interest rate was not distortive.

8. Plainly, the information provided by the United States is the most accurate information available on what Howe's borrowing cost is.

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<sup>1</sup> *Canada – Measures Affecting The Export Of Civilian Aircraft*, WT/DS70/AB/R, Report of the Appellate Body (2 August 1999), adopted September 1999 (paras. 203 - 204)

<sup>2</sup> 1999 Financial Statements for ALH were unavailable.

**ANNEX 2-1**

**FIRST SUBMISSION OF AUSTRALIA**

(3 November 1999)

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**EXECUTIVE SUMMARY**

1. Australia has implemented the recommendations of the Panel Report Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) ("the Report") in good faith on the basis of the reasoning and findings of the Report itself. Australia implemented the Report's recommendations on 14 September 1999 by withdrawing \$8.065m<sup>1</sup> from Howe and Co. ("Howe"). At the same time it terminated all obligations under the Grant Contract of March 1997 ("Grant Contract"), including those under the sales performance targets. This termination was contingent upon the repayment of the \$8.065m. by Howe.

2. Australia considered that the termination of all obligations under the Grant Contract would by itself have been sufficient to bring Australia into conformity. However, to provide greater certainty in resolving this case, Australia also withdrew \$8.065m. from Howe. This amount exceeded the amount required to be withdrawn for implementation. Australia has complied with its obligations under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

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<sup>1</sup> Australian dollars are used throughout this submission.

3. The Report found the grant payments under the Grant Contract to be contingent upon export performance on the basis of the sales performance targets in the Grant Contract over the period 1 April 1997 to 30 June 2000. These sales performance targets applied to all sales by Howe, not just sales of automotive leather and so certainly were not limited to exports of automotive leather. Accordingly, they included not only domestic sales of automotive leather by Howe but also all other sales by Howe. The grant payments were tied to those sales and the amount withdrawn, \$8.065m., exceeded the unexpensed part of the \$30m. attributable to automotive leather exports at the implementation date of 14 September 1999.

4. The Report found that the concessional loan provided in 1997 to Howe and ALH ("1997 Loan") is consistent with SCM Article 3.1(a). The "factor" that distinguished between the findings on the 1997 Loan and the grant payments was the sales performance targets under the Grant Contract. The Report found that the grant payments were tied to actual and anticipated exports because of the sales performance targets, which the Report found were effectively export performance targets.<sup>2</sup> Without the "factor" of the sales performance targets the Report found that for the 1997 Loan " ... there is not a sufficiently close tie between the loan and anticipated exportation or export earnings."<sup>3</sup> The Report clearly considered that the grant payments were tied to export performance in the period 1 April 1997 to 30 June 2000 and so were to be expensed in achieving these export targets arising from the sales performance targets.

5. The loan provided to Australian Leather Holdings Ltd (ALH) in 1999 ("1999 Loan") is not within the terms of reference of the Panel. If the Panel decides to consider the 1999 Loan, then clearly it is consistent with SCM Article 3.1(a) and the USA has not sought to prove otherwise.

6. Australia is entitled to provide subsidies to ALH, so long as they are consistent with the WTO. Even if the 1999 Loan were to be regarded as replacing all or part of the subsidies to Howe, despite them being different entities with ALH's subsidiaries as a whole producing a broader product range, there would be nothing wrong with that under WTO rules. The Report says that "[I]t is, therefore, necessary that each subsidy be evaluated on its own terms in deciding whether it is consistent with the SCM Agreement<sup>4</sup> and that no conclusion can be drawn about the status of a subsequent subsidy from the status of the preceding one."<sup>5</sup>

7. Therefore, Australia has complied with the DSB's recommendation by withdrawing \$8.065m. from Howe by 14 September 1999, and, as a separate matter, the 1999 Loan is consistent with the WTO.

## I. INTRODUCTION

8. Australia has implemented the recommendations of the Panel Report Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) ("the Report") in good faith on the basis of the reasoning and findings of the Report itself. Australia decided that the best way of resolving this dispute was to accept the Report (without making an appeal) and to implement on the basis of the Report.

9. The Report was adopted by the Dispute Settlement Body (DSB) on 16 June 1999 and so Australia had 90 days, i.e. until 14 September 1999, to implement the recommendations and rulings adopted by the DSB. It did so by having Howe and Co. ("Howe") repay \$8.065m. of the grant payments on 14 September 1999. At the same time it terminated all obligations under the Grant Contract of March 1997 ("Grant Contract"), including those under the sales performance targets.

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<sup>2</sup> At paragraph 9.71 of the Report.

<sup>3</sup> At paragraph 9.75 of the Report.

<sup>4</sup> At paragraph 9.61 of the Report

<sup>5</sup> At paragraph 9.64 of the Report.

This termination was contingent upon the repayment of the \$8.065m. by Howe. The Deed of Release and the letter confirming receipt of the \$8.065m. are at Exhibits 1 and 2.

10. The \$8.065m. repaid by Howe exceeds the amount required to be withdrawn for implementation. As shown below this amount represents more than the portion of the grant payments unexpensed at 14 September 1999 on the basis of the sales performance targets contained in the Grant Contract.

11. Accordingly, Australia requests the Panel to find that it has fully implemented the recommendations of the DSB of 16 June 1999 (WT/DS126/5).

12. A concessional loan ("1999 Loan") of \$13.654m. was made to Australian Leather Holdings Ltd (ALH) with terms derived from those for the 1997 Loan.

13. The terms of reference of the Panel under Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) limit it to the examination of whether Howe has repaid a sufficient amount of money, since the recommendation of the Report was limited to the issue of withdrawal of the grant payments to Howe. The 1999 Loan to ALH is not covered by the terms of reference of the Panel.

14. The USA has not provided any argument that the 1999 Loan to ALH is inconsistent with Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Indeed at paragraph 50 of the USA's first submission, it says that "the issue is not whether the loan itself should be condemned as a prohibited subsidy." The USA could hardly argue otherwise, since the 1999 Loan clearly is consistent. In any case on the basis of the Report's conclusion on the Loan provided in 1997 to Howe and ALH ("1997 Loan") there could be no inconsistency with SCM Article 3.1(a). Moreover, consistent with the Report, a Member is permitted to provide a new subsidy without prejudice to its WTO status and the WTO consistency of any such subsidy has to be assessed on its own terms.<sup>6</sup> The issue of whether Australia has brought itself into compliance in respect of the grant payments under the Grant Contract and the consistency of the 1999 Loan are separate issues and need to be addressed individually. Accordingly, the 1999 Loan does not affect the matter of implementation before the Panel.

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<sup>6</sup> The Report at paragraph 9.64 says:

"... WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, thereby bringing themselves into compliance with their multilateral obligations under the SCM Agreement. We agree that, even assuming the ICS and EFS were prohibited export subsidies (a question on which we draw no conclusions), this would not, *ipso facto*, mean that any subsequent subsidy granted to a company that had previously benefited from those programmes would be a prohibited export subsidy."

The Report at paragraph 9.61 says:

"We agree with Australia that we must consider the challenged measures individually to determine their consistency with the SCM Agreement. Merely because all the challenged subsidies form part of a single "package" of assistance to Howe does not mean that all of them are perforce prohibited export subsidies or not. In this regard, we note that, in our view, it is perfectly possible for a Member to construct a package of subsidies to aid domestic industry, of which some are consistent with the SCM Agreement, and others are not. It is, therefore, necessary that each subsidy be evaluated on its own terms in deciding whether it is consistent with the SCM Agreement."

## II. PRELIMINARY RULING

15. At the request of the Panel under its preliminary ruling on 2 November 1999, Australia has provided as exhibits documents on the 1999 Loan and a letter from the Department of Industry, Science and Resources to ALH. These are provided under the protection of the Business Confidential Information (BCI) procedures for this panel and without prejudice to Australia's view that the 1999 Loan does not come within the Panel's terms of reference and that the USA has not laid adequate foundation why it should be considered by the Panel.

## III. WITHDRAWAL OF SUBSIDIES UNDER THE GRANT CONTRACT

16. The amount of \$8.065m., which was withdrawn from Howe, exceeds the amount required for implementation. The following sets out the requirements on Australia for implementation.

### Who should repay the money?

17. The Report is clear that it considered the money to have been paid to Howe, e.g. at paragraphs:

"9.62 ... the terms of the grant contract are specifically directed at Howe, and more particularly at Howe's automotive leather operations. ... ."

and

"9.63 ... the fact that the government of Australia was providing assistance to Howe ... ."

18. Accordingly, consistent with the Report, Australia withdrew the money from Howe.

### Time-period for the allocation of the \$30m of grant payments

19. In its first submission, the USA states that withdrawal of a subsidy under the SCM Agreement does not mean that all of a subsidy has to be repaid by way of a retrospective remedy.<sup>7</sup> Moreover, the USA's position in the Brazil Aircraft Panel was that subsidies should be withdrawn in respect of the period to which that they are "*properly allocated*".<sup>8</sup>

20. Australia considered that the termination of all subsisting obligations under the Grant Contract, and hence the termination of any sales performance requirements on Howe, would have been sufficient for Australia to implement the recommendations adopted by the DSB, given that there is now no obligation on Howe in respect of sales. However, to ensure an end to this dispute, Australia withdrew a substantial sum on money from Howe based on the Report's finding that that the allocation of grant payments was in respect of the sales performance targets and hence applied over

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<sup>7</sup> At paragraph 15 of the USA's first submission:

"There is no disagreement between the parties that the provisions of Article 4.7 of the SCM Agreement and the recommendations in the Panel Report call for Australia to withdraw only the prospective portion of the illegal subsidy. ..."

<sup>8</sup> See paragraph 5.26 of WT/DS46/R:

"... The United States agrees with the proposition that remedies in the WTO dispute settlement system are not retroactive. However, in the case of a subsidy that is properly allocated over several years (as appears to be the case with respect to PROEX subsidies in question), the withdrawal of that portion of the subsidy allocated to future time periods would not constitute a retroactive remedy or retroactive implementation. ..."

the period 1 April 1997 to 30 June 2000. Accordingly, Australia decided to withdraw an amount that would cover the "anticipated exports" over the remaining period from the date of implementation to the end of the sales performance requirements under the Grant Contract on 30 June 2000.

21. The Report explicitly linked the grant payments to the sales performance targets under the Grant Contract.<sup>9</sup> The period covered by the sales performance targets under the Grant Contract's was 1 April 1997 to 30 June 2000.<sup>10</sup> The Report found that the grant payments were contingent upon export performance because of the sales performance targets and the linkage of those payments to the sales performance targets.<sup>11</sup> The Report's finding was that the anticipated exports were those imposed by the sales performance targets. Those targets applied only to the period 1 April 1997 to 30 June 2000.

22. The Report found that the 1997 Loan is consistent with SCM Article 3.1(a)<sup>12</sup> and this conclusion has been adopted by the DSB. This conclusion was based on the Report's finding that:

"There is nothing in the loan contract that explicitly links the loan to Howe's production or sales, and therefore nothing in its terms, the design of the loan payment, or the repayment provisions that would tie the loan directly to export performance, or even sales performance."<sup>13</sup>

Moreover, although "other factors" in relation to the granting of the assistance package to Howe were

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<sup>9</sup> For example, the Report at paragraph 9.62 says:

"... the terms of the grant contract are specifically directed at Howe, and more particularly at Howe's automotive leather operations. The contract provides for an aggregate sales performance target for the period 1 April 1997 – 31 December 2000, broken down into four interim sales targets. [*Footnote 207: Howe is obligated to submit reports of its performance against the interim performance targets for each of the periods ending 30 June 1997, 1998, 1999 and 2000, as well as final report in September 2000.*] ..."

<sup>10</sup> Note that in the reference in Footnote 9, the Report said 1 April 1997 to 31 December 2000 rather than 1 April 1997 to 30 June 2000. This is clearly a typographical error given that Footnote 207 of the Report (also incorporated in Footnote 9) specifies the correct date of 30 June 2000 with the final report under the Grant Contract being due in September 2000.

<sup>11</sup> In the Report see, for example:

"9.67 ... Therefore, we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the government of Australia was aware of this necessity, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe's anticipated export performance was one of the conditions for the grant of the subsidies. ..."

"9.68 We note that confidential business information provided by Australia indicates that, in fact, the proportion of Howe's sales going to export has not increased. However, we must make our determination on the facts that existed at the time the contract establishing the conditions for the grant payments was entered into. Thus, the fact that the anticipated exports may not have come to pass in the volumes anticipated does not affect our conclusion. ..."

"9.71 ... these sales performance targets are, in our view, effectively, export performance targets."

<sup>12</sup> The Report at paragraph 10.1(a) says:

"The loan from the Australian government to Howe/ALH is not a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement".

<sup>13</sup> At paragraph 9.74 of the Report.

"relevant to our consideration of the nature of the loan contact ... there was nothing in the terms of the loan contract itself which suggests a specific link to actual or anticipated exportation or export earnings, as there is in the terms of the grant contract.<sup>14</sup>

This led the Panel to the view that there

"is not a sufficiently close tie between the loan and anticipated exportation or export earnings.<sup>15</sup>

This conclusion was accepted by the USA, since it did not appeal it.

23. The Report concluded that the concessional 1997 Loan was not contingent upon export performance, either in law or in fact. Under the 15 year 1997 Loan, no interest was payable for the first 5 years. Thus the first payment of interest is on 1 February 2003 far beyond the end of the period for the sales performance targets of 30 June 2000. While the interest payable after the 5 year grace period is 2 per cent above the 10 year government bond rate, that rate was considered by the USA to be concessional<sup>16</sup>. This was not disputed by Australia and was not questioned by the Panel in the Report. The existence of an ongoing subsidy to Howe in respect of automotive leather after 30 June 2000 was thereby found not to be contingent upon export performance. It was only the grant payments that were found to be tied to exports of automotive leather and that depended critically on the sales performance targets, which only ran to 30 June 2000.

24. The Panel looked at all the facts surrounding the provision of the subsidies to Howe.

"In our view, the concept of 'contingent... in fact ... upon export performance', and the language of footnote 4 of the SCM Agreement, require us to examine all the facts that actually surround the granting or maintenance of the subsidy in question.<sup>17</sup>

It was the Panel's consideration of all these facts that contributed to the Report's findings, but it was the sales performance targets that tipped the scales and led to the grant payments being found to be export subsidies. All the other facts combined applied equally to the 1997 Loan but without the sales performance targets they were not considered by the Report to represent a "sufficiently close tie" to anticipated exports.

25. The fundamentally different findings on the grant payments and the loan subsidies result from the existence of the sales performance targets. The findings mean that any argument by the USA that the grant payments should be allocated over a period beyond 30 June 2000 is not sustainable. The Report considered that the grant payments were tied to export performance in the period 1 April 1997 to 30 June 2000 because of the sales performance targets, and were to be used, i.e. expensed, in achieving those targets. It does not make sense to say that a subsidy is tied to exports over a specific period, then, having found the subsidy to be in breach because of that fact, expense it over a much longer period.

26. The USA sought to argue before the original Panel both that the subsidies extended over a long time and that they were directly tied to the sales performance targets.<sup>18</sup> Australia pointed out that

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<sup>14</sup> At paragraph 9.75 of the Report.

<sup>15</sup> At paragraph 9.75 of the Report.

<sup>16</sup> At paragraphs 2.4 and 7.48-7.50 of the Report.

<sup>17</sup> At paragraph 9.56 of the Report.

<sup>18</sup> For example, at paragraph 7.290 of the Report, the USA said:

'... as the Australian government itself indicates, the continued payment of the grant was tied to the volume of "sales." ...'



the USA could not have it both ways.<sup>19</sup> If the money was not allocated over the period 1 April 1997 to 30 June 2000 on the basis of anticipated exports in this period, then it would not have been in breach of SCM Article 3.1(a). Such subsidies would have been a case for Parts III or V of the SCM Agreement, not Part II. The issue of implementation of the Panel's recommendations is not one of trade or production effect but one of complying with WTO rules. The USA has to seek remedy against measures it considers to be in breach of a Member's obligations on the basis of WTO rules.

27. The Report accepted the USA's argument that the grant and loan subsidies were a replacement for the Import Credit and Export Facilitation Schemes, which terminate in 2000. The main scheme for automotive leather was the Import Credit Scheme, which terminates on 30 June 2000 to be replaced by new assistance arrangements for the textiles, clothing and footwear industries: this is why the grant payments and the sales performance targets only ran until 30 June 2000.

28. The Panel concluded that the three tranches of grant payments were paid in advance of performance of actual and anticipated sales performance for the period 1 April 1997 to 30 June 2000.<sup>20</sup> This is supported by the USA in paragraph 40 of its first submission, which reads:

"The grants amounted to an export subsidy because they were contingent on export performance."

The USA then goes on to claim that:

"The export-contingent feature of the subsidy, however, is not a useful tool for measuring how the subsidy should be allocated."

29. The point being made in those statements by the USA is not clear but it is illogical to claim that the allocation of the subsidy can be done in two different ways for the same case. The USA is saying that the conditions on which a subsidy is provided are critical to determining whether it is in breach SCM Article 3.1(a), but that, once that subsidy has been found to be in breach, the conditions and nature of the subsidy suddenly change when the issue of remedy is addressed. There is nothing in the WTO to support that view and the USA certainly has not presented anything to do so. Indeed the USA recognizes in paragraph 15 of its first submission that, to the contrary, the issue for implementation is one of coming into conformity with the rule that has been breached. Either subsidies are "tied to" exports or they are not. If they are subsidies contingent upon export performance (i.e. prohibited export subsidies in law or in fact), then they are expensed in achieving the contingent export sales. If they are not contingent on exports, then they are expensed in other ways and are subject to different disciplines and remedies under the SCM Agreement.

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<sup>19</sup> At paragraphs 7.67 and 7.68 of the Report.

<sup>20</sup> At paragraph 9.71 the Report says:

"All of the facts, weighed together, lead us to conclude that the three subsidy payments under the grant contract are in fact tied to Howe's actual or anticipated exportation or export earnings. [Footnote 215: ] We note that our conclusion matches the understanding of the recipient of the subsidy payments. In March 1997, Schaffer Corporation, the parent of Howe and ALH, reported that the Australian government had "finalised a compensation package" for Howe/ALH, consisting, inter alia of "A grant of [A]\$30 million based on projected exports and paid on performance criteria". Schaffer Corporation Limited Half Yearly Results to December 1996, Exhibit 1 to United States first submission, at page 2.] These payments are conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets. The second and third grant payments are, in addition, explicitly conditioned on satisfaction, on a best endeavours basis, of interim sales performance targets. Given the export-dependent nature of Howe's business, and the size of the Australian market, these sales performance targets are, in our view, effectively, export performance targets. The sales performance targets set out in the grant contract, in conjunction with the other facts enumerated above, therefore lead us to the conclusion that the grant of the subsidies was conditioned on anticipated exportation. ..."

30. The only way to try to make some sense of the USA's approach is to assume that only monies allocated to the period 1 April 1997 to 30 June 2000 were found to be inconsistent with SCM Article 3.1(a) while monies allocated on the basis of the USA's 12.8 year scheme to the period after 30 June 2000 were not. This would mean that all Australia was required to do was withdraw the monies allocated to the remaining "prohibited subsidy" period (15 September 1999 to 30 June 2000). This would amount to some \$1.9m<sup>21</sup>, which Australia has exceeded.

31. There is some confusion between the USA's approach on allocating on the basis of assets life and on the other hand its comment at paragraph 25 of its first submission where it says:

"... Given the fungibility of money, it is unproductive and unrealistic to attempt to trace the use of grants in order to determine how they should be allocated."

32. There is a prohibition on export subsidies because they are contingent upon export performance, i.e. tied to export performance. The prohibition arises because the subsidies contingent upon export performance are presumed to be expensed on actual exports, paid either in advance or in arrears. The grant payments are necessarily allocated to the sales performance targets on which they were contingent, i.e. to the period 1 April 1997 to 30 June 2000. The income from any one type of export subsidy programme is no more or less fungible than the income from any other type of export subsidy programme. There would be no more reason for treating the grant payments in the way suggested by the USA than export subsidies under a programme such as the USA's Foreign Sales Corporations. The Panel in the Report on which this implementation dispute is based found that the grant payments were contingent upon sales performance over the period 1 April 1997 to 30 June 2000. Accordingly, the allocation period was 1 April 1997 to 30 June 2000 for the purpose of implementing the DSB's recommendations.

#### Time-period for determining unexpensed subsidies ("Withdrawal Period")

33. The USA has argued in paragraphs 44-47 of its first submission that that the monies unexpensed at the date of adoption of the report have to be withdrawn rather than the amount unexpensed at the date of implementation. To require the withdrawal of monies that have been allocated prior to the date of withdrawal would be retroactive action. The rationale for requiring the repayment of money is that that money has not been expensed at the time of implementation and so needs to be repaid to bring the Member into conformity at that date, not the date of adoption of the Panel Report. To interpret it otherwise, would be to make the concept of the implementation period meaningless. This is also the only interpretation consistent with paragraph 15 of the USA's first submission, which interprets SCM Article 4.7 in light of DSU Article 19. The DSU provides that the obligation is for a Member to bring a measure into conformity within a specified period provided for in DSU Article 21, and for the SCM Agreement, SCM Article 4.7.

34. The USA's argument is based on SCM Article 4.7, which applies to all prohibited subsidies. If it were to be found that the Withdrawal Period for the grant payments should start at the date of the adoption of a Panel Report, then the finding would apply to all prohibited subsidies and would also require the withdrawal of all monies paid between that date and the date of implementation for any prohibited subsidy programme. This would mean that for an export subsidy programme where payments are made after the performance, e.g. the USA's Foreign Sales Corporations, all monies paid between adoption of the Panel Report and the termination of the legislation would have to be repaid.

35. Since the USA has argued at paragraph 15 of its first submission that this is an issue of bringing into conformity, the same reasoning would also apply to many other cases under the WTO. For example, by analogy in the case of an illegal tariff, all monies collected between the date of

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<sup>21</sup> \$30m. x [290/366]/12.8 = \$1.9m. This is based on the 12.8 year period claimed by the USA. The period 15 September 1999 to 30 June 2000 is 290 days.

adoption and the date of implementation would have to be refunded. Indeed it would be much easier for a government to repay monies in the tariff example than to recover monies from industry in a subsidies case, but that has not been required under GATT 1947 and WTO practice and law. There is no basis for singling out subsidies contingent in fact upon export performance for such punitive treatment.

36. Accordingly, all monies allocated to the period on or before 14 September 1999 have been expensed for the purpose of implementation by 14 September 1999. Thus the period for determining the amount to be withdrawn is 15 September 1999 to 30 June 2000 ("Withdrawal Period") for the purpose of this Panel.

#### Calculation of amount required to be withdrawn

37. The amount of \$8.065m. withdrawn from Howe does not represent the amount that Australia considers was required to be withdrawn, but rather a figure that exceeded all sensible options. Australia recognized that there may be differing views on what the appropriate level should be, and so negotiated a high figure with Howe in order to finalize this dispute.

38. The parameters used were:

- the period for allocation of the \$30m. is 1 April 1997 to 30 June 2000
  - This has been demonstrated above.
- the unexpensed amount for 15 September 1999 to 30 June 2000 was to be withdrawn
  - This has been demonstrated above.
- only the amount allocated to exports of automotive leather was required to be withdrawn.

#### Only the amount allocated to exports of automotive leather was required to be withdrawn

39. Since the \$30m. was allocated over 1 April 1997 to 30 June 2000 and since the amount allocated to the period 1 April 1997 to 14 September 1999 had been expensed for the purpose of implementation, the issue is how much was allocated to the Withdrawal Period (15 September 1999 to 30 June 2000).

40. Since the case is about subsidies contingent upon exports of automotive leather, only those subsidies tied to exports of automotive leather were found to be inconsistent. Accordingly, only the unexpensed proportion of such subsidies were required to be withdrawn. Paragraph 9.67 of the Report concluded that:

" ... in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports.  
... "

It was the subsidy attached to those exports (of automotive leather) that was found to be in fact tied to exports. The monies paid in respect of actual or anticipated domestic sales of automotive leather (or indeed any other sales by Howe) could not have been inconsistent with SCM Article 3.1(a) in respect of automotive leather.

#### Options for calculation

41. The above leaves two important questions to be answered:
- (a) what portion of the \$30m. is to be allocated to the period 15 September 1999 to 30 June 2000 (the "Withdrawal Period")
  - (b) what portion of that should be allocated to exports of automotive leather.

42. Taken together, these will give the amount required to be withdrawn.

43. At paragraph 9.67 the Report says:

"... we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (*interim targets and the aggregate target*) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the government of Australia was aware of this necessity, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the *sales performance targets into export performance targets*. ... " [Emphasis added.]

44. Again at paragraph 9.71 the Report says:

"... These payments are conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the *aggregate performance targets*. The second and third grant payments are, in addition, explicitly conditioned on satisfaction, on a best endeavours basis, of *interim sales performance targets*. Given the export-dependent nature of Howe's business, and the size of the Australian market, these sales performance targets are, in our view, effectively, *export performance targets*. ... " [Emphasis added.]

45. Moreover, the Report says at paragraph 9.68 that:

"... However, we must make our determination on the facts that existed at the time the contract establishing the conditions for the grant payments was entered into. Thus, the fact that the anticipated exports may not have come to pass in the volumes anticipated does not affect our conclusion. ... "

46. Thus the Report concluded that the obligation on Howe was in respect of the aggregate of the sales performance targets over 1 April 1997 to 30 June 2000. The Withdrawal Period is 290 days and 1 April 1997 to 30 June 2000 is 1186 days. This means that the portion of the \$30m. allocated to the Withdrawal Period is 30 times 290/1186, i.e. about \$7.336m.

47. While this seems to Australia be the appropriate approach most in line with the Report, Australia also considered the alternative of allocating the \$30m. on the basis of the schedule of sales performance targets. Taking that approach, the amount of the \$30m. allocated to 1999-2000 (July-June) is \$11.31m. and so the amount allocated to the Withdrawal Period is \$8.961m.<sup>22</sup>

48. The second question was how to allocate this to exports of automotive leather. As the Report notes, the sales performance targets were not achieved for automotive leather. Indeed as pointed out by Australia the sales performance targets were not for automotive leather alone but overall sales by

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<sup>22</sup> The sales performance target for 1999-2000 was \$214.0m and the total over the period 1 April 1997 to 30 June 2000 was \$567.5m. Thus the allocated amount of the grant payments for 1999-2000 was  $30 \times [214/567.5] = \$11.31\text{m.}$  Accordingly, the allocated amount of the grant payments for the Withdrawal Period was  $11.31 \times [290/366] = \$8.961\text{m.}$

Howe. The USA used a figure of 90 per cent as the proportion of Howe's exports of automotive leather. Australia could have pursued the argument regarding the proportion of automotive leather exports of the actual total sales of Howe covered by the sales performance targets. Some figure approaching this level was implicitly accepted by the Panel in its Report. Accordingly, rather than revisiting this issue with the Panel, Australia simply took this 90 per cent figure.

49. For the preferred approach this would mean that \$6.602m<sup>23</sup> was required to be withdrawn and for the alternative approach \$8.065m.<sup>24</sup> A more detailed explanation of this calculation is at Attachment A.

#### IV. 1999 LOAN

50. The 1999 Loan is not part of the implementation of the recommendation adopted by the DSB. Australia did not notify it to the DSB in WT/DS126/7.

51. Australia considers that the 1999 Loan to ALH alone is not covered by the Panel's terms of reference, which relate to the implementation of the recommendation of the Report, i.e. to withdraw the grant payments from Howe.

52. The USA has not sought to show that the 1999 Loan is inconsistent with SCM Article 3.1(a), and indeed says that that is not an issue.<sup>25</sup> This is presumably because it recognizes that the 1999 Loan is clearly consistent and that this is reinforced by the Report's findings and conclusion on the 1997 Loan.

53. The Report at paragraph 9.61 said that each subsidy has to be evaluated on its own terms in deciding consistency with the SCM Agreement.<sup>26</sup> Moreover, at paragraph 9.64, the Report agreed with Australia that a prohibited subsidy can be replaced with a non-prohibited subsidy.<sup>27</sup> In this case the money is paid by Howe and the loan was to ALH without any reference to automotive leather.<sup>28</sup> How companies choose to organize their business is not a matter for government obligations under the WTO. In any case, even if the 1999 Loan to ALH were to be considered to replace all or part of the grant payments to Howe, it would need to be considered on its individual merits.

54. Australia is entitled to provide subsidies to ALH, so long as they are consistent with the WTO. Even if the 1999 Loan were to be regarded as replacing all or part of the subsidies to Howe, despite Howe and ALH being different entities with ALH's subsidiaries as a whole producing a broader product range, there would be nothing wrong with that under WTO rules. The Report says that "[i]t is, therefore, necessary that each subsidy be evaluated on its own terms in deciding whether it is consistent with the SCM Agreement<sup>29</sup> and that no conclusion can be drawn about the status of a subsequent subsidy from the status of the preceding one."<sup>30</sup>

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<sup>23</sup> 7.336 x 0.9 = 6.602.

<sup>24</sup> 8.961 x 0.9 = 8.065.

<sup>25</sup> See paragraph 50 of the USA's first submission.

<sup>26</sup> See at Footnote 6.

<sup>27</sup> See at Footnote 6.

<sup>28</sup> The 1997 Loan was for purposes relating to automotive leather.

<sup>29</sup> At paragraph 9.61 of the Report

<sup>30</sup> At paragraph 9.64 of the Report.

**V. CONCLUSION**

55. Australia has implemented the Report's recommendations and rulings in good faith by closely following the reasoning and findings in the Report.

56. Australia requests the Panel to find that in withdrawing \$8.065m. from Howe by 14 September 1999:

Australia has fully implemented the recommendation of the DSB of 16 June 1999 (WT/DS126/5).

**ATTACHMENT A**

**CALCULATION OF AMOUNT TO BE WITHDRAWN**

**PREFERRED OPTION**

**Amount to be repaid:** \$6.602m.

**Calculation**

Contract Period:

1 April 1997 – 30 June 2000: 1186 days.

Withdrawal Period:

15 Sept 1999 – 30 June 2000: 290 days.

Proportion of period after implementation:

290 / 1186.

Amount not expensed at implementation date:

$\$30 \times [290/1186] = \$7.336\text{m.}$

Amount allocated to exports of automotive leather on the basis of 90% exports not expensed at implementation date:

90% of \$7.336m. = \$6.602m.

**ALTERNATIVE OPTION**

**Amount to be repaid:** \$8.065m.

**Calculation**

Aggregate sales performance targets under the Grant Contract: \$567.5m.

Sales performance target for 1999-2000 (July-June):

\$214.0m.

Proportion of \$30m. allocated to 1999-2000:

$214.0/567.5 = 0.377$

Amount allocated to 1999-2000:

37.7% of \$30m. = \$11.31m.

Withdrawal Period:

15 Sept 1999 – 30 June 2000: 290 days.

Withdrawal Period as proportion of 1999-2000:

290/366

Amount not expensed at implementation date:

$\$11.31 \times [290/366] = \$8.961\text{m.}$

Amount allocated to exports of automotive leather on the basis of 90% exports not expensed at implementation date:

90% of \$8.961m. = \$8.065m.

|   | PREFERRED OPTION | ALTERNATIVE OPTION |
|---|------------------|--------------------|
| Amount covering all domestic and export sales, including automotive leather | \$7.336m.        | \$8.961m.          |
| Amount covering 90% of total sales  | \$6.602m.        | \$8.065m.          |

\* \* \* \* \*

### LIST OF EXHIBITS

AUS-1 Deed of Release

AUS-2 Letter confirming payment

#### EXHIBITS BUSINESS CONFIDENTIAL INFORMATION (BCI)

AUS-BCI-1 Grant Contract

AUS-BCI-2 1997 Loan Contract

AUS-BCI-3 A\$ Loan Agreement

AUC-BCI-4 Fixed and Floating Equitable Charge

AUS-BCI-5 Deed Variation

AUS-BCI-6 Letter from the Department of Industry, Science and Resources to ALH



**ANNEX 2-2**

**REBUTTAL SUBMISSION OF AUSTRALIA**

(15 November 1999)

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**EXECUTIVE SUMMARY**

1. This submission rebuts the USA's attempt to introduce a trade effect and trade outcome approach to assessment of conformity with Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM). Instead, the USA should be focussed on the matter before the Panel of whether Australia has brought the grant payments into conformity with SCM Article 3.1(a) in accordance with the Panel Report Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) ("the Report").

2. The finding by the Report on the grant payments was that these were tied to the sales performance targets under the Grant Contract over the period 1 April 1997 to 30 June 2000. This is the period during which the grant payments were expensed.

3. Australia demonstrates that the USA's argument, that subsidies are no longer expensed after the date of the adoption of panel reports and even accumulate interest ad infinitum, is inconsistent with WTO law and GATT 1947 and WTO practice in having Members bring themselves into conformity.

4. In withdrawing \$8.065m<sup>1</sup> on 14 September 1999 from Howe and Co., Australia has done more than is necessary to comply with the recommendations of the Report and meet its WTO obligations by bringing the grant payments into conformity with SCM Article 3.1(a).

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<sup>1</sup> Australian dollars are used throughout this submission.

## I. INTRODUCTION

5. In the absence of third party submissions, this rebuttal limits itself to a brief recapitulation of key issues and then goes on to comment on aspects of the USA's First Submission.

## II. KEY POINTS

6. The sales performance targets under the Grant Contract show that the grant payments were expensed during the period 1 April 1997 to 30 June 2000. The Panel Report Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) ("the Report") found that the grant payments were contingent upon export performance because of the sales performance targets. The grant payments were in any case provided to automotive leather as part of ongoing assistance arrangements for the period in which automotive leather was not eligible for assistance under the general textiles, clothing and footwear programmes. Automotive leather was excised from the current Import Credit Scheme (ICS) from 1 April 1997. The ICS was to terminate on 30 June 2000 and will be replaced by the new general textiles, clothing and footwear programme coming into force on 1 July 2000. This programme will include automotive leather.

7. In accordance with WTO rules, as well as practice under GATT 1947 and the WTO, a Member is only required to bring a measure into conformity on the date of implementation. The Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) is not a punitive mechanism and does not have retroactive effect. Any subsidy that is allocated over time, continues to be expensed over the allocation period until the Member brings the measure into conformity by withdrawing the amount of money still outstanding. Alternatively, the measure comes into conformity automatically at the end of the allocation period as a consequence of all of the monies having been expensed.

8. Australia has withdrawn more than was necessary for it to comply with the Report's recommendations and bring the grant payments into conformity with Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) by 14 September 1999.

- The grant payments were tied to sales performance targets during the period 1 April 1997 to 30 June 2000.
- The grant payments were expensed during the period 1 April 1997 to 30 June 2000.
- Only the money tied to exports of automotive leather had to be withdrawn.<sup>2</sup>
- \$8.065m<sup>3</sup> was withdrawn from Howe and Co. (Howe) on 14 September 1999.
- Australia's First Submission proved that this amount exceeded any reasonable calculation of money from the grant payments tied to actual or anticipated exports over the rest of the period 1 April 1997 to 30 June 2000.
- The grant payments to Howe are separate measures from the concessional loan provided to Australian Leather Holdings Ltd (ALH) in 1999 (1999 Loan).
- The matter before the Panel is whether the grant payments have been brought into conformity with SCM Article 3.1(a).

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<sup>2</sup> That is, money allocated to domestic sales of automotive leather and other sales did not have to be withdrawn, since that money was not tied to actual or anticipated exports of automotive leather.

<sup>3</sup> Australian dollars are used throughout this submission.

In the alternative.

- Nothing stops the Australian Government providing new, WTO consistent subsidies to Howe, ALH or any other company.
- If the panel decides to consider the 1999 Loan, then it needs to be examined as a separate measure and assessed on its own merits under SCM Article 3.1(a).
- While the 1999 Loan to ALH is a subsidy, it is consistent with SCM Article 3.1(a).

### III. USA'S FIRST SUBMISSION

9. Following are some comments on specific aspects of the USA's First Submission.

(a) Bringing into conformity

10. The USA at paragraph 15 in its First Submission said that:

"There is *no disagreement* between the parties that the provisions of Article 4.7 of the SCM Agreement and the recommendations in the Panel Report call for Australia *to withdraw only the prospective portion* of the illegal subsidy." [*Emphasis added.*]

and

'... Article 19 of the DSU provides that "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement." The use of the phrase "bring the measure into conformity" indicates that the recommendations contemplated by Article 19 of the DSU include only recommendations calling for prospective corrective action by Members, not retrospective action.'

11. Australia considers that the Deed of Release<sup>4</sup> was sufficient to bring Australia into conformity because it terminated any obligations under the Grant Contract. However, to finalize this dispute, Australia decided to withdraw more than would be required under any reasonable alternative interpretation, i.e. \$8.065m.

12. It appears to be common ground with the USA that:

- the issue is one of the Member bringing a measure into conformity with SCM Article 3.1(a); and
- where a subsidy has been expensed, it does not have to be withdrawn.

However, Australia considers that

- where an amount of the subsidy is expensed prior to the date that a Member brings the measure into conformity, then that amount does not have to be withdrawn; and
- only the amount considered to be tied to exports of automotive leather has to be withdrawn, not amounts tied to domestic sales of automotive leather or other sales.

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<sup>4</sup> AUS-Exhibit 1.

13. Where a subsidy is allocated over a period, then only that part of the subsidy allocated to the period beyond the date of implementation has to be withdrawn to bring the measure into conformity at the date of implementation. As time passes the amount to be withdrawn becomes smaller and goes to zero at the end of the period over which the subsidy is allocated. Of course, if a Member does not bring the measure into conformity by the date recommended by a panel under SCM Article 4.7, then the complainant may have compensation or retaliation rights until the measure comes into conformity. However, that cannot increase, or halt the reduction over time of, the amount of subsidy to be withdrawn to bring the measure into conformity. By analogy, if the measure was a tariff rather than a subsidy, the USA's approach would entail that not only would the tariff have to be brought into conformity, the monies collected to the date of implementation would have to be refunded to the importers of record with interest. The DSU is not supposed to be a punitive instrument but rather a mechanism: "... providing security and predictability to the multilateral trading system. ..."<sup>5</sup>

14. Australia disagrees with the approach taken by the USA in its First Submission that:

- the amount to be withdrawn is the amount outstanding at the time of the adoption of the Report (i.e. 16 June 1999);
- the amount to be withdrawn by the end of the 90 days (i.e. 14 September 1999) includes interest for the period between 16 June 1999 and the date of withdrawal; and
- the amount to be withdrawn keeps on increasing until the date on which some much larger number is withdrawn.

15. The USA has not made any argument for this beyond saying:

- "Although the Panel accorded Australia 90 days in which to comply, Australia was free to comply at any time within that period. Instead, Australia used the entire 90-day period, waiting until September 14 to put its remedy in place and then claiming that its withdrawal would be effective from that day forward."<sup>6</sup>

and

- "The United States submits that the 90-day compliance period did not provide Australia with an additional three months during which it could continue to provide the prohibited export subsidy with impunity."

and then goes on to make the assertion, not based on any WTO provision, that

- 'Such an interpretation would reward—and encourage—delay in carrying out the Panel's recommendations. Rather, the date from which the prospective element of the subsidy should be derived is the date of the Panel Report. This approach, which would not discourage early compliance, would give effect to the express intent of Article 4.7, which calls for panels to recommend that the Member concerned withdraw the prohibited subsidy "without delay."<sup>7</sup>

16. The provisions of the DSU, including SCM Article 4.7, do allow a Member time to bring a measure into conformity "with impunity". The purpose of the DSU is to have measures brought into conformity, not to punish the Member in some way. When a measure has been brought into conformity the object and purpose of the DSU has been served.

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<sup>5</sup> At DSU Article 3.2.

<sup>6</sup> At paragraph 45 of the USA's First Submission.

<sup>7</sup> At paragraph 46 of the USA's First Submission.

17. In paragraph 46 of its First Submission, the USA appears to be saying that there is a distinction between “without delay” in SCM Article 4.7 and the period recommended by the original Panel for Australia to bring the grant payments into conformity. This conflicts with the wording of SCM Article 4.7, which says:

“... withdraw the subsidy without delay. *In this regard*, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.”  
[*Emphasis added.*]

Thus under SCM Article 4.7, it is the task of a panel to recommend what time-period is meant by “without delay” in the case being considered. In this regard, paragraphs 10.6 and 10.7 of the Report say:

“... Moreover, we do not, as a factual matter, believe that a period of seven and one-half months can reasonably be described as corresponding to the requirement that the measure must be withdrawn "without delay". ... In light of the nature of the measures, we consider that a 90-day period would be appropriate for the withdrawal of the measures. We therefore recommend that the measures be withdrawn within 90 days.”

18. Thus the period provided for under SCM Article 4.7 allows the Member "with impunity" to withdraw the measures at any time between the date of adoption and the end of the period recommended by the panel. There is nothing wrong in a Member using the time that it has been given. Where a Member has an export subsidy programme, which pays exporters at the time of export, there is nothing to suggest that such a Member would have to clawback the money it provided between the date of adoption and the date the programme was terminated. There is no basis for treating an in fact export subsidy paid in advance in a punitive way.

19. If the outstanding part of a subsidy did not continue to be expensed over whatever period it is allocated, then the amount to be withdrawn would never decline. Indeed, if the USA's punitive approach on interest were to be adopted, it would increase. This would mean that at the end of the allocation period, even though there would no longer be any benefit to the company involved, the Member would still have to withdraw the original outstanding amount, together with interest, to bring the measure into conformity. Indeed on this line of argument, if a Member could not, for whatever reason, withdraw the money, then it could never bring the measure into conformity, and presumably would be subject to compensation or retaliation forever despite there being no continuing benefit to the company concerned. That approach would rightly hold the WTO up to ridicule.

20. Indeed, if Australia had not withdrawn \$8.065m. and if the \$30m. is allocated over the entire period of 1 April 1997 to 30 June 2000, the amount to be withdrawn by Australia to bring the grant payments into conformity would have declined over time until it became zero on 30 June 2000. By the time that this Panel's report is adopted on say 14 February 2000, the amount of the subsidy that would have been left<sup>8</sup> would have been about \$3.5m<sup>9</sup> under the preferred approach set out in Australia's First Submission<sup>10</sup> and \$4.2m<sup>11</sup> under the alternative approach.<sup>12</sup> Taking exports of automotive leather at no more than 90 per cent of sales<sup>13</sup>, this would have left \$3.1m. or \$3.8m., respectively, to be withdrawn at that date for Australia to bring the grant payments into conformity.

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<sup>8</sup> i.e. if the \$8.065m. had not been withdrawn on 14 September 1999.

<sup>9</sup> Preferred linear approach: 137 days would be left in 1999-2000 (July-June) and there are 1186 days in 1 April 1997 to 30 June 2000; and so the allocation would be  $30 \times [137/1186] = \$3.5m.$

<sup>10</sup> See paragraph 46 of Australia's First Submission.

<sup>11</sup> On the basis of the sales performance target for 1999-2000:  $30 \times [214/567.5] \times [137/366] = \$4.2m.$

<sup>12</sup> See paragraph 47 of Australia's First Submission.

<sup>13</sup> See paragraphs 48 and 49 of Australia's First Submission.

21. The USA's First Submission, is apparently seeking to invent a new legal concept for assessing conformity with SCM Article 3.1(a) based on trade effect and trade outcome.

22. For example, it says:

"This Panel's findings on these points are critical if its Panel Report is to have *any practical meaning*." [Emphasis added.]<sup>14</sup>

"... Australia is seeking the Panel's permission to declare its illegal subsidy largely *irremediable*. ... *This cannot be permitted*. ... " [Emphasis added.]<sup>15</sup>

"The prospective portion of the subsidy *must* be determined on a *reasonable economic basis*" [Emphasis added]<sup>16</sup>

Australia submits that the task of a panel under the WTO system is to:

"... 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 ... ." <sup>17</sup>

SCM Article 3.1(a) is not about adverse effect under SCM Article 5 or some other non-violation issue. The matter before this Panel is whether Australia has brought the measures in question into conformity with SCM Article 3.1(a), and, if not, why and how it has not implemented the findings and recommendations of the Report.

The concept of making a subsidy "irremediable" is a misunderstanding of the purpose of a dispute under SCM Article 3.1(a), which is a violation case and so is about conformity with a rule. The key issue to implementing a recommendation in respect of a subsidy inconsistent with SCM Article 3.1(a) is why it was found to be inconsistent. That provides the basis for how a Member can reconfigure assistance to be consistent with SCM Article 3.1(a).

(b) "Reimbursement"

23. Paragraph 13 of the USA's First Submission says:

"... this small amount was not a [*sic*] even a partial withdrawal of the subsidy, to the extent it was *reimbursed* by the Australian Government through a loan on non-commercial terms." [Emphasis added.]

24. The 1999 Loan is a separate measure from the grant payments. As determined by the Report, if it were considered necessary to look at the consistency of the 1999 Loan, that would need to be assessed separately from the matter before the Panel of whether the grant payments have been brought into conformity with SCM Article 3.1(a).

25. In paragraph 9 of its First Submission, the USA agrees with the Report that the grant payments were to Howe.<sup>18</sup> The 1999 Loan was to a different company, ALH, with a wider product

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<sup>14</sup> At paragraph 6 of the USA's First Submission.

<sup>15</sup> At paragraphs 17 and 18 of the USA's First Submission.

<sup>16</sup> The title of Subsection III.A.2 of the USA's First Submission, which is reflected in the subsequent paragraphs.

<sup>17</sup> At DSU Article 11.

range. Even if the 1999 Loan had been to Howe/ALH like the 1997 Loan, Australia considers that it would have brought the grant payments into conformity with SCM Article 3.1(a). Such a loan would have itself been consistent with SCM Article 3.1(a), given that the 1997 Loan is consistent. To bring the grant payments into conformity, Australia did not have to impose a punitive measure on an individual company, be it Howe or ALH. This matter is about Australia's rights and obligations as a Member.

26. Australia was found to be in breach of the WTO by the original Panel and accepted that ruling without appealing. It has now brought the grant payments into conformity within the time-period provided for by the Report. SCM Article 3.1(a) is not a trade effect or trade outcome test but a rule about whether money is tied to actual or anticipated exportation. The impact on Howe or ALH or any other Australian company is irrelevant: they are not Members, Australia is. That said, there is a significant impact on Howe and on ALH through repaying the \$8.065m. This is an asset loss on the balance sheet. The equity of Howe and ALH has been reduced by this amount. While a concessional loan (1999 Loan) was provided to ALH, this does not affect the capital structure. The 1999 Loan is a liability and will have to be paid back. Its benefits will only come over the life of the loan. There is a clear distinction between the impact on capital and liabilities from providing a grant and from providing a concessional loan.

27. Paragraph 12 of the USA's First Submission says that the 1999 Loan to ALH turns withdrawal into a "sham". ALH and its associated companies produce a wider range of products than automotive leather. ALH can do whatever it wants with the money under the 1999 Loan. It is under no obligation to put one cent of it towards the production or sale of automotive leather. The Report found that the grant payments were inconsistent with SCM Article 3.1(a) but that the 1997 Loan to Howe and ALH for purposes related to automotive leather was consistent. The Report (and the US<sup>19</sup>) also agreed that there was nothing wrong in a government replacing one subsidy with another that is consistent. What Australia has done is called, in WTO parlance, "bringing a measure into conformity", not a "sham".

28. Australia has a right to provide further subsidies to Howe and ALH provided that they are WTO consistent. The 1999 Loan to ALH is a separate measure from the grant payments and its consistency with SCM Article 3.1(a) would need to be assessed separately from the matter of whether Australia has brought the grant payments into conformity with SCM Article 3.1(a) by withdrawing sufficient money from Howe to comply with the Report's findings and recommendations

(c) Allocation period

29. The issue before the Panel is the actual period of allocation of the \$30m., which was the key factor for the finding in the Report that the grant payments were inconsistent with SCM Article 3.1(a). The issue of what an economist might say about "benefit – and the resulting distortion to trade"<sup>20</sup> is irrelevant to the matter before the Panel.

30. The USA says in paragraph 17 of its First Submission referring to the \$30m. that:

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<sup>18</sup> "On 9 March 1997, however, the Australian Government replaced these subsidy programmes with a A\$30 million grant, also contingent on export performance, [*Footnote 4 omitted.*] to Howe, the sole Australian automotive leather producer and exporter. ... "

<sup>19</sup> At Footnote 132 of the Report:

" ... the United States acknowledged that a prohibited export subsidy could be replaced by another form of assistance that is not tied to export performance and a Member could thus bring itself into conformity with the SCM Agreement. ... "

<sup>20</sup> At paragraph 16 of the USA's First Submission.

"... agreeing to remove the export subsidy from the automotive leather industry, and then simply swapping it for another equally illegal export subsidy. ... ."

This statement supports the fact that the \$30m. was to be expensed during the period 1 April 1997 to 30 June 2000. The agreement between Australia and the USA was in respect of the removal of automotive leather from the ICS from 1 April 1997.<sup>21</sup> The ICS only runs until 30 June 2000 because the legislation is sunsetted. Producers of automotive leather will be eligible to receive subsidies under the new general textiles, clothing and footwear programme from 1 July 2000. Thus the grant payments were simply allocated to fill in the gap from 1 April 1997 to 30 June 2000, and the Report found that this amount was tied to the sales performance targets for this period, which the Report found effectively created export targets for this period.

31. In paragraph 40 of its First Submission, the USA says:

"The grants amounted to an export subsidy because they were contingent on export performance."

32. In paragraph 41 of its First Submission, the USA says:

"... the time-period established in a grant contract for performance requirements is not a reasonable measure of how long the benefits conferred by the subsidy lasts or for calculating the "prospective" portion."

33. The USA is saying that the grant payments are on the one hand allocated to the period of the sales performance requirements for the purposes of being found to be inconsistent with SCM Article 3.1(a), but then somehow they were not expensed over that period.

34. In paragraph 41 of its First Submission, the USA also says:

"... there is no necessary relationship between the criteria for an export subsidy – such as export performance requirements – and the actual duration of the benefit. Inventing such a relationship makes export subsidies open to manipulation."

The USA is saying that a measure can be found to be an export subsidy on the basis of a tie to exports in a specific period (i.e. "the criteria") but that the period of allocation for bringing the measure into conformity can be something quite different. The USA gives no explanation for this except that it wants more of the subsidy withdrawn. It is difficult to understand the USA's reasoning behind this, but clearly the fact that a subsidy is found to be inconsistent because of performance requirements is hardly "[I]nventing such a relationship". Similarly, using the criteria set out by a panel as being critical to its finding of inconsistency with SCM Article 3.1(a) cannot be said to make "export subsidies open to manipulation." The relationship is the basis of the inconsistency and so is crucial to the matter of bringing a measure into conformity.

35. Regarding paragraph 42 of the USA's First Submission, the tie to the sales performance targets was the critical difference between the grant payments and the 1997 Loan. While the sales performance targets were not the only factor, they were the only factor that did not apply also to the 1997 Loan, which was found to be consistent with SCM Article 3.1(a). The second sentence in paragraph 42 of the USA's First Submission is misleading. It reads:

"The "other facts" included that the expanded production resulting from the grants and from the "required capital investments" would translate into increased exports."  
*[Footnote reference to paragraph 9.67 of the Report not included.]*

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<sup>21</sup> A small amount of assistance was also provided under the Passenger Motor Vehicle Export Facilitation Scheme (EFS), which terminates on 31 December 2000.



To the extent that this "other fact" was relevant, it was equally true for the 1997 Loan. The 1997 Loan required that the monies be used for purposes related to automotive leather. Also paragraph 7.244 of the Report says that:

'In its half yearly report, Schaffer ... stated that the loan was given "to assist with the capital programme." '

It is clear from paragraph 9.67 of the Report<sup>22</sup> that the key factor was the anticipated export performance during the period covered by the sales performance targets, i.e. 1 April 1997 to 30 June 2000.

36. Paragraphs 26 and 27 of the USA's First Submission put up a straw man for this dispute. The period involved for the expensing of the grant payments (1 April 1997 to 30 June 2000) is not "arbitrary". The sales performance targets in relation to this period were the key to the case. Clearly each situation would have to be addressed individually. If a Member nominated 6 months or a year or some obviously fictitious period, this would be taken into account by any panel in making its judgement. However, in this case the period is clear-cut and genuine, and was the basis for the findings in the Report. It is a nonsense that action by a Member to bring an inconsistent measure into conformity should be regarded as an action that "severely undercut" the rules. SCM Article 3.1(a) is not about removing adverse effect or about injuring the recipients of subsidies, but rather about the form of the subsidy involved and compliance with Members' obligations. Even the USA admitted this to the original Panel at Footnote 132 of the Report-<sup>23</sup>

(d) Allocable versus non-allocable

37. The USA uses the language of recurrent and non-recurrent subsidies to seek to justify its approach. The USA provides no justification for its assertion that practice on countervailing and work being done on SCM Article 6.1(a) under Footnote 62 to SCM Annex IV should be indicative of how a measure should be assessed for the consistency with SCM Article 3.1(a).

38. Even in its own countervailing duty regulations, the USA notes that: 'Section 351.524 retains the distinction between "recurring" and "non-recurring" benefits. Although more precise terms might be "non-allocable" and "allocable" ...'.<sup>24</sup>

39. The term "allocable" means "able to be allocated".<sup>25</sup> Clearly the grant payments are able to be allocated, since they are tied to the sales performance targets. The fact that the sales performance targets may not have been actually achieved does not affect this, given the finding of the Report at paragraph 9.68 that: "[t]hus, the fact that the anticipated exports may not have come to pass in the volumes anticipated does not affect our conclusion. "

40. The rationale for the concept of recurrent and non-recurrent is to deal with large one off subsidy payments for the purposes of serious prejudice and countervailing where there is no actual tie

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<sup>22</sup> For example:

" ... Therefore, we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the government of Australia was aware of this necessity, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe's anticipated export performance was one of the conditions for the grant of the subsidies. ... "

<sup>23</sup> See Footnote 19.

<sup>24</sup> Federal Register Vol. 63, No. 227 at page 65392, or at page 83 of G/ADP/N/1/USA/1/Suppl.4 - G/SCM/N/1/USA/1/Suppl.4.

<sup>25</sup> New Shorter English Oxford Dictionary - CD - January 1997.

to production or sales in a particular period. Thus the asset life approach to allocation is used as a default because there is no tie to another period.<sup>26</sup>

41. The situation is quite different for a case under SCM Article 3.1(a) where there must be a tie between the granting of the subsidy and the actual or anticipated exportation of the product concerned, if a breach is to exist. The task of the panel concerned is to determine whether such a tie exists. The basis for the panel's finding will determine the period over which the subsidy is allocated. In this case it is the period 1 April 1997 to 30 June 2000. Moreover, unless it is an explicit part of the factual record, it will not be possible to say what a company will be producing in the future or how much it exports, let alone that the money was tied by the granting government to such anticipated exports.

42. To make an assumption that money paid to Howe in return for sales performance during 1 April 1997 to 30 June 2000 should somehow be allocated as being an export subsidy on automotive leather for the next 10 years is fanciful. The money was paid for performance during 1 April 1997 to 30 June 2000, and so was allocated to that period and expensed during that period. This is also consistent with the approach in paragraphs 171 and 172 of the Appellate Body's Report on Canada Aircraft (WT/DS70/AB/R).

43. The 1997 Loan provided a concessional loan out to 2012 with no interest payable until 1 February 2003. The Report found that that was not inconsistent with SCM Article 3.1(a), even for the period to 30 June 2000, let alone out beyond that date. The only factor missing from the 1997 Loan that was present for the grant payments was the interim and aggregate sales performance targets over the period 1 April 1997 to 30 June 2000. Thus any part from the grant payments that was allocable to a period beyond 30 June 2000 could not be contingent upon export performance in terms of SCM Article 3.1(a). In particular, suppose that the grant payments were allocated across the 13 years proposed by the USA. The money allocated outside of the period 1 April 1997 to 30 June 2000 would not be contingent upon export performance in terms of SCM Article 3.1(a) and so would not be inconsistent with SCM Article 3.1(a). In that case, the amount required to be withdrawn on 14 September 1999 would have been only \$1.8m.<sup>27</sup>

44. The situation in the case of Howe and automotive leather is that:

- Howe benefited from the ICS (and in a minor way from EFS) for automotive leather until the removal of automotive leather from the schemes from 1 April 1997.
- The \$30m. Grant Contract covered the period through to the termination of the ICS on 30 June 2000.
- automotive leather will be eligible for subsidy payments under the new general programme for the textiles, clothing and footwear industry from 1 July 2000.

45. Presumably even the USA would agree that the assistance under the ICS was recurrent up to 1 April 1997. The tranches of the grant payments were payable: \$5m in March 1997; \$12.5m. on the basis of sales performance over the next quarter; and another \$12.5m. on the basis of performance over the subsequent 12 months. The Report found that these were also based on the aggregate sales performance target to 30 June 2000. After that date, there is a new general subsidy programme for the textiles, clothing and footwear industry. As was noted in paragraph 9.4 of the Report:

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<sup>26</sup> Of course allocation across asset life can also be subject to abuse by countervailing authorities for protectionist reasons.

<sup>27</sup> \$30m. x [290/366]/13 = \$1.8m (there being 290 days from 14 September 1999 to 30 June 2000).

"The grant contract provides for a series of three grant payments totalling up to a maximum of A\$30 million. The aggregate of payments under the grant contract was capped at A\$30 million to limit the overall level of *ad valorem* subsidization of sales over the period to mid-2000 to approximately 5 per cent "

The USA did not challenge this. Against any reasonable assessment assistance on automotive leather has been and is recurrent in the sense of "occurring frequently or periodically."<sup>28</sup> The grant payments are allocable in the sense of being able to be allocated to sales over specific time periods. Where grants are in fact linked to sales in a particular period, any reasonable authority would expense them over the relevant period. In this case, assistance was given to automotive leather over a lengthy period, albeit in different forms for the three periods in question.<sup>29</sup>

46. The Report found that the grant payments were made on anticipated sales, i.e. paid in advance, as well as on past sales, and so were tied to the aggregate sales performance target, as well as the interim sales performance targets. This did not affect the Report's conclusion that the grant payments were tied to those sales performance targets.

47. Suppose that the interim targets had been set on a quarterly basis with the grant payments also paid quarterly after the event. Presumably the original Panel would still have found that the payments were in breach of SCM Article 3.1(a). Australia could simply have made the last payment on 14 September 1999 and it would have been in conformity. The subsidy would have been withdrawn and none of the money paid prior to 14 September 1999 would have had to be withdrawn from the company. There is no basis in the SCM Agreement, or the DSU, or GATT 1947 and WTO practice, that more money should be withdrawn because a subsidy is paid in advance than if it is paid after the fact.

48. The USA talks about the allocation of benefits over 13 years. If a recipient is obliged as a condition of receiving the subsidy to expense it to achieve sales in a particular period, then the money and benefits are expensed on those sales. In such a case the subsidy is increasing the income stream of the company, but the subsidy cannot be spent twice. The overall income stream of the company may go to investment in the same product, or it may go to investment in another product, or it may go to dividends, or anywhere else. The point about SCM Article 3.1(a) is that the purpose for which the subsidy is given is not fungible. It has to be tied in law or in fact to the export performance of the product concerned. The Report found the sales performance targets to be the critical factor with the grant payments tied to the interim and aggregate sales performance targets. Australia has implemented in good faith on the basis of that finding.

49. In any case, the future income and profit streams from automotive leather after 30 June 2000 are unclear. Currently Howe produces automotive leather at its plant at Thomastown in Melbourne. The tannery at Rosedale in eastern Victoria does not produce any finished leather let alone automotive leather – it is a tannery. Thomastown could shut or change to producing leather coats, and Rosedale could still go on.

50. The Rosedale tannery can produce inputs for any leather products, e.g. for shoes, upholstery, automotive, garment and accessories purposes. This is a matter for good management, including quality control, and delivering what the market wants. Similarly, at the Thomastown plant, while it actually produces automotive leather at the moment, there is little of its machinery apart from some specialized cutting equipment that is specific to automotive leather. It could use the machinery to produce leather for anything from shoes to couches. Even the cutting equipment can be adjusted for products other than car seats. The value in respect of automotive leather is in the quality control and business relationships. When the fashions change for car seats, as they will, then companies such as

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<sup>28</sup> New Shorter English Oxford Dictionary - CD - January 1997.

<sup>29</sup> Prior to 1 April 1997; 1 April 1997 to 30 June 2000; and post 30 June 2000.

Howe will refocus on other lines as well. The USA is implicitly asserting that Rosedale will only produce for Thomastown; Thomastown will only produce automotive leather for the next 10 years; and all of that product will be exported. USA has not provided any argument for what is an unjustifiable claim.

51. Regarding paragraphs 33 and 34 of the USA's First Submission, the issue of an appropriate interest rate is irrelevant for this Panel. However, Australia notes for completeness that the USA has not provided any sensible data on what should be an appropriate interest rate as of 1999 or 2000. The USA has simply resubmitted an exhibit from the original Panel regarding ALH's 1997 financial statements. The USA has made no attempt to justify what an appropriate interest rate would be now, whatever the purpose might be. The data related to payments are also obviously inaccurate.<sup>30</sup>

(e) Countervailing duty methodology and practice

52. The treatment by the countervailing authorities in the USA or the EC has no probative value for the Panel. In any case, this Panel is about SCM Article 3.1(a) and not countervailing practice. The reference to Canada Aircraft (WT/DS70/AB/R) in Footnote 10 of the USA's First Submission was in respect of the existence of a subsidy and not the issue of conformity with SCM Article 3.1(a), which is being addressed by this Panel. The Appellate Body found that the guidelines under SCM Article 14 were relevant context for assessing whether a benefit arose for the purposes of SCM Article 1.1(b). The guidelines of SCM Article 14 do not address the issue of allocation across asset life. Australia disputes that the countervailing practice of the USA should be considered to be dispositive of an interpretation of aspects of SCM Part V, let alone SCM Article 3.1(a).

(f) SCM Annex IV

53. This is a different part of the SCM Agreement. The USA has laid no foundation for arguing that an approach taken to one type of grant under SCM Article 3.1(a) should be dealt with in the same way as a quite different type of grant under SCM Article 6.1(a).

54. The report of the Informal Experts Group has no formal status and has only been noted by the SCM Committee. It has not been adopted as an Understanding as provided for under SCM Footnote 62 for the purposes of SCM Article 6.1(a). In any case, the report by the Group<sup>31</sup> makes it completely clear that each situation will have to be dealt with on a case by case basis by the panel involved.

"Fourth, the Group *does not view the report as exhaustive of every potentially relevant issue* under Article 6.1(a) and Annex IV. Thus, the fact that the report may not refer to a given issue or given measure is *not meant to imply that such an issue is irrelevant in this context*, or that such a measure should not be included in any calculation under Article 6.1(a) and Annex IV.<sup>32</sup> [Emphasis added.]

"... the applicability and usefulness of any of the Group's recommendations to a particular situation should be *assessed on a case-by-case basis*.<sup>33</sup> [Emphasis added.]

"The illustrative table reflects the Group's conclusions regarding a number of points. First, the table indicates that certain types of subsidies (e.g., grants) may be *either expensed or allocated, depending on the circumstances*.<sup>34</sup> [Emphasis added.]

<sup>30</sup> For example, see paragraphs 2.2 and 2.3 of the Report.

<sup>31</sup> G/SCM/W/415/Rev.2 and Suppl.1.

<sup>32</sup> At second full paragraph on page 2 of G/SCM/W/415/Rev.2.

<sup>33</sup> At paragraph 5 of G/SCM/W/415/Rev.2/Suppl.1.

<sup>34</sup> At paragraph 5 of G/SCM/W/415/Rev.2.

"The table and cover note reflect certain additional recommendations, as well. The first of these is that research subsidies be presumptively allocated, unless expensing is demonstrated to be more appropriate in a given case. Similarly, it is recommended that non-recurring and/or large subsidies be presumptively allocated, *unless expensing is demonstrated to be more appropriate in a given case.*<sup>35</sup> [Emphasis added.]

"Similarly, non-recurring subsidies should be presumptively allocated, *except where it is demonstrated that this would be inappropriate.*<sup>36</sup> [Emphasis added.]

"The table includes a category for *export-related subsidies*, notwithstanding that the relevance of the question of expensing versus allocating in the context of such subsidies might be limited, at least with respect to those export-related subsidies that are export subsidies in the sense of the Agreement.<sup>37</sup> [Emphasis added.]

The only entries in the table for export-related subsidies are in the expensing column.

55. SCM Part III, SCM Annex IV, and the work of the Informal Group of Experts have no probative value for the interpretation of conformity with SCM Article 3.1(a). Moreover, these excerpts shown clearly that even under SCM Part III and SCM Annex IV, the tie of the grant payments to the period 1 April 1997 to 30 April 2000 would require that they be expensed during that period.

#### IV. CONCLUSION

56. Australia complied with the Report's recommendations and brought the grant payments into conformity with SCM Article 3.1(a) by withdrawing \$8.065m. from Howe on 14 September 1999.

- The grant payments were tied to sales performance targets, and expensed, during the period 1 April 1997 to 30 June 2000.
- \$8.065m. was withdrawn from Howe on 14 September 1999.
- Only the money tied to exports of automotive leather had to be withdrawn.
- \$8.065m. exceeded any reasonable calculation of money from the grant payments tied to actual or anticipated exports over the rest of the period 1 April 1997 to 30 June 2000.
- The concessional 1999 Loan to ALH has to be assessed as a separate measure from the grant payments and the matter whether sufficient money has been withdrawn from Howe - the 1999 Loan is consistent with SCM Article 3.1(a).

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<sup>35</sup> At paragraph 6 of G/SCM/W/415/Rev.2.

<sup>36</sup> At paragraph 2 of Recommendation 1 of G/SCM/W/415/Rev.2.

<sup>37</sup> At paragraph 7 of G/SCM/W/415/Rev.2.

## ANNEX 2-3

### ORAL STATEMENT OF AUSTRALIA

(23 November 1999)

#### I. INTRODUCTION

1. In this statement Australia first summarizes the key points proving that it has brought the grant payments into conformity with SCM Article 3.1(a) within the time-period recommended by the Report of the original Panel (WT/DS126/R), subsequently referred to as "the Report". It will then comment on several aspects of the USA's Second Submission.

2. When Australia received the Report, it examined it closely, and decided that its recommendations could be implemented in full by following its findings and reasoning, which cleared the 1997 Loan while finding that the grant payments were tied to actual or anticipated exports. Accordingly, Australia did not appeal the Report but accepted its adoption on 16 June 1999. By not appealing the Report, the USA also accepted that implementation should be based on the Report.

3. The USA's position from its First Submission is that the issue is one of bringing the grant payments into conformity. Australia agrees with that. This means that there is nothing special or punitive about implementing a recommendation in respect of prohibited subsidies. The obligation is simply to bring the measure into conformity.

#### II. MAIN POINTS

4. The issues for the Panel are:

- (1) How much money needed to be withdrawn by Australia in order to bring the measures into conformity?
- (2) Was sufficient money withdrawn?

II.1. How much money needed to be withdrawn by Australia in order to bring the measures into conformity?

5. Australia submits that given the reasoning and findings of the Report

- (a) the grant payments were tied to the period of the sales performance targets, i.e. 1 April 1997 to 30 June 2000,

and consequently the Panel should find that

- (b) the grant payments were allocated to the period of 1 April 1997 to 30 June 2000.

Australia submits that the Panel should also find that:

- (c) only the monies paid to Howe that were tied to exports of automotive leather were required to be withdrawn
- (d) Australia was not required to withdraw monies allocated to the period prior to the date of implementation in order to bring the grant payments into conformity.

II.1(a). The grant payments were tied to the period of the sales performance targets, i.e. 1 April 1997 to 30 June 2000.

6. The one factor in the Report that distinguished the grant payments from the 1997 Loan was the sales performance targets, aggregate and interim. All the other factors that surrounded the granting of the assistance package by the Australian Government applied equally to the granting of the 1997 Loan. Even on the issue of investment, the USA in paragraph 7.244 of the Report quoted from a half yearly report by Schaffer that: 'the loan was given "to assist with the capital programme."' ' If investment had been the key, or if the Government's knowledge of Howe's export propensity or expectation about future exports had been the key, then the 1997 Loan would have been inconsistent also, since that was for purposes of automotive leather.

7. Given the difference in findings on the grant payments and the 1997 Loan, the sales performance targets were the crucial factor that made the grant payments inconsistent with SCM Article 3.1(a). Accordingly, the grant payments were tied to the period of the sales performance targets, i.e. they were tied to the period from 1 April 1997 to 30 June 2000.

8. Clearly the Report considered that facts about Howe's operations and investment were not sufficient to create the tie to exports required to meet the "in fact" test under SCM Article 3.1(a) for the 1997 Loan. The sales performance targets were the necessary fact to create the tie for the grant payments because they effectively created export performance targets.

9. Accordingly, the grant payments were tied to the period of the sales performance targets, i.e. 1 April 1997 to 30 June 2000.

II.1(b) The grant payments were allocated to the period of 1 April 1997 to 30 June 2000

10. The consequence of the tie of the grant payments to the sales performance targets is that the grant payments have been allocated to the period in question, i.e. the period to 30 June 2000. There were no sales performance targets beyond that date. The grant payments were to be expensed during that period for the purpose of achieving the sales performance targets. Australia understood that the significance put on the aggregate sales performance target by the Report, in particular paragraph 9.67<sup>1</sup>, meant that the expensing should be made uniformly across the period, i.e. Australia's preferred option in paragraph 46 of its First Submission. Thus \$7.336m. of the grant payments was outstanding at 14 September 1999.

11. There is nothing in the history or detail of this case that could in any way suggest that the period of 1 April 1997 to 30 June 2000 was a contrived period for expensing the grant subsidies. The use of the grant payments to achieve export sales in this period was the key to the Report's finding of the tie under SCM Footnote 4. Moreover, there was nothing artificial about this period. It was simply the gap between the date of the removal of automotive leather from the current textiles, clothing and footwear programme to the entry into force of the new programme on 1 July 2000.

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<sup>1</sup> The Report says at paragraph 9.67:

"Therefore, we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the Government of Australia was aware of this necessity, and thus anticipated continued and possible increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe's anticipated export performance was one of the conditions for the grant of the subsidies. Australia argues that this consideration would lead to a result that would penalize small economies, where firms are often dependent on exports in order to achieve rational economic levels of production. Nevertheless, in the specific circumstances of this case, we find this consideration compelling evidence of the close tie between anticipated exportation and the grant of the subsidies."

12. It is not a question in this case of having to establish a future export stream as the basis on which to calculate the level of subsidy to be withdrawn. The grant payments were tied to specific sales performance targets over a specific period. Moreover, and most importantly, it was this tie that led to the finding that the grant payments were inconsistent with SCM Article 3.1(a).

II.1(c). Only the monies that were paid to Howe tied to exports of automotive leather were required to be withdrawn

13. The prohibition under SCM Article 3.1(a) is about monies paid on exports of the product, the good, that is the subject of the complaint. In this case, it is exports of automotive leather.

14. As far as SCM Article 3.1(a) is concerned, there is nothing stopping Australia paying money on domestic sales of automotive leather, or on sales of other goods. Of course, Australia is not saying that this can be used as a subterfuge to circumvent the in fact provision of SCM Article 3.1(a). However, that is clearly not the case here, and the USA has not made any suggestion that this should be regarded as being the case.

15. While the sales performance targets were crucial to the Report's finding of the tie to exports of the grant payments, the Report nevertheless recognized that these targets included sales other than exports of automotive leather. The Report did not say that Howe was expected to achieve \$567.5m. worth of export sales of automotive leather. It did conclude, however, that in the light of the level of Howe's domestic sales of automotive leather (as well as other sales) a large percentage of this target was exports of automotive leather. It was the tie to those exports that was found to be inconsistent with SCM Article 3.1(a).

16. Suppose that in 1997 the Australian Government had given Howe \$27m. on the basis of achieving specified export sales of automotive leather and \$3m. for achieving a specified volume of other sales, both to be achieved over 1 April 1997 to 30 June 2000. Then the \$27m. would have been unambiguously contingent in law upon export performance and so inconsistent with SCM Article 3.1(a). However, the \$3m. would have been consistent with SCM Article 3.1(a). There is no basis for having a harsher treatment of a subsidy found to be contingent in fact than one found to be contingent in law upon export performance.

17. Therefore, Australia was only obliged to withdraw monies found tied to exports of automotive leather to bring the grant payments into conformity with SCM Article 3.1(a).

II.1(d) Australia was not required to withdraw monies allocated to the period prior to the date of implementation in order to bring the grant payments into conformity

18. The issue here is whether, at the date on which a Member claims to have implemented a recommendation of the Dispute Settlement Body, there are any further outstanding monies that are inconsistent with SCM Article 3.1(a). Where the monies have been paid out, the amount outstanding will decline over time until the end of the allocation period. It does not make any sense to suggest that the act of the adoption of a panel report somehow freezes the expensing of a subsidy, and even increases the amount outstanding through interest, as suggested by the USA.

19. A Member is given a period by the panel under SCM Article 4.7 to bring the measure into conformity. If it does not, then the complainant may have compensation or retaliation rights. However, establishing this implementation period cannot affect the way in which the monies are being expensed and the continuing decline in the amount of outstanding monies throughout this period.



20. The USA's Second Submission seeks to argue this freezing of expensing would only apply to payments made in advance and not to subsidies under ongoing export subsidy programmes.<sup>2</sup> It is unclear why the USA considers that there should be a more punitive regime for advance payments and why there should be an obligation to take faster action against advance payments. The USA appears to have modified its position between its First and Second Submissions on this, following the raising by Australia of the implications of its position for the Foreign Sales Corporations dispute.

## II.2 Was sufficient money withdrawn?

21. The facts of the case are:

- Howe repaid \$8.065m. to the Australian Government on 14 September 1999
- the Report said that new subsidies could be given to a company in place of a prohibited subsidy
  - ◆ the USA agreed that this is true<sup>3</sup>
- the Report found that measures must be examined individually and separately to assess their compliance with SCM Article 3.1(a)
- the Report found that the 1997 Loan was consistent as part of a package of assistance provided to Howe and ALH
- since the 1997 Loan is consistent, given its terms, the 1999 Loan must also be consistent.
  - ◆ the USA has not sought to present any argument that the 1999 Loan is itself inconsistent with SCM Article 3.1(a).

22. Thus, Australia was entitled to provide a new WTO consistent subsidy to ALH in the process of bringing the grant payments into conformity with SCM Article 3.1(a). In addition the 1999 Loan is consistent with SCM Article 3.1(a). The fact that this is a dispute under DSU Article 21.5 does not affect Australia's right to provide WTO consistent subsidies to an Australian company.

23. Australia has withdrawn \$8.065m. from Howe. This withdrawal had the effect of a substantial reduction in Howe's net income for the period and a reduction in Howe's equity position.

## III. COMMENTS ON USA'S SECOND SUBMISSION

24. Australia will not go through the USA's Second Submission point by point, since it has dealt with all the important issues contained in it, and rebutted them already. However, it may be useful for the Panel if Australia comments on a few aspects of it.

25. The USA's approach is one based on trade outcome and effect. This includes its claim that the Panel should adopt an approach that is "economically reasonable". Essentially what the USA is seeking is a remedy that may have been "economically reasonable" if a finding had been made against Australia on the basis of export propensity alone or on the basis of a factor that meant the subsidy

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<sup>2</sup> See paragraph 16 of the US's Second Submission.

<sup>3</sup> The Report says at Footnote 132 that:

"In the course of the Panel proceedings, the United States acknowledged that a prohibited export subsidy could be replaced by another form of assistance that is not tied to export performance and a Member could thus bring itself into conformity with the SCM Agreement."

should be applied over the life of the company's assets. This was not the finding in this case. In this case, the remedy consistent with the Report's findings and "economic reasonableness" is to withdraw the amount tied to the prospective export sales targets.

26. The issue is what the rules are. This Panel has to consider what Australia's obligations were in bringing the grant payments into conformity, while acknowledging Australia's right to provide a new subsidy to an Australian company provided that the subsidy is consistent with SCM Article 3.1(a).

27. A recurrent theme of the USA in this dispute is that if it does not get its way, it would:

“... effectively render the obligations in Article 4.7 of the SCM Agreement meaningless. Australia's interpretation means that Members who provide significant illegal, prohibited export subsidy grants can easily relegate most or all of those grants to the past, declaring them outside the reach of the SCM Agreement remedies.”<sup>4</sup>

28. That is clearly a nonsense. The approach does have implications for the status of the period between adoption and implementation, where even the USA has agreed with Australia's position as far as an ongoing programme such as the Foreign Sales Corporations is concerned.<sup>5</sup>

29. There is no “Australia's interpretation” for the main aspects of implementation at issue here. It is the Report's approach that Australia has followed. Under that approach, even where money has been paid out in advance of performance, implementation would depend on the circumstances and on the reasons why a panel found against the measure. Implementation must necessarily be judged on a case by case basis.

30. For example, if a grant was found to be inconsistent with SCM Article 3.1(a) because it was tied to a specific long-term export contract of, say, 10 years duration, then the panel might find that the money was allocated over the 10 years. How much money would have to be withdrawn would depend on when the dispute was taken. Moreover, if the contract continued, then the recommendation of the panel may not be able to be implemented in a way analogous to this case, since new subsidies may be found to be still tied to the original contracts. If that tie was the basis of the finding of the panel, then some cosmetic cover, such as having the government's arrangement with the company nominally only tied to the first two years, would not get around the problem. The finding of the panel would set the framework for implementation. The responsibility of the panel is to determine what are the critical factor or factors, which create the tie to exports. Once that is determined, then the Member can implement the recommendation. If there were to be no relationship between the reasons for a panel's findings and the basis for implementation, then a Member would have no idea what its rights were or how it should implement to satisfy an Article 21.5 panel.

31. The Panel's task is to determine whether Australia has implemented the Report's recommendations in the light of the Report.

32. The key to bringing into conformity is to remove the tie “to actual or anticipated exportation or export earnings.” How a Member can do this will depend on the findings by a panel. But what is clear from the Report and supported by the Canada Aircraft Appellate Body Report (WT/DS70/AB/R), in particular at paragraphs 171 and 172, the tie has to be demonstrated and not some proxy for an export propensity test as pushed by the USA. This means that there has to be a demonstrable tie to actual or anticipated exports. This would not have to be a short-term tie – that would depend on the circumstances found by the panel. In this case the finding was based on the sales performance targets over the period 1 April 1997 to 30 June 2000. That was the concrete tie found by the Report.

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<sup>4</sup> At paragraph 2 of the US's Second Submission.

<sup>5</sup> At paragraph 28 of the US's Second Submission.

33. The Report did not find that the money was tied to some ongoing export propensity or to any ongoing expectation that there would be a continued high level of exports. It found that there was a concrete tie created by the Australian Government's conditions on Howe over the period 1 April 1997 to 30 June 2000. In the absence of those conditions, the Report must have cleared both the grant payments as well as the 1997 Loan. There was no difference between them as part of the package of assistance that went to fill the temporary gap between the removal of automotive leather from the Import Credit Scheme (ICS) and the new textiles, clothing and footwear programme coming into force from 1 July 2000. The USA continues to emphasize the fact that the grant payments were provided to Howe and not to other leather manufacturers. As has been explained before the original Panel, the reason for that is that there was only one manufacturer of automotive leather. All leather was eligible for assistance. However, between 1 April 1997 and 30 June 2000 automotive leather alone was not eligible under the ICS. If there had been other manufacturers of automotive leather, then they also would have received assistance outside the ICS. This reinforces the fact that the grant payments were allocated to the period 1 April 1997 to 30 June 2000.

34. Australia notes that the USA has not argued that the preferred option set out in paragraph 46 of Australia's First Submission is incorrect in the context of the period 1 April 1997 to 30 June 2000, i.e. that \$7.336m. was allocated to the Withdrawal Period of 15 September 1999 to 30 June 2000. Accordingly, Australia submits that the Panel should find that that approach is consistent with the Report, in which case the issue of withdrawing 90% rather than 100% becomes irrelevant, since \$8.065m. was withdrawn.

35. While the Panel will of course assess the factual nature of the USA's submissions, it may be useful to comment on a few points. For example, paragraph 32 of the USA's Second Submission implies that Australia has done something underhand. The Australian Government informed the USA's government in advance about the terms of the 1999 Loan, i.e. before 14 September 1999. The USA made no subsequent request for information prior to its demand on 18 October 1999, at the first organizational meeting of the Panel. Because this deals with only two companies, Howe and ALH, it was not appropriate to make all commercial details public. However, there has never been any suggestion that the 1999 Loan was not concessional. The documents available to the Panel (and the USA) make it clear that the repayment of the \$8.065m. was by Howe and the 1999 Loan is to ALH and is unencumbered by any reference to automotive leather. Australia would note that it does not consider that this separation was necessary to bring the measure into conformity, but it sought in all aspects to exceed what was required by the Report.

36. Australia also notes that at paragraph 32 of its Second Submission the USA states that: 'ALH acknowledged receiving "valuable consideration" in exchange for the repayment [Footnote 25: Exhibit AUS-1, para.2.]'. This statement is inaccurate and Australia does not understand the reason for this misrepresentation. It is clear from the Deed that "valuable consideration" this does not refer to the 1999 Loan but to the removal of any subsisting obligations on Howe and ALH, including reporting obligations, under the Grant Contract.

37. Paragraph 33 of the USA's Second Submission says that Australia transferred \$8.065m. back to ALH. Clearly this is inaccurate. The USA is entitled to make claims about the benefit of the 1999 Loan to ALH over the life of the loan when compared to the \$8.065m. repaid by Howe, provided that it does so primarily as BCI. In Australia's view that is irrelevant to the matter at hand. However, the USA's Second Submission presents an inaccurate picture, an impression which would be heightened by its redacted version. Apart from the fact that the repayment was by Howe and the 1999 Loan was to ALH, there is a major difference to companies between making a large repayment such as made by Howe and receiving a concessional loan such as that provided to ALH. The repayment affects the income as well as the equity position of Howe. A loan has a major impact on the balance sheet of ALH, in particular the increase in liabilities. While the concessional nature of the 1999 Loan will provide a stream of benefits to ALH through to 2012, this is over time with the

bulk of the benefits necessarily occurring some years out. A loan of this sort is not able to be traded and must be repaid at the end of the period. It also can be devoted to any of ALH's operations.

38. It is clear from paragraph 36 of the USA's Second Submission that the USA considers that the 1999 Loan itself is consistent with SCM Article 3.1(a). Accordingly, the Panel should reject the USA's argument in its paragraph 38. The Report determined that the 1997 Loan was consistent with SCM Article 3.1(a), where it was explicitly part of a package of assistance with the Grant Contract. As noted above the USA acknowledged to the original Panel that: "that a prohibited export subsidy could be replaced by another form of assistance that is not tied to export performance and a Member could thus bring itself into conformity with the SCM Agreement."<sup>6</sup> At paragraph 38 of its Second Submission, when the USA says that the 1999 Loan "steps into the shoes" of the amount withdrawn, it must mean that the withdrawn grant payments have been being replaced by another form of assistance, the 1999 Loan. However, the USA does not dispute that the 1999 Loan itself is consistent with SCM Article 3.1(a). Therefore, the USA has already acknowledged in the Report that Australia was entitled to reconfigure the assistance in this way to bring itself into conformity with SCM Article 3.1(a).

#### IV. CONCLUSION

39. Australia considers that it has implemented the Report's recommendations in good faith in light of the Report and has brought itself into conformity with SCM Article 3.1(a). Accordingly, it asks the panel to find that it has brought the grant payments into conformity with SCM Article 3.1(a) within the 90 day period recommended by the Report.

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<sup>6</sup> At Footnote 132 of the Report.

**ANNEX 2-4**

**FINAL ORAL STATEMENT OF AUSTRALIA**

(24 November 1999)

1. Australia and the USA agree that any part of the monies that are allocated to the period before the adoption of the Report are gone and are no longer a matter for the WTO. They do not have to be withdrawn.
2. Australia disagrees with the USA that any remaining money is frozen and indeed has interest added. This means that that money is not allocated after the date of the adoption of the Report. This is inconsistent with even the USA's basis for allocating subsidies over time. It is saying that there is money outstanding but that it is not allocated after the adoption of the Report. Apart from having no foundation in the WTO, this approach leads to inherent inconsistencies with a Member potentially remaining in breach with large outstanding amounts of money to be withdrawn indefinitely when even on the USA's approach the money in question would have been spent or the assets fully depreciated.
3. The USA is arguing that its approach to allocation is "economically reasonable", but by ceasing to allocate money after the date of adoption it throws any pretence of economic reasonableness out of the window. Under the USA's approach an even greater amount would have to be withdrawn in 2010 than on 17 June 1999 even though under its own countervailing methodology the calculated benefit would decline over time and then vanish at the end of the period. Apart from the fact that the USA has not attempted to give a legal justification of this, it has no pretence of being "economically reasonable".
4. SCM Article 3.2 makes it clear that the obligation is not to grant or maintain subsidies inconsistent with SCM Article 3.1(a). Where part or all of the monies have been spent, they are no longer being maintained. Indeed where the monies are allocated over a particular period, the level of outstanding monies continues to decline until they go to zero by the end of the period. Moreover, where an outstanding subsidy is not contingent upon export performance, then it does not fall under SCM Article 3.1(a) and so Australia would not be maintaining a subsidy in breach of SCM Article 3.2.
5. The Report found that the granting of the grant payments fell under SCM Article 3.1(a) because of the sales performance targets. Accordingly, the grant payments applied to the period of the sales performance targets, i.e. 1 April 1997 to 30 June 2000. This meant that they were used in seeking to meet those sales performance targets. Thus the money is allocated on that basis.
6. The USA's approach of having a division of the money at the date of the adoption of the Report on the basis of 13 years is just as much tying the expensing of the money to a particular period. Its period, however, is based on its own objectives of maximizing the protectionist effect of countervail, which have nothing to do with this case involving SCM Article 3.1(a). In this case, the basis for the allocation is set out in the Report, i.e. the sales performance targets over the period 1 April 1997 to 30 June 2000.
7. There has been no finding in the Report or any evidence before this Panel about what Howe will be doing beyond 30 June 2000 and over the longer term. There is no basis for assuming that existing assets will be used for maintaining exports of automotive leather or even for producing automotive leather. There is no claim, or any basis for a claim, that Howe will continue to concentrate on automotive leather at its Thomastown plant. Next year it could be producing some other form of upholstery leather or shoe leather. While the original Panel had evidence before it

relating to the period 1 April 1997 to 30 June 2000 it had nothing before it concerning the period after 30 June 2000 and neither has this Panel. The Report's finding on the grant payments was for the period 1 April 1997 to 30 June 2000. By contrast the Report cleared the 1997 Loan, which stretched to 2012.

8. The USA has not provided any argument based on SCM Article 3.1(a) how the Panel could find that part of the \$30m. is being spent in some sense over a 13-year period. It refers to the USA's and the EC's countervail practices. These are for quite different purposes and the USA has been unable to establish any legal link to SCM Article 3.1(a).

9. Domestic legislation in areas such as countervail and competition policy, e.g. EU State Aids practice, do not provide guidance in this case. In the case of State Aids the issue is the treatment of money that has been given illegally under EU law and the focus is subsidization distorting competition in the EU's own market. SCM Article 3.1(a) is about the form of the granting of the subsidy not about the level of money provided. Moreover, there is nothing illegal about the subsidies in this case. The Australian Government acted legally, as did Howe and ALH. A breach of the WTO does not make the granting of a subsidy illegal under Australian law. This is a matter of Australia's international obligations.

10. Arguing in the alternative about the allocation period, if the Panel found that the grant payments should be allocated over a period beyond 30 June 2000, then the Panel should take into account that there has been no finding of contingency upon export performance beyond 30 June 2000. If money is allocated and so considered to be expensed after that date, then that money could not be found to be tied to export performance. In this circumstance the Panel should find that the only money that had to be withdrawn was the money allocated to 15 September 1999 to 30 June 2000. As shown in Australia's two submissions this amounts to less than \$2m. Therefore, Australia would have withdrawn far more than was required and so would have fully complied with the recommendations of the Report.

11. In withdrawing \$8.065m., Australia has withdrawn the amount of monies outstanding at 14 September 1999. Indeed in Australia's view more than sufficient to cover that. That was the subsidy that was being maintained at that time.

12. Moreover, the Deed of Release terminated all remaining obligations under the Grant Contract and hence in respect of the grant payments.

13. Therefore, Australia has withdrawn the measures and brought the m into conformity with SCM Article 3.

14. The USA has not disputed that the 1999 Loan itself does not fall under SCM Article 3.1(a). It could hardly do so given that the Report cleared the 1997 Loan. However, the USA's argument is in essence that a Member when implementing the recommendation of the DSB has less rights than other Members. This is also translated by the USA to mean that such a Member is subject to different interpretations of WTO rules under an Article 21.5 Panel. The USA has not put forward any basis for this extraordinary approach to international law, except the attainment of its own narrow trade objectives. Adoption of such an approach by panels would have severe adverse consequences for the WTO system.

15. The Report found at paragraph 9.64 that Members can replace inconsistent subsidies with consistent ones and thereby bring themselves into conformity. The USA also acknowledged that at Footnote 132 of the Report. The Report found that the Grant Contract and payments under it had to be examined separately from the 1997 Loan even though they were part of the one package of assistance. Australia is entitled to be able to rely on the Report when implementing its

recommendations. Australia was entitled to provide the 1999 Loan, which is in conformity with SCM Article 3.1(a).

16. While not claiming that the 1999 Loan is inconsistent in itself, the USA has claimed that the 1999 Loan is inconsistent because it is linked to the repayment of an export subsidy, the \$8.065m. The USA agreed in the Report that an inconsistent measure could be reconfigured but somehow now if there is a contingency with the repayment of export subsidy money a measure becomes an export subsidy itself. No reasoning is given for this.

17. A measure is an export subsidy if it is contingent upon export performance, not if it is contingent upon the repayment of money whether or not that money is linked in some way to money provided as an export subsidy in the past. The USA has not claimed that the 1999 Loan is contingent upon export performance. It could not have done so because clearly the 1999 Loan is not contingent upon export performance. Moreover, even putting to one side the issue of the allocation of the grant payments, the USA does not dispute that the Report only found that the grant payments were contingent upon export performance over 1 April 1997 to 30 June 2000. The Report did not find any link to export performance after 30 June 2000. Moreover, the stream of benefits from the 1999 Loan only comes over time to 2012, since they derive from the concessional interest rate. The USA has not sought to argue any contingency upon export performance of automotive leather in respect of the 1999 Loan. There is no such contingency. Indeed ALH can use the 1999 Loan for any purpose with no link to automotive leather. Accordingly, the Panel should find that the 1999 Loan does not fall under SCM Article 3.1(a).

## CONCLUSION

18. There seems to be agreement between Australia and the USA that the grant payments were found to be export subsidies because of the sales performance targets in the Grant Contract created the necessary tie required by SCM Footnote 4. At the very least there does not seem to be a disagreement between Australia and the USA that the existence of this tie was required for the finding in the Report that the subsidies fell under SCM Article 3.1(a) and so were prohibited.

19. Having acknowledged this tie, the USA then says that this tie bears no connection or relationship to remedying the breach of the rules that has been found. The USA says that it is the subsidy allocated to production that flows from the investment base of the company over the life of the productive assets that has to be withdrawn. It does this without any basis of what those assets might be used for in the future, and even whether automotive leather would be produced by those assets. The USA cites no evidence from the Report to support its argument, and not surprisingly is mute on the 1997 Loan. The flaw in the USA's argument is that if the USA was correct that this was the remedy required, the Report would have had to have given some clue that the subsidy should be seen in this way. It gave none. If the subsidies had been tied to productive assets over their life rather than to the sales performance targets, then there would not have been a sufficiently close tie between the granting of the subsidy and anticipated exportation or export earnings for the subsidy to fall under SCM Article 3.1(a).

20. This is not an assumption or a hypothesis on Australia's part. This is the plain reading of the findings and reasoning of the Report. The Report looked at precisely the sort of measure that the USA is addressing, i.e. it looked at the 1997 Loan, and found that the granting of the subsidies in these circumstances did not "suggests a specific link to actual or anticipated exportation or export earnings".<sup>1</sup> They did not fall under SCM Article 3.1(a) and did not have to be "withdrawn".

21. The only justification that the USA provides for allocating the grant payments over the life of Howe's assets is that the period for which these subsidies were specifically provided is a contrivance.

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<sup>1</sup> At paragraph 9.75 of the Report.

There is no evidence in the history of this case to even hint at such a contrivance. The Report does not have any such finding. No evidence has been put to this Panel by the USA that it was a contrivance. It is absolutely clear from everything that this Panel and the original Panel have seen or heard that the assistance package was to “tide Howe over after it had lost eligibility for benefits related to automotive leather under these programmes.”<sup>2</sup>

22. The report found that the grant payments were provided to Howe to assist the company to achieve the sales performance targets for the period 1 April 1997 to 30 June 2000. The Report found that these sales performance targets were effectively export performance targets. The Report found that the granting of these subsidies were “tied to” these targets and so were export subsidies. There have been many definitions of “tied to” suggested in this case, but the one accepted by the original Panel in the Report that was sufficient to demonstrate that there was, and had to be, a “close connection between the grant or maintenance of a subsidy and export performance.”<sup>3</sup> The Report found the close connection in the grant payments because of the sales performance targets. The Report found that there was not a “close connection” for the 1997 Loan subsidy although the loan was for automotive leather purposes and was used to “assist with the capital programme.”

23. Australia has implemented the Report’s recommendations adopted by the DSB in good faith in light of the Report. Australia was entitled to rely on the Report for determining how it could implement its recommendations.

24. Therefore, Australia asks the Panel to reject the claims by the USA and to find that Australia has withdrawn the subsidies and brought the measures into conformity with SCM Article 3.

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<sup>2</sup> At paragraph 9.65 of the Report.

<sup>3</sup> At paragraph 9.55 of the Report.



**ANNEX 2-5**

**AUSTRALIA'S ANSWERS TO WRITTEN QUESTIONS OF THE PANEL  
AND THE UNITED STATES**

(1 December 1999)

**ANSWERS TO QUESTIONS FROM THE PANEL TO AUSTRALIA**

1. (a) *Australia says, at para. 32 of its first submission, that "the subsidies contingent on export performance are presumed to be expensed on actual exports, paid either in advance or in arrears". How would Australia approach the question of remedy where the contingency was expressed simply as "something must be exported". That is, a grant would be provided on the assumption that the recipient would export, with no performance targets or time-period specified. In Australia's view, would this mean that no action would be needed either to "withdraw the subsidy" or, in Australia's terminology, to "bring the subsidy into conformity"? If so, on what basis?*

Answer 1(a):

If a grant were to be provided simply on the "assumption that the recipient would export", then this would not fall under SCM Article 3.1(a). That would amount to a very weak export propensity test. For example, if a firm exported even a minor proportion of its production, say 10%, there could be an assumption that there would be some exports in the future, but the subsidy would hardly fall under SCM Article 3.1(a).

It is difficult to imagine a government imposing a condition as simple as that "something must be exported". Presumably, that could be satisfied by exporting one widget out of a production of one million widgets. If there was an explicit condition to export at least one widget and if that were to be removed before the one widget was exported, then the measure would be in conformity. Similarly, if the one widget had been exported already, then that condition would no longer apply and the measure would be in conformity. Of course in a real situation, a panel might find that the measure was in breach of SCM Article 3.1(a) as the result of factors other than "something must be exported". In that case, further action might need to be taken to withdraw the measure and bring it into conformity.

(b) *How would Australia approach the question of remedy where the contingency was exclusively, although in a general way, based on past exports? For example, the contingency might be expressed in very general terms, such as "past export success" or "last year's good export performance". In such cases, would Australia argue that nothing would need to be done to "withdraw the subsidy" or "bring the subsidy into conformity"? If so, on what basis?*

Answer 1(b):

Again, this would depend on the actual circumstances. For example, if this was no more than a random reward where there was no expectation by the recipient of receiving money, then it is highly questionable whether the money should be considered to fall under SCM Article 3.1(a) at all. However, it is unlikely that a government would provide money on such a simple basis and so the actual circumstances would have to be looked at. In any case, if the payment was simply based on past exports, then it would have gone and so there would be no subsidy to withdraw.

If this was part of a programme so that a company knew in advance, or had a reasonable expectation, that there would be a reward for export performance, then the action required would be to terminate the programme providing subsidies in this way.

There is nothing unusual or untoward in GATT and now WTO practice in not having some form of retroactive punishment for breaching a rule. The WTO is an agreement between sovereign states and there is a presumption that Members will try to follow the rules. There is no provision for dealing with one-off cases of past breaches.

(c) *Is Australia effectively arguing that only export subsidies that are expressly conditioned on specific, explicit performance targets covering future periods would require any action to be taken by the subsidizing government in order to be “withdrawn” or “brought into conformity”? If so, on what basis?*

Answer 1(c):

No. The quote in the chapeau to this question was simply stating that for a finding of inconsistency with SCM Article 3.1(a) a panel must find a tie to actual or anticipated exports and so the money is tied to those exports. This is consistent with the Panel's questions on export subsidies being presumed to cause adverse trade effects - the reason for that is the presumption that the money is tied to exports, which are what cause the adverse effects. The quote did not prejudge what would happen in any particular case. However, in this case the grant payments were found to be tied to the sales performance targets over 1 April 1997 to 30 June 2000, which in turn effectively created export performance targets.

(d) *Would not the implication of such an approach be that a subsidizing government could provide (even de jure) export subsidies with complete impunity simply by omitting any specific performance requirements as to export levels and time periods in the expression of the export contingency? If not, why not?*

Answer 1(d):

Not applicable.

(e) *Would not such an approach be equivalent to saying that the only thing really prohibited under Article 3.1(a) is specific export performance requirements (that is, that an export subsidy is completely “safe” so long as it is not associated with any explicit export performance requirements)? If not, why not? If so, on what basis can such an approach be justified?*

Answer 1(e):

Not applicable.

2. *Australia argues that trade effects are irrelevant in the context of export subsidies, where, according to Australia, the question is not one of trade effects, but rather one of conformity with a rule. What, in Australia's view, is the purpose or rationale underlying the prohibition on export subsidies? Would Australia disagree that the reason that export subsidies are prohibited is because they are irrebutably presumed to cause adverse trade effects? Please explain the basis for any disagreement. In Australia's view, if such a presumption exists, is it relevant to this dispute? Why or why not?*

Answer 2:

The rules in the WTO on export subsidies are there primarily because of their potentially damaging trade effects. However, there is a distinction between the reason for having a rule and the basis for determining conformity with it. For example, tariffs are considered to cause adverse trade effects and hence the provision for bindings under GATT Article II. However, in order to demonstrate a violation of GATT Article II, the complainant does not have to demonstrate adverse trade effect. It would only have to do that in a non-violation case.

Similarly, the complainant does not have to demonstrate adverse trade effect, for a subsidy to be found to fall under SCM Article 3.1(a). On the other hand, the fact that a subsidy causes adverse trade effect would not prove that it fell under SCM Article 3.1(a).

SCM Parts III and V, together with GATT 1994 Article II, are about adverse trade effect and injury complaints regarding subsidies.

Such a presumption (about causing adverse trade effects) is not relevant to the matter before the Panel, which is about conformity with SCM Article 3 not about trade effects. Australia is not arguing conformity on the basis that trade effects have not been proved. Australia's point is that the USA is arguing that it wants a particular trade outcome and argues that the Panel should reach a decision not based on the rules but on the USA's desire for a particular trade effect from this case. Australia's obligation was limited to implementing the Report's recommendation adopted by the DSB.

The USA is arguing that because the granting of the grant payments was found to be inconsistent with SCM Article 3.1(a), it is entitled to a remedy based on its own protectionist approach to subsidies under its countervailing regime. This approach is based on a concept of "benefit" aimed at extending the scope of any countervailing duty action. It argued in its First Submission that the remedy should have nothing to do with the basis why the subsidy was found to be inconsistent by the Report.<sup>1</sup> Australia's argument is that the "export-contingent feature", to use the USA's words, is the only tool to use to measure how the subsidy should be allocated. The USA is arguing about its concept of "benefit", which it pursues from its view of trade effect, while Australia argues that this case is about rules. Even in the alternative, Australia considers that the grant payments are clearly allocable against the sales during 1 April 1997 to 30 June 2000.

3. *Is not Australia itself introducing a "trade effects" and "trade outcome" test (which is one of its criticisms of the US approach to determining the amount of the subsidy to be withdrawn), when Australia argues that export performance targets are the sole determinant of the allocation period that it proposes and of whether and how much money needs to be "withdrawn"? Please explain.*

Answer 3:

Australia's approach is a rules test, not a trade effect test. The issue is why the Report found the grant payments to fall under SCM Article 3.1(a). This was because the grant payments were tied to the sales performance targets in 1 April 1997 to 30 June 2000, which in turn effectively created export performance targets in the period 1 April 1997 to 30 June 2000. This was the key finding of the Report. Australia is arguing that the basis for the inconsistency must be the basis for the way in which Australia can bring the measure into conformity.

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<sup>1</sup> Paragraph 40 of the USA's First Submission says:

"The grants amounted to an export subsidy because they were contingent on export performance. The export-contingent feature of the subsidy, however, is not a useful tool for measuring how the subsidy should be allocated."

4. *Australia, although arguing that Howe's interest rate is irrelevant to this dispute, criticizes the US's estimate of that rate, derived from 1997 financial statements of Howe Leather (Australia's second submission at para. 51). What in Australia's view would be the commercial interest rate and loan terms that Howe would have been able to obtain on the market for long-term borrowing during each of the past three years? Please provide a full explanation and supporting documentation.*

Answer 4:

The USA had simply taken the amount of interest and costs of other finance paid for ALH for the year 1996-97 and divided it by the borrowings shown under Current Liabilities in the balance sheet at the 30 June 1997.

The reality is that this is not comparing like with like. It compares total interest paid over 12 months with the borrowings on outstanding Current Liabilities on 30 June. No consideration is taken of the fluctuations in borrowings and interest costs under both Current and Non-Current Liabilities during the course of the fiscal year or the significant reduction in commercial borrowed funds during that same year.

The published accounts for ALH for the year 1997-98 and for subsequent years require full details of all loans and the averaged interest rate for those classes of loans for that year. For example, the published figures show that for the year ending 30 June 1997 ALH had an average interest rate for bills of exchange of 7.5 per cent and an overdraft rate of 9.25per cent See Tables 1 and 2 below.

TABLE 1

## 28(b) Interest rate risk

The economic entity's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognized and unrecognized at the balance date, are as follows:

| Financial instruments                  | Floating interest rate |                | Fixed interest rate maturing in: |                |                   |                |                   |                | Non-interest bearing |                | Total carrying amount as per the balance sheet |                | Weighted average effective interest rate |                |
|--|------------------------|----------------|----------------------------------|----------------|-------------------|----------------|-------------------|----------------|----------------------|----------------|--|----------------|--|----------------|
|  |                        |                | 1 year or less                   |                | Over 1 to 5 years |                | More than 5 years |                |                      |                |  |                |  |                |
|  | 1998<br>\$'000         | 1997<br>\$'000 | 1998<br>\$'000                   | 1997<br>\$'000 | 1998<br>\$'000    | 1997<br>\$'000 | 1998<br>\$'000    | 1997<br>\$'000 | 1998<br>\$'000       | 1997<br>\$'000 | 1998<br>\$'000                                 | 1997<br>\$'000 | 1998<br>\$'000                           | 1997<br>\$'000 |
| <i>(i) Financial assets</i>            |                        |                |                                  |                |                   |                |                   |                |                      |                |  |                |  |                |
| Cash                                   |                        |                |                                  |                |                   |                |                   |                | 519                  | 1,408          | 519  | 1,408          | N/A                                      | N/A            |
| Receivables – trade                    |                        |                |                                  |                |                   |                |                   |                | 21,909               | 17,463         | 21,909   | 17,463         | N/A                                      | N/A            |
| Receivables – related parties/entities |                        |                |                                  |                |                   |                |                   |                | 305                  | 2,179          | 305  | 2,179          | N/A                                      | N/A            |
| Receivable on sale of property         |                        |                |                                  |                |                   |                |                   |                | 1,250                | -              | 1,250  | -              |  |                |
| Total financial assets                 |                        |                |                                  |                |                   |                |                   |                | 23,983               | 21,050         | 23,983   | 21,050         |  |                |
| <i>(ii) Financial liabilities</i>      |                        |                |                                  |                |                   |                |                   |                |                      |                |  |                |  |                |
| Bank overdrafts                        | 6,657                  | 4,042          |                                  |                |                   |                |                   |                |                      |                | 6,657  | 4,042          | 8.25%                                    | 9.25%          |
| Bills of exchange and promissory notes |                        |                | 28,000                           | 14,000         | -                 | 10,000         |                   |                |                      |                | 28,000   | 24,000         | 6.8%                                     | 7.5%           |
| Trade creditors and accounts           |                        |                |                                  |                |                   |                |                   |                | 13,760               | 10,765         | 13,760   | 10,765         | N/A                                      | N/A            |
| Other loans                            |                        |                |                                  |                |                   |                | 25,000            | 25,000         |                      |                | 25,000   | 25,000         | Nil                                      | Nil            |
| Total financial liabilities            | 6,657                  | 4,042          | 28,000                           | 14,000         | -                 | 10,000         | 25,000            | 25,000         | 13,760               | 10,765         | 73,417   | 63,807         |  |                |

TABLE 2

## 28(b) Interest rate risk

The consolidated entity's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognized and unrecognized at the balance date, are as follows:

| Financial instruments                  | Floating interest rate |        | Fixed interest rate maturing in: |        |                   |        |                   |        | Non-interest bearing |        | Total carrying amount<br>as per the balance<br>sheet |        | Weighted average<br>effective interest rate |        |
|--|------------------------|--------|----------------------------------|--------|-------------------|--------|-------------------|--------|----------------------|--------|--|--------|---|--------|
|  |                        |        | 1 year or less                   |        | Over 1 to 5 years |        | More than 5 years |        |                      |        |  |        |   |        |
|  | 1999                   | 1998   | 1999                             | 1998   | 1999              | 1998   | 1999              | 1998   | 1999                 | 1998   | 1999   | 1998   | 1999  | 1998   |
|  | \$'000                 | \$'000 | \$'000                           | \$'000 | \$'000            | \$'000 | \$'000            | \$'000 | \$'000               | \$'000 | \$'000   | \$'000 | \$'000                                      | \$'000 |
| <i>(i) Financial assets</i>            |                        |        |                                  |        |                   |        |                   |        |                      |        |  |        |   |        |
| Cash                                   |                        |        |                                  |        |                   |        |                   |        | 67                   | 519    | 67   | 519    | N/A   | N/A    |
| Receivables – trade                    |                        |        |                                  |        |                   |        |                   |        | 27,633               | 21,909 | 27,633   | 21,909 | N/A   | N/A    |
| Receivables – related parties/entities |                        |        |                                  |        |                   |        |                   |        | -                    | 305    | -  | 305    | N/A   | N/A    |
| Receivable on sale of property         |                        |        |                                  |        |                   |        |                   |        | 1,250                | 1,250  | 1,250  | 1,250  | N/A   | N/A    |
| Other receivables                      |                        |        |                                  |        |                   |        |                   |        | 2,409                | 13,924 | 2,409  | 13,924 | N/A   | N/A    |
| Total financial assets                 |                        |        |                                  |        |                   |        |                   |        | 31,359               | 37,907 | 31,359   | 37,907 |   |        |
| <i>(ii) Financial liabilities</i>      |                        |        |                                  |        |                   |        |                   |        |                      |        |  |        |   |        |
| Bank overdrafts                        | 322                    | 6,657  |                                  |        |                   |        |                   |        |                      |        | 322  | 6,657  | 10.25%                                      | 8.25%  |
| Bills of exchange and promissory notes |                        |        | 20,000                           | 28,000 | -                 | -      |                   |        |                      |        | 20,000   | 28,000 | 8.25%                                       | 6.8%   |
| Trade creditors and accruals           |                        |        |                                  |        |                   |        |                   |        | 25,056               | 13,760 | 25,056   | 13,760 | N/A   | N/A    |
| Other loans                            |                        |        |                                  |        |                   |        | 25,000            | 25,000 | 25,000               | 25,000 | 25,000   | 25,000 | Nil   | Nil    |
| Total financial liabilities            | 322                    | 6,657  | 20,000                           | 28,000 | -                 | -      | 25,000            | 25,000 | 50,056               | 38,760 | 70,378   | 73,417 |   |        |

5. *How does Australia respond to the US argument that the repayment by Howe of part of the grant would not have occurred absent the 1999 loan, and that therefore provision of the loan made the withdrawal of the part of the grant a “sham”? In light of this argument, how in Australia’s view are these transactions separate, and not so inextricably linked as to be inseparable in practical terms? That is, why can the “replacement measure” not be seen as part of the original measure, at least for purposes of the 21.5 proceeding? Is there any distinction to be drawn between an original dispute, where certain actions must be judged on their own merits as “separate measures”, and an implementation dispute under 21.5 where all steps related to implementation must be examined for compliance with the DSB’s recommendations? Please explain.*

Answer 5:

Australia is entitled to provide a new WTO consistent subsidy to ALH. The 1999 Loan was to ALH, while the \$8.065m. was repaid by Howe.

Even if the Panel considered that there was no distinction between ALH and Howe, Australia is entitled to reconfigure a prohibited measure. The Report agrees with that at paragraph 9.64 and the USA acknowledged it at Footnote 132 of the Report.

The matter before the Panel is whether Australia has brought itself into conformity with SCM Article 3.1(a). Australia considered that the 1999 Loan was not before the Panel but did not ask for any preliminary rulings on this and has provided the relevant documentation to the Panel. Clearly if the Panel considers that the 1999 Loan is before it, then it will need to assess it. However, Australia argues that the Panel should find that it is in conformity with SCM Article 3.1(a).

The Report considered the grant payments and the 1997 Loan separately even though they were a package of assistance. The Report found that the WTO status of the previous assistance measures was irrelevant to its assessment of the consistency of the grant payments and the 1997 Loan.

Any reconfiguration of an assistance measure that is WTO consistent is in a sense linked to the original measure. However, the assessment of conformity must be on the basis of what the current measures are. The 1999 Loan to ALH is a distinct, separate measure without any conditionality, in particular without any conditionality in respect of automotive leather. Given that the 1997 Loan was found to be consistent, no basis has been put forward by the USA why the 1999 Loan should fall under SCM Article 3.1(a).

An Article 21.5 proceeding is about whether the Member has brought a measure into conformity, in this case with SCM Article 3.1(a). The fact that a measure has been found to be inconsistent with SCM Article 3.1(a) does not reduce the Member’s rights to provide WTO consistent subsidies to a company.

Australia considers that an Article 21.5 proceeding is about whether the inconsistent measure has been brought into conformity, and not that “all steps related to implementation must be examined for compliance”.

The matters before the Panel are whether in the light of the Report Australia withdrew sufficient money from Howe and, if the Panel considers that the 1999 Loan is before it, whether in the light of the Report the 1999 Loan is WTO consistent. If the answer to both of those questions is yes, then the Panel should find that Australia has withdrawn the measures as required and so has brought the measure into conformity. Anything else would lead to the paradoxical finding that even though Australia had no measures in place that were inconsistent with the WTO, somehow Australia was nonetheless in breach of the WTO.

Regarding the issue of separate measures, Australia considers that no distinction should be drawn between an original dispute and an implementation dispute under Article 21.5 regarding the assessment of measures on their own merits.

The USA has not sought to provide any argument justifying its extraordinary new concept that a Member's rights are reduced when it is bringing itself into conformity after a dispute and that it should be subject to different rules before an Article 21.5 panel.

6. *Does Australia agree that the logic of the remedies under SCM Agreement is that prohibited subsidies are subject to the most severe remedies, actionable subsidies the next most severe, and non-actionable the least severe? If not, why not and on what legal basis?*

Answer 6:

This depends on what is meant by "severe remedies". Australia agrees that SCM Article 9 on non-actionable subsidies would be ineffective, since it relies on a consensus in the SCM Committee for action.

The time periods under SCM Article 4 are shorter than under SCM Article 7, and so to that extent the remedy is more severe.

Moreover, SCM Part II is about rules rather than trade effect which must be proven under SCM Part III (or at least is subject to rebuttal under SCM Article 6.3 in the event that there is a presumption of serious prejudice under SCM Article 6.1.)

How a Member would comply with recommendations under SCM Articles 4.7 and 7.8 would depend on the circumstances of the case.

For the purpose of this Panel, it is not a question of what is most severe. SCM Articles 4 and 7 deal with different situations. SCM Article 4 deals with the rules set out in SCM Article 3, while SCM Article 7 deals with adverse effect. Subsidies falling under SCM Article 3 are also subject to SCM Article 7. Moreover, any reconfiguration of subsidies inconsistent with SCM Article 3 could also be subject to a complaint under SCM Article 7, unless it was non-actionable.

7. *Australia argues at para. 22 of its second submission that "the concept [raised by the United States] of making a subsidy 'irremediable' is a misunderstanding of the purpose of a dispute under 3.1(a), which is a violation case and so is about conformity with a rule". Is Australia thereby saying that where a pure violation exists (i.e., an export-contingent subsidy under SCM 3.1(a)) but there are no explicit performance targets, the measure is already "in conformity" and therefore no remedy is required? Would this not be the same as saying that a measure was simultaneously "a violation" and "in conformity"? Please comment.*

Answer 7:

No. Australia was saying that the issue is about bringing a measure into conformity. That is the remedy. The USA is focused on maximizing the amount of money to be withdrawn from Howe and objecting to the provision of a new subsidy to ALH. Its concept of remedy is not about conformity but about the outcome of a dispute in trade terms rather than rules terms.

If a subsidy has been brought into conformity with SCM Article 3, then the remedy of SCM Article 4 has been achieved.



A measure would not be simultaneously “a violation” and “in conformity”. An assessment that a measure falls under SCM Article 3.1(a) is not simply about a sum of money but also about the contingency with export performance in the granting of that money. How a measure can be brought into conformity needs to be examined on a case by case basis. For example, in some cases this may be a matter of changing the conditions, which would in a legal sense amount to terminating the programme and replacing it with a consistent one.

Australia has not argued that there is a need for "explicit performance targets". It has argued that the Report found that the grant payments were tied to the explicit sales performance targets which the Report in turn found were effectively export performance targets. Thus, in this case, the grant payments were found by the Report to be tied to "explicit performance targets".

In addition, it is quite possible to have the situation that there was a measure in violation of SCM Article 3 but there no longer is a measure in violation of SCM Article 3. For example, suppose that there was a subsidy programme that was inconsistent with SCM Article 3 and it has been terminated. Then there has been a violation in the past but not in the present. There is no longer any measure, and so there is conformity only in the sense that there is no measure that is not in conformity.

8. *What is Australia's theoretical basis for allocating the subsidy in this case, and if different from that in the countervail context, please explain. If there had been no performance targets in this case, would Australia have argued for subsidy allocation, and if so, over what period and why? If not, why not?*

Answer 8:

Australia considers that the Report found that the grant payments were tied to the sales performance targets over 1 April 1997 to 30 June 2000. The critical factor in the finding on inconsistency with SCM Article 3.1(a) was the tie to the interim and aggregate sales performance targets. Accordingly, the Report allocated the grant payments to the sales in the period 1 April 1997 to 30 June 2000. Accordingly, given the weight put on the aggregate sales performance target by the Report, the approach in paragraph 46 of Australia's First Submission is to apportion, or allocate, the grant payments uniformly over the full period of the sales performance targets, i.e. 1 April 1997 to 30 June 2000. The alternative approach in paragraph 47 of Australia's First Submission is to apportion, or allocate, the grant payments over 1 April 1997 to 30 June 2000 on the basis of the interim sales performance targets.

Australia does not consider that the countervailing methodology is relevant here. Nonetheless, given that the grant payments were allocated to sales in this period, Australia considers that the same period for allocation should be used for countervailing purposes. If the money had been paid after the event on say a quarterly basis, then presumably not even the USA would argue about the allocation. Australia sees no reason why just because the money was paid in the first half of the period covered by the Grant Contract, albeit in three tranches in three separate fiscal years, that that should affect the period of allocation for countervail purposes.

If there had been no performance targets, then the Report would have cleared both the grant payments and the 1997 Loan, since the surrounding circumstances would have been identical. However, if there had been some other conditions that led to an adverse finding, that would have been a different case with different reasoning. In that situation implementation would have depended on what those other conditions were and the reasoning and findings of the panel.

Nonetheless, since the \$30m. was to fill the period between the excision of automotive leather from the ICS and the entry into force of the new general industry programme, Australia would still have considered that the money should be allocated to sales in that same period, i.e. 1 April 1997 to

30 June 2000. See also the comments under the answer to Question 14(a) about "large" and "one-time".

9. *Could Australia please explain the significance of its argument, in para. 45 of its second submission, that the assistance under the ICS was "recurrent" up to April 1997, and that the tranches of the grant payments were payable thereafter at certain intervals. Is Australia arguing that the grant payments were recurring? How is this relevant to the Panel's task in this dispute?*

Answer 9:

This is a supplementary argument about allocation, which has already been touched on in the answer to Question 8. The USA has made an argument about recurrent and non-recurrent subsidies from its own, unilateral countervailing duty practice. Australia, while rejecting the relevance of the USA's approach, has noted that as a matter of fact the grant payments were part of a continuum of industry assistance to the textiles, clothing and footwear industries. Automotive leather was removed from eligibility of the ICS from 1 April 1997 and will not come back under the general industry programme until the entry into force of the new programme from 1 July 2000. The grant payments were to cover the period in between, i.e. 1 April 1997 to 30 June 2000. Thus they are allocable to that period alone, and so should not be treated as being non-allocable and so spread over an average asset life for the firm.

This confirms that, even in the absence of the sales performance targets, the grant payments are allocated over 1 April 1997 to 30 June 2000.

The grant payments were also paid in three tranches over three separate fiscal periods. The fiscal year 1999-2000 (July-June) is the only fiscal period in which there was not a grant payment.

Australia noted that assistance to the automotive leather industry, including the grant payments meets the definition of recurrent in the New Shorter English Oxford Dictionary – 1997 CD, i.e. "occurring frequently and periodically". It also meets the definition used by the USA in its own countervail regulations, i.e. allocable<sup>2</sup>

If by "recurring", the question means "allocable" the answer is yes. Moreover, the grant payments are part of a continuing system of assistance to the industry, albeit in a different form for automotive leather for 1 April 1997 to 30 June 2000.

The Report recognized this when at paragraph 9.65 it says:

"Howe earned significant benefits from its exports of automotive leather pursuant to those programmes [ICS and EFS]. Automotive leather was removed from eligibility under those programmes, and the government of Australia entered into the loan contract and the grant contract providing financial assistance at least in part to tide Howe over after it had lost eligibility for benefits related to automotive leather under these programmes".

In that context, the expression "tide Howe over" clearly indicates that the Report considered that the money was to cover sales, in replacement for the previous assistance, until the new programme came into force for automotive leather from 1 July 2000. Thus this was a genuine and not a contrived period for apportioning the grant payments.

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<sup>2</sup> See paragraph 38 and Footnote 24 of Australia's Second Submission.

The relevance to the Panel of this is that: on the one hand it puts to rest the straw men put up the USA regarding contrivances about the period to which export subsidies might be claimed to apply; and on the other it provides a supplementary argument why the grant payments are allocated to sales in the period 1 April 1997 to 30 June 2000. It also provides an argument in the alternative if the panel decided to accept the USA's argument about using the period to which the grant payments should be considered to be allocable for countervailing purposes. In this regard it also shows that grant payments are not one-time or one-off payments (nor were they out of keeping with other assistance provided). See comments on "large" and "one-time" in the answer to Question 14(a).

10. *Australia argues, in paras. 25 of its second submission, that “to bring the grant payments into conformity, Australia did not have to impose a punitive measure on an individual company, be it Howe or ALH. This matter is about Australia’s rights and obligations as a Member”; and in para. 26 that “[t]he impact on Howe or ALH or any other Australian company is irrelevant: they are not Members, Australia is”. How does Australia reconcile these arguments with the fact that, under Article 1 of the SCM Agreement, a necessary condition for a subsidy to exist is the conferral of a benefit, which by definition is a benefit to a recipient, and therefore has nothing to do with the Member itself? (See Appellate Body report in Canada Aircraft (WT/DS70/AB/R) at paras. 153-161 for a discussion of the term “benefit” in SCM Article 1.)*

Answer 10:

The obligation to bring the measure into conformity is that of Australia as a Member of the WTO. The WTO does not directly affect domestic law in Australia. So far as the WTO rules are concerned, the actual impact on the recipient of the subsidy of the withdrawal of the measure under SCM Article 4.7 is irrelevant. However, in some cases to bring a measure into conformity may require action that has a significant impact on the recipient. In this case, the withdrawal of \$8.065m. has, in fact, had a major impact on the net income and equity structure of Howe. In some cases, the impact might be even greater. However, if a method of withdrawing a measure and bringing it into conformity were to be available that had no impact on the recipient, then that would still be an acceptable remedy, and there would be no basis for using the lack of effect as an argument about lack of conformity.

The use of the term "benefit" in SCM Article 1.1(b) is about determining the existence of a subsidy. That is distinct from the issues of whether the subsidy falls under SCM Article 3.1(a) and of how a measure might be withdrawn for the purpose of SCM Article 4.7.

Question 11

11. *Related to the preceding question, when Australia is proposing “expensing” subsidy amounts, is it referring to subsidy “benefits” or to something else? Please explain.*

Answer 11:

Australia is referring to the way the money has been found to be allocated by the Report in finding that the grant payments were tied to export performance in the period 1 April 1997 to 30 June 2000. The Report tied the grant payments to the sales performance targets, which ran over 1 April 1997 to 30 June 2000. Thus, the grant payments were considered to go to meeting those sales performance targets. On 14 September 1999 the only subsidy outstanding was any money allocated to sales over 15 September 1999 to 30 June 2000. This was the money covered by the withdrawal of the \$8.065m. from Howe.

"Benefits" is an invention of the USA in the context of this Panel assessing whether Australia has implemented the Report's recommendations. The USA acknowledges, at least implicitly, in

paragraph 40 of its First Submission that its approach of allocating supposed "benefits" over the life of assets using its own countervailing duty approach has no connexion with the question of contingency on export performance under SCM Article 3.1(a), i.e. the fundamental matter before the original Panel and this Panel. However, this whole case is about contingency upon export performance and the Report's finding. The Report found that the grant payments were tied to the sales performance targets in the period 1 April 1997 to 30 June 2000. Thus, that is the basis for implementation of the Report's recommendations.

12. *The Panel recalls that in a communication dated 1 November, Australia provided a response to, inter alia, a question posed by the United States at para. 54.7 of the US's first submission, specifically, a request by the US for "any written calculation of the amount of the \$A13.654 million loan communicated to or by Howe or its related entities to or by the Australian Government", and "an explanation of how the \$A13.65 million was calculated or determined." Australia's response to this question was in part that there was "none", which the Panel understands to mean that there was no "written calculation" communicated between Howe or its related entities and the Australian Government. Australia offered no specific explanation or derivation of the amount of the loan. In footnote 26 of its second submission, the United States refers to a calculation which it has used to derive the \$A13.654 million loan amount. Could Australia please comment on this calculation. Could Australia please explain, and provide calculations demonstrating, how the \$A13.654 million amount was determined/derived.*

Answer 12:

The USA's calculation is interesting. Of course, virtually any number could be derived by the appropriate choice of interest rate. It does not take any account of other issues such as taxation implications.

The final figure was a negotiated one. A wide range of figures was discussed. It would not be factual to present the Panel with a methodology that purported to be the way in which the figure was derived. The options for the treatment of taxation and interest rates can give rise to virtually any figure. Note that the reason for the \$54,000 was not the result of a precise calculation but the addition of the amount for stamp duty to the negotiated figure.

13. (a) *Does Australia see no difference at all between the term "withdraw the subsidy" within the meaning of Article 4.7 of the SCM Agreement and the term "bring the measure into conformity" within the meaning of Article 19.1 of the DSU? If so, how does Australia reconcile this view with the fact that Article 4.7 of the SCM Agreement is a special or additional dispute settlement provision which, pursuant to Article 1.2 of the DSU "shall prevail" over any different provisions in the DSU? In your answer, please take into consideration the report of the Appellate Body in Brazil – Export Financing Programme for Aircraft, WT/DS46/AB/R, at para. 191, where the Appellate Body stated:*

*"We note that Article 4.7 of the SCM Agreement is listed in Appendix 2 to the DSU as a "special or additional rule or procedure" on dispute settlement. We note also that Article 4.7 contains several elements which are different from the provisions of Articles 19 and 21 of the DSU with respect to recommendations by a panel and implementation of rulings and recommendations of the DSB. For example, Article 19 of the DSU requires a panel to recommend that the Member concerned bring its measure "into conformity" with the covered agreements. In contrast, Article 4.7 of the SCM Agreement requires a panel to recommend that the subsidizing Member withdraw the subsidy. In addition, paragraph 1 of Article 21 of the DSU requires "prompt compliance with recommendations or rulings of the DSB", and paragraph 3 of that Article allows an implementing Member "a reasonable period of time" to*

*implement the recommendations or rulings of the DSB, where it is impracticable to comply immediately. In contrast, Article 4.7 of the SCM Agreement requires a panel to recommend that a subsidy be withdrawn "without delay".*

Answer 13(a):

The Appellate Body did not say in the text cited what it thought “withdraw the subsidy” means. The ruling by the Appellate Body was in respect of the determination of the time period for withdrawal.

Australia has never said that there was no obligation to “withdraw the subsidy”. However, Australia considers that the phrases “withdraw the subsidy” and “withdraw the measure” in SCM Article 4.7 must be read in the context of DSU Article 19 to interpret them against the object and purpose of the WTO Agreement. The object and purpose is to have a Member bring an inconsistent measure into conformity. The SCM Agreement was negotiated as a stand-alone agreement and this language reflects the nature of the measure. DSU Article 19 could not have “withdraw the measure” since this would not fit all potential inconsistent measures. For example, a tariff in breach of a binding will remain in the same form by being reduced rather than withdrawn. Normally, withdrawing the subsidy/measure will be achieved by terminating a programme, or equivalently modifying it so that it no longer falls under SCM Article 3.1(a). However, as with most WTO disputes, the approach to bringing a measure into conformity, needs to be considered on a case by case basis. The object and purpose of the WTO would not be served by an interpretation of a provision, which made implementation not merely impracticable but also impossible in many cases. The purpose of disputes under WTO rules is to remove current inconsistencies, not to punish Members for past inconsistencies and provide a basis for retaliation or compensation in perpetuity after the inconsistencies have disappeared.

*(b) Under what circumstances would Australia see repayment of subsidy amounts as indispensable to fulfill the Article 4.7 obligation?*

Answer 13(b):

It is difficult to set out a complete set of parameters for this, which would have to be examined on a case by case basis. However, one example might be the following (which in itself could have many variants). Suppose that there is a large custom built item, e.g. a transformer, where the government pays the manufacturer money to allow it to win a tender in an export market, and suppose for simplicity that the date for withdrawal is before the item is exported. Then it is difficult to see how the subsidy could be withdrawn by the due date without withdrawing money.

14. (a) *Assume Member X grants a large, one time, in law export subsidy payment to a company, explicitly conditioned on export sales over a two-year period. Assume further that a dispute settlement proceeding is commenced after the two year period over which the contingency applies has expired. Is it Australia's view that an amendment to the law, eliminating the contingency ex post facto, is all that would be required to "withdraw the subsidy"?*

Answer 14(a):

The answer would depend very much on the particular circumstances. For example, if the panel found that the measure was inconsistent with SCM Article 3.1(a) simply and only because the granting of the subsidy was "explicitly conditioned on export sales over a two-year period", then there would be nothing to remove after that two-year period. There would be no need to amend the law "eliminating the contingency *ex post facto*". Indeed there may be no more export sales after the two-year period, or the subsidy might have been for some particular item exported in that two-year period. If there were no more sales tied to the subsidy, then there would be no more export subsidy with or without an amendment. So there would be no subsidy or measure to withdraw.

It is unclear what is meant by a "large" subsidy and why that qualification has been included. "Large" would need to be defined, in particular whether this somehow relates to it being a contrivance. Note that in the matter before the Panel, the grant payments are not "large" when measured against any reasonable criteria. The basis of the sales performance targets was that the level of subsidy from the grant payments should not exceed 5% ad valorem. The after tax level of subsidy was much less. It is clear from the paragraphs 7.170-7.172 of the Report that the \$30m. is considerably less than the rate of assistance under the ICS and EFS, which even the USA would regard in its language as being "recurrent" and allocated to the actual sales.

Similarly, the grant payments were not a "one-time" payment. Apart from the fact that there was assistance before 1 April 1997 and will be after 30 June 2000, the grant payments were paid in three tranches over three fiscal years (July/June) with compliance assessment during that period under the Grant Contract. These were hardly one-time payments in normal parlance.

(b) *Would your answer to part (a) of this question be different if the dispute settlement proceeding is commenced before the two year period over which the contingency applies has expired, but the Panel's report is adopted after that period has expired? Please explain.*

Answer 14(b):

No. For example, under the scenario in the first paragraph of the answer to Question 14(a) above, the measure would still be a matter under SCM Article 4 when the dispute was commenced, but the measure would have gone by the time the panel report was adopted.

15. *Assume a large one-time subsidy granted to a company on the basis of a business plan that it submits to the government. Assume further that a panel finds that this subsidy was granted because the company had demonstrated an "adequate commitment to export", and therefore the panel found the subsidy was tied to anticipated exports. In Australia's view, would any action need to be taken by the subsidizing government in order to "withdraw" the subsidy after the adoption of the panel's report?*

Answer 15:

Again there are the issues of what are meant by "large" and "one-time", as addressed in the answer to Question 14(a).

This is difficult to answer because in Australia's view a panel should not find that a measure fell under SCM Article 3.1(a) solely because of a phrase such as "adequate commitment to export". The panel would have to have a demonstrable tie to actual or anticipated exports. Particularly in smaller economies, a wide range of companies export and may have to export to be viable. This in turn would probably be reflected in a business plan. For a panel to then go on and say that this meant that any subsidy to such a company fell under SCM Article 3.1(a) would not be consistent with Australia's interpretation of this article.

The action required of the government concerned would depend on what other conditions the panel took into account in reaching its decision, including any time frame the panel found for the anticipated exports on which it based its conclusion that the measure fell under SCM Article 3.1(a).

## **ANSWERS TO QUESTIONS FROM THE PANEL TO BOTH PARTIES**

1. *Both parties have proposed a calculation methodology to determine what they refer to as the "prospective" amount of the subsidy to be repaid. Given that the subsidy itself was entirely paid before the Panel's report was adopted, in what sense can any amount of repayment be considered "prospective"?*

### Answer 1:

Australia's position is that there is no prospective amount payable, but in order to finalize the dispute, it has withdrawn \$8.065m.

The issue is whether, given the Deed of Release, some part of the \$30m. of grant payments remained tied to exports of automotive leather by Howe between 15 September 1999 and 30 June 2000, and, if so, how much.

2. *On what legal basis do the parties base the argument that the phrase "withdraw the subsidy" has "prospective" effect only. One interpretation of the phrase "withdraw the subsidy", which is not argued by either party, would be that it means "repay in full" or "take back" the financial contribution to the recipient. Please comment on this possible interpretation, with specific reference to the text, context, and object and purpose of Part II of the SCM Agreement.*

### Answer 2:

As Australia understands the question, this issue is not a matter of dispute between the two parties and Australia wonders therefore whether it is an issue before the Panel.

The term "subsidy" is used in different ways in the text of the SCM Agreement. At times it could be read as being limited to money, but often it is clear from the text, that it includes the conditionality of the granting, e.g. "prohibited subsidy" in SCM Article 4.1 and "nature of the subsidy" in SCM Article 4.2. Moreover, in SCM Article 4.7, "subsidy" is used as being synonymous with "measure". In SCM Part II, it is not the money as such that is prohibited, but the combination of the money and the conditionality. Accordingly, withdraw the subsidy/measure in SCM Article 4.7 means the termination of a programme, including a modification of a programme to remove the reason for the inconsistency. This includes the termination or modification of in law and in fact contingency.

In some situations, this may be able to be done by removing the offending conditions without stopping a flow of money to industry, though the impact on industry's behaviour would usually be modified by the lack of, or different, conditions being imposed. The termination of the conditions is the "withdrawal of the subsidy". Past payments do not have to be repaid, or the flow of money does not have to be stopped. However, it is possible that the conditions may not be able to be terminated in some cases, e.g. see the answer to Question 13(b) to Australia.

Australia considers that through the Deed of Release, it has withdrawn the subsidy and brought the measures into conformity. However, Australia decided to take the precautionary step of withdrawing sufficient money to cover alternative interpretations. This was based on the possibility

that while the critical factor was the sales performance targets in the Grant Contract, the Panel might consider that these targets continue to apply for the remainder of 1 April 1997 to 30 June 2000 despite the Deed of Release. In such a case the ongoing programme is the portion of the remaining money tied to the sales performance targets over the residual of the period 1 April 1997 to 30 June 2000.

On the question of “withdraw the subsidy” meaning “repay in full” or “take back” the financial contribution to the recipient, it is clear from the above that Australia does not agree with that interpretation. However, what is clear is that if that interpretation were to apply to the current matter, then it would have to apply to all cases falling under SCM Article 3.1(a) and (b).

This would be at odds with all past practice in the GATT and the WTO about remedy.

Such an interpretation could mean that, where a programme has been in place for a number of years, huge amounts of irretrievable money could be involved. The consequences for the WTO system would be extremely adverse and would result in giving retaliation rights to Members, which could be in perpetuity.

The object and purpose of the WTO dispute settlement provisions are to have Members conform to the WTO Agreement. Where a panel finds that a Member has breached a rule, usually, as in this case, inadvertently because of differing interpretations of the rules, the aim is to have the breach removed. Withdraw the subsidy/measure, is simply the term used in the SCM Agreement regarding the achievement of that objective.

3. *In European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, the Panel noted that “any assessment of the level of nullification or impairment presupposes an evaluation of consistency or inconsistency with WTO rules of the implementation measures taken by the European Communities, i.e. the revised banana regime, in relation to the panel and Appellate Body findings concerning the previous regime.” WT/DS27/ARB, 9 April 1999, at para. 4.3. The Panel further noted that both parties accepted that it was the consistency or inconsistency with WTO rules of the new EC bananas regime – and not of the previous regime – that had to be the basis for the assessment of the equivalence between the nullification suffered and the level of the proposed suspension, id. at para. 4.5, and that it would be the WTO-inconsistency of the revised EC regime that would be the root cause of any nullification or impairment suffered by the United States. Id. at para 4.8. Is there any relationship, or should there be, between the concept of “equivalence” of the nullification or impairment of benefits to the suspension of concessions under Article 22 of the DSU, and calculation of the relevant amounts, and the calculation of the amount to be withdrawn in accordance with Article 4.7 of the SCM Agreement?*

4. *Further to the preceding question, would your answer change in light of the provisions of Article 4.10 of the SCM Agreement? That is, Article 4.10 of the SCM Agreement provides for “appropriate countermeasures” in the event a recommendation of the DSB is not followed, that is, the subsidy found to be prohibited is not withdrawn. Article 9 provides that “appropriate” countermeasures does not allow countermeasures that are disproportionate in light of the fact that the subsidies in question are prohibited. Does or should this have any relation to or consequences for the calculation of the amount to be withdrawn?*

#### Answers 3 and 4:

Australia is not certain of the relevance of the questions in respect of DSU Article 22 to the matter before this Panel.



The matter before the Panel is about the existence and consistency with the SCM Agreement of the measure or measures taken by Australia to implement the recommendations adopted by the DSB.

Thus the issues are whether any money had to be withdrawn given the Deed of Release and, if so, whether Australia withdrew sufficient money to bring the measures into conformity.

If there is no inconsistency, then there is no nullification or impairment. In that case there cannot be any money to be withdrawn. This emphasizes that the objective is to get the respondent to bring measures into conformity so that there is no inconsistency. Linkages between the new and old measures are irrelevant.

SCM Article 4.10 does not change the answer, rather it reinforces it. Clearly it would be disproportionate to impose countermeasures when there is no inconsistency. Thus when measures have been brought into conformity, there can be no further money to be withdrawn.

5. *Australia has argued, based on the Panel's original decision, that it is entitled to replace a prohibited export subsidy with a WTO-consistent subsidy, and that the 1999 loan at most falls into this category of replacement. Assuming the 1999 loan is not inconsistent with the SCM Agreement, it might nonetheless be argued that once the DSB had adopted a decision that a subsidy was inconsistent, that ruling could not be implemented simply by replacing the inconsistent subsidy with a consistent one. To implement a recommendation to "withdraw the [prohibited] subsidy" by repayment, and then immediately replace it with a WTO-consistent subsidy has no remedial effect, because the harmful trade effects presumed to have been caused by the prohibited subsidy in the first instance will necessarily continue. Would the parties please comment on this proposition.*

Answer 5:

If a measure is brought into conformity with SCM Article 3.1(a), then the remedy provision of SCM Article 4 has been effective, i.e. there has been a remedial effect, the measure has been brought into conformity with the rules. It is not a matter of whether this provides a remedial trade effect. There is no basis for assuming that the act of bringing a measure into conformity with SCM Article 3.1(a) will of itself have any particular trade effect. Of course, depending on the circumstances, the complainant may then have a case under SCM Part III regarding adverse effect. However, that would be a separate dispute.

Since Australia has brought the measures into conformity with SCM Article 3.1(a), the issue of a trade remedial effect is irrelevant for this Panel.

In answer to the hypothetical question posed by the Panel, if a Member has brought a measure into conformity, then that is an end to the matter. A Member does not lose WTO rights because it has been in breach in the past. There is no basis for suggesting that such a Member would be in some sense on parole and lose its rights to provide WTO consistent assistance to its industry. If the measure has been brought into conformity, then the rules have worked.

Australia rejects the USA's extraordinary argument that a Member has less rights in introducing new measures as the result of losing a dispute, and that different rules apply to the responding Member under an Article 21.5 panel.

As explained in the answer to Question 2 to Australia, there is a distinction between why there is a rule prohibiting export subsidies and the basis for determining conformity with it. There is no basis for assuming that the remedy must remove "the harmful trade effects presumed to have been caused". The issue is one of conformity with rules, not a case of adverse trade effect, presumed or actual.

In most cases, it would be difficult for a Member to readily reconfigure assistance to be WTO consistent and to have exactly the same trade effect. It would be allowed if it could. However, this would probably mean that the complainant had taken a case that was technical in nature and that the breach was a technical one. Where assistance contingent on export performance is causing harmful trade effects, the reconfiguration of that assistance away from export contingency would usually affect the behaviour of the recipient and would certainly remove the presumption of harmful trade effects coming from the inconsistency with SCM Article 3.1(a).

## ANSWERS TO QUESTIONS FROM THE UNITED STATES

1. *Does the grant contract state that the grant is to be “expensed” in achieving the sales targets? If so, where in the contract does it state this?*

### Answer 1:

The Deed does not use the actual term “expensed”. However, the Report found that the Grant Contract tied the \$30m. to the sales performance targets in the Grant Contract, and so allocated the grant payments to the achieving of those sales in the period 1 April 1997 to 30 June 2000.

2. *On October 28, the Panel requested that Australia produce copies of certain documents identified in the U.S. First Submission or to object to their production. Among these was a request for*

1. *Any agreement, whether by formal agreement or by correspondence with Howe or its related entities, under which Howe agreed to repay, or repaid, A\$8.065 million of the A\$30 million provided in 1997 and/or 1998.*

2. *Any correspondence between the Government of Australia and Howe or its related entities that refers to the agreement to repay, or to the repayment of, the A\$8.065 million referred to in request 1. above.*

3. (a) *Any written calculation of the \$A8.065 million communicated to or by Howe or its related entities to or by the Australian Government.*

(b) *An explanation of how the \$8.065 million was calculated.*

*Australia did not object to the production of such documents, and responded with a document submitted as Exhibit AUS-2 (Letter confirming payment). That document references another document, stating: “The amount of the repayment is in accordance with the terms of our request to them [Howe & Company, Pty. Ltd.] for a partial repayment of the grant, we had previously provided to them.”*

- (a) *Could the Australian Government confirm that the latter referenced document has been submitted to the Panel as an exhibit, and, if so, identify it.*

Answer 2(a):

AUS – BCI – 6 contains the request for the \$8.065m. The reference to “the terms of our request” is limited to the first paragraph of AUS – BCI – 6.

- (b) *Could the Australian Government confirm that there are no other responsive documents that have not been submitted as exhibits?*

Answer 2(b):

Yes.

**ANNEX 2-6**

**AUSTRALIA'S COMMENTS ON NEW FACTUAL INFORMATION  
FROM THE UNITED STATES**

(3 December 1999)

1. Australia would like to comment on the new factual material in the USA's answers to questions from the panel on 1 December 1999. This is in respect to the status of the Informal Group of Experts (IGE).

2. In its answer to Question 4 addressed to the USA it says:

in the first paragraph

"The determination ... by recognized experts"

and in the fourth paragraph

"Further, the Informal Group of Experts was created by the Committee on Subsidies and Countervailing Measures to clarify the calculation of subsidies. The experts were chosen by the Committee based on their substantive experience in subsidy calculation methodology. Their status and expertise in subsidy calculations should therefore be carefully considered by the Panel."

3. The IGE was set up by the Committee to try to develop the understanding referred to in SCM Footnote 62 to SCM Annex IV related solely to calculation issues under SCM Article 6.1(a). See G/SCM/5 and G/SCM/M/2, paragraphs 70-74, in particular 72.

4. Participants were not chosen by the Committee. The USA may be confusing the IGE with the Permanent Group of Experts.

5. There was no substantive qualification for participation in the IGE. There is no expertise on the issue of calculation in respect of SCM Article 6.1(a), let alone SCM Article 3.

6. Some participants from some Members, in particular the USA, reflected their countervail experience and this was in turn reflected in the IGE report as part of compromises over effectively irreconcilable concepts.

7. Australia's understanding is that of the list of persons who participated from time to time, at most two attended all the meetings of the IGE.

8. Members did not adopt the IGE's report and only noted it. There is no consensus amongst Members on the IGE's report and it does not constitute the understanding referred to in SCM Footnote 62, which has yet to be developed. Australia understood that the USA does not support the adoption of the IGE's report. Indeed the USA disagrees with the IGE's report even on the issue of allocation of subsidy benefits over time - see for example, G/SCM/M/16, paragraph 70.

## ANNEX 3-1

### ORAL STATEMENT OF THE EUROPEAN COMMUNITY

(23 November 1999)

#### **Introduction**

1. The European Communities makes this third party submission to you today because of its systemic interest in the correct interpretation of the Subsidies Agreement and the DSU.

#### **Violation of Article 10.3 DSU**

2. The EC wishes to express its profound disappointment with the refusal of the Panel communicated by fax of 11 November 1999 to allow the EC to receive the second written submissions of the parties in this case.

3. As the EC pointed out in its letter to the Panel of 8 November 1999, Article 10.3 DSU provides that:

“Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel.”

4. Since in this case there is only one meeting of the Panel and the Panel is considering at that meeting both written submissions of each party, the EC should, in accordance with Article 10.3 DSU, have received all the submissions of the parties.

5. Not only is this clearly required by Article 10.3 DSU, it is also necessary for the EC to be able to make known its views on the issues that the Panel is actually considering at this meeting, rather than having to express views on the incomplete positions of the parties that have been developed and may even have changed in the further submissions that the Panel has before it at this meeting.

6. The EC considers that it is transparently wrong for the Panel to endeavour to justify this position, as it does in its fax message of 11 November, by arguing that “had the Panel decided to hold two meetings with the parties, as is the normal situation envisioned in Appendix 3 of the DSU, third parties would only have received written submissions made prior to the first meeting but not rebuttals made subsequently.”

7. There is no requirement in the DSU for a panel to hold two meeting. This is only required by the Working Procedures contained in Appendix 3, which the Panel is entitled to modify, as has been done in this case, notably by deciding to only hold a single meeting. The requirement to allow the EC as third party to know the arguments of the parties that are before the Panel when it meets to consider this case at that single meeting is however laid down in Article 10.3 of the DSU, which the Panel was not entitled to modify. By denying the EC its right, the Panel has violated the DSU.

8. Faced with this position of the Panel, the EC also asked the parties to provide it with copies of their second written submissions on the basis of both Article 10.3 and, for good measure, Article 18.2 DSU. Australia responded positively, and the EC thanks Australia for its cooperation and respect for the rules, but the US has refused, a matter that the EC profoundly regrets, since it has contributed to preventing the EC from commenting on the substance of the issues before the Panel in this case.

### **Business Confidential Information**

9. The EC also feels that it must recall its position on the special procedures for the protection of “Business Confidential Information.”

10. The EC recognises that certain information used in panel proceedings may be of such a nature that particular care is called for to protect it. The EC cannot accept however that protective procedures are adopted which it is impossible for the EC to follow. As the EC explained in its letter to the Panel of 8 November, EC officials are not allowed to enter into personal commitments to third country governments concerning the conduct of dispute settlement proceedings. Such obligations may only be undertaken by the EC, which is bound vis-à-vis other WTO Members by Article 18.2 DSU to ensure that confidential information is protected. In the case of the EC, the effectiveness of this obligation is ensured by the fact that EC officials are all bound by the EC Treaty and their terms of employment not to disclose confidential information, including business confidential information.

### **The Agreement not to Appeal**

11. The EC notes that the parties to this proceeding have agreed not to appeal the Panel Report. The EC does not believe that it is possible to exclude a right of appeal in panel proceedings under Article 21.5 DSU.

12. The EC believes that the fact that the parties have agreed not to appeal, and have apparently taken the view that other rules of the DSU (such as those relating to third parties) may be dispensed with or varied, means that this proceeding is in fact an arbitration under Article 25 DSU.

13. The EC believes that these circumstances, and the absence of the discipline of a potential appeal in these proceedings, should be taken into account by any future panel which is considering whether the reasoning of the report arising out of these proceedings is of any guidance in resolving similar questions with which it may be confronted.

### **The scope of the proceeding**

14. This is a proceeding under Article 21.5 DSU. This provision allows a panel to adjudicate on two kinds of disagreements:

- those relating to the *existence* of measures taken to comply with the recommendations and rulings; and
- those relating to the *consistency* with a covered agreement of measures taken to comply with the recommendations and rulings.

15. The terms of reference of the Panel are set out in WT/DS126/8 of 4 October 1999 and seem to indicate that the disagreement in this case relates to the *consistency* with a covered agreement (that is, the Subsidies Agreement) of measures taken to comply with the recommendations of the Panel. In particular, the terms of reference do not clearly indicate whether there is a dispute before the Panel as to the *existence* of measures taken to comply with the recommendations.

16. The EC notes however that the parties have spent much time discussing whether certain action by Australia does in fact comply with the *recommendation* of the Panel. However, this is, for the EC, a question of the *existence* of measures taken to comply with the *recommendations*.

17. The EC understood document WT/DS126/8 of 4 October 1999 as limiting the mandate of the Panel to the question of whether the measures taken are in any way inconsistent with the Subsidies

Agreement and not to include the consistency of those measures with the recommendations of the Panel.

### **Substance**

18. The EC is unable to say much about the substantive issues that arise in these proceedings.

19. One of the reasons for this is arises out of the peculiar factual background to this case. That is that it involves an *ad hoc* subsidy and *de facto* export contingency. This means that the present case is particularly fact intensive – and it is particularly difficult for the EC to comment when it has not been shown the evidence.

20. One thing that is clear is that the burden of proof under a “compliance panel,” under Article 21.5, whether the obligation for implementation arises under Article 19.3 DSU or 4.7 Subsidies Agreement, is on the party contesting the existence of implementation measures or their consistency with a covered agreement.

### **The Panel’s Questions**

21. The EC has received questions from the Panel yesterday but has not had time to consider how to respond before finalising this statement.

22. The EC will endeavour to provide answers in writing as requested. In this regard, it would be of great assistance to the EC to have the written submissions of the parties and their statements to the Panel. Even if the Panel and any of the parties should still consider that the EC is not entitled to receive the second written submissions, they may still consider it useful to allow the EC to have them voluntarily – and thus put into practice the principle of transparency in dispute settlement about which there is so much talk these days. The same applies to the oral statements.

### **Conclusion**

23. The EC regrets that its submission is limited to procedural questions and that it has not been possible, for the time being, for it to assist the Panel on the substance of the difficult and fundamental issues concerning the interpretation of the Subsidies Agreement which arise in this case.

24. The EC nonetheless wishes the Panel well in its deliberations and thanks you for your attention.

## ANNEX 3-2

### EUROPEAN COMMUNITY'S ANSWERS TO WRITTEN QUESTIONS OF THE PANEL

(1 December 1999)

#### Questions N° 1 and 2

1. *Each party has identified an amount of money that it refers to as the "prospective" amount of the subsidy to be repaid. Given that the subsidy itself was entirely paid before the Panel's report was adopted, in your view can any amount of repayment be considered "prospective" ? Please explain.*

2. *The parties both argue that the phrase "withdraw the subsidy" has "prospective" effect only. One interpretation of the phrase "withdraw the subsidy", which is not argued by either party, would be that it means "repay in full" or "take back" the financial contribution to the recipient. Please comment on this possible interpretation, with specific reference to the text, context, and object and purpose of Part II of the SCM Agreement.*

#### Answers 1 and 2

1. The EC considers the above questions to be linked and will answer them together. It will first set out its view that the obligation to withdraw a subsidy cannot be retroactive and must only be for the future. It will then briefly consider the question of how the prospective portion may be calculated. The withdrawal can only be prospective

#### **1.1 The withdrawal can only be prospective**

2. The EC agrees with the parties to this dispute that the remedy under Article 4 *SCM Agreement*, like all other remedies under the WTO, can only be prospective in nature and cannot seek to compensate for a violation to the extent that its effects are situated in the past. Retroactive effect of WTO remedies is not acceptable to the Members.

3. The intent of the Members to exclude retroactive effect of WTO remedies can be discerned from an interpretation of the WTO provisions in accordance with the customary rules of interpretation of public international law, as required by Article 3.2 DSU.

4. The customary rules of interpretation of public international law are set out in Articles 31 and 32 Vienna Convention on the Law of Treaties (VCLT). In particular, Article 31.1 provides that a treaty must be interpreted "in good faith 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."<sup>1</sup> Article 31.3(c) provides that "there shall be taken into account together with the context .... any relevant rules of international law applicable in the relations between the parties."

5. The EC is of the view that, since the WTO Agreement is part of international law, international law principles must generally be applied. It notes that the Appellate Body has made frequent reference to general international law, for example in the *Hormone*<sup>2</sup> and *Shrimp*<sup>3</sup> cases.

6. The relevant elements of context and legal principles which the EC submits should guide the Panel are as follows:

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<sup>1</sup> Article 31.1 Vienna Convention on the Law of Treaties, 1969.

<sup>2</sup> WT/DS26/AB/R and WT/DS48/AB/R of 16 January 1998 (paras 120 to 125).

<sup>3</sup> WT/DS58/AB/R of 12 October 1998 (para 130).



- One purpose of the dispute settlement is to provide “security and predictability to the multilateral trading system” (Article 3.2 DSU).
- The WTO Agreement, like international law in general, lays down rights and obligations for the States and International Organisations which are its Members. It does not create rights and obligations for private parties.
- It is a general principle of law that legitimate expectations should be protected.

7. Since past trade effects can only be remedied in a market economy by interfering with the acquired rights of private parties, the EC considers that there can be no obligation on Members to remedy violations with retroactive effect. Indeed, any such obligation would be entirely ineffective since the resulting interference with private rights could give rise to claims within the internal legal systems of the Members to restore the *status quo ante*.

8. The EC considers that the principle of non-retroactivity of WTO remedies results clearly from the provisions of Article 19.1 DSU which imposes an obligation to “bring the measure into conformity with” the covered agreement and is confirmed by the circumstance that Article 21 DSU allows Members a reasonable period of time in which to implement panel reports. Even in the area of prohibited subsidies, Article 4.7 also allows a panel to take account of the impracticability of immediate implementation and to provide a period of time in which the subsidy is to be withdrawn. If immediate implementation is recognised as not being practicable, it goes without saying that *retroactive* implementation is not possible.

9. This principle has also been confirmed in the report of the Article 21.5 panel in *European Communities – Bananas – Recourse by Ecuador*<sup>4</sup> where the panel held that:

“In framing this issue for consideration, we do not imply that the European Communities is under an obligation to remedy past discrimination. Article 3.7 of the DSU provides that “... the first objective of the dispute settlement is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.” This principle requires compliance *ex nunc* as of the expiry of the reasonable period of time for compliance with the recommendations and rulings adopted by the DSB. If we were to rule that the licence allocation to service suppliers of third-country origin were to be “corrected” for the years 1994 to 1996, we would create a retroactive effect of remedies *ex tunc*. However, in our view, what the EC is required to ensure is to terminate discriminatory patterns of licence allocation with *prospective* effect as of the beginning of the year 1999.”

10. In the same way, the Article 22.6 Report referred to by the Panel in its Question 3 considered, as the Panel has noted in that question, that the level of nullification and impairment had to be assessed as it existed at the end of the reasonable period of time (which may, for a number of reasons, be different from that which existed before). This supports the view that the obligation to implement only relates to the future, not the past.

11. Consequently, the EC considers that the obligation to “withdraw” the prohibited export subsidy in Article 4.7 SCM Agreement can only be to withdraw the portion of it that corresponds to the future and not that which corresponds to effects which have occurred in the past. The EC will consider below the question of how the future portion may be calculated.

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<sup>4</sup> Report by the Panel on *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*, WT/DS27/RW/ECU, 12 April 1999, at paragraph 6.105.

12. The EC realises that this position means that the SCM Agreement may be considered not to provide a “remedy” against past subsidies (i.e. those which have been expensed prior to the deadline for implementation).<sup>5</sup> However this is a common feature of all the Multilateral Trade Agreements and an unavoidable consequence of the present rules which must be accepted. The WTO Agreement only provides a right to have violations remedied for the future.

13. The absence of a remedy for past and consummated violations has always been a well-known feature of the GATT/WTO system. First, it is inherent in the principle that DSB rulings do not have retroactive effect. Second, it is established and accepted that it can lead in some cases to there being no remedy at all for the complaining party. In the Panel Report under the Agreement on Government Procurement on *Norway - Procurement of Toll Collection Equipment for the City of Trondheim* there was such a situation and the panel discussion of GATT practice is still pertinent.

“... the Panel observed that, under the GATT, it was customary for panels to make findings regarding conformity with the General Agreement and to recommend that any measures found inconsistent with the General Agreement be terminated or brought into conformity from the time that the recommendation was adopted. The provision of compensation had been resorted to only if the immediate withdrawal of the measure was impracticable and as a temporary measure pending the withdrawal of the measures which were inconsistent with the General Agreement ... Questions relating to compensation or withdrawal of benefits had been dealt with in a stage of the dispute settlement procedure subsequent to the adoption of panel reports.”

“The Panel also believed that, in cases concerning a particular past action, a panel finding of non-compliance would be of significance for the successful party: where the interpretation of the Agreement was in dispute, panel findings, once adopted by the Committee, would constitute guidance for future implementation of the Agreement by Parties.

“In the light of the above, the Panel did not consider that it would be appropriate for it to recommend that Norway negotiate a mutually satisfactory solution with the United States that took into account the lost opportunities of United States companies in the procurement or that, in the event that such a negotiation did not yield a mutually satisfactory result, the Committee be prepared to authorise the United States to withdraw benefits under the Agreement from Norway with respect to opportunities to bid of equal value to the Trondheim contract.”<sup>6</sup>

14. It is significant that this experience with the 1979 Government Procurement Agreement led the Parties to the WTO Government Procurement Agreement to negotiate special provisions on domestic challenge procedures (Article XX) so as to provide a remedy where the WTO system could not. No such mechanism has yet been negotiated in the field of subsidies.

15. The EC does not consider that it is possible to find support for retroactive remedies against prohibited subsidies by relying on the presence of the word “withdraw” in Article 4.7.

16. The word “withdraw” is also found in Article 3.7 and Article 26.1(b) DSU where it is used to mean the same as “bring into conformity” in Article 19.1 DSU. It does not therefore imply any retroactive effect but merely an obligation to withdraw the future effects.

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<sup>5</sup> The term “expensed” is used as in the Report of the Informal Group of Experts G/SCM/W/415/Rev.2.

<sup>6</sup> GPR/DS.2/R, adopted on 13 May 1992, paras. 4.21, 4.24 and 4.26.

## 1.2 The calculation of the prospective portion

17. Certain subsidies provide a benefit which is fully expensed in the period in which it is granted (e.g. a bounty paid on the export of each shipment) . Others provide a benefit which extends over a longer period of time (e.g. a loan at a concessionary interest rate or a large one-off grant). In the latter case, the benefit cannot be allocated only to the period when the subsidy is granted, but should be allocated over the period of time that the benefit is conferred.

18. The period of time over which the benefit is conferred is a question of fact in each case.

19. In the present case, Australia has argued that the grant was made in order to compensate Howe for being "excised" from the current Import Credit Scheme (ICS) from 1 April 1997 to its due termination date of 30 June 2000 (after which it will be replaced by the new general textiles, clothing and footwear programme coming into force on 1 July 2000 which will include automotive leather.<sup>7</sup>

20. The EC is not in a position to take a view on this issue of fact. If the Panel finds it to be correct that Australia granted this subsidy as a temporary replacement for the ICS and that Howe would have considered the payment as relating to this period and treated it and accounted for it accordingly, it may be that the subsidy may be properly allocated over this period. If this were so, one would expect the amount of the grant to correspond to the amount of the ICS assistance which it was replacing.

21. The EC disagrees with Australia that the duration of the *de facto* export contingency is necessarily relevant to the question of the allocation period (although it may be relevant supporting evidence). The period over which an export subsidy benefits a company may be different from the period over which export performance is measured or the company has export performance obligations. The question of whether removal of export contingency is sufficient to remove the violation is also a different question from the question of what is the future benefit resulting from the financial contribution and what action is necessary to remove it.

22. In addition, without taking a position on the facts of this particular case, the EC considers that the average useful life of assets (AUL) may also, in certain circumstances, be a valid methodology for allocating non-recurring subsidies over time.

### Questions N° 3 and 4

3. *In European Communities - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, the Panel noted that "any assessment of the level of nullification or impairment presupposes an evaluation of consistency or inconsistency with WTO rules of the implementation measures taken by the European Communities, i.e. the revised banana regime, in relation to the panel and Appellate Body findings concerning the previous regime", WT/DS27/ARB, 9 April 1999, at para. 4.3. The Panel further noted that both parties accepted that it was the consistency or inconsistency with WTO rules of the new EC bananas regime - and not of the previous regime - that had to be the basis for the assessment of the equivalence between the nullification suffered and the level of the proposed suspension, id. At para. 4.5. and that it would be the WTO-inconsistency of the revised EC regime that would be the root cause of any nullification or impairment suffered by the United States. Id. At para 4.8. Is there any relationship, or should there be, between the concept of "equivalence" of the nullification or impairment of benefits to the suspension of concessions under Article 22 of the DSU, and calculation of the relevant amounts, and the calculation of the amount to be withdrawn in accordance with Article 4.7 of the SCM Agreement ?*

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<sup>7</sup> See second written submission of Australia at e.g. paragraph 6.

4. *Further to the preceding question, would your answer change in light of the provisions of Article 4.10 of the SCM Agreement ? That is, Article 4.10 of the SCM Agreement provides for "appropriate countermeasures" in the event a recommendation of the DSB is not followed, that is, the subsidy found to be prohibited is not withdrawn. Article 9 provides that the term "appropriate" countermeasures does not allow countermeasures that are disproportionate in light of the fact that the subsidies in question are prohibited. Does or should this have any relation to or consequences for the calculation of the amount to be withdrawn ?*

Answers to 3 and 4

23. The EC does not consider that the Recourse to Arbitration by the European Communities under Article 22.6 of the DSU referred to in the question can properly be referred to as a "Panel" as is done in the question. It was, as its title indicates, an arbitration, even if the arbitrators were evidently confused about their role and powers. It was, in particular, never adopted by the DSB. However much the same conclusions can be drawn from the Panel Report on *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*, referred to above.

23. The EC does not believe that there is, nor should there be, any relationship between the level of suspension of concessions under Article 22 DSU or the level of appropriate countermeasures under Article 4.10 SCM Agreement to be imposed in case of non-implementation of the report and the proportion of the subsidy to be withdrawn under Article 4.7 SCM Agreement.

24. It is true that the level of suspension of concessions under Article 22 DSU must be equivalent to the nullification and impairment. However the obligation to implement a panel report is an obligation to "bring the measure into conformity with [the covered agreement with which an inconsistency has been found]" (see Article 19.1 DSU) or to "withdraw the subsidy" found to be prohibited (see Article 4.7 SCM Agreement), **not** to remove any nullification and impairment. The nullification and impairment is assumed to be removed to whatever extent is required by the bringing into conformity of the measure or the withdrawal of the subsidy.

25. Bringing a measure into conformity or the withdrawing the subsidy can be more or less burdensome for the Member found to have violated the WTO Agreement than suffering temporary withdrawal of concessions or countermeasures. It may be more or less beneficial for the complaining Member. There is no necessary relationship between the obligation to bring a measure into conformity or withdraw a subsidy and the temporary measures of constraint provided for in case of non-compliance such that the calculation of the latter can help to assess the nature or extent of the former.

Questions N° 5 and 6

5. *Australia has argued, based on the Panel's original decision, that it is entitled to replace a prohibited export subsidy with a WTO-consistent subsidy, and that the 1999 loan at most falls into this category of replacement. Assuming the 1999 loan is not inconsistent with the SCM Agreement, it might nonetheless be argued that once the DSB has adopted a decision that a subsidy was inconsistent, that ruling could not be implemented simply by replacing the inconsistent subsidy with a consistent one. That is, to implement a recommendation to "withdraw the [prohibited] subsidy" by repayment, and then immediately replace it with a WTO-consistent subsidy would have no remedial effect, because the harmful trade effects presumed to have been caused by the prohibited subsidy in the first instance would necessarily continue. Please comment on this proposition.*

6. *The United States agreed, in the original dispute, that a Member is permitted to replace a prohibited subsidy with a non-prohibited subsidy, and that the consistency of the new subsidy would need to be judged on its own merits. In your view, can this argument be reconciled with the US's new*

*argument that the 1999 loan should be judged on the basis of the Panel's original finding concerning the grant ?*

Answers to 5 and 6

26. It appears that the Panel's question assumes a retroactive remedy when it relates the "remedial effect" to "the harmful trade effects presumed *to have been* caused". The EC has already explained that there can be no retroactive effect of WTO remedies.

27. The EC also considers that the Panel's question begs a number of questions. First it is necessary to ask what is required by implementation or withdrawal? If a "remedial effect" is required, what remedial effect? It is only then that the Panel's question arises and the answer to it will not only depend on the answers to the earlier questions but also on the specific factual circumstances of which the EC has not been informed.

Question N° 7

*7. Do you agree that the logic of the remedies under SCM Agreement is that prohibited subsidies are subject to the most severe remedies, actionable subsidies the next most severe, and non-actionable the least severe ? If not, why not and on what legal basis ?*

Answer to 7

28. The EC considers that the SCM Agreement contains the remedies considered appropriate for the particular characteristics of each type of subsidy. It does not consider it correct to describe them in terms of "severity." They are simply different.

## ANNEX 4

### PROCEDURES GOVERNING BUSINESS CONFIDENTIAL INFORMATION

#### I. BASIC PRINCIPLE

1. The treatment of information as Business Confidential under these procedures imposes a substantial burden on the Panel and the parties. The indiscriminate designation of information as Business Confidential could limit the ability of a party to fully include in its litigation team individuals who have particular knowledge and expertise relevant to presenting the party's case, impede the work of the Panel and complicate the Panel's task in formulating credible public findings and conclusions. Accordingly, while the Panel recognizes that parties have a legitimate interest in protecting sensitive Business Confidential information, *the Panel expects that parties will exercise the utmost restraint in designating information as Business Confidential.*

#### II. DEFINITIONS

approved person” means

- (i) a Panel member;
- (ii) a representative; or
- (iii) a Secretariat employee

who has filed with the Chairman of the Panel a Declaration of Non-disclosure.

“capital city office” means the buildings and grounds of the United States Trade Representative in Washington, DC, United States of America, and [ appropriate designation for Australia ].

“conclusion of the Panel” means when,

- (i) pursuant to DSU Article 16.4, the Panel report is adopted;
- (ii) pursuant to DSU Article 16.4, the Panel report is not adopted; or
- (iii) when the authority for establishment of the Panel lapses pursuant to DSU Article 12.12.<sup>1</sup>

“Business Confidential information” means any information that has been designated as Business Confidential by the party submitting the information, and that is not otherwise available in the public domain.

“Declaration of Non-disclosure” means a copy of the declaration set out in Annex I, signed and dated by the person making the declaration.

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<sup>1</sup> By exchange of letters dated 1 October 1999, the parties to this dispute have mutually agreed that they both will unconditionally accept the Panel report and that there will be no appeal of that report.

“designated as Business Confidential” means:

- (i) for printed information, clearly marked with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ and with the name of the party that first submitted the information;
- (ii) for binary-encoded information, clearly marked with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ on a label on the storage medium, and clearly annotated in the binary-encoded files with the notation ‘BUSINESS CONFIDENTIAL INFORMATION’ and with the name of the party that first submitted the information; and
- (iii) for uttered information, declared by the speaker to be “Business Confidential information” prior to the disclosure, and identified with the name of the party that first submitted the information.

“dispute” means the United States' recourse under Article 21.5 of the DSU in respect of measures taken by Australia to comply with the recommendations and rulings of the WTO Dispute Settlement Body in the dispute WT/DS126, entitled “Australia —Subsidies Provided to Producers and Exporters of Automotive Leather”.

“DSU” means the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes.

"Geneva mission" means the buildings and grounds of the United States and Australia at 1-3 Avenue de la Paix, 1211 Geneva and 2 Chemin des Fins, 1209 Geneva, respectively.

“information” means:

- (i) printed information;
- (ii) binary-encoded information stored in computer diskettes, computer disc drives, CD roms, or other electronic media; or
- (iii) uttered information,

including without limiting the generality of the foregoing, offers, agreements, reports, forecasts, compilations, studies, plans, presentations, charts, graphs, pictures and drawings.

“Panel” means the WTO panel considering this dispute pursuant to DSU Article 21.5 and the 14 October 1999 decision of the WTO Dispute Settlement Body.

“Panel meeting” means a substantive meeting of the Panel with the parties as described in the working procedures adopted by the Panel.

“Panel member” means a person serving on the Panel.

“Panel process” means the process of the Panel as described in relevant provisions of the DSU.

“party” means the United States or Australia.

“premises of the WTO” means buildings and grounds of the WTO at Centre William Rappard, Rue de Lausanne 154, Geneva, Switzerland.

“representative” means:

- (i) an employee of a party;
- (ii) an agent for all purposes of a party; or
- (iii) a legal counsel or other advisor of a party,

who has been authorized by a party to act on behalf of such party in the course of the dispute and whose authorization has been notified to the Chairman of the Panel and to the other party, but in no circumstances shall this definition include an employee, officer or agent of a private company engaged in automotive leather manufacturing.

“Secretariat” means the Secretariat of the World Trade Organization.

“Secretariat employee” means a person employed or appointed by the Secretariat who has been authorized by the Secretariat to work on this dispute and whose authorization has been notified to the Chairman of the Panel, including without limiting the generality of the foregoing, interpreters and transcribers present at the Panel hearings.

“secure location” means a locked storage receptacle on the premises of the WTO chosen by the Secretariat to provide secure storage for Business Confidential information.

“submit” means:

- (i) the filing by a party of printed or binary-encoded information at the Secretariat during the dispute;
- (ii) the filing by a party of printed or binary-encoded information with the Panel during a Panel hearing; or
- (iii) the uttering of information during a Panel hearing.

“third party” means the European Communities or Mexico.

### **III. SCOPE**

1. These procedures apply to all Business Confidential information submitted during the Panel process, but do not apply to a party with respect to Business Confidential information first submitted by that party, including in derivative form.

### **IV. OBLIGATION ON PARTIES**

1. Each party shall ensure that its representatives comply with these procedures.

### **V. SUBMISSION BY A PARTY**

1. When submitting information, a party may designate all or any part or parts of that information as Business Confidential information. Business Confidential information shall be submitted in three copies: one copy of the Business Confidential information shall be provided to the Secretariat, and two copies shall be provided to the other party. Of the two copies for the other party, one copy is for that party’s Geneva mission, and one copy is for that party’s capital city office.

2. Where a submission by a party incorporates Business Confidential information first submitted by the other party, that submission shall identify all such information as set forth in Article II of these procedures concerning “designated as Business Confidential”.



3. If, taking into the account the Basic Principle stated in Article I, the Panel considers that a party has designated as Business Confidential information which is not reasonably entitled to such treatment, the Panel may decline to consider such information. In such a case, the party submitting the information may, at its discretion:

- (i) withdraw the information, in which case the Panel and the other party shall promptly return the information to the party submitting it; or
- (ii) withdraw the designation of the information as Business Confidential.

4. When submitting printed or binary-encoded Business Confidential information, the party shall also provide:

- (i) a non-Business Confidential edited version, redacted in such a manner as to convey a reasonable understanding of the substance of the information;
- (ii) a non-Business Confidential summary in sufficient detail to convey a reasonable understanding of the substance of the information; or
- (iii) in exceptional circumstances, a written statement:
  - (a) that such a non-Business Confidential edited version or non-Business Confidential summary cannot be made, or
  - (b) that such a non-Business Confidential edited version or non-Business Confidential summary would disclose facts that the party has a proper reason for wishing to keep business confidential.

5. If the Panel considers that a non-Business Confidential edited version or summary does not fulfill the requirements of paragraph 4(i) or (ii), or that such exceptional circumstances as justify a statement pursuant to paragraph 4(iii) do not exist, the Panel may decline to consider the Business Confidential information in question. In such a case, the party submitting the information may, at its discretion,

- (i) withdraw the information, in which case the Secretariat and the other party shall promptly return the information to the party submitting it; or
- (ii) comply with the provisions of paragraph 4 to the satisfaction of the Panel.

6. When uttering Business Confidential information at a Panel meeting, the speaker shall also provide a brief non-Business Confidential oral statement in sufficient detail to convey a reasonable understanding of the substance of the information that will be uttered.

## **VI. STORAGE**

1. The Secretariat shall store all Business Confidential information submitted in the secure location when not in use by an approved person.

2. Each party shall store all Business Confidential information submitted to it by the other party in a locked storage receptacle, to which only approved persons have access, at the premises of its Geneva mission or its capital city office, when not in use by an approved person.

3. An approved person shall take all necessary precautions to safeguard Business Confidential information when in use and when being stored.

## **VII. OBLIGATION NOT TO DISCLOSE**

1. Where Business Confidential information has been submitted pursuant to these procedures, no approved person who views or hears such information shall disclose that information, or allow it to be disclosed, to any person other than another approved person, except in accordance with these procedures.
2. The Panel shall not disclose Business Confidential information in its report, but may make statements of conclusion drawn from such information.

## **VIII. DISCLOSURE**

1. Business Confidential information submitted by a party and stored at the Geneva mission or capital city office of the other party may only be viewed by an approved person acting as representative of that other party.
2. An approved person viewing or hearing Business Confidential information may take written summary notes of that information for the sole purpose of the Panel process.
3. Business Confidential information shall not be copied, distributed, or removed from the premises of the WTO, or from the premises of a party's Geneva mission, or from the premises of a party's capital city office, except as specifically provided in these Procedures.
4. Notwithstanding paragraph 3. above, a party may bring with it to a Panel meeting, for the sole purpose of that meeting, one of the two copies of Business Confidential information that it has received from the other party under these procedures, and shall immediately thereafter return any and all such information to the locked storage receptacle at its premises.
5. Notwithstanding paragraph 3. above, a Panel member may make and remove from the premises of the WTO a copy of Business Confidential information. Any copies of Business Confidential information removed from the premises of the WTO by a Panel member shall be used exclusively by that Panel member for the purpose of working on the dispute, and shall be returned to the Secretariat upon conclusion of the Panel. Copies of Business Confidential information removed from the premises of the WTO by a Panel member shall be stored in a locked receptacle.

## **IX. DISCLOSURE AT A PANEL MEETING**

1. A party that wishes to submit Business Confidential information during a Panel meeting shall so inform the Panel prior to doing so. The Panel shall exclude persons who are not approved persons from the meeting for the duration of the submission of such information.

## **X. DISCLOSURE TO THIRD PARTIES**

1. Article 10.3 of the DSU provides that “[t]hird parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel.” Accordingly, disclosure of Business Confidential information contained in the first written submissions of the parties shall be granted to representatives of third parties who have filed a Declaration of Non-disclosure with the Chairman of the Panel. The provisions of these procedures shall apply *mutatis mutandis* to any such disclosure.

## **XI. TAPES AND TRANSCRIPTS**

1. Any tapes and transcripts of Panel meetings at which Business Confidential information is uttered shall be treated as Business Confidential information under these procedures.

## **XII. RETURN OR DESTRUCTION**

1. After the conclusion of the Panel the Secretariat and the parties shall:
  - (i) return any printed or binary-encoded Business Confidential information (including any notes taken pursuant to paragraph VIII:2 above) in their possession to the party that first submitted such Business Confidential information, or certify in writing that any such Business Confidential information has been destroyed, unless the party that first submitted such Business Confidential information objects;
  - (ii) destroy all tapes and transcripts of the Panel hearings that contain Business Confidential information and certify in writing that this has been done, unless the parties mutually agree otherwise.

**ANNEX I**

**DECLARATION OF NON-DISCLOSURE**

In accordance with the Procedures Governing Business Confidential information contained in Procedures on Business Confidential Information of the Panel on Australia—Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126) – Recourse to Article 21.5 of the DSU Requested by the United States (the Procedures), I agree to the following:

Words defined in the procedures have the same meaning in this Declaration of Non-Disclosure as in the Procedures.

1. I acknowledge having received a copy of the Procedures, a copy of which is attached.
2. I acknowledge having read and understood the Procedures.
3. I agree to be bound by, and to adhere to, the provisions of the Procedures and, accordingly, without limitation, to treat confidentially all Business Confidential information that I may view or hear from time to time in accordance with the Procedures.

Executed on this \_\_\_\_\_ day of \_\_\_\_\_, 1999.

BY: \_\_\_\_\_

Name:

Title:

(Advisors only) Affiliation or employment:

\_\_\_\_\_

**AUSTRALIA – SUBSIDIES PROVIDED TO  
PRODUCERS AND EXPORTERS OF  
AUTOMOTIVE LEATHER -**

**RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE  
UNITED STATES**

**REPORT OF THE PANEL**

Corrigendum

Please note that, due to a typographical error, there are no footnotes numbered 1 or 2 in the Panel's report, pages 1-21 of the document. Instead, the footnote numbering, which should have started with footnote 1, starts with footnote 3.