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BRAZIL – EXPORT FINANCING PROGRAMME FOR AIRCRAFT

Second Recourse by Canada to Article 21.5 of the DSU

Report of the Panel

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I. PROCEDURAL BACKGROUND

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

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

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

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

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

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

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

1.8 At its meeting on 16 February 2001, the DSB decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by Canada in document WT/DS46/26. At that DSB meeting, it was also agreed that the Panel should have standard terms of reference as follows:

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1.9 To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS46/26, the matter referred to the DSB by Canada in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.10 The Panel was composed as follows:

Chairperson: Dr. Dariusz Rosati

Members: Prof. Akio Shimizu
Mr. Kajit Sukhum

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

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

1.13 The Panel submitted its interim report to the parties on 20 June 2001. On 25 June 2001, both parties submitted a written request that the Panel review precise aspects of the interim report. Neither party requested an interim review meeting. The Panel submitted its final report to the parties on 10 July 2001.

II. FACTUAL ASPECTS

2.1 As described in our original Panel Report[2], the *Programa de Financiamento às Exportações* (PROEX) was created by the Government of Brazil on 1 June 1991 by Law No. 8187 and is being maintained by provisional measures issued by the Brazilian government on a monthly basis. PROEX provides export credits to Brazilian exporters, inter alia through interest rate equalisation payments.[3] Interest rate equalisation involves payments by Brazil's National Treasury to entities financing or refinancing export transactions involving goods and services.

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

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

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

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

[1] Australia did not make any written or oral submissions to the Panel.
[2] *Brazil – Export Financing Programme for Aircraft* ("*Brazil- Aircraft*"), Report of the Panel ("original Panel Report") adopted on 20 August 1999, WT/DS46/R, paras. 2.1-2.6.
[3] Law No. 8187 of 1 June 1991, replaced by Provisional Measure No. 1629 of 12 February 1998.
[4] Exhibit BRA-1.

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enough to render financing costs compatible with those practiced in the international market.

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

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

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

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

2.7 Thus, the maximum financing terms for which interest rate equalisation payments may be made are established by a Ministerial Directive.[5] The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to a maximum of 2.5 percentage points per annum, for a term of over nine years and up to ten years.[6] The spread is fixed throughout the financing term.

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

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

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

[5] See Ministerial Directive 374 of 21 December 1999 (hereafter "Directive 374") (Exhibit BRA-3).
[6] See Central Bank of Brazil Circular Letter No. 2881 of 19 November 1999 (hereafter "Circular Letter 2881") (Exhibit BRA-2).

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

III. PROCEDURAL ISSUE

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

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

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

3.4 In the view of Canada, paragraph 13 of the Panel's Working Procedures recognizes that parties may consult advisors who are not members of their delegations. Canada submits that the only reason why parties should have the responsibility for these advisors in regard to the confidentiality of the proceedings is because a party may share submissions and other documents with these advisors. Canada considers that statements by the Appellate Body in *Canada – Measures Affecting the Export of Civilian Aircraft*[7] and Panel in *Korea – Taxes on Alcoholic Beverages*[8] confirm its view that submissions may be shared with a party's advisors who are not on its "delegation". Canada also notes that, were it otherwise, parties would simply protect their ability to make a full response by greatly expanding their delegations, as is their right.

3.5 The **Panel** notes that, as a factual matter, Canada does not deny that a member of its delegation at the meeting of the Panel with the parties of 4 April 2001 provided a copy of Brazil's written version of its oral statement to people who were not members of its delegation, as notified to the Panel. In fact, Canada acknowledges that it has "shared [Brazil's submissions and statements]

[7] Canada refers to the Appellate Body Report on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/RW, adopted 20 August 1999, para. 141 (hereafter "Original Appellate Body Report on *Canada – Aircraft*").

[8] Canada refers to the Panel Report on *Korea – Taxes on Alcoholic Beverages*, WT/DS75/R and WT/DS84/R, adopted 17 February 1999, para. 10.32 (hereafter "Panel Report on *Korea – Alcoholic Beverages*").

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with members of a private law firm retained by a Canadian aircraft manufacturer".[9] Accordingly, the issue facing us is whether it was permissible for Canada to share Brazil's oral statement and other documents submitted to the Panel with the private law firm in question. In considering this issue, we note that Article 18.2 of the *DSU* provides in relevant part that:

> … Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential.[10]

3.6 In our view, it emerges from this provision that Canada must keep confidential all information submitted to this Panel by Brazil.[11] However, as the Appellate Body has noted, "a Member's obligation to maintain the confidentiality of […] proceedings extends *also* to the individuals whom that Member selects to act as its representatives, counsel and consultants."[12] Thus, the Appellate Body clearly assumed that Members may provide confidential information also to *non*-government advisors.

3.7 We see nothing in Article 18.2 of the *DSU*, or any other provision of the *DSU*[13], to suggest that Members may share such confidential information with non-government advisors only if those advisors are members of an official delegation at a panel meeting.[14] Indeed, paragraph 13 of this Panel's Working Procedures expressly provides that:

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

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

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[9] Canada's Response to Panel Question 31 (Annex A-4).

[10] Paragraph 3 of this Panel's Working Procedures also includes the quoted sentence.

[11] This is subject, of course, to the provisions of the last sentence of Article 18.2 of the *DSU*, which allow a party to panel proceedings to disclose to the public non-confidential summaries of the information contained in the written submissions of the other party, if such summaries are requested.

[12] Original Appellate Body Report on *Canada – Aircraft*, *supra*, para. 141 (emphasis added). The Appellate Body made the quoted statement in respect of appellate review proceedings. We do not see, however, why the same reasoning should not extend, by analogy, to panel proceedings.

[13] Contrary to Brazil, we do not think that Article 14 of the *DSU* is relevant to the issue before us. Article 14 focuses on panels and their obligations in respect of confidentiality; it does not address itself to the obligations of the parties in respect of confidentiality.

[14] The following statement by the Panel in *Korea – Alcoholic Beverages* supports this view:

> We note that written submissions of the parties which contain confidential information may, in some cases, be provided to non-government advisors who are not members of an official delegation at a panel meeting. The duty of confidentiality extends to all governments that are parties to a dispute and to all such advisors *regardless of whether they are designated as members of delegations and appear at a panel meeting.* (Panel Report on *Korea – Alcoholic Beverages*, *supra*, para. 10.32, emphasis added)

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party.[15] Were it otherwise, there would be no point in requiring parties to safeguard the confidentiality of panel proceedings in respect of such "other advisors".[16]

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

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

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

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

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

3.14 Brazil does not contest these facts. Moreover, Brazil has provided no evidence that those private lawyers have disclosed Brazil's confidential documents to the regional aircraft manufacturer which is their client or any other persons who are not advisors to the Government of Canada.

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

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

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

[17] It should be pointed out that Brazil did not, in these proceedings, submit any business confidential information.

[18] We recall that Brazil's concern is with the confidentiality of its arguments and statements. Business confidential information, which might require other procedures and safeguards, is not, as already mentioned, involved in this situation.

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for questioning Canada's representation that the relevant private lawyers are subject to a confidentiality agreement with the Government of Canada.[19]

IV. INTERIM REVIEW[20]

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

A. COMMENTS BY CANADA

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

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

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

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

[20] Pursuant to Article 15.3 of the DSU, the findings of the final panel report shall include a discussion of the arguments made at the interim review stage. This Section of our report is, therefore, part of our findings.

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

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

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

B. COMMENTS BY BRAZIL

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

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

V. FINDINGS

A. MEASURE AT ISSUE AND TASK OF THE PANEL

5.1 **Canada** submits that the only issue to be decided in these second Article 21.5 proceedings is whether PROEX III is consistent with the *SCM Agreement*. Canada notes that, so long as Brazil continues to make payments pursuant to letters of commitment issued under PROEX I and II, it will remain non-compliant with the recommendations of the DSB of 18 November 1999 that it withdraw its prohibited export subsidies.

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5.2 Canada states that it is challenging the PROEX III *scheme* in so far as it relates to the financing of exports of regional aircraft because, no matter how it is delivered, it enables Brazil to continue to grant prohibited export subsidies. Canada is also challenging PROEX III *payments* made in support of regional aircraft exports because payments under PROEX III remain prohibited export subsidies. With respect to its challenge to PROEX *payments*, Canada refers to the original Panel Report in this dispute, which stated that "we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft."[21]

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

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

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

5.6 Regarding the nature of Canada's complaint, it is clear that, in these proceedings, Canada challenges the PROEX III programme *as such*.[25] In our view, it is not open to question, and Brazil

[21] Panel Report on *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R, adopted 20 August 1999, para. 7.2 (hereafter "Original Panel Report on *Brazil – Aircraft*").

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

[23] See Appellate Body Report on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/RW, adopted 4 August 2000, para. 36 (hereafter "Article 21.5 Appellate Body Report on *Canada – Aircraft*").

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

[25] It should be recalled that, by contrast, in the original proceedings, Canada did *not* challenge the PROEX programme *per se*. See Original Panel Report on *Brazil – Aircraft*, *supra*, footnote 187.

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does not contest, that a panel is entitled to review a subsidy programme *per se* for its consistency with the *SCM Agreement*.[26]

5.7 Canada also challenges *payments* under PROEX III, by which it means "the practice involving PROEX payments". Canada has not, however, disputed Brazil's contention that, under PROEX III, no payments have yet been made, nor letters of commitment issued, in respect of exports of regional aircraft. Therefore, and in the absence of specific evidence to the contrary[27], we are not in a position to review the consistency either of individual PROEX III payments in respect of regional aircraft or a "practice" in respect of such payments with the *SCM Agreement*.[28] It is evident to us that, in the absence of *any* payments or letters of commitment under PROEX III in respect of regional aircraft, there is no "practice" that we could review.

5.8 It follows from the foregoing that our task in these proceedings is to examine the consistency with the *SCM Agreement* of the PROEX III programme *per se*, i.e. the legal framework of PROEX III, in so far as it relates to exports of regional aircraft[29].

B. REVIEW OF LEGISLATION *PER SE*

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

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[26] A number of panels have reviewed subsidy programmes for their consistency with the *SCM Agreement*. See, e.g., the Panel Reports on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999 (hereafter "Original Panel Report on *Canada – Aircraft*"); *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000; *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998.

[27] Canada has alleged that PROEX support was "offered" *by the Brazilian regional aircraft manufacturer*, Embraer, in negotiations to sell regional aircraft which would have been governed by PROEX III. See Canada's Rebuttal Submission, paras. 32-38 (Annex A-2). We recall, however, that an exporter that seeks PROEX interest rate equalisation submits a request, setting forth the proposed terms and conditions for a transaction, to the Export Credit Committee. Only if the Committee approves the transaction does the Committee issue a "letter of commitment" committing the Government of Brazil to provide PROEX support if a contract is concluded according to the terms and conditions contained in the request. See Panel Report on *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, para. 2.5 (hereafter "Article 21.5 Panel Report on *Brazil - Aircraft*"). Brazil has confirmed that it has issued no letters of commitment in respect of regional aircraft under PROEX III, and that, with respect to the negotiations for sales of regional jets to Air Wisconsin Airlines Corporation raised by Canada, no application for interest rate support had been received. See Brazil's Response to Canada's Question 1 (Annex B-5). Canada has not contested those statements, much less offered any evidence to the contrary. Nor has Canada provided any evidence that the Government of Brazil, as opposed to Embraer sales representatives, has otherwise "offered" interest rate support under PROEX III in respect of regional aircraft. We do not believe that we can establish the existence of a practice by the Government of Brazil on the basis of offers by a private entity.

[28] To the extent that Canada's challenge to PROEX III payments may be understood as a challenge to the legal framework governing the provision of PROEX III payments for exports of regional aircraft, that challenge would be subsumed, in our view, within Canada's challenge to the PROEX III programme *per se*. Indeed, where this Report uses the term "PROEX III payments", it is to be understood in the aforementioned sense.

[29] In the original proceedings, Canada defined the regional aircraft market as consisting of commercial aircraft of 20-90 seats, whether turboprop or jet. See Original Panel Report on *Brazil – Aircraft*, *supra*, footnote 188. We see no reason to deviate from that definition in these Article 21.5 proceedings.

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action which was not in conformity with a Contracting Party's/Member's obligations under the GATT 1947/WTO Agreement.

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

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

The Appellate Body further explained that:

> [P]anels developed the concept that mandatory and discretionary legislation should be distinguished from each other, reasoning that only legislation that mandates a violation of GATT obligations can be found as such to be inconsistent with those obligations.[31]

The Appellate Body in that case upheld, to the extent it found it necessary to consider the issue, the interpretation and application by the Panel of the distinction between mandatory and discretionary legislation.[32]

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

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

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[30] Appellate Body Report on *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, para. 88.

[31] *Ibid*., para. 60.

[32] *Ibid*., para. 102.

[33] See Original Panel Report on *Canada – Aircraft*, *supra*, paras. 9.124-9.129, 9.208-9.213. The Panel in that case proceeded to assess the consistency of the programmes in question *as applied*. GATT panel reports applying this principle include the following: Panel Report on *United States – Measures Affecting the Importation, Internal Use and Sale of Tobacco,* BISD 41S/131, adopted 4 October 1994, para. 123; Panel Report on *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes,* BISD 37S/200, adopted 7 November 1990, para. 84; Panel Report on *United States – Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, adopted 17 June 1987.

[34] See Panel Report on *United States – Section 301-310 of the Trade Act of 1974,* WT/DS152/R, adopted 27 January 2000, paras. 7.53-7.54.

[35] Canada does not specifically contest the relevance of the distinction between mandatory and discretionary legislation to claims under Article 3.1(a) of the *SCM Agreement*. It asserts, however, that the distinction does not apply in the context of an affirmative defence such as the second paragraph of item (k) of

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5.13 For the foregoing reasons, in reviewing whether the PROEX III scheme *per se* is a prohibited export subsidy, our examination will entail a consideration as to whether PROEX III *requires* Brazil to provide subsidies prohibited by Article 3.1(a) of the *SCM Agreement*.

C. OVERVIEW OF THE PARTIES' ARGUMENTS

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

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

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

D. ARTICLE 3 OF THE *SCM AGREEMENT*

1. General

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

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

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the Illustrative List of Export Subsidies. We address this issue in the context of our consideration of Brazil's defence under the second paragraph of item (k). See Section E.3(a) *infra*.

[36] We recall that, in the original proceedings, this Panel found that Brazil did not benefit from the transition period for developing country Members set forth in Article 27.4 of the *SCM Agreement* because it did not comply with certain conditions contained in that provision and that, as a result, the prohibition of Article 3.1(a) of the *SCM Agreement* applied to Brazil. See Original Panel Report on *Brazil – Aircraft, supra*, para. 8.1. In the present proceedings, Brazil does not argue that Article 3.1(a) is not applicable to it.

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> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I (footnotes omitted).[37]

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

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

2. Examination of PROEX III

(a) Financial Contribution by a Government

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

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

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

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

(b) Conferral of a Benefit

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

[37] Article 3.2 of the *SCM Agreement* specifies that subsidies of the kind referred to in Article 3.1 must neither be granted nor maintained.

[38] See Original Panel Report on *Brazil – Aircraft*, *supra*, para. 7.13; Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.21.

[39] See Articles 5-7 of BCB Resolution 2799.

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within the meaning of Article 1.1 of the *SCM Agreement*. Canada adds that, if Embraer's customers could achieve financing in the marketplace at rates equivalent to those achieved by PROEX III buy-downs, there would be no need for PROEX III.

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

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

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

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

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

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5.28 In our view, whether the financial contribution has conferred a benefit to producers of regional aircraft -- as opposed merely to a benefit to suppliers of financial services -- depends upon the impact of PROEX III payments on the terms and conditions of the export credit financing available to purchasers of Brazilian regional aircraft. In fact, the arguments of the parties have focused on precisely this question.[42]

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

(i) Structure and Design of PROEX III

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

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

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

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

[43] See Appellate Body Report on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 157 (hereafter "Original Appellate Body Report on *Canada – Aircraft*").

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

[45] See, e.g., Canada's Rebuttal Submission, para. 12 (Annex A-2); Canada's Comments on Brazil's Response to Panel Question 1, para. 3 (Annex A-5).

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5.33 Brazil has identified two features of PROEX III which it considers ensure that PROEX III does not confer a benefit in respect of regional aircraft.[46] First, Brazil argues that BCB Resolution 2799 establishes a minimum net interest rate of the CIRR for all PROEX-supported transactions. Second, Brazil contends that BCB Resolution 2799 employs the "international market" as a benchmark for determining whether or not PROEX III support may be granted. We will consider these alleged features in turn.

(ii) CIRR as Minimum Interest Rate

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

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

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

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

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[46] We note that Brazil did not assert, either in the original proceedings or in the first Article 21.5 proceedings, that PROEX payments did not confer a benefit within the meaning of Article 1.1 of the *SCM Agreement*. To the contrary, Brazil conceded in those proceedings that PROEX I and II did confer a benefit. See Original Panel Report on *Brazil – Aircraft*, *supra*, para. 7.12; Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.21.

[47] Canada's argument that the wording of Article 1, paragraph 1 of BCB Resolution 2799 does not preclude Brazil from supporting net interest rates at below CIRR-level, is addressed at para. 5.141.

[48] Appellate Body Report on *Brazil – Export Financing Programme for Aircraft*, WT/DS/46/AB/RW, adopted 4 August 2000, para. 64 (footnote omitted) (hereafter "Article 21.5 Appellate Body Report on *Brazil – Aircraft*"). The CIRR may be out of line with commercial rates because it is constructed on the basis of government bond yields plus a fixed margin and also because, due to the method of its fixation, it may lag behind the market.

[49] See Article 15 of the 1998 *OECD Arrangement*.

[50] Brazil's argument that net interest rates at the CIRR level would not confer a benefit appears to rest, at least in part, on the Appellate Body's view that net interest rates at the CIRR level would not secure a *material advantage* in the field of export credit terms within the meaning of the first paragraph of item (k). In making this argument, Brazil seems to interpret the term "benefit" in Article 1.1 of the *SCM Agreement* to have the same meaning as the "material advantage" advantage clause in the first paragraph of item (k), something the Appellate Body specifically said is impermissible. See Appellate Body Report on *Brazil – Export Financing Programme for Aircraft*, WT/DS/46/AB/R, adopted 20 August 2000, para. 179 (hereafter "Original Appellate Body Report on *Brazil – Aircraft*").

[51] We note, based on evidence submitted by Canada, that, as of 31 January 2001, out of thirteen US airlines, including the major ones, none had a "first-class" rating for unsecured debt. Thus, none of the thirteen airlines had "triple A" rating or, for that matter, any "A" rating at all. See Exhibit CDA-17, p. 6. Brazil itself

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even if the CIRR did accurately reflect commercial market rates for first-class borrowers, the requirement in BCB Resolution 2799 that PROEX III support must not result in net interest rates below the CIRR does not mean that PROEX-supported interest rates are no more favourable than those which particular purchasers of Brazilian aircraft could have obtained in the commercial marketplace. We therefore find that the prescription of a CIRR floor for financing operations involving regional aircraft does not establish the absence of a benefit for the buyers of such aircraft.

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

(iii) International Market Benchmark

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

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

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

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has stated that at least one of these airlines, Continental Airlines, has actually purchased Embraer regional jets. See Brazil's Comments on Canada's Response to Panel Question 18 (Annex B-6). Continental Airlines was rated, on the date indicated, at "Ba2/BB-".

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

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

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

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

[56] See Brazil's Responses to Panel Questions 14(a), 14(c), 14(d) and 14(e) (Annex B-5).

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5.40 However, Brazil has also noted that "there may be situations in which the CIRR is *below* the marketplace rates […]. In those circumstances, the Committee could provide PROEX support [in accordance with the provisions of the second paragraph of item (k)]."[57] We understand this statement to mean that Article 8, paragraph 2 would *not* preclude Brazil from granting PROEX III support to reduce net interest rates *below* those which could be obtained commercially.[58] This reply squarely contradicts some of the aforementioned statements by Brazil.

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

(iv) Mandatory versus Discretionary Conferral of a Benefit

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

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

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

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

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

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

[60] We note that nothing on the face of the phrase "the financing terms practiced in the international market" suggests that the benchmark terms must necessarily be the *commercial* terms available to the buyer in question for a comparable transaction. See also Canada's Comments on Brazil's Response to Panel Question 14, para. 4 (Annex A-5).

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> … the National Treasury *may* provide to the financing or re-financing agency […] equalization enough to render financing costs compatible with those practiced in the international market. (emphasis added)[61]

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

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

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

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

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

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[61] The term "may" is expressed as "pode ser" in the original Portuguese-language text.

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

[63] See Brazil's Response to Panel Question 13 (Annex B-5)

[64] See Section D.2(b)(iii) *supra*.

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5.49 We note that Canada itself has asserted that Brazil's executive branch has broad discretionary authority with respect to the administration of PROEX III.[65] Further, Canada has recognised that, under the traditional distinction between mandatory and discretionary legislation, it is incumbent on the complaining party to establish that the executive branch of the responding party is required to act inconsistently with its obligations under the WTO Agreement.[66]

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

5.51 We emphasize that our ruling is limited to a finding that Brazil is not *required* by PROEX III to confer a benefit on producers of Brazilian regional aircraft through interest rate equalisation payments. We do not mean to suggest that Brazil *will not* confer a benefit in some if not most cases in which PROEX III interest rate equalisation is provided. To the contrary, we believe that the very logic of PROEX III would be undermined if Brazil were to limit the provision of PROEX III interest rate equalisation to cases where no benefit was conferred.[68] We recall, however, that Brazil may avoid violating Article 3.1(a) of the *SCM Agreement either* by not conferring a benefit (such that no subsidy contingent upon export performance exists) *or* by taking advantage of the "safe haven" provided for in the second paragraph of item (k)[69], and that Brazil has asserted that it will operate PROEX III in such a manner[70].

(c) Export Contingency

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

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

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

[65] See, e.g., Canada's Comments on Brazil's Response to Panel Question 8, para. 3 (Annex A-5).

[66] See Canada's Response to Panel Question 21 (Annex A-4).

[67] This is not a case where PROEX III interest rate equalisation would necessarily confer a benefit, and where the only discretion available is that of not providing the equalisation at all. We do not express a view as to whether our approach in this case would be equally applicable in such factual circumstances. Rather, this is a case where Brazil has discretion to operate PROEX III interest rate equalisation in such a manner that it does not confer a benefit. Further, we note that the facts before us are unlike those before the Appellate Body in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*. In that case, the Appellate Body was reviewing mandatory legislation. See Appellate Body Report on *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998, paras. 49 and 54.

[68] Brazil has stated that PROEX III payments are intended to enable Embraer to avoid a competitive disadvantage *vis-à-vis* other regional aircraft manufacturers the sales of which are enjoying official support. See Brazil's Response to Panel Question 4 (Annex B-5). To the extent that PROEX III payments do not allow purchasers of Brazilian regional aircraft to obtain export credit financing on terms more favourable than would be available to them in the commercial market, it is hard to see how this stated purpose would be served. Rather, the sole beneficiaries of PROEX III payments in such cases would be *lenders*. In other words, PROEX III payments in such cases would be subsidies *in respect of financial services*, rather than regional aircraft. Given that the lender receiving PROEX III payments need not be Brazilian, this is an unlikely scenario.

[69] See Section E *infra*.

[70] See Brazil's Closing Statement, para. 11 (Annex B-4).

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apply only to export financing operations.[71] Again, Brazil does not dispute that PROEX III payments are export-contingent.

3. Conclusion

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

5.56 In the light of our conclusion with respect to Canada's claim under Article 3.1(a) of the *SCM Agreement*, we could exercise judicial economy and end our analysis at this point. We consider, however, that a more complete analysis of the issues before us would facilitate the work of the Appellate Body in the event that this Panel Report is appealed. We further recall Brazil's statement that "the [Export Credit] Committee, operating under PROEX III will *either* operate under the safe haven of the second paragraph of item (k) *or*, when providing terms of interest rates [*sic*] support consistent with the market under the exception [provided for in Article 8, paragraph 2 of BCB Resolution 2799], will confer no 'benefit'".[72] In the light of Brazil's stated intention to rely on the "safe haven" in certain circumstances, and in the interests of promoting a full resolution of this dispute, we proceed to consider Brazil's arguments in respect of the "safe haven" in the second paragraph of item (k).[73]

E. SECOND PARAGRAPH OF ITEM (K)

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

1. Burden of Proof

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

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

[71] See Article 1 and Article 1, paragraph 1 of BCB Resolution 2799.

[72] Closing Statement of Brazil, para. 11 (emphasis added) (Annex B-4).

[73] There is, in our view, particular justification for facilitating a full resolution of this particular dispute in view of the fact that this is the *second* time that Canada has asked us to review Brazil's measures taken to comply with the relevant recommendations and rulings of the DSB.

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the second paragraph. Specifically, it is necessary, according to Canada, to establish conformity with *all* of the "interest rates provisions" of the relevant *OECD Arrangement*.

5.60 The **Panel** recalls that the text of the second paragraph of item (k) reads as follows:

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

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

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

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

2. Specific Interpretative Issues

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

(a) "Export Credit Practices"

5.65 The Article 21.5 Panel in *Canada – Aircraft* considered that there is "… no basis to consider any practice associated with export credits as *a priori* not constituting an 'export credit practice' in the sense of the second paragraph of item (k)."[75]

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

[74] See the Appellate Body Report on *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, adopted 23 May 1997, WT/DS33/AB/R, p. 16; Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 66.

[75] Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, para. 5.81 (footnote omitted).

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(b) "Relevant International Undertaking on Official Export Credits"

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

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

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

5.70 In respect of Brazil's interpretation, Canada argues that if the drafters had meant to refer to the 1992 *OECD Arrangement*, they could simply have done so. Canada also recalls that the second paragraph of item (k) tracks the text of the 1979 GATT Subsidies Code. Canada notes that the 1979 GATT Subsidies Code also referred to a "successor undertaking" to the 1978 *OECD Arrangement*. Canada points out, however, that, in 1979, there was no successor undertaking to the 1978 *OECD Arrangement*. Canada deduces from this that the term "successor undertaking" must necessarily be forward looking.

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

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flexibility to update agreements and, therefore, included the possibility of an updated *OECD Arrangement* in the language "a successor undertaking".

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

> … if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members) …

5.73 It is not in dispute that the phrase "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979" is a reference to the *OECD Arrangement* in effect on 1 January 1979.[76] Nor is it in contention that the bracketed phrase "a successor undertaking which has been adopted […]" refers to a "successor undertaking" to the *OECD Arrangement* in effect in 1979. The parties differ, however, regarding whether the relevant "successor undertaking" is the 1992 version of the *OECD Arrangement* or the 1998 version.

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

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

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

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

[76] See also Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, para. 5.78.

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There is, to be sure, another relevant phrase in the second paragraph which reads: "[…] if in practice a Member applies the interest rates provisions of the relevant undertaking". However, a Member that becomes a party to the 1992 *OECD Arrangement* after 1995 would not be covered by that phrase either. It would apply the 1992 *OECD Arrangement* as a matter of *law*. It cannot, in our view, be said to apply that Arrangement as a matter of *practice*.[77] Thus, such a Member would, in effect, be precluded from successfully invoking the safe haven in the second paragraph of item (k), a result which we think the drafters could not have intended.

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

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

5.80 Turning next to the term "successor undertaking", we note that, in its ordinary meaning, this term refers to an undertaking which "succeeds [i.e. follows] another in […] function".[78] There can be no question, in our view, that both the 1992 and the 1998 version of the *OECD Arrangement* constitute "successor" undertakings *to the OECD Arrangement in effect in 1979*.[79] It should be pointed out, in this regard, that the 1998 *OECD Arrangement* is the latest adopted version of the *OECD Arrangement* and, as such, is currently in effect, whereas the 1992 *OECD Arrangement* is no longer in effect. This raises the question of which successor undertaking is the *relevant* successor undertaking if there is more than one. The text of the second paragraph of item (k) does not explicitly answer that question.[80]

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

5.82 Specifically with respect to the issue of whether the 1992 *OECD Arrangement* or the 1998 *OECD Arrangement* is the relevant successor undertaking, it should be noted that the 1992 *OECD*

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

[78] The New Shorter Oxford English Dictionary, Vol. II, Oxford (1993), pp. 3127 and 3128.

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

[80] It is clear to us, however, that the drafters could not have left the addressees of the second paragraph free to choose among different successor undertakings. Were it otherwise, complainants could select the strictest successor undertaking with as much justification as respondents could select the most generous successor undertaking. The second paragraph would then fail to do what it is there to do, i.e. to inform Members regarding what their rights and obligations are.

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Arrangement was in existence at the time the *SCM Agreement* was negotiated. Had Members intended the 1992 *OECD Arrangement* to be the relevant successor undertaking, they could simply have expressed that intention in the text of the second paragraph of item (k). It is significant, in our view, that they did not do so and instead chose to refer, broadly, to "a successor undertaking".

5.83 In view of the foregoing, we conclude that the "successor undertaking" at issue in the second paragraph of item (k) is the most recent successor undertaking which has been adopted prior to the time that the second paragraph is considered. For purposes of these proceedings, we conclude that the most recent successor undertaking which has been adopted is the 1998 *OECD Arrangement*.[81]

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

5.85 We do not agree that the interpretation of the second paragraph of item (k) which we found to be the correct one and which is based on Article 31 of the Vienna Convention on the Law of Treaties "leads to a result which is manifestly absurd or unreasonable" within the meaning of Article 32 of the Vienna Convention.[82]

5.86 It is true that, under our interpretation, the Participants to the *OECD Arrangement* could modify the 1998 *OECD Arrangement*, and thus effectively the scope of the safe haven in the second paragraph of item (k), without Members' consent.[83] As the Article 21.5 Panel in *Canada – Aircraft* (hereafter "the Article 21.5 Panel") has remarked:

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[81] It should be reiterated here that the 1992 *OECD Arrangement* is no longer in effect.

[82] Article 31(1) of the Vienna Convention reads:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Article 32 of the Vienna Convention reads:

> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
>
> (a) Leaves the meaning ambiguous or obscure; or
> (b) Leads to a result which is manifestly absurd or unreasonable.

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

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> … the second paragraph of item (k) is quite unique in the sense that it creates an exemption from a prohibition in a WTO Agreement, the scope of which exemption is left in the hands of a certain *subgroup* of WTO Members – the Participants, all of which as of today are OECD Members – to define, and to change as and when they see fit.[84]

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

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

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

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

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

[84] Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, para. 5.132.

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

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

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

[86] In any event, we must assume that the drafters were aware that the *OECD Arrangement* had undergone a number of changes *pre*-1995 (see Exhibit CDA-31) and, hence, were equally aware of the possibility of the scope of the safe haven being modified *post*-1995. Thus, this result in our view reflects a negotiated balance of rights and obligations, which is not for a panel to upset. If the Participants were to abuse their power to modify the scope of the safe haven, the recourse of other Members would be to renegotiate the second paragraph of item (k).

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5.91 As noted by Canada, the 1979 GATT Subsidies Code contained a provision the wording of which was almost exactly identical to that of the second paragraph of item (k) as it appears in the *SCM Agreement*. Specifically, the 1979 GATT Subsidies Code also used as benchmarks the *OECD Arrangement* as in effect in 1979 or a "successor undertaking which has been adopted by those original signatories". Applying Brazil's interpretation of the *SCM Agreement* to the 1979 GATT Subsidies Code, the relevant "successor undertaking" for purposes of the 1979 GATT Subsidies Code would need to be one that "ha[d] been adopted" in 1979 or on 1 January 1980, when the GATT Subsidies Code came into force. However, neither in 1979 nor on 1 January 1980 was there a "successor undertaking". This confirms our view that the present perfect "has been adopted" cannot be read to refer to the drafters' present, i.e. 1 January 1980.[87]

(c) "Conformity with the Interest Rates Provisions of the Relevant Undertaking"

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

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

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

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

[87] Brazil's argument that the term "successor undertaking" was included in the GATT Subsidies Code to refer to any possible action within the OECD between 1 January 1979, i.e. the effective date of the *OECD Arrangement*, and 1 January 1980, i.e. the effective date of the GATT Subsidies Code, is not convincing. Had the drafters intended to do so, they could have referred to the date of the entry into force of the GATT Subsidies Code. In fact, we believe they would have done so precisely to preclude an interpretation of the term "successor undertaking" which allows for the incorporation of successor undertakings which post-date the effective date of the GATT Subsidies Code.

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5.96 The Article 21.5 Panel began its inquiry into what were the "interest rates provisions" of the *OECD Arrangement* by noting that, unlike the second paragraph of item (k), the *OECD Arrangement* did not use or define the term "interest rates provisions".[88] It was therefore incumbent on that Panel to construe the term "interest rates provisions". It found that the "interest rates provisions" of the *OECD Arrangement* were those provisions which "specifically" or "directly or explicitly" address interest rates "as such".[89] With that interpretation in mind, the Article 21.5 Panel turned to the *OECD Arrangement* to identify those provisions which were consistent with its interpretation of the term "interest rates provisions". It indicated that it would base its conclusions on a reading of the *OECD Arrangement* which was in accordance with the customary rules of interpretation of public international law and which, in particular, was consistent with the ordinary meaning of the text of the *OECD Arrangement*.[90]

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

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

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

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

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[88] Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, para. 5.83.

[89] *Ibid.*, paras. 5.83 and 5.91.

[90] *Ibid.*, 5.74 and 5.83.

[91] *Ibid.*, 5.83.

[92] *Ibid.*, 5.83 and 5.84.

[93] See the parties' responses to Panel Question 25. The parties have not specifically discussed Article 28b) (on minimum interest rates with respect to used aircraft). There can be no question, in our view, that Article 28b) is an interest rate provision within the meaning of the second paragraph of item (k).

[94] We consider that Article 19 of Annex III (on best endeavours to respect customary market terms) also directly addresses interest rates.

[95] EC Submission, footnote 21 (Annex C-1).

[96] US Submission, para. 23 (Annex C-3).

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provisions. To accept that view would, in our opinion, be to disregard, even to render nugatory, the explicit textual reference to "interest rates" provisions. This we do not feel entitled to do.[97]

5.101 We further note that, if an expansive reading of the term "interest rates provisions" were adopted, then export credit practices with respect to which the 1998 *OECD Arrangement* establishes *no* minimum interest rates -- and with respect to which the *Arrangement* establishes *no* disciplines regarding interest rates -- would nevertheless be "in conformity with the interest rates provisions" of the 1998 *OECD Arrangement.* In our view, it is not possible to read the second paragraph of item (k) in such a manner that export credit practices which are not subject to the minimum interest rates set forth in the 1998 *OECD Arrangement* are nevertheless in conformity with the interest rates provisions of the *Arrangement*.[98]

5.102 In this respect, we agree with the Article 21.5 Panel that the only export credit practices which are subject to the interest rates provisions of the 1998 *OECD Arrangement* at present and which, therefore, are potentially "in conformity" with those provisions are those which are (i) in the form of "official financing support", i.e. direct credits/financing, refinancing or interest rate support, (ii) have repayment terms of at least two years and (iii) have fixed interest rates.[99] It is only in respect of these categories of export credit practices that any minimum interest rates apply.

5.103 While the Article 21.5 Panel did not take a broad view of the term "interest rates provisions", it considered that adherence to the "interest rates provisions" alone was insufficient for export credit practices to qualify for the safe haven in the second paragraph of item (k).[100] Brazil, however, contests that the safe haven clause contemplates compliance with any provisions of the *OECD Arrangement* other than its interest rates provisions. In the light of Brazil's challenge, it is appropriate to examine the reasons which support the view adopted by the Article 21.5 Panel.

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

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

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

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

[100] There is no need, however, to duplicate the reasoning of the Article 21.5 Panel. It is sufficient, for present purposes, to outline the main analytical steps of the approach followed by the Article 21.5 Panel.

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support.[101] The Article 21.5 Panel submitted that any financing transaction consisted of a package of financing terms and conditions, many of which affect the interest rate. Among these were the maximum repayment term, the amount of the cash down payment and the timing of principal and interest payments. The Article 21.5 Panel concluded on that basis that, if minimum interest rates were prescribed when no limitations existed for those terms and conditions which could affect the minimum interest rate, it would be easy to circumvent the limiting effect of that minimum interest rate.[102] The Article 21.5 Panel pointed out, however, that the *OECD Arrangement* did impose limitations on the generosity of the terms which affect its minimum interest rates provision.[103]

5.105 The safe haven clause, of course, only refers to the "interest rates provisions" of the *OECD Arrangement*, including its minimum interest rates provision. The Article 21.5 Panel recalled, however, that the safe haven clause spoke of "conformity with" the interest rates provisions of the *OECD Arrangement*. In the view of the Article 21.5 Panel, it was appropriate to adopt a sufficiently broad interpretation of the concept of "conformity" so as to guard against the possibility of circumvention of the minimum interest rates provision.[104] More specifically, the Article 21.5 Panel considered that conformity with the interest rates provisions of the *OECD Arrangement* had to be judged on the basis of (i) conformity with the minimum interest rates provision, i.e. the CIRR, and (ii) adherence to those provisions of the *OECD Arrangement* which "operate to support or reinforce the minimum interest rate rule".[105]

5.106 The Article 21.5 Panel then considered which provisions of the *OECD Arrangement* operate to support or reinforce the minimum interest rates provision. It concluded that the following provisions performed a supporting or reinforcing function in respect of the minimum interest rates provision: Article 7 (on minimum cash payments), Article 8 (on the definition of repayment terms), Article 9 (on the definition of the starting point of credit), Article 10 (on maximum repayment terms), Article 12 (on the classification of countries for maximum repayment terms), Article 13 (on the repayment of principal), Article 14 (on the payment of interest), Article 20, as well as the related Articles 21-24 (on minimum premium benchmarks), Article 25 (on local costs) and Article 26 (on the maximum validity period for export credits).[106] With respect to regional aircraft, that Panel found that the following provisions of Sector Understanding on Export Credits for Civil Aircraft in Annex III to the *OECD Arrangement* also had to be respected, in addition to the minimum interest rates provision: Article 21 (on maximum repayment terms for new aircraft), Article 28 (on maximum repayment terms for used aircraft), Article 23 (on insurance premium and guarantee fees), Article 24 (on aid support), Article 29a)-c) (on the financing of spare engines and spare parts) and Article 30 (on support for maintenance and service contracts).[107] In identifying the above provisions, the Article 21.5 Panel stressed that not all of them would necessarily be applicable to every transaction enjoying official financing support.[108]

5.107 The Article 21.5 Panel next considered various provisions of the *OECD Arrangement* which authorize exceptions and derogations from the aforementioned terms and conditions. Specifically, the issue was whether official financing support provided under those exceptions and derogations could be viewed as being "in conformity" with the interest rates provisions within the meaning of the safe

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[101] *Ibid*., para. 5.109. The Article 21.5 Panel stressed, in this regard, that the *OECD Arrangement*, by its own terms, "seeks to encourage competition among exporters … based on quality and price of goods and services exported rather than on the most favourable officially supported [export credit] terms" by placing "limitations on the terms and conditions of export credits that benefit from official support". See *ibid*., paras. 5.82 and 5.110.

[102] *Ibid*.

[103] *Ibid*., para. 5.110.

[104] *Ibid*.

[105] *Ibid*., para. 5.114.

[106] *Ibid*., paras. 5.116-5.117.

[107] *Ibid*., para. 5.118.

[108] *Ibid*., para. 5.119.

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haven clause. The Article 21.5 Panel noted that the *OECD Arrangement*, by its terms, drew a distinction between "permitted exceptions" and "derogations".[109] It found that permitted exceptions were "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was specifically foreseen and permitted.[110] The Article 21.5 Panel thus concluded that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could qualify for the safe haven in the second paragraph of item (k).[111]

5.108 With respect to derogations, on the other hand, the Article 21.5 Panel considered that they were *not* "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was not foreseen and not permitted.[112] Accordingly, where official financing support "derogated" from one of the provisions which could affect the minimum interest rates provision, the underlying transaction would *not* be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could *not* qualify for the safe haven in the second paragraph of item (k).[113]

5.109 The Article 21.5 Panel also addressed the so-called "matching" provisions of the *OECD Arrangement* which permit the Participants to the *OECD Arrangement*, within certain limits, to "match" the terms and conditions offered by other Participants and by non-Participants. On this issue, the Article 21.5 Panel took the view that matched permitted exceptions "conformed" with the provisions of the *OECD Arrangement* and, hence, also "conformed" with the interest rates provisions in the sense of the safe haven clause.[114] In contrast, matched derogations were not "in conformity" with the provisions of the *OECD Arrangement* and, as a result, were also not "in conformity" with the interest rates provisions in the sense of the safe haven clause.[115] The Article 21.5 Panel stated, in this regard, that, if it were accepted that matched derogations were "in conformity" with the interest rates provisions of the *OECD Arrangement*, then the concept of "conformity" could not possibly discipline official financing support.[116] The Article 21.5 Panel also recalled that non-Participants to the *OECD Arrangement* would not, as a matter of right, have access to information regarding the terms and conditions offered or matched by Participants. Such information was available only to Participants. Thus, if matched derogations were eligible for the safe haven in the second paragraph of item (k), non-Participants would be at a systematic disadvantage *vis-à-vis* Participants.[117]

5.110 Brazil argues that the approach taken by the Article 21.5 Panel is too broad and that the safe haven clause only requires conformity with the interest rates provisions of the *OECD Arrangement*, as identified by the Article 21.5 Panel. We disagree. The Article 21.5 Panel was correct, in our view, in its underlying assumption that the *OECD Arrangement* provides for minimum interest rates in order to discipline official financing support and that it was on the same grounds that the minimum interest rates provision was incorporated into the safe haven clause. We also agree that minimum interest

[109] *Ibid*., paras. 5.121 and 5.126.

[110] *Ibid*., paras. 5.121 and 5.124. The Article 21.5 Panel referred to Articles 27b), 48 and 49 of the *OECD Arrangement*. *Ibid*., para. 5.123.

[111] *Ibid*., para. 5.126.

[112] *Ibid*., paras. 5.121 and 5.125. The Article 21.5 Panel referred to Articles 28, 29 and 47b) of the *OECD Arrangement*. *Ibid*., para. 5.125.

[113] *Ibid*., para. 5.126.

[114] *Ibid*., paras. 5.124 and 5.126. The Article 21.5 Panel referred to Articles 29 and 51 of the *OECD Arrangement* as well as Articles 25, 29d) and 31 of the Sector Understanding on civil aircraft. *Ibid*., para. 5.124 and footnote 113.

[115] *Ibid*., paras. 5.125 and 5.126. The Article 21.5 Panel referred to Articles 29 and 47b) of the *OECD Arrangement* as well as Articles 25, 29d) and 31 of the Sector Understanding on civil aircraft. *Ibid*., para. 5.125 and footnote 113.

[116] *Ibid*., paras. 5.120 and 5.125.

[117] *Ibid*., para. 5.134.

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rates, on their own, could not meaningfully exercise a limiting effect. As we see it, the minimum interest rates were fixed, at a particular level, in the light of and with regard for the fixing of other relevant parameters, i.e. credit terms and conditions. The intended limiting effect of the minimum interest rates cannot, therefore, be achieved unless the relevant parameters are fully respected. Consequently, the Article 21.5 Panel was justified, in our view, in adopting a reading of the concept of "conformity with the interest rates provisions" which safeguards the intended limiting effect of the minimum interest rates provision of the *OECD Arrangement* by requiring adherence also to those terms and conditions of the *OECD Arrangement* which support or reinforce the minimum interest rates provision. We therefore conclude that eligibility of an individual financing transaction for the safe haven in the second paragraph of item (k) cannot be judged on the basis of conformity with minimum interest rates alone.

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

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

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

[118] See Article 29b).

[119] See Article 29a) in conjunction with Article 20 of Annex III.

[120] See Article 15 and Article 22 of Annex III.

[121] In our view, Article 19 of Annex III of the *OECD Arrangement* (on best endeavours to respect customary market terms) may also be viewed as being one of the provisions which operates to support or reinforce the minimum interest rates provision.

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transactions involving matching of derogations were not eligible for the safe haven in the second paragraph of item (k). We find the reasoning of the Article 21.5 Panel in this regard persuasive. There is nothing in the arguments advanced by the two third parties which would give us grounds for deviating from the findings of the Article 21.5 Panel.

5.114 It seems to us that both third parties tend to argue -- incorrectly -- from the standpoint of the *OECD Arrangement* rather than from the standpoint of the safe haven clause and the *SCM Agreement*. The United States considers that it would be unfortunate if Participants to the *OECD Arrangement* were dissuaded from using its matching provisions for fear that doing so might be contrary to the provisions of the *SCM Agreement*. The United States appears to suggest that, deprived of the possibility of matching, Participants would somehow be left defenceless in the face of non-conforming practices under the *OECD Arrangement*. This is not the case, however. It notably overlooks the fact that, to the extent those non-conforming practices are covered by the *SCM Agreement*, they would be enforceable through the WTO dispute settlement mechanism.[122]

5.115 The European Communities asserts that the reasoning on matching by the Article 21.5 Panel ignores the fact that the *OECD Arrangement* is a non-binding gentlemen's agreement. The Article 21.5 Panel was well aware of the nature of the *OECD Arrangement*.[123] As we understand it, however, the Article 21.5 Panel based its view on the provisions of the *SCM Agreement* and the need to prevent the scope of the safe haven clause from being improperly enlarged.[124] It convincingly stated that, to accept, for purposes of the *SCM Agreement*, that even non-conforming departures from the provisions of the *OECD Arrangement* were covered by the safe haven, would, in effect, remove any disciplines on official financing support for export credits. The European Communities contests that statement, arguing that the Participants to the *OECD Arrangement* consider matching to be compatible with effective disciplines on officially supported export credits. However, the fact that the *OECD Arrangement* allows matching of derogations does not logically imply that it should also be allowed under the *SCM Agreement*. Indeed, the *OECD Arrangement* and the *SCM Agreement* are very different. The European Communities itself acknowledges that the *OECD Arrangement* is a non-binding gentlemen's agreement. In those circumstances, matching may serve an important deterrent and enforcement function. That rationale for matching does not apply to the *SCM Agreement*. The *SCM Agreement* is a binding instrument, and it is enforceable through the WTO dispute settlement mechanism. The European Communities' argument is therefore unavailing.

5.116 What is more, the Article 21.5 Panel correctly noted that, if matching of derogations were not subject to challenge under the *SCM Agreement*, Members could, in principle, match the practices of non-Members. This would lead to the odd and unjustifiable result that a Member could justify the provision of an otherwise prohibited export subsidy on the basis of measures taken by a non-Member.[125] Another argument advanced by the Article 21.5 Panel which the European Communities fails to mention is that matching could, *de facto*, lead to the elimination of special and differential treatment of developing country Members provided for in Article 27 of the *SCM Agreement*, in so far as export credit practices are concerned. To appreciate this, it is sufficient to recall the example given by the Article 21.5 Panel, whereby a developed country Member matches the subsidized terms of a developing country Member, even though those terms are in accordance with a provision according special and differential treatment to that Member, such as Article 27 of the *SCM Agreement*.[126]

[122] It is worth noting here that, arguably, the findings of the Article 21.5 Panel in *Canada – Aircraft* did not, in any event, affect the provisions of the *OECD Arrangement* requiring notification to other Participants of non-conforming terms. Thus, if anything, Participants would be at an advantage *vis-à-vis* non-Participants in terms of their abilities of monitoring compliance with the *SCM Agreement*.

[123] See Article 21.5 Panel Report in *Canada – Aircraft*, *supra*, para. 5.82.

[124] See *ibid*., para. 5.137.

[125] *Ibid*., para. 5.138.

[126] *Ibid*., para. 5.136.

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5.117 Finally, we note the European Communities' view that the fact that non-Participants do not receive the notifications of non-conforming terms which Participants receive should not stop them from matching non-conforming offers. According to the European Communities, non-Participants could simply proceed to match if they did not receive adequate information from the party which they suspect of offering non-conforming terms.[127] Even were we to accept this point, non-Participants would still be at a systematic disadvantage compared to Participants in all those situations where Participants notify other Participants, on their own motion, of non-conforming terms, as required by the *OECD Arrangement*.[128] The European Communities' point fails to dispose of *this* argument.

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

3. Examination of PROEX III

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

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

5.120 It will be recalled that we have found that it is the PROEX III scheme as such, i.e. the legal framework for PROEX III, which is before this Panel, and that, applying the distinction between mandatory and discretionary legislation, the question presented is whether Brazil is *required* to apply PROEX III in a manner that gives rise to a prohibited export subsidy.[129] However, at this point in our analysis, we are dealing with an affirmative defence raised by Brazil under the second paragraph of item (k). Thus, we are confronted with the preliminary issue of whether the distinction between mandatory and discretionary legislation is applicable in the context of an affirmative defence under the second paragraph of item (k).

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

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

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

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

[129] See para. 5.43.

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

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

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

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

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

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

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

[132] We note the Appellate Body's view that "… the burden of proof is a procedural concept which speaks to the fair and orderly management and disposition of a dispute." (Original Appellate Body Report on *Canada –Aircraft*, *supra*, para. 198)

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Arrangement[133] or, expressed otherwise, whether PROEX III allows compliance with the interest rates provisions.[134]

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

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

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

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

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

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

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

[135] It is not in dispute that PROEX III is an "export credit practice" within the meaning of the second paragraph of item (k); that PROEX III is available for export credit financing for regional aircraft with repayment terms of two years or more; and that PROEX III applies in respect of export credits with fixed interest rates. We see no need to disagree with the parties regarding these points.

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interest rate support. The **United States** notes that "interest rate support" refers to practices under which a government enters into an agreement on interest rates with a commercial bank that is providing the export credit financing for an export credit transaction, but is not sufficiently familiar with the facts to opine as to whether PROEX III payments, as applied, constitute interest rate support.

5.131 The **Panel** notes that the 1998 *OECD Arrangement* does not define the term "interest rate support". It merely states that "interest rate support" is a form of official financing support.[136] Since the 1998 *OECD Arrangement* does not give a special meaning to the term "interest rate support", we must read it in accordance with its ordinary meaning in context.

5.132 We consider that, in its ordinary meaning, the term "interest rate support" relates broadly to official support for one particular export credit term, namely the interest rate to be paid in connection with export credits. Moreover, as a matter of relevant context, it is clear from the 1998 *OECD Arrangement* that interest rate support is distinct from direct credits/financing, refinancing, export credit insurance and guarantees.[137] From this it may be deduced that official interest rate support will normally involve government payments to providers of export credits.[138] For such payments to amount to "support", we think they need to be made with the aim or effect of securing net borrowing rates for the recipients of export credits which are lower than they would have been in the absence of official financing support.[139]

5.133 Turning to PROEX III, we note that BCB Resolution 2799 envisages payments by the Government of Brazil to financial institutions "enough to render financing costs [i.e. net interest rates] compatible with those practiced in the international market."[140] Thus, PROEX III provides for support for interest rates ("financing costs"), involves payments by the Brazilian Government to commercial providers of export credits and is designed to lower the net interest rates charged by particular commercial lenders to levels which are compatible with those prevailing in the international market. In light of this, we conclude that PROEX III support constitutes "interest rate support" as we understand that term.[141]

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

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

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

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

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

[138] See Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.53 and footnote 53.

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

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

[141] None of the Participants in these proceedings has specifically contested that PROEX III is properly viewed as one form of "interest rate support".

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Members that "in practice … appl[y] [its] interest rates provisions". Brazil is not a Participant to the 1998 *OECD Arrangement*, but claims that it will in practice apply the interest rates provisions of the *Arrangement*. We are satisfied, therefore, that PROEX III can, in principle, qualify for protection under the second paragraph of item (k) and that we may entertain Brazil's claim of justification under that paragraph.[142] Canada has not suggested otherwise.

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

(i) Interest Rates Provisions[143]

Article 22 of Annex III (on minimum interest rates)[144]

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

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

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

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

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

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

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

[145] Brazil translates the Portuguese phrase "respeitada a … CIRR" as "complying with" the CIRR.

[146] Canada translates the Portuguese phrase "respeitada a … CIRR" as "in accordance with" the CIRR.

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

[148] It is our understanding from Brazil's submissions that, notwithstanding the provisions of Article 8, paragraph 2 of BCB Resolution, the Export Credit Committee must comply with the CIRR in *all* cases involving

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5.141 Canada disagrees with the last point, arguing that the wording of Article 1, paragraph 1 would not prevent Brazil from supporting net interest rates at below-CIRR level. The Portuguese version of BCB Resolution 2799 uses the words "respeitada a … CIRR", which Brazil translates as "complying with". We are satisfied that this is an accurate translation and also that this language requires Brazil to "respect" or "comply with" the relevant CIRR.[149]

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

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

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

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

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

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

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transactions in the regional aircraft sector. See, e.g., Brazil's Response to Panel Question 1 (Annex B-5); Brazil's First Submission, para 44 (Annex B-1).

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

[150] See Article 16d).

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5.147 In reviewing PROEX III for conformity with Article 17a), it must be borne in mind that, once the Export Credit Committee has approved a request for PROEX III support, a letter of commitment is issued to the applicant.[151] As we explained in our previous Article 21.5 report, such a letter

> […] commits the Government of Brazil to providing support as specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into within a specified period of time, usually 90 days […]. If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.[152]

5.148 PROEX III is not different from PROEX II with respect to the maximum period for offers of interest rate support.[153] We therefore have no basis for finding, at this point, that offers of PROEX III support will not be in conformity with the 120-day maximum period laid down in Article 17a).

5.149 We also found in our previous Article 21.5 report that applicants requested letters of commitment prior to conclusion of a formal agreement with the buyer.[154] Assuming that remains the case, the minimum net interest rate Brazil could fix would be the relevant CIRR plus 20 basis points. It should be noted, in this regard, that Article 1, paragraph 1 of BCB Resolution 2799 requires that the CIRR be the floor rate. It does not oblige Brazil to approve interest rate support at the CIRR in all cases. In fact, it specifically states that the extent of the interest rate support to be provided is to be established "on a case-by-case basis".[155] On its face, PROEX III is not, therefore, inconsistent with the provisions of Article 17a). At a minimum, we cannot say that PROEX III does not *allow* Brazil to comply with this provision.

5.150 Article 17b) applies to situations where official financing support is provided for floating rate loans. It provides that financial institutions must not be allowed to offer borrowers the option of the lower of either the CIRR, at the level prevailing on the date of the original contract, or the short-term market rate throughout the life of the loan. Brazil submits that PROEX III only applies to fixed rate export credits.[156] We consider that this assertion is consistent with Article 1, paragraph 1 of BCB Resolution 2799, which, to recall, stipulates that PROEX III support must not reduce net interest rates below the CIRR level. This suggests to us that Brazil could not support export credits which entail the possibility, envisaged in Article 17b), of net interest rates (temporarily) below the CIRR. We therefore agree with Brazil that Article 17b) is not applicable to PROEX III. At a minimum, we cannot say that PROEX III does not *allow* Brazil to comply with this provision.

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

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

5.152 **Canada** submits that, if PROEX III payments are interest rate support, Articles 18 and 19 are relevant to PROEX III.

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[151] See Article 8, letter d) of BCB Resolution 2799.

[152] Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 2.5. See also the Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 11.

[153] See, *inter alia*, Brazil's Response to Panel Question 1 (Annex B-5); Canada's Comments on Brazil's Response to Panel Question 1 (Annex A-5).

[154] Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 2.5.

[155] See Brazil's Responses to Panel Questions 1 and 13 (Annex B-5).

[156] See Brazil's Comments on the United States' Response to Panel Question 26 (Annex B-6). Brazil also refers to Article 1, paragraph 2 of BCB Resolution 2799. See Brazil's First Submission, para. 44 (Annex B-1).

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5.153 The **Panel** agrees with Canada that Articles 18 and 19 apply to official financing support in the form of interest rate support.[157] Interest rate support must not, therefore, be offered at cosmetic interest rates.[158] Article 18 defines cosmetic interest rates as rates below the relevant CIRR which benefit from official support.

5.154 PROEX III does not allow for interest rate support to bring down net interest rates below the level of the relevant CIRR.[159] PROEX III does not, in other words, allow Brazil to offer interest rate support at cosmetic rates. We are satisfied, therefore, that PROEX III is in conformity with the relevant provisions of Articles 18 and 19. At a minimum, we cannot say that PROEX III does not *allow* Brazil to comply with this provision.

(ii) Provisions Supporting or Reinforcing the Interest Rates Provisions

Article 7 (on minimum cash payments)

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

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

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

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

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

[157] See the first tiret of Article 19b).
[158] See *ibid.*
[159] See Article 1, paragraph 1 of BCB Resolution 2799.

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

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

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

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

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

Article 13 (on repayment of principal) and Article 14 (on payment of interest)

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

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

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

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

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PROEX III is used to buy down risk premiums, Brazil would not be providing interest rate support as envisaged in Article 14.

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

5.167 We recall that we have agreed with the Article 21.5 Panel in *Canada – Aircraft* that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be in conformity with the interest rates provisions of the 1998 *OECD Arrangement*.[162] We note that Articles 13a) and 14a) provide that principal and interest "shall normally" be treated in a particular fashion. We further note that Article 49 of the 1998 *OECD Arrangement*, entitled "Permitted Exceptions: Prior Notification Without Discussion" includes notification of a Participant's intention "not to follow normal payment practices with respect to the principal or interest referred to in Articles 13 a), b) and 14 a)".[163] Thus, we conclude that Brazil may be in conformity with the interest rates provisions of the 1998 *OECD Arrangement* even if it does not respect these provisions.[164]

5.168 We agree with Canada that one element of Article 13a), the requirement that the first instalment of principal be made within six months after the starting point of credit, is subject to a non-derogation engagement under Article 27 of the 1998 *OECD Arrangement*. It thus is not a permitted exception. Canada alleges that Article 2 of Directive 374 enables Brazil to approve transactions which do not comply with this element of Article 13a).[165] Canada does not, however, contend that Brazil is *required* to approve transactions that do not comply. Further, Canada does not address Article 3 of BCB Resolution 2799, referred to by Brazil[166], which specifically requires that the principal of the underlying commercial export credit be repaid in six-monthly instalments and that the first instalment be made six months after one of certain specified events.[167] In the absence of a response from Canada, we see no reason to reject Brazil's assertion that Article 3 of BCB Resolution 2799 may be applied consistently with Article 13a).

Articles 20–24 (on minimum premium benchmarks)

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

[162] See Section E.2(c) *supra*.

[163] Article 49a)2) of the 1998 *OECD Arrangement*.

[164] We note that Article 3 of BCB Resolution 2799 in any event appears to require that both principal and interest be repaid in six-month (or "semi-annual") instalments.

[165] Article 2 of Directive 374 does not appear to place any limit on the grace period for principal which may be negotiated for exports.

[166] Brazil has explained to us that Article 3 of BCB Resolution 2799, which post-dates Directive 374, limits any flexibility which exists under Article 2 of Directive 374. See Brazil's Comments on Canada's Response to Panel Question 16 (Annex B-6). We see no reason to disagree with Brazil on this point.

[167] PROEX III stipulates that, depending on the case, the starting point of credit is the date of shipment or delivery of the goods, of the invoice, or of the commercial or financing contract. Article 9 of the 1998 *OECD Arrangement* provides that the starting point of credit "in the case of a contract for the sale of capital goods […] useable in themselves (e.g. locomotives)" is the date on which the buyer takes possession of the goods in his own country. We assume regional aircraft fall within the scope of this provision. The reference in PROEX III to the date of "delivery of the goods" is, in our view, consistent with the language of Article 9. As regards the other starting points contemplated under PROEX III, we consider that they would, likewise, be consistent with Article 9 to the extent that the relevant events do not occur after the delivery of the goods.

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the language of Article 20 expressly omits interest rate support from the application of the minimum premiums. Brazil also points out that PROEX III does not provide protection to the lender for possible default by the borrower. Brazil considers that there is, therefore, no need for charging a premium.

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

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

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

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

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

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

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

[169] It is important to note, however, as did the Article 21.5 Panel in *Canada – Aircraft*, that "[…] a transaction that involve[s] interest rate support *and* a guarantee or insurance would need to respect the interest rate provisions of the *Arrangement*, as well as the requirements pertaining to minimum premia […] to be 'in conformity' with the interest rate provisions of the *Arrangement*." (Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, footnote 103; emphasis added.)

[170] The European Communities, in our view, mischaracterizes PROEX III when it asserts that it is the economic equivalent of an insurance or guarantee. See the European Communities' Response to Panel Question 27 (Annex C-6) and also Canada's Comments on Brazil's Response to Panel Question 11 (Annex A-5). It is true that interest rate support under PROEX III may, in effect, reduce the risk of non-repayment by the borrower inasmuch as lower interest rates make it easier for the borrower to meet its obligation to repay the principal sum and pay interest. However, this kind of risk reduction is not at issue in Articles 20-24, which are not concerned with interest rate support. It is also very different from the kind of risk reduction associated with export credit insurance and guarantees. Unlike in the case of pure interest rate support, credit risk insurance or guarantees require a government to *compensate* the lender in case the borrower *actually* fails to repay the principal sum or pay interest. No such requirement is envisaged under PROEX III.

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5.175 The **Panel** is not aware, and has not been made aware, of any requirement or authorization, under PROEX III, of official support for local costs. Article 25 on local costs is not, therefore, relevant to the issue of whether or not PROEX III is in conformity with the second paragraph of item (k).

5.176 As regards Article 26, we note that it lays down a six-month maximum validity period for individual offers of particular export credit terms. Assuming that Article 26 applies to interest rate support (a question we do not here decide), we see nothing in the legal instruments submitted to us which would require Brazil to fix the credit terms under PROEX III for a period exceeding six months. To the contrary, we recall that letters of commitment issued by the Export Credit Committee as a usual matter are valid for 90 days.[171] We therefore have no basis for finding that PROEX III support will not be in conformity with the six-month maximum validity period laid down in Article 26.[172]

Article 19 of Annex III (on best endeavours)

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

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

5.179 The **Panel** notes that Article 19 has two sentences. The first sentence makes clear that the Participants to the 1998 *OECD Arrangement* must not offer more favourable terms than those set forth in the chapter of Annex III which deals with new non-large civil aircraft, specifically in Articles 21-24.[173] For reasons which are explained under the relevant headings of our inquiry, we are satisfied that PROEX III does not envisage, much less require, that Brazil provide more generous terms than those permitted under Articles 21 (on maximum repayment terms), 22 (on minimum interest rates), 23 (on insurance premium and guarantee fees) and 24 (on aid support).

5.180 The second sentence of Article 19 requires the Participants to continue to respect "customary market terms" for the different categories of aircraft and to "do everything in their power" to prevent these terms from being eroded.[174] In considering whether PROEX III "respect[s] the customary market terms" for regional aircraft, we must recall the provisions of Article 8, paragraph 2 of BCB Resolution. They instruct the Export Credit Committee to approve only those requests for PROEX III support which are consistent with "the financing terms practiced in the international market". We are of the view that this language is compatible with that of Article 19.[175] With respect to the other

[171] See also our discussion above, at paras. 5.146-5.148, of Article 17 of the 1998 *OECD Arrangement*.

[172] We recall that no letters of commitment have been issued under PROEX III in respect of regional aircraft. See Brazil's Response to Panel Question 10 (Annex B-5).

[173] We note that Article 19 refers to the "provisions of this Chapter". The Chapter of which Article 19 is part is entitled "Scope" and does not discuss the "terms that Participants may offer". It seems to us, therefore, that the reference to "this Chapter" must be a reference to the Chapter entitled "Provisions for Export Credits and Aid", which includes Articles 21-24. That Chapter does address the terms which Participants may offer.

[174] Article 19 is entitled "Best Endeavours", but in the operative text uses the term "shall". It is not necessary, for purposes of our inquiry, to take a position on whether Article 19 is mandatory in nature.

[175] As we have explained above, we do not understand Article 8, paragraph 2 to use only "commercial" market terms as a benchmark. On the other hand, the ordinary meaning of the term "customary market terms" as it appears in Article 19 does not appear to be so limited either. In fact, it appears that, in practice, the "customary market terms" for regional aircraft are terms which result from some form of official support. See

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requirement in the second sentence of Article 19 -- that Participants must do everything in their power to prevent an erosion of the customary market terms -- we think that Brazil, by promulgating Article 8, paragraph 2 of BCB Resolution 2799, has "done" enough to bring PROEX III, as such, in conformity with this requirement.

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

Article 21 of Annex III (on maximum repayment terms)

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

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

5.184 The **Panel** notes that Article 21 of Annex III provides that the maximum repayment term for Category A aircraft is 10 years.[176] It is common ground that Brazilian regional aircraft fall within Category A. Both Brazil and Canada have construed the provisions of Article 21 -- in the context of these proceedings concerning PROEX III -- as placing a limitation on the amount of time for which interest rate support may be granted. We consider it appropriate to adopt that interpretation for purposes of our analysis.

5.185 We begin our analysis with Article 3, paragraph 1, sub-paragraph II of Directive 374. According to that provision, the term for interest rate equalisation may not exceed the maximum term indicated for the good in the annex to Directive 374. The annex in question specifies, in relevant part,

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Brazil's Response to Panel Question 4 (Annex B-5). This reinforces our view that Article 8, paragraph 2 is not, as such, inconsistent with Article 19.

[176] We note that Article 10 of the main text of the 1998 *OECD Arrangement* also contains rules on the maximum repayment term. However, pursuant to Article 3c) of the 1998 *OECD Arrangement*, Annex III of the *OECD Arrangement* prevails where it contains a corresponding provision. We believe Article 21 of Annex III is a corresponding provision within the meaning of Article 3c). There is, therefore, no need separately to examine the conformity of PROEX III with Article 10.

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that the maximum financing term for aeroplanes (HS code 8802, except 8802.11 and 8802.20) is 120 months, i.e. 10 years. This, in our view, is fully consistent with Article 21 of Annex III. As an additional matter, it is worth pointing out that the other provisions relied on by Brazil, that is to say, Article 1, paragraph 1 of BCB Resolution 2799 and BCB Circular Letter 2881, support that conclusion, albeit indirectly.[177]

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

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

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

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

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

[178] Article 3, paragraph 2 uses the phrase "may be extended".

[179] See also our findings concerning the conformity of PROEX III with Article 7 of the 1998 *OECD Arrangement*, which address the same issue.

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

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

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

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

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

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

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

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

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

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

[180] Canada has provided us with sworn declarations of people who claim to know about the terms offered by Embraer in the relevant sales campaigns involving regional aircraft.

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

[182] See Brazil's Comments on Canada's Response to Panel Question 24 (Annex B-6).

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not think Brazil is obliged, at this point, to establish the conformity of PROEX III with Article 28a) of Annex III.[183]

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

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

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

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

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

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

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

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

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

[184] Sub-paragraphs b) and c) of Article 29 deal with new spare engines and spare parts which are *not* ordered with aircraft. As Canada's complaint is directed at those parts of the PROEX III programme which relate to the financing of exports of regional *aircraft*, we need not examine the conformity of PROEX III with these provisions. Article 29c) is, in any event, not relevant to these proceedings since it deals with new spare engines for *large* rather than *regional* aircraft.

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negotiated by the exporter and the buyer. *They* decide whether or not to "include" spare parts in a transaction. Article 6, as we understand it, makes clear that transactions for which PROEX III support is requested may include spare parts and are thus eligible, in principle, for PROEX III support. It is also apparent from Article 6 that if transactions include spare parts worth *in excess of* 20 per cent of the price of the principal good of the transaction, they are *not* eligible for PROEX III support. Thus, we are not convinced that the Committee could, *on the basis of Article 6*, refuse to approve a request for PROEX III support for a transaction which includes spare parts worth *up to* 20 per cent of the price of the principal good in question.

5.204 We recall, however, Brazil's uncontested statement to the effect that the Export Credit Committee has discretion regarding whether or not PROEX III support is provided, even where a request for PROEX III support meets all applicable eligibility criteria.[185] It follows that the Committee could deny PROEX III interest rate equalisation in cases where the value of the spare parts exceeded the maximum percentage set forth in Article 29a).

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

4. Conclusion

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

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

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

F. FIRST PARAGRAPH OF ITEM (K)

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

1. General

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

[185] See Brazil's Response to Panel Question 5 (Annex B-5). For a discussion of the discretionary features of PROEX III see Section D.2(b)(iv) *supra*.

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second paragraph of item (k), it would nevertheless not be prohibited because PROEX III payments do not secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k). Brazil accepts that, for this defence to succeed, it must establish (i) that the first paragraph of item (k) may be used to establish that PROEX III is not a prohibited export subsidy (possibility of an *a contrario* interpretation of the first paragraph), (ii) that PROEX III payments are payments within the meaning of the first paragraph of item (k) and (iii) that PROEX III payments are not used to secure a material advantage in the field of export credit terms.

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

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

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

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

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

2. Payment of the Costs Incurred in Obtaining Credits

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

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

[186] See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 58.

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interpretation of "credits" as meaning the same in the latter part, so the reference to "the funds so employed" in the first part justified an interpretation of the word "obtaining" in the second part as meaning "obtaining the funds [that are] so employed" when they are subsequently provided to export purchasers.

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

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

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

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

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

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

5.222 In the previous Article 21.5 proceedings, we said the following in respect of the meaning of the "payment" clause:

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> … we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.
>
> […]
>
> Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so.[187]

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

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

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

5.226 Brazil argues that, when the financial institution is outside of Brazil, Embraer, i.e. the *Brazilian exporter*, faces costs in obtaining export credits for its customers. While this may or may not be true, PROEX III payments are made to financial institutions financing exports of regional aircraft, not to Embraer. Thus, we fail to perceive how PROEX III payments could represent the payment of all or part of the costs incurred by Embraer in "obtaining the export credits it provides".[190]

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

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[187] Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.71 and 6.72.

[188] See Brazil's Oral Statement, para. 74 (Annex B-3).

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

[190] We recall that Brazil does not argue that Embraer itself provides export credits.

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5.228 In accordance with the foregoing, we conclude that PROEX III payments do not fall within the scope of the "payment" clause of the first paragraph of item (k).

3. Material Advantage

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

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

(a) Appropriate Benchmark

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

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

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

(i) Appropriateness of the CIRR Alone

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

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

5.236 As always, the starting-point for the **Panel's** analysis is the text of the first paragraph of item (k), which identifies as a prohibited export subsidy:

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

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

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

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

> To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" identified in the original dispute as an "appropriate" basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".[191]

5.240 In these proceedings, Brazil argues for the appropriateness of a "CIRR only" benchmark. The Appellate Body's statement is relevant to this issue in two respects. First, it emerges that Brazil may indeed use the relevant CIRR as an "appropriate market benchmark" for determining whether the net interest rates resulting from the "revised PROEX" are used to secure a "material advantage in the field of export credit terms".[192] Second, the Appellate Body's statement makes no mention of any export credit terms other than interest rates. This could conceivably be construed to support Brazil's view that the CIRR, on its own, is dispositive of the existence of a material advantage.

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

> … a participant in the *OECD Arrangement* can always offer borrowers officially-supported export credits if, besides respecting the CIRR, it also respects the other "repayment terms and conditions" of the *OECD Arrangement*.[193]

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

[191] Article 21.5 Appellate Body Report, *supra*, para. 67 (footnote omitted).

[192] There is no apparent reason why the Appellate Body's statement should not apply to the "revised PROEX" at issue in these proceedings, i.e. PROEX III.

[193] Article 21.5 Report on *Brazil - Aircraft*, *supra*, footnote 68 (reference omitted).

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CIRR can be offered to borrowers *irrespective* of what the other export credit terms and conditions are. We do not think that the Appellate Body would have introduced such a significant distinction *sub silentio*.

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

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

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

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

5.247 We recall that, in reaching its conclusion that the CIRR was a relevant international benchmark for determining whether payments were used to secure a material advantage in the field of export credit terms, the Appellate Body relied upon the second paragraph of item (k) as relevant context.[194]

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

5.249 As a matter of contextual interpretation, we believe that the concept of "conformity with the CIRR" as it exists in the "material advantage" clause[195] should normally have the same meaning as the

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[194] The Appellate Body stated that:

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

[195] We realise that the concept of "conformity with the CIRR" does not appear, as such, in the text of the material advantage clause. It is sufficient to note, in this regard, that we must take as given the Appellate Body's interpretation of that clause. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 67 ("To establish that subsidies under the revised PROEX are not 'used to secure a material advantage in the

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concept of "conformity with the CIRR" as it exists in the second paragraph of item (k). In our view, there would be little logic to interpreting the first paragraph of item (k) in the light of one element found in the second paragraph of item (k) -- the CIRR -- while neglecting other elements of the second paragraph which are essential to determining whether an export credit practice is in conformity with the CIRR.

5.250 We note that the reasoning which underpins our interpretation of the second paragraph of item (k) applies with equal force to the Appellate Body's interpretation of the "material advantage" clause. In this regard, it is sufficient to recall our view that the CIRR cannot meaningfully perform the limiting function of a minimum commercial interest rate unless it is applied as part of the package of terms and conditions set forth in the *OECD Arrangement*.[196] If that is a correct view, then it must be correct regardless of whether the CIRR serves as an interest rate benchmark for purposes of the "material advantage" clause or for purposes of the second paragraph of item (k).

5.251 It could be argued that this interpretation of the "material advantage" clause in effect re-creates in the first paragraph of item (k) the standard already provided for in the second paragraph of item (k), at least insofar as the interest rate benchmark used under the first paragraph of item (k) is the CIRR.[197] However, this is an unavoidable implication of the Appellate Body's adoption of the CIRR as an appropriate benchmark for determining the existence of a material advantage. Had we adopted Brazil's view, that is, had we found that compliance with the CIRR, on its own, was sufficient for purposes of establishing that payments are not used to secure a "material advantage" within the meaning of the first paragraph of item (k), we would have made it easier to comply with the first paragraph of item (k) than with the second paragraph of item (k).[198] To the extent that the first paragraph of item (k) could be used *a contrario* to establish that a payment that is not used to secure a material advantage is not prohibited -- an issue addressed below -- we would, in other words, not only have re-created a safe haven in the first paragraph, but, in fact, would have deprived the second paragraph of *all* useful effect with respect to the export credit practices at issue in the first paragraph. This we think we must not do.

5.252 For the foregoing reasons, we find that, in order for Brazil to establish by reference to the CIRR that PROEX III interest rate equalisation payments are not used to secure a "material advantage", Brazil must demonstrate that export credits supported by PROEX III respect, in addition to the CIRR itself, the applicable rules of the *OECD Arrangement* which relate to the application of the CIRR and which operate to support or reinforce the CIRR as a minimum interest rate.[199]

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field of export credit terms', Brazil must prove […] that the net interest rates under the revised PROEX are at or above the relevant CIRR.").

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

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

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

[199] See paras 5.97 *et seq.* and 5.106 *et seq*. It should be noted that Brazil does not seek to establish, in these proceedings, an appropriate market benchmark other than the CIRR.

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(ii) Appropriateness of a Benchmark Other than the CIRR

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

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

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

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

> Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be *able*, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions.[200]

5.257 Canada would have us construe this statement as *requiring* that a Member that seeks to demonstrate that its payments are not used to secure a material advantage must, in the circumstances referred to, use a benchmark other than the CIRR. We think that the plain words of the Appellate Body do not support such a conclusion. The Appellate Body did not say that a Member "must" establish an alternative benchmark where the CIRR does not reflect the rates available in the marketplace. Instead, the Appellate Body said that a Member should, "in principle", be "able" to do so, that is, that it should have the possibility to do so.[201]

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

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

[201] It is worth noting that we, too, in the previous Article 21.5 proceedings, used permissive rather than mandatory language when addressing this issue ("may"). The Appellate Body reproduced, and agreed with, the relevant statement of our previous Article 21.5 report. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 63.

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> To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate" basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".[202]

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

5.260 Accordingly, while we see merit in Canada's argument that the CIRR may not constitute an "appropriate" market benchmark in situations where it differs significantly from the rates available to borrowers in comparable market transactions, we nevertheless cannot accept that argument in view of our understanding of the Appellate Body's Article 21.5 report on *Brazil - Aircraft*.[203]

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

> The reasoning of the Appellate Body in choosing the CIRR seems to have been that a payment would be used to secure a *material* advantage … if it resulted in an interest rate that was below the lowest *commercial* interest rates available to the best borrowers in respect of a particular currency, irrespective of whether that rate would have been available to the borrower in question.[204]

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

5.263 It should be pointed out that the Appellate Body, in its Article 21.5 report, did not contradict our interpretation of its reasoning. Nor do we see, in that report, any other statements which would make us reconsider our statement. Whereas we find Canada's argument persuasive, as a general matter,[205] this does not provide us with a justification for departing from what we consider to be the Appellate Body's view.

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

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

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

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

[205] We note that Canada's argument is similar in content to our original finding that the question of whether there was a "material advantage" was comparable to the question of whether there was a benefit to the recipient. See Panel Report on *Brazil – Aircraft*, *supra*, para. 7.23. The Appellate Body, however, overturned our finding on that issue. See Original Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 179.

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5.265 For the foregoing reasons, we find that a Member may always use the CIRR -- accompanied by the applicable rules of the *OECD Arrangement* which operate to support or reinforce the CIRR as a minimum interest rate -- as a benchmark to demonstrate that a payment is not used to secure a material advantage in the field of export credit terms.[206] Given the nature of the CIRR as a (periodically) constructed interest rate, a Member may, however, attempt to demonstrate that a rate *below* the CIRR would, at a particular point in time, constitute a more appropriate benchmark.

(b) Examination of PROEX III

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

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

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

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

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

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

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

[207] Brazil has not identified a market benchmark other than the CIRR.

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

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

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

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

5.273 We recall that we addressed precisely this issue in the first Article 21.5 panel report in *Brazil – Aircraft*. The Appellate Body, in considering our findings, stated that it was not "necessary for [it] to rule on these general questions in order to resolve this dispute", and thus declared our findings to be "moot" and "of no legal effect".[208] Nevertheless, given that the issue was considered in detail in that dispute, we begin our examination with a review of the reasoning set forth in that report.

5.274 In the first Article 21.5 panel report on *Brazil – Aircraft*, we found that the first paragraph of item (k) could not be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* is permitted.[209] In reaching this conclusion, we observed that footnote 5 to the *SCM Agreement* provides an explicit textual basis for determining whether and under what conditions the Illustrative List may be used to demonstrate that a subsidy which is contingent on export performance is not prohibited.[210] We noted that footnote 5 provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." We observed that, in its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy. We considered that the first paragraph of item (k) does not contain any affirmative statement that a measure is *not* an export subsidy, nor that a measure not satisfying the conditions of that paragraph is *not* prohibited, and thus does not fall within the scope of footnote 5.[211] We observed that this finding does not render the material advantage clause "ineffective", as the "material advantage" clause nevertheless serves an important role by narrowing the range of measures that would otherwise be subject to the "*per se*" violation set forth in the first paragraph of item (k).[212] Finally, we noted that a broad reading of footnote 5 could place developing country Members at a permanent, structural disadvantage in the field of export credit terms, a result we considered to be inconsistent with one of the objects and purposes of the *WTO Agreement*.[213]

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

[208] Article 21.5 Appellate Body Report on *Brazil – Aircraft, supra*, para. 81.
[209] Article 21.5 Panel Report on *Brazil – Aircraft, supra*, para. 6.67.
[210] See *ibid.*, paras. 6.33-6.34.
[211] See *ibid.*, paras. 6.36-6.37.
[212] See *ibid.*, paras. 6.42-6.45.
[213] See *ibid.*, paras. 6.46-6.66.

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governed by footnote 5 to the *SCM Agreement*, and that the first paragraph of item (k) does not "refer to" any measures as "not constituting export subsidies" within the meaning of the footnote. We consider that this reading gives effect both to the material advantage clause *and* to footnote 5.[214] As a result, we incorporate by reference our reasoning in the first Article 21.5 panel report into this Section.

5. Conclusion

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

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

VI. CONCLUSION

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

(a) It has not been established that PROEX III, as such, is inconsistent with Article 3.1(a) of the *SCM Agreement*;

(b) PROEX III, as such, is, in any event, justified under the second paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the *SCM Agreement*;

(c) PROEX III, as such, cannot, however, be justified under the first paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the *SCM Agreement*.

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

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

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

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

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view that it is legally possible for Brazil to operate the PROEX III programme in such a way that it will:

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

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

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

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ANNEX A

SUBMISSIONS OF CANADA

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ANNEX A-1

FIRST SUBMISSION BY CANADA

(2 March 2001)

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I. INTRODUCTION

1. The issue in this proceeding is whether certain revisions, made on 6 December 2000 to Brazil's *Programa de Financiamento às Exportações* (PROEX)[1] bring PROEX into conformity with the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement) and the findings and the recommendations of the Panel, as modified by the Appellate Body, and adopted by the Dispute Settlement Body (DSB) in *Brazil – Export Financing Programme for Aircraft* (*PROEX*).[2] Brazil contends that they do. Canada's position is that they do not.

2. This is the second time that Brazil has claimed that it has complied with the recommendations and rulings of the DSB and the second time that Canada has sought recourse to Article 21.5 of the Dispute Settlement Understanding (DSU) in this dispute. Brazil made the same claim in respect of previous modifications to the original PROEX program made in response to the 20 August 1999 DSB rulings.

3. In its Report of 28 April 2000, this same Panel found that payments in respect of regional aircraft under modifications to PROEX made as of 19 November 1999 ("PROEX II") are export subsidies prohibited by Article 3 of the SCM Agreement and that, accordingly, Brazil had failed to implement the recommendation of the DSB to withdraw its export subsidies for regional aircraft under PROEX within 90 days.[3] On appeal by Brazil, the Appellate Body, in its Report of 21 July 2000, upheld the Panel's conclusions.[4]

4. Canada has brought this proceeding because there is, again, a disagreement as to the consistency with the SCM Agreement of measures taken by Brazil that purport to comply with the recommendations and rulings of the DSB.

5. Brazil considers that by limiting its interest rate buy-down payments under PROEX to the Commercial Interest Reference Rate ("CIRR") established under the Organization for Economic Cooperation and Development's Arrangement on Guidelines for Officially Supported Export Credits (the "OECD Arrangement"), it has brought PROEX into compliance with the SCM Agreement. However, as Canada will show, payments made under the latest revisions to PROEX continue to be prohibited subsidies under Articles 1 and 3 of the SCM Agreement. Contrary to Brazil's claims, these prohibited subsidies cannot be sheltered under an *a contrario* exception allegedly found in Item (k) of Annex I to the SCM Agreement because no such exception exists. Even if such an exception does exist, Brazil's PROEX payments do not qualify for it because they are not "payments" within the meaning of Item (k) and because they secure a material advantage in the field of export credit terms.

II. FACTS

6. The revisions at issue are set out in the Central Bank of Brazil (BCB) Resolution No. 2799 of 6 December 2000. Resolution 2799 is entitled: "Redefining the rules applicable to transactions under the interest rate equalization system of the Export Financing Program – PROEX".[5]

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[1] "Redefining the rules applicable to transactions under the interest rate equalization system of the Export Financing Program – PROEX," Central Bank of Brazil (BCB) Resolution No. 002799 (6 December 2000) [hereinafter "Resolution 2799"]. (Exhibit CDA-1)

[2] WT/DS46/R and WT/DS46/AB/R, Reports of the Panel and the Appellate Body, adopted 20 August 1999.

[3] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, 28 April 2000, para. 6.106 [hereinafter "Article 21.5 Panel Report"].

[4] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, para. 82 [hereinafter "Article 21.5 Appellate Body Report"].

[5] Resolution 2799, *supra* note 1.

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7. Resolution 2799 makes only one material revision to the PROEX II program that has already been found to be inconsistent with the SCM Agreement: it provides that interest rate buy-downs offered under PROEX shall be established "in accordance with the Commercial Interest Reference Rate (CIRR), published each month by the OECD, for the respective currency and financing term of the transaction."[6] In all other material respects, PROEX remains unchanged. Canada will refer to the PROEX program as revised by Resolution 2799 as "PROEX III".

8. By virtue of Article 10 of Resolution 2799, PROEX III applies to all transactions approved by the Committee on Export Credits (the "Committee") on or after 6 December 2000, the date it was published in the official gazette. In the light of Brazil's constant position that it cannot affect prior commitments, it is reasonable to infer that PROEX III does not modify commitments made before 6 December 2000. Moreover, nothing in Resolution 2799 indicates that it has a retroactive effect.

9. Other than the requirement that interest rate buy-downs shall be "in accordance with" the CIRR, the basic elements of the PROEX program found by the original Panel and confirmed in the Article 21.5 Panel Report,[7] remain the same under PROEX III:

(a) PROEX payments continue to be grants from the Brazilian National Treasury to buy down commercial interest rates freely negotiated by the borrower;

(b) the program is still administered by the Committee; and

(c) the interest rate buy-down payments made under PROEX are still being provided at the time of export of the aircraft in the form of non-interest bearing National Treasury Bonds (Notas do Tesouro Nacional – Série I) referred to as NTN-I bonds. These are denominated in Brazilian Reals indexed to the United States dollar.

10. Under PROEX III, the length of the financing term continues to determine the percentage of the interest rate buy-down and the maximum specified term continues to be 10 years as set out in BCB Newsletter No. 2881 of 19 November 1999.[8] However, the Committee retains its authority to extend the length of the financing term beyond ten years – as it did consistently, as found by the Panel in the first Article 21.5 proceedings.[9] PROEX payments also continue to be applied to financing covering 100 percent of the value of the exported aircraft.[10]

11. In the weeks before Resolution 2799 was made operational, Brazil's then Foreign Minister, Luis Felipe Lampreia confirmed how Brazil intends to apply PROEX III. He said:

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[6] The English translation of Article 1 of the Resolution reads as follows:

Article 1: In financing transactions for the export of goods and services, as well as of computer programs ("software") referred to in Law No. 9609 of February 19, 1998, the National Treasury may grant to the financing or refinancing party, as the case may be, equalization sufficient to make the financial charges consistent with those prevailing in the international market.

Paragraph 1: In financing for the export of aircraft for regional aviation, interest rate equalization shall be established transaction by transaction, at levels that may differ depending on the characteristics of each transaction, in accordance with the Commercial Interest Reference Rate (CIRR), published each month by the OECD, for the respective currency and financing term of the transaction.

Paragraph 2: Equalization is fixed and limited, for its entire duration, to the percentages established by the Central Bank of Brazil.

[7] *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999,.paras. 2.2-2.6 [hereinafter "Original Panel Report"]; Article 21.5 Panel Report, paras. 2.1-2.6.

[8] "Establishing maximum percentages for the tax rate equalization system under the Export Financing Program – PROEX," Banco Central do Brasil Newsletter No. 002881, 19 November 1999. (Exhibit CDA-2)

[9] As the Panel found, "the most frequent waiver has been to extend the length of the financing term from 10 to 15 years. (Article 21.5 Panel Report, para. 2.4).

[10] See Original Panel Report, paras. 4.162-4.163 and 7.91.

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> For us, the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms.[11]

12. In effect, the only discipline that Resolution 2799 imposes on PROEX payments is that they must be "in accordance with the CIRR". At the 12 December 2000 meeting of the DSB, Brazilian officials stated that this wording prohibits buy-downs to interest rates below the relevant CIRR,[12] although clearly the phrasing "in accordance with" imposes no such explicit discipline.

13. According to Resolution 2799, the CIRR "limitation" is based on the applicable CIRR "for the respective currency *and financing term of the transaction*" [emphasis added].[13] The wording of the Resolution recognises that the currency and financing term of the transaction will determine the applicable CIRR. Under the OECD Arrangement, the maximum term allowable for CIRR financing in the regional aircraft sector is ten years.[14] There is no applicable CIRR for a financing term of more than ten years. However, Brazil has clearly indicated that it will impose "no limits on the length of terms".[15] This statement and the financing term of the market for regional aircraft transactions, which typically is fifteen years or more, cannot be reconciled with the Resolution. In effect, the CIRR "limitation" in Resolution 2799 is meaningless.

III. THE JURISDICTION OF THIS PANEL UNDER ARTICLE 21.5

14. Under Article 21.5 of the DSU, the Panel must determine whether a measure taken to comply with the recommendations and rulings of the DSB is consistent with a covered agreement.[16]

15. In the context of this proceeding, the Panel must determine whether, as a result of the modifications made by Resolution 2799, PROEX III is consistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement to neither grant nor maintain such subsidies and Article 4.7 of the SCM Agreement to withdraw the prohibited subsidy. As demonstrated below, PROEX III does not comply with these obligations.

16. This dispute has been ongoing since 1998, when Canada successfully challenged the original PROEX program ("PROEX I") as a prohibited export subsidy. This Panel, in the original proceeding, found that interest equalisation payments made under PROEX I for the benefit of purchasers of exported Brazilian regional aircraft were subsidies contingent upon export performance. The Panel further found that these subsidies were not covered by any exceptions or affirmative defences under the SCM Agreement and were therefore prohibited in accordance with Article 3 of that Agreement. The Appellate Body upheld these findings. The Panel recommended that Brazil withdraw these prohibited export subsidies within ninety days of the adoption of its report by the DSB, that is, by 18 November 1999. Brazil still has not done so.

17. In its 28 April 2000 Report, this Panel also found that by continuing to issue NTN-I bonds pursuant to letters of commitment issued under PROEX I as it existed before 18 November 1999,

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[11] M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000). (Exhibit CDA-3)

[12] Statement by Brazil: DSB Meeting of 12 December 2000: Agenda Item 3: *Brazil – Export Financing Programme for Aircraft*: Implementation of the recommendations of the DSB [hereinafter "Brazil's 12 December 2000 DSB Statement"]. (Exhibit CDA-4)

[13] Resolution 2799, *supra* note 1, Article 1, para. 1.

[14] OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998), Annex III, Part 2, Article 21. (Exhibit CDA-5)

[15] *Supra* note 11.

[16] Article 21.5 states, in relevant part:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. …

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Brazil was continuing to grant subsidies contingent upon export performance within the meaning of Article 3.2 of the SCM Agreement. [17] Brazil also appealed, unsuccessfully, this conclusion of the Panel in the first Article 21.5 proceeding.

18. Since 18 November 1999, despite the adopted findings of the Panel as upheld by the Appellate Body in the original Article 21.5 proceedings, Brazil has continued to make illegal subsidy payments on aircraft delivered after 18 November 1999 pursuant to commitments made under PROEX I and II both before and after 18 November 1999. In response to this ongoing non-compliance, Canada sought and obtained from the DSB authorization to impose certain countermeasures against Brazil.

19. Therefore, this second Article 21.5 proceeding is to consider only whether PROEX III is consistent with the SCM Agreement. Regardless of the outcome of this proceeding, so long as Brazil continues to make payments under PROEX I and II, it will remain non-compliant with the DSB's recommendation that it withdraw its prohibited export subsidies.

IV. THE BURDEN OF PROOF

20. In the following section, Canada presents evidence that payments under PROEX III on exports of regional aircraft continue to be prohibited export subsidies. In so doing, Canada has met its legal and evidential burden in this proceeding. The burden now shifts to Brazil to establish the three requisite elements of its alleged affirmative defence.[18] Brazil needs to prove:

(i) that the first paragraph of Item (k) of Annex I to the SCM Agreement gives rise to an *a contrario* exception; and that PROEX payments qualify for this alleged exception in that:

(ii) the PROEX payments are the payment by governments of all or part of the costs incurred by exporters or financial institutions in obtaining credits; and

(iii) the PROEX payments are not used to secure a material advantage in the field of export credit terms.

21. Although the shifting of the burden to Brazil obviates the need for Canada to address the three elements of the alleged defence that Brazil has implied that it will rely on,[19] Canada will show in this submission that Brazil cannot establish any of these elements.

22. It is evident that in an effort to continue providing illegal export subsidies, Brazil intends to exploit any alleged ambiguity and any judicial economy exercised by the Panel and the Appellate Body in this dispute. In the circumstances, it is essential that the Panel issue detailed findings on all three elements of Brazil's defence in order to facilitate the effective resolution of this dispute.[20]

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[17] Article 21.5 Panel Report, para. 6.17.

[18] Before the Original Panel, Brazil explicitly acknowledged that its alleged Item (k) exception constituted an affirmative defence and that the burden of establishing the defence was on Brazil: Original Panel Report, at para. 7.17. As in the previous Article 21.5 proceeding in this dispute, the burden of proof lies with Brazil in that it is using Item (k) to make an affirmative claim in its defence. Article 21.5 Appellate Body Report, para. 66; *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, p. 16.

[19] Brazil's 12 December 2000 DSB Statement, *supra* note 12.

[20] As articulated by the Appellate Body, a panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings and the effective resolution of the dispute: *Australia – Measures Affecting the Importation of Salmon*, WT/DS18/AB/R, adopted

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V. LEGAL ARGUMENT

A. PROEX III PAYMENTS CONTINUE TO BE PROHIBITED SUBSIDIES UNDER ARTICLES 1 AND 3 OF THE SCM AGREEMENT

23. As has been confirmed twice before by both the Panel and the Appellate Body, PROEX payments continue to involve a direct transfer of funds from the Government of Brazil that confers a benefit.[21] Accordingly, PROEX III involves "subsidies" within the meaning of Article 1 of the SCM Agreement. The subsidies are *de jure* contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. Accordingly, they are prohibited under Articles 3.1 and 3.2.

24. It is implicit in Brazil's statement to the DSB on 12 December 2000, which is grounded in Brazil's alleged Item (k) exception, that Brazil continues to acknowledge that PROEX subsidies are prohibited export subsidies.[22] Nevertheless, Brazil has changed nothing about PROEX except the maximum interest rate buy-down. This presumably is the basis for Brazil's contention that since 6 December, PROEX "fully conforms to WTO disciplines".[23] This contention appears to be based entirely on the revisions in Resolution 2799 that provide that PROEX interest rate buy-downs shall be established "in accordance with" the CIRR,[24] and on Brazil's belief that this qualifies PROEX for an *a contrario* exception under its theory of Item (k) and its PROEX program.

25. Thus, at the 12 December 2000 meeting of the DSB, at which Brazil announced that Resolution 2799 was "operational", Brazil stated that it:

> … chose to revise PROEX so as not to allow for payments that result in interest rates below the relevant CIRR. Furthermore, the Committee on Export Credits (CCEx) will approve equalization for regional aircraft financing having as a benchmark the financing conditions existing in the international market. With these parameters, PROEX has been brought into full conformity with Brazil's obligations under the Agreement on Subsidies and Countervailing Measures and the GATT 1994.[25]

B. BRAZIL CANNOT ESTABLISH AN AFFIRMATIVE DEFENCE

26. Brazil appears to be contending that by requiring its interest rate buy-down payments under PROEX to be made "in accordance with the CIRR", it has sheltered PROEX III under an alleged a *contrario* exception in the first paragraph of Item (k) of Annex I to the SCM Agreement.

27. In accordance with the prior findings of this Panel and the Appellate Body, in order for Brazil to escape the prohibition in Article 3 of the SCM Agreement, it must establish that:

(i) The first paragraph of Item (k) of Annex I is an *a contrario* exception; and that PROEX payments qualify for that exception because:

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6 November 1998, para. 223; *United States – Definitive Safeguard Measures On Imports Of Wheat Gluten from The European Communities*, WT/DS166/AB/R, adopted 19 January 2001, para. 180.

[21] The nature of PROEX equalization payments as prohibited export subsidies was discussed in the Original Panel Report at para. 7.13. This nature has not changed.

[22] Brazil acknowledged that PROEX equalization payments were prohibited export subsidies under both PROEX I (see para. 7.12 of the Original Panel Report) and PROEX II (see para. 6.7 of the Article 21.5 Panel Report).

[23] Statement by Brazil: DSB Meeting of 16 February 2001: Agenda Item II: *Brazil – Export Financing Programme for Aircraft*, para. 3. (Exhibit CDA-6)

[24] Resolution 2799, *supra* note 1, Article 1, para. 1.

[25] Brazil's 12 December 2000 DSB statement, *supra* note 12.

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(ii) PROEX payments are the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits"; and

(iii) PROEX payments are not "used to secure a material advantage in the field of export credit terms".[26]

28. As demonstrated below, Brazil cannot establish any of these elements. Accordingly, payments made pursuant to PROEX III are prohibited export subsidies under Article 3 of the SCM Agreement.

1. The First Paragraph of Item (K) Cannot Be Interpreted As An *A Contrario* Exception

(a) The Nature of Brazil's *A Contrario* Argument

29. The foundation of Brazil's position appears to be that the first paragraph of Item (k) of the Illustrative List under Annex I can be interpreted *a contrario sensu* to create an exception to the prohibition in Article 3.1 of the SCM Agreement for measures that in some respect fall outside of the description of the export subsidy illustrated in the first paragraph of Item (k).[27]

30. In the past, Brazil has argued that its otherwise prohibited PROEX export subsidies are exempt from the obligations of Article 3 of the SCM Agreement because it considered that the first paragraph of Item (k) of the Illustrative List creates an exception *a contrario* for practices similar to those described in the first paragraph but which do not meet all of the terms of that description.

31. Brazil has argued further, that various iterations of PROEX meet the terms of this alleged exception because PROEX provided, in Brazil's view, the type of payments that *are* discussed in Item (k) first paragraph, but that these payments, according to Brazil, did not secure a material advantage in the field of export credit terms.

32. In the context of the PROEX case, Brazil infers from the text of the first paragraph of Item (k), which refers only to export credits and payments used to secure a material advantage, that when such activities are <u>not</u> used to secure a material advantage, they are <u>not</u> export subsidies that are subject to the prohibition in Article 3.1.

(b) The Applicable Rules of Treaty Interpretation

(i) The A Contrario *Maxim Cannot Be Applied Automatically*

33. The *a contrario* exception is another way of referring to one of the maxims of statutory and treaty interpretation, that is, *expressio unius est exclusio alterius* (to express one thing is to exclude another).[28] Its basic rationale is as follows: given what has been expressly set out in a text, it is plausible to infer that the drafters intended to exclude similar things that are not expressly mentioned.

34. The argument is based on the expectation that if the drafters had meant to include a similar or related thing within the ambit of a treaty provision, they would have referred to that thing expressly. The failure to mention such a thing then becomes a basis for inferring that it was deliberately excluded.

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[26] Article 21.5 Appellate Body Report, para. 58.

[27] "*A contrario sensu"* means "on the other hand; in the opposite sense". (*Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 23. (Exhibit CDA-7))

[28] Lord McNair, *The Law of Treaties* (Oxford: Clarendon Press, 1961), p. 400 [hereinafter "McNair"]. (Exhibit CDA-8)

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35. So-called canons or maxims of interpretation, such as *expressio unius est exclusio alterius* or the *a contrario* approach, are not automatic in their application. They have not attained the status of customary rules of interpretation of public international law, although they are sometimes referred to in the decisions of international tribunals.[29]

36. The International Law Commission's final recommendations about the interpretation of treaties make it clear that the application of any given maxim depends upon discretion and will not be suitable in all cases:

> Their suitability for use in any given case hinges on a variety of considerations which have first to be appreciated by the interpreter of the document; the particular arrangement of the words and sentences, their relation to each other and to other parts of the document, the general nature and subject-matter of the document, the circumstances in which it was drawn up, etc. Even when a possible occasion for their application may appear to exist, their application is not automatic but depends on the conviction of the interpreter that it is appropriate in the particular circumstances of the case. In other words, recourse to many of these principles is discretionary rather than obligatory … .[30]

37. Thus, the *a contrario* reasoning advocated by Brazil is not of universal application. In fact, in the form of *expressio unius est exclusio alterius*, the *a contrario* approach can be an unreliable tool and must be used with caution. In *The Law of Treaties*, Lord McNair gave warnings as to the possible misapplication of this maxim:

> That there is a substantial element of truth in this maxim is obvious …. But, like other maxims, it must be regarded as a 'valuable servant' and not allowed to become a 'dangerous master', and must be applied with caution.[31]

38. He cited an English case to the effect that:

> The exclusio [*i.e.*, the thing not expressly mentioned] is often the result of inadvertence or accident, and the maxim ought not to be applied, when its application, having regard to the subject matter to which it is to be applied, leads to inconsistency or injustice".[32]

39. Accordingly, whether a provision gives rise to an *a contrario* interpretation depends very much upon the context of the provision being interpreted. Brazil's contention that Item (k) should be interpreted as containing an implicit *a contrario* exception must therefore be examined, like any other claim as to the interpretation of a treaty provision, in accordance with those rules of treaty interpretation that, having attained the status of customary international law, are automatic in their application.

(ii) The General Rule Of Interpretation In Article 31 of the Vienna Convention And The Principle Of Effectiveness

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[29] G.G. Fitzmaurice, "The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points," (1951) 28 B.Y.I.L. 1.; and Sir G. Fitzmaurice, "The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Certain Other Treaty Points," (1957) 33 B.Y.I.L. 203. (Exhibits CDA-9 and CDA-10)

[30] "Report of the International Law Commission on the work of its eighteenth session" (U.N. Doc. A/6309/Rev. 1) in *Yearbook of the International Law Commission 1966*, vol. II, Part II (New York, 1966) (UN Doc. A/CN.4/Ser.A/1966/Add.I), p. 218. (Exhibit CDA-11)

[31] McNair, *supra* note 28, p. 400.

[32] *Ibid*., quoting *Colquhoun* v. *Brooks*, 21 Q.B.D. 52, p. 65.

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40. It is well established that the starting point for interpreting a WTO agreement or a provision such as Item (k), is the general rule of interpretation in Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention").[33]

41. According to the general rule, treaty interpretation begins with a careful reading of the text. Treaty terms must be given their ordinary meaning unless the text indicates that a term is intended to have a special meaning. The ordinary meaning of a term is determined in the context of the treaty and in the light of the treaty's object and purpose.

42. The Appellate Body has also recognized that the principle of effectiveness in the interpretation of treaties (*ut res magis valeat quam pereat*) is a fundamental tenet of treaty interpretation flowing from this general rule.[34] The principle of effectiveness requires that a treaty interpreter:

> must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.[35]

43. The Appellate Body has elaborated upon this principle, stating that:

(i) It is the *duty* of any treaty interpreter to read all applicable provisions of a treaty in a way that gives meaning to *all* of them harmoniously;

(ii) An important corollary of this principle is that a treaty should be interpreted as a whole, and, in particular, its sections and parts should be read as a whole; and

(iii) *All of the provisions* of a treaty must be given meaning and legal effect.[36]

---

[33] United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, adopted 20 May 1996, pp. 16-17 [hereinafter United States – Gasoline]. Article 3.2 of the WTO's Understanding on the Rules and Procedures Governing the Settlement of Disputes (DSU) requires WTO Agreements (including the SCM Agreement) to be interpreted in accordance with "customary rules of interpretation of public international law". These rules are set out in the Vienna Convention. Article 31 of the Vienna Convention reads as follows:

> Article 31
>
> General rule of interpretation
>
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
> a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
>
> b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
>
> [….]
>
> 4. A special meaning shall be given to a term if it is established that the parties so intended.

[34] *United States – Gasoline*, p. 23; *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R; WT/DS810/AB/R; WT/DS11/AB/R, adopted 1 November 1996, p. 11; *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 179, note 110 [hereinafter "Original Appellate Body Report"]; *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, paras. 80-82 [hereinafter *Korea – Dairy Safeguards*].

[35] *Ibid*., para. 80.

[36] *Ibid*., paras. 81-82. [emphasis in the original].

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44. The principle of effectiveness is particularly relevant to the interpretation of the first paragraph of Item (k). To the extent that the paragraph is open to two interpretations – *i.e.*, it does or does not offer an *a contrario* exception – the interpretation that gives meaning and legal effect to all of the applicable provisions of the SCM Agreement must be adopted. As the following analysis demonstrates, this is achieved only if Item (k) is interpreted as not offering an *a contrario* exception.

(c) The Applicable Provisions of the SCM Agreement

45. In addition to Annex I, the applicable provisions of the SCM Agreement are the prohibition in Article 3 and the corresponding footnotes. These read as follows:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact[4], whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[5];
>
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.
>
> Footnote 4: 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. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.
>
> Footnote 5: Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

46. These provisions provide important context for the interpretation of Item (k). Moreover, Item (k) must not be interpreted in such a way as to deprive these provisions of meaning.

(i) Footnote 5

47. Footnote 5 is particularly important to the analysis of Brazil's claim that its export subsidies are permitted by Item (k), because footnote 5 recognizes that Annex I contains certain exceptions to the prohibition in Article 3. Brazil's claim can have no basis outside of footnote 5. As an explicit exclusionary clause, footnote 5 precludes the possibility of relying on an implied exclusion based on an alleged *a contrario* exception independent of footnote 5. The Panel recognized this in its original Article 21.5 Report where it stated:

> If we were to conclude that the Illustrative List by implication gave rise to "permitted" measures beyond those allowed by footnote, we would be calling into serious question the *raison d'être* of footnote 5.[37]

48. That is, if simply by identifying certain types of measures as prohibited export subsidies, the Illustrative List could be said implicitly to allow other subsidies, footnote 5 would be redundant. The principle of effectiveness precludes this result. Accordingly, Brazil's legal argument that an *a contrario* exception exists in the first paragraph of Item (k) must somehow be grounded in footnote 5.

[37] Article 21.5 Panel Report, para. 6.41. Moreover, the Article 21.5 Panel Report stated, at para. 5.3, that "footnote 5 controls the interpretation of item (k) with respect to when the Illustrative List can be used to demonstrate that a measure is not a prohibited subsidy".

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49. In its Report in the previous Article 21.5 proceeding, the Appellate Body, in *obiter dictum* stated that it would have been prepared to find that Brazil's PROEX II payments were justified under Item (k) if Brazil could have demonstrated that those payments satisfied the other two elements again at issue here (which it could not). However, it also stated that:

> … we wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5, or on the meaning of any other items in the Illustrative List.[38]

50. In Canada's view, it is impossible to reach a conclusion as to the existence of an *a contrario* exception without interpreting the language of footnote 5. Along with Article 3.1(a) of the SCM Agreement, footnote 5 and the other items in the Illustrative List constitute the immediate context of Item (k). In accordance with Article 31 of the *Vienna Convention* any full analysis of the meaning of Item (k) requires that it be considered.

51. For the purpose of assessing the existence of an alleged *a contrario* exception in Item (k) based on footnote 5, the key phrase in footnote 5 is "measures referred to in Annex I as not constituting export subsidies". In order to make out the existence of such an exception, Brazil must establish that a measure impliedly excluded from the list of illustrations in Annex I is a measure "referred to in Annex I as not constituting" an export subsidy. It cannot do so. The ordinary meaning of footnote 5 does not support such an interpretation.

52. A measure impliedly excluded from the Illustrative List is not a measure "referred to" in it. *The New Shorter Oxford English Dictionary* offers as the most relevant definition of "refer": "direct *to* a fact, event, etc., by drawing attention to it."[39] The usual synonyms for "referred to" – "mentioned, cited, named" – also involve a positive reference to something by means of words or other symbols.[40]

53. In legal instruments, matters are referred to by words. If something must be "referred to" in a written text, the thing must be named or described in words set out in the text. Otherwise the thing would not be referred to *in* the text. Since a text consists of expressed language, a reference *in* a text must equally consist of expressed language. The Appellate Body recognized this in *United States – Tax Treatment for "Foreign Sales Corporations*" where it described footnote 5 as applying "where the Illustrative List *indicates* that a measure is not a prohibited export subsidy".[41]

54. Footnote 5 does not require that the words "is not an export subsidy" be used in the Illustrative List. Rather, it requires positive authorizing language in Annex I that a measure is not being categorized as a prohibited subsidy. [42] To find otherwise would nullify the meaning and legal effect of the phrase "referred to in" and, therefore, would be inconsistent with the principle of effectiveness as articulated by the Appellate Body.

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[38] Article 21.5 Appellate Body Report, para. 80.

[39] *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 2520 ("refer"). (Exhibit CDA-12)

[40] *Oxford Thesaurus: An A-Z Dictionary of Synonyms* (Oxford: Clarendon Press, 1991), p. 384 ("refer). (Exhibit CDA-13)

[41] WT/DS108/AB/R, adopted 20 March 2000, para. 93. [emphasis altered]

[42] There are four such statements in Annex I. The second paragraph of Item (k) contains an explicit statement that certain practices shall not be considered a prohibited export subsidy. In three other instances, footnote 59 to Item (e), Item (h) and Item (i), the Annex includes affirmative statements authorizing the use of certain measures without explicitly stating that they do not constitute export subsidies. These statements provide contextual support for Canada's position that the words "measures referred to in Annex I as not constituting export subsidies" in footnote 5 means measures for which there are positive statements in Annex I to indicate that such measures are not export subsidies.

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55. Seen in the light of the ordinary meaning of footnote 5, Brazil's contention that its PROEX payments are permitted, *a contrario*, because they are not referred to in Item (k) creates an absurdity. It is this absence of reference from which Brazil infers that its measure is impliedly excluded from the prohibition in Article 3. However, in order to fall within footnote 5, Brazil's measure must be referred to in Item (k). Brazil cannot have it both ways.

(ii) The Illustrative List

56. The Illustrative List is illustrative only. That is, it is not an exhaustive list of those measures that are prohibited export subsidies. This is confirmed by the plain language of Article 3.1(a), which prohibits subsidies contingent upon export performance "*including* those illustrated in Annex I." [emphasis added]

57. It was also confirmed by the Panel in *Canada – Measures Affecting the Automotive Industry*. The Panel found that:

> it is … reasonable, in our view, to consider that the Illustrative List may be of some utility in informing the notion of export contingency in certain precise situations. We find it difficult to accept, however, that the practices identified in the Illustrative List represent a circumscription … of the conditions under which a subsidy is deemed to be contingent upon export performance. Indeed, the use of the words "including" and "illustrated" makes it clear that, while all practices identified in the Illustrative List are subsidies contingent upon export performance, there may be other practices not identified in the Illustrative List that are also subsidies contingent upon export performance.[43]

58. The Panel's finding confirms that the analysis of whether a given practice falls within the terms of an item in the Illustrative List is not determinative of whether it constitutes a subsidy contingent upon export performance. In other words, the Illustrative List only covers a subset of export subsidies to which the general prohibition applies.

59. In the case of a non-exhaustive illustrative list, an *a contrario* interpretation or the maxim *expressio unius est exclusio alterius* is not applicable. While the Illustrative List defines a part of a whole – that is, examples of export subsidies – it does not prescribe a special rule to be applied only to the examples mentioned. On the contrary, save for measures covered by footnote 5, pursuant to Article 3.1(a) the rule applicable to the whole – the prohibition of export subsidies – is also applicable to the part of the whole mentioned on the Illustrative List.

60. Since no special rule is defined for the Illustrative List, there is no basis to infer that unmentioned export subsidies are subject to a different rule. An *a contrario* interpretation is not possible, because unmentioned export subsidies are covered by the same rule as the expressly mentioned export subsidies.

61. Accordingly, when Item (k) is considered in accordance with the ordinary meaning to be given to the relevant terms of the SCM Agreement in their context, it is clear that Brazil's *a contrario* interpretation is unsustainable.

2. PROEX Payments Are Not The "Payment By [Governments] Of All Or Part Of The Costs Incurred By Exporters Or Financial Institutions In Obtaining Credits"

62. Item (k) of the Illustrative List does not allow for an *a contrario* exception. Even if it did, to qualify for it Brazil would have to show that its payments under PROEX III are of a type covered by

[43] WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 10.196.

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the first paragraph of Item (k) but not "used to secure a material advantage in the field of export credit terms".

63. Item (k) specifically relates to only two types of practices to which the "material advantage" clause applies: (i) export credits granted by governments or certain government-controlled institutions at below their own cost of funds; and (ii) payments by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits".

64. Throughout this dispute, Brazil has argued that its PROEX export subsidies are of the latter type. It has contended that they are payments by the Government of Brazil of all or part of the costs incurred by exporters (Embraer) or financial institutions in obtaining credits.[44]

65. Brazil's contention was considered by this Panel in the previous Article 21.5 proceeding. The Panel rejected Brazil's argument.[45] The Appellate Body subsequently declared the Panel's findings to be "moot" because it had already found that Brazil had failed to show that the PROEX payments were not used to secure a material advantage.[46] Nevertheless, the Panel's findings were clearly correct.

66. The Panel found as follows:

> It will be recalled that item (k) refers to the payment by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". In interpreting this provision, we must of course start with its ordinary meaning. In this respect, we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.
>
> Read in light of the foregoing considerations, we do not believe that PROEX payments can be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining export credits". Brazil's argument equates the cost for a financial institution of raising capital with the cost of "obtaining [export] credits". While the financial institutions involved in financing PROEX-supported transactions certainly *provide* export credits, they cannot be seen as *obtaining* such credits. Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so. In short, we do not agree that payments to a lender that amount to interest rate support can reasonably be understood to be payments of all or part of the costs of obtaining export credits.
>
> Even if we did agree that the provision of export credits at below a financial institution's cost of borrowing entailed a "cost incurred by … financial institutions in obtaining credits", we are unconvinced that PROEX payments necessarily serve to reimburse such below-cost-of-borrowing export credits. In this respect, we note that Brazil's argument focused on the fact that Embraer and Brazilian financial institutions had a high cost of borrowing as a result of "Brazil risk". As Canada points out, however, Embraer does not itself provide export credit financing, and the financial institutions receiving PROEX payments are not necessarily Brazilian financial institutions. Rather, they are in many cases leading international financial institutions unhampered by "Brazil risk". Thus, there is no basis for us to conclude, nor even to

[44] Original Panel Report, para. 4.76.
[45] Article 21.5 Panel Report, paras. 6.69-6.73.
[46] Article 21.5 Appellate Body Report, para. 78.

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> hypothesise, that the financial institutions in question are providing export credits at below their cost of funds.[47]

67. As the Panel noted, the ordinary meaning and context of the "payment" clause in the first paragraph of Item (k) makes clear that the costs referred to are those relating to *obtaining* export credits and not those relating to providing them. The first part of the first paragraph of Item (k) refers to the cost incurred by a government in granting export credits at rates below its own borrowing cost. The second part of the paragraph refers to a situation where a government covers the same cost incurred by a financial institution or an exporter.

68. PROEX payments do not reimburse an exporter or a financial institution for the costs it incurs in "obtaining" export credits. Instead, they buy down commercially negotiated interest rates for a purchaser of exported goods to below market rates. As such, they are not "payments" within the meaning of the second part of the first paragraph of Item (k).

69. Accordingly, PROEX payments would not qualify for any *a contrario* exception under Item (k), even if such an exception existed.

3. PROEX Payments Are "Used To Secure A Material Advantage In The Field Of Export Credit Terms"

70. The third element that Brazil would have to demonstrate in order to qualify for its alleged *a contrario* exception under Item (k) is that PROEX payments are not "used to secure a material advantage in the field of export credit terms". Brazil has been unable to demonstrate this in any of the prior proceedings in this dispute. However, it now claims that it has revised PROEX by way of Resolution 2799 "so as not to allow for the payments that result in interest rates below the relevant CIRR" and that this is sufficient to establish the third element.[48]

71. It is very much open to question whether the words of Resolution 2799, which provide that PROEX III buy-downs are to be "in accordance with" the relevant CIRR for the respective currency and financing term of the transaction, actually prohibit buy-downs to below the CIRR as Brazil claims. As noted, the typical financing term for regional aircraft transactions exceeds the 10-year CIRR term. That is, there is no CIRR for the financing term used most often for regional aircraft.

72. Even if for the sake of argument there were a relevant CIRR and the words of Resolution 2799 did prohibit buy-downs below that rate, it is readily demonstrated that, contrary to Brazil's assertions, PROEX III payments provide a "material advantage" as that term should be interpreted in accordance with the SCM Agreement and the relevant panel and Appellate Body findings.

(a) PROEX III Confers a Material Advantage When Compared to Rates Available to Borrowers in the Commercial Marketplace

73. Because PROEX III is constructed as a buy-down of interest rates that have already been freely negotiated by Embraer's customers in the market, the resulting net interest rates will necessarily be below market rates. The Appellate Body has stated that the existence of a "material advantage" depends on where the government interest rate "stands in relation to the range of commercial rates available."[49] The range of commercial rates available must be interpreted to refer to the commercial rates that are actually available to the borrower in question. The Appellate Body has acknowledged

[47] Article 21.5 Panel Report, paras 6.71 to 6.73. [emphasis in original]
[48] Brazil's 12 December 2000 DSB Statement, *supra* note 12.
[49] Original Appellate Body Report, para. 182. [emphasis added].

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that "the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity *as well as the creditworthiness of the borrower*."[50]

74. Given that PROEX III interest rates are necessarily below the market rates available to the borrower in question, and therefore provide an "advantage," the only question is whether the PROEX rates are sufficiently below market to be considered as providing a "material" advantage. The ordinary meaning of "advantage" is "a more favorable or improved position" or a "superior position". [51] The ordinary meaning of "material" is "serious, important; of consequence." [52] "Material" is also defined as referring to evidence or facts which are "significant, influential, esp. to the extent of determining a cause, affecting a judgement, etc."[53]

75. Therefore, a "material advantage" occurs if PROEX III provides a "more favorable" or "superior" position relative to the commercial rates available to the borrower in question, and that improvement is "important" in nature. Alternatively, a "material" advantage occurs where the improvement provided by PROEX III is "significant", especially to the extent of affecting a judgement or determining a cause, *i.e.* influencing the aircraft purchaser's selection of aircraft.

76. Canada has submitted affidavits from airlines and a financial institution indicating that a reduction in interest rates of as little as 25 basis points can have a material impact on a purchaser's choice of aircraft. [54]

77. Assuming that PROEX III buys down the interest rate to the CIRR, it will almost always confer an advantage of more than 25 basis points compared to the commercial rates available to borrowers under similar terms and conditions. The extent to which the CIRR is divorced from market terms is illustrated by comparing the U.S. dollar CIRR (the CIRR rate for terms in excess of 8.5 years is set at a fixed margin of 100 basis points over the 7-year U.S. Treasury bond) with the actual all-in borrowing rates paid by fixed-rate airline borrowers.

78. As shown in the annexed Morgan Stanley Dean Witter Market Update (the "MSDW Report") the airline with the best credit rating (i.e., lowest risk) is American, whose debt currently trades between 135 to 200 basis points above Treasury rates.[55] That is, even at the lowest end of the lowest risk airline, the 135 basis point spread is still 35 basis points higher than a rate achieved at CIRR alone.

79. The spread between the CIRR and market rates is higher – in some cases far higher – for other, less creditworthy airlines. As the MSDW Report shows, the spread paid by an airline above U.S. Treasury rates can range up to 500 basis points. Thus, even comparing PROEX III to market rates – without taking into consideration other terms and conditions – PROEX confers a material advantage.

80. However, other terms and conditions must also be taken into account. By its express wording, a material advantage under Item (k) is "in the field of export credit terms". Accordingly, the determination of whether a material advantage exists must be based on a consideration of those "export credit terms" and not simply based on a comparison of interest rates.

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[50] *Ibid*. [emphasis added].

[51] *Ibid*., para. 177.

[52] *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), pp. 1713-1714 ("material"). See also *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 991 ("material"). (Exhibits CDA-14 and CDA-15)

[53] The New Shorter Oxford English Dictionary ("material"), supra note 51.

[54] Affidavits from Tyrolean Airways (2 February 2000); Augsburg Airways (1 February 2000); Comair, Inc. (2 February 2000); and CIBC World Markets (2 February 2000). (Exhibit CDA-16)

[55] "EETC Market Update: Monthly Update: Airlines" (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials) 10 February 2001, p. 13. (Exhibit CDA-17)

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81. The Appellate Body identified as "terms and conditions of export credit transactions in the marketplace" the following: "the product involved, the size or volume of the transaction, the type of export credit practice, the duration of the repayment term, the type of interest (fixed or floating) used, and when the transaction is concluded."[56] As this Panel noted:

> In its ordinary meaning, the field of export credit terms would refer to items directly related to export credits, such as interest rates, grace periods, transaction costs, maturities and the like. We consider that this interpretation is supported contextually be item (k) itself, which refers to a loan's "maturity and other credit terms".[57]

82. If these terms and conditions are considered, as they must be under the express terms of the SCM Agreement and prior rulings in this case, they further demonstrate the material advantage provided by PROEX III. As noted previously, the PROEX III repayment period is "unlimited" and the financed amount may be up to 100 percent of the value of the aircraft.[58] In contrast, the American Airlines spread is based on a loan-to-asset value of only 47% and an average life of roughly 10 years, both of which significantly reduce the risk to the point where the credit is rated as Investment Grade.

83. The significantly longer maturities, and higher loan-to-asset value available under PROEX III would require significantly higher rates in the commercial marketplace. The fact that PROEX III rates are actually lower than commercial rates available to borrowers, despite having significantly longer maturities and higher loan-to-asset values, demonstrates that the program confers a material advantage in the field of export credit terms.

(b) The CIRR Alone Is Not Determinative of Material Advantage

84. Nevertheless, Brazil appears to be claiming that it can establish that PROEX payments do not secure a material advantage so long as they do not buy down interest rates below the CIRR rate. This flies in the face of the very nature of PROEX as a below-market buy-down scheme. Moreover, in advancing this argument, Brazil has misinterpreted the guidance of the Appellate Body.

85. In its Report in the previous Article 21.5 proceeding, the Appellate Body stated:

> To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate" basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark."[59]

86. Brazil has seized on this statement and cited it as the basis for its contention that PROEX III is in conformity with its WTO obligations.[60] Its position appears to be that as long as net interest rates under PROEX III will be at or above the relevant CIRR, payments under PROEX III do not secure a material advantage in the field of export credit terms. This is incorrect for several reasons.

87. First, as discussed above, the express terms of the SCM Agreement, as well as the prior findings of the Appellate Body and this Panel, demonstrate that the existence of a "material advantage" must be determined with regard to the field of export credit terms, rather than solely with

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[56] Article 21.5 Appellate Body Report, para. 73.
[57] Original Panel Report, para. 7.28.
[58] See *Valor Econômico* (30 October 2000), *supra* note 11.
[59] Article 21.5 Appellate Body Report, para. 67.
[60] Brazil's 12 December 2000 DSB Statement, *supra* note 12.

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respect to the interest rate comparison. Thus, to the extent that the CIRR is a "benchmark", that is, a "point of reference" [61] against which something may be compared, one must still look at the field of export credit terms in order to determine whether a "payment", within the meaning of Item (k) first paragraph, is used to secure a material advantage.

88. In other words, a CIRR benchmark cannot be conclusive on the issue of material advantage because it does not (as interpreted by Brazil in its PROEX III program) take into account the other aspects of the transaction, (*i.e.* maturity, the loan-to-asset value or minimum cash payment to be made, etc.) and the creditworthiness of the borrower.

89. Thus, while the CIRR may be relevant evidence to determine or assess whether a payment is used to secure a material advantage in the field of export credit terms, it cannot, in and of itself, be determinative.

90. That the CIRR alone is not determinative of a material advantage is confirmed by the rules of treaty interpretation. To find that the CIRR alone is determinative of a material advantage would reduce paragraph 2 of Item (k) to redundancy or inutility. No WTO Member would have any incentive to conform their export credit practices to the CIRR and the other requirements of the OECD Arrangement in order to shelter their export subsidies; they could achieve the same result by conforming their practices to the CIRR alone under paragraph 1. Such a result would be contrary to the principle of effectiveness in the interpretation of treaties (*ut res magis valeat quam pereat*) as articulated by the Appellate Body. [62]

91. Second, an approach that treated the CIRR as conclusive on the issue of material advantage would disregard the Appellate Body's clear ruling that the CIRR may not reflect the rates available in the marketplace, in which case it may be disregarded as a standard in favor of actual market rates. The Appellate Body held that even where an interest rate was <u>below</u> the CIRR, a defending Member could demonstrate that its program did not confer a material advantage, by relying on an alternative "market benchmark."[63]

92. The Appellate Body's decision with respect to below-CIRR rates was premised on its recognition that in certain circumstances, "the CIRR does not, in fact, reflect the rates available in the marketplace."[64] Thus, the Appellate Body recognized that the role of the CIRR was to serve as a proxy for the rates available in the marketplace. Where the CIRR is not an adequate proxy for market rates – as it is not, as discussed above – then an alternative market benchmark must be used. Brazil is wrong in interpreting the Appellate Body's statement as authorizing Brazil to make the CIRR determinative of the existence of a material advantage. The Appellate Body was merely indicating that the CIRR constitutes evidence that is relevant to that consideration.

93. Third, Brazil's reference to a CIRR interest rate divorced from the terms and conditions on which that rate depends is untenable and contrary to the findings of the Appellate Body. While the Appellate Body has found that the CIRR is an appropriate "market benchmark" for determining whether "payments" within the first paragraph of Item (k) are used to secure a material advantage, it did so because the CIRR is the interest rate reference point under the OECD Arrangement.[65] As the Appellate Body explained:

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[61] *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), p. 212 ("benchmark"). (Exhibit CDA-18)

[62] Korea – Dairy Safeguards, para. 80.

[63] Article 21.5 Appellate Body Report, para. 64.

[64] Ibid.

[65] Article 21.5 Appellate Body Report, para. 61, citing the Original Appellate Body Report, para. 181.

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> … the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are 'used to secure a material advantage in the field of export credit terms'.[66]

94. The CIRR is an interest rate that has been constructed within the context of the OECD Arrangement. Under that Arrangement, the CIRR can only be offered when the other disciplines of the Arrangement are respected. As the Appellate Body noted:

> … a participant in the *OECD Arrangement* can always offer borrowers officially-supported export credits if, besides respecting the CIRR, it also respects the other "repayment terms and conditions" of the *OECD Arrangement* (see Introduction, *OECD Arrangement*).[67]

95. Thus, the CIRR is only reflective of the market by virtue of its application within the framework of the OECD Arrangement, which *requires* that participants respect, in addition to the CIRR, other repayment terms and conditions. The CIRR has meaning and relevance as a benchmark only when considered as part of this "package" of terms and conditions. As noted in the OECD Arrangement, this package includes minimum premium benchmarks, the minimum cash payments to be made (*i.e.* loan-to-asset value) and maximum repayment terms.[68] Unless these other terms and conditions are respected, the CIRR is not representative of any market and is not an "appropriate" benchmark.

96. It therefore is clear, that when the Appellate Body referred to the CIRR as a appropriate benchmark by which to assess whether payments are used to secure a material advantage in the field of export credit terms, it could not have been referring to the CIRR stripped of the other terms and conditions set out in the OECD Arrangement from which it is derived. As a matter of treaty interpretation, the other requirements of the OECD Arrangement are essential context for understanding the relevance of the CIRR as a "market benchmark".

97. Accordingly, simply by limiting interest rate buy-downs to the CIRR, Brazil cannot demonstrate that PROEX III does not secure a material advantage in the field of export credit terms.

VI. FINDINGS REQUESTED

98. For the foregoing reasons, Canada requests that the Panel find that conditional commitments as of 6 December 2000 to pay PROEX subsidies on the export of Brazilian regional aircraft pursuant to PROEX III are subsidies contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and that Brazil has failed to implement measures that would bring the PROEX export subsidy program into compliance with the recommendations and rulings of the DSB and Articles 4.7 and 3.2 of the SCM Agreement.

99. Canada further requests that the Panel make detailed findings in respect of all three elements of Brazil's affirmative defence. Canada requests that the Panel find that:

(a) there is no *a contrario* exception under Item (k) of Annex I to the SCM Agreement;

(b) PROEX payments are not payments of the type covered by the first paragraph of Item (k); and

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[66] Original Appellate Body Report , para. 181, also cited in the Article 21.5 Appellate Body Report, para. 61.

[67] Article 21.5 Appellate Body Report, para. 62, n. 68.

[68] OECD Arrangement, *supra* note 14, Introduction, p. 4.

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(c) PROEX payments are used to secure a material advantage in the field of export credit terms.

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CDA-18. *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), p. 212 ("benchmark").

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ANNEX A-2

REBUTTAL SUBMISSION BY CANADA

(23 March 2001)

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Note: Certain exhibits to this submission contain business confidential information, the disclosure of which to non-government persons including those directly or indirectly involved in the aircraft industry would prejudice private commercial interests. These exhibits have been designated "Confidential", in accordance with Article 18.2 of the DSU.

I. INTRODUCTION

1. In its 16 March 2001 First Submission, Brazil offers three main arguments in defence of its export subsidy practices. First, it asserts that PROEX III payments on exports of regional aircraft no longer constitute a subsidy within the meaning of Article 1 of the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). Second, it contends in the alternative that PROEX III payments, as subsidies, now comply with the interest rate provisions of the OECD's Arrangement on Guidelines for Officially Supported Export Credits (the "Arrangement")[1] and are therefore eligible for the "safe haven" of the second paragraph of Item (k) to Annex I of the SCM Agreement. Brazil also asserts that, although the version of the OECD Arrangement now in force dates from 1998, the relevant version for the purposes of the second paragraph of Item (k) should be the 1992 version. Third, Brazil argues in the further alternative that PROEX III payments are not used to secure a material advantage in the field of export credit terms and therefore qualify for an alleged *a contrario* exception under the first paragraph of Item (k).

2. Nowhere does Brazil describe in its First Submission how PROEX III is currently administered with respect to exports of regional aircraft. As Canada will demonstrate, it appears that in addition to the traditional method of administering PROEX (i.e. as interest rate buy-down payments on financing negotiated in the commercial market), PROEX III is now offered in conjunction with, or as part of, export financing packages provided by Brazil's development bank, the Banco Nacional de Desenvolvimento Económico e Social (BNDES). In addition, Brazilian export subsidies for regional aircraft may be completely subsumed in BNDES financing in such a way that the PROEX III payments are hidden. These latter approaches to the administration of PROEX provide a benefit that is no different from that provided under the traditional approach to administering PROEX I and II.

3. In this submission, Canada will demonstrate that, as a matter of fact and of law, each of Brazil's three defences for PROEX III must be rejected, whether PROEX is implemented as traditional interest rate buy-down payments or in conjunction with BNDES financing. As Canada will demonstrate, PROEX III financing support on exports of regional aircraft continue to amount to subsidies within the meaning of Article 1 of the SCM Agreement that are contingent upon export performance within the meaning of Article 3 of that Agreement.[2]

4. Brazil's first defence, that PROEX III support does not confer a "benefit" within the meaning of Article 1.1 of the SCM Agreement is without merit. Whether or not PROEX III support is consistent with the commercial interest reference rate ("CIRR") or the OECD Arrangement does not go to the legal question of whether a benefit is conferred. Thus, Brazil has not rebutted the *prima facie* case presented in Canada's First Submission, that PROEX III financing support continues to be a

[1] OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998, 1992) [hereinafter "1998 OECD Arrangement" and "1992 OECD Arrangement" respectively]. Canada has filed the relevant sections of the 1998 OECD Arrangement as Exhibit CDA-5. Brazil has filed the 1998 OECD Arrangement as Exhibit Bra-9 and the 1992 OECD Arrangement as Exhibit Bra-7.

[2] In this submission, Canada uses the term "PROEX III financing support" or "PROEX III support" to encompass both the traditional PROEX payments and the other forms of support offered by Brazil as described in paragraph 2 of this submission.

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prohibited export subsidy because it consists of cash payments to a recipient to buy down further the interest rate available to that recipient in the marketplace.[3]

5. Canada will also demonstrate that Brazil has not met its burden of proof with respect to the two affirmative defences it attempts to invoke. With respect to the second paragraph of Item (k), the legal argument and evidence put forward by Brazil does not establish compliance with either the 1998 or the 1992 versions of the OECD Arrangement. Rather, the evidence presented by both Brazil and Canada is to the contrary. As Brazil acknowledges, for financing support for regional aircraft to conform to the interest rate provisions of the OECD Arrangement, it must be limited to terms of no more than 10 years and to coverage not exceeding 85 percent of the value of the aircraft. Brazil has not established that PROEX III financing support is limited to these terms. On that basis alone, Brazil has not established that PROEX III can benefit from the "safe haven" of the second paragraph of Item (k). Nor has Brazil demonstrated compliance with the other requirements of the OECD Arrangement.

6. Canada will show that, contrary to Brazil's further assertion, the 1998 version of the OECD Arrangement is indeed the applicable one under the second paragraph of Item (k). However, irrespective of which version of the OECD Arrangement applies, PROEX III is not in compliance.

7. With respect to paragraph 1 of Item (k), Brazil's submission does not respond to the arguments set out in Canada's First Submission, let alone establish a *prima facie* case for the application of the alleged exception. In this submission, Canada highlights the legal and factual flaws in the limited arguments presented by Brazil.

II. PROEX III CONFERS A BENEFIT AND IS A SUBSIDY WITHIN THE MEANING OF ARTICLE 1 OF THE SCM AGREEMENT

8. Brazil's claim that PROEX III is not an export subsidy is based on its contention that PROEX III does not confer a "benefit". This contention is based on two arguments. First, Brazil argues that to the extent that PROEX III buys down to the CIRR interest rate, the payments do not confer a benefit.[4] Second, Brazil argues that to the extent that PROEX III conforms more broadly to the interest rates provisions of the OECD arrangement, it does not confer a benefit.[5]

A. PROEX III CONFERS A BENEFIT EVEN IF IT COMPLIES WITH A CIRR OR THE OECD ARRANGEMENT

9. With respect to both arguments, Brazil is misconstruing the legal significance of compliance with the CIRR or the OECD Arrangement. Such compliance is legally relevant only to the extent that paragraph 2 of Item (k) or the alleged *a contrario* exception in paragraph 1 of Item (k) is invoked. Upon successful invocation, compliance does not mean that a benefit within the meaning of Article 1 has not been conferred. Rather, it means that the prohibitions in Article 3 of the SCM Agreement may not apply. As noted by the Arbitrators in the proceeding in this dispute under Article 22.6 of the DSU, the fact that an export subsidy is justified under Item (k) "does not mean that it is no longer a subsidy. It simply means that it is not a *prohibited* subsidy".[6] [emphasis in the original]

10. Brazil's arguments at paragraphs 11 through 15 of its First Submission conflate the meaning of "benefit" in Article 1 of the SCM Agreement with the concepts of "material advantage" in

[3] First Written Submission of Canada, 2 March 2001, paras. 9 and 73 [hereinafter "Canada's First Submission"].

[4] First Submission of Brazil, 16 March 2001, para. 11 [hereinafter "Brazil's First Submission"].

[5] *Id*., para. 15.

[6] *Brazil – Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, adopted 12 December 2000, para. 3.39.

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paragraph 1 of Item (k) and compliance with the OECD Arrangement in paragraph 2 of Item (k). All references by the Appellate Body to CIRR have been in the context of determining whether payments under PROEX I and II were used to "secure a material advantage".[7] The Appellate Body has recognized that the meaning of "material advantage" in Item (k) is legally distinct from the existence of a "benefit" under Article 1.[8] Brazil fails to recognize this critical distinction.

11. The applicable legal test for the existence of a "benefit" is set out in the Appellate Body Report in *Canada – Aircraft*.[9] The Appellate Body found that a benefit is provided to a recipient where a financial contribution makes the recipient better off than it would otherwise have been absent that contribution.[10] According to the Appellate Body:

> the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[11]

12. As Canada noted in its First Submission, PROEX III, like its predecessor schemes, is constructed as a buy-down of interest rates that have already been freely negotiated by the recipients – Embraer's customers – in the marketplace.[12] Accordingly, any buy-down below those freely negotiated rates will necessarily result in net interest rates on terms more favourable than those available to Embraer's customers in the market. Thus, PROEX III, like its predecessor schemes, necessarily confers a benefit. If Embraer's customers could achieve financing in the marketplace at rates equivalent to those achieved by PROEX buy-downs, there would be no need for PROEX.

13. In the Article 22.6 proceeding in this dispute, Canada presented evidence that, contrary to Brazil's previous assertions, Brazil also offers direct financing for its regional aircraft through BNDES. Canada quoted from page 12 of Embraer's Preliminary Prospectus, which stated:

> In addition to the PROEX program, we rely on the BNDES-exim program, also a government-sponsored financing program, to assist customers with financing. This program provides our customers with direct financing for Brazilian exports of goods and services. At March 31, 2000, approximately 51.1% of our backlog (in terms of value) was subject to financing by the BNDES-exim program.[13]

14. The same reasoning that applies to traditional PROEX buy-downs also applies to PROEX III payments that are administered in conjunction with BNDES financing or to BNDES financing that has completely subsumed PROEX III. It is apparent that the BNDES financing being offered in conjunction with PROEX III is being offered at the interest rate floor designated for PROEX III – *i.e.*,

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[7] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, adopted 4 August 2000, para. 61 [hereinafter "Article 21.5 Appellate Body Report"].

[8] *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 179 [hereinafter "Original Appellate Body Report"].

[9] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999 [hereinafter "*Canada – Aircraft*, Appellate Body Report].

[10] *Id*., para. 157.

[11] *Id*.; see also *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, Report of the Appellate Body, WT/DS138/AB/R, adopted 7 June 2000, paras. 67-68.

[12] Canada's First Submission, para. 73.

[13] Canada's Answers to the Questions to the Parties, 24 July 2000, p. 11. The Prospectus uses a 57.5% figure at p. 77.

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the CIRR.[14] To the extent that PROEX III allows for the buy-down of BNDES financing to this level, or that BNDES is subsuming and offering PROEX financing support, Embraer customers are receiving financing at rates that would not be achievable either in the commercial market or from BNDES in the absence of PROEX III support.

15. Thus, PROEX III financial contributions confer a "benefit" under Article 1 of the SCM Agreement. They are therefore a subsidy. Brazil has not disputed that PROEX III is also contingent on export performance. Accordingly, PROEX III is a prohibited export subsidy within the meaning of Article 3 of the SCM Agreement. The burden lies with Brazil to prove that PROEX III support meets the conditions of the safe haven in the second paragraph of Item (k) or the alleged exception in the first paragraph (as well as to demonstrate that such an exception exists at all). It cannot do so.

B. EVEN AT CIRR, PROEX III CONFERS A BENEFIT

16. At paragraphs 11-14 of its First Submission, Brazil argues that the CIRR is representative of market rates and sometimes is above prevailing market rates. In certain circumstances Brazil may be correct. However, this observation in no way establishes that PROEX III financing support does not confer a benefit.

17. Canada has already explained why PROEX III, by its very design, confers a benefit. Even if this were not the case, PROEX III does not avoid conferring a benefit by establishing the CIRR as an interest rate floor. Canada demonstrated in its First Submission that the CIRR alone, divorced from the other terms and conditions of the OECD Arrangement such as the ten-year term limit and the limit on financing to 85 percent of the value of the contract, in no way reflects market realities.[15] Brazil has not rebutted Canada's evidence and submissions on this point. Moreover, at paragraphs 87 to 90 of this Submission Canada demonstrates that, under current market circumstances, the CIRR is substantially below the commercial interest rates available to regional airlines for the purchase or lease of regional aircraft.

III. BRAZIL'S REVISED POSITION ON PARAGRAPH 2 OF ITEM (K) OF THE ILLUSTRATIVE LIST

18. In its First Submission, Brazil substantially revises its position on paragraph 2 of Item (k) of the Illustrative List. Brazil did not invoke the second paragraph of Item (k) in the PROEX I proceeding because, in its own words to the Appellate Body "it 'has concluded that conformity to the OECD provisions is too expensive'".[16] It was silent on the second paragraph of Item (k) in the PROEX II proceeding. Brazil now claims that it "has complied with Canada's stated wishes and conformed PROEX to the interest rate provisions of the *Arrangement*, as required by the second paragraph of Item (k)" and goes so far as to suggest in the conclusion of its First Submission that "[t]he sole issue before this Panel is whether the regulations governing PROEX conform to the relevant provisions of the *Arrangement*".[17]

19. Had Brazil actually brought its export subsidy practices into conformity with the relevant provisions of the OECD Arrangement as it now claims, this long-standing dispute would have been largely resolved. Unfortunately, as described in this section, there are strong reasons to doubt Brazil's

[14] Declaration of Ian Darnley, dated 21 March 2001 [hereinafter "Darnley Declaration"]. (Confidential Exhibit CDA-19)

[15] Canada's First Submission, paras. 77-83 and 94-95.

[16] Original Appellate Body Report, para. 180.

[17] Brazil's First Submission, para. 72.

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claim. Moreover, because Brazil's claim is in the nature of an affirmative defence, Brazil bears the burden of proof.[18]

A. BRAZIL'S POSITION IS CONTRARY TO ITS PUBLIC STATEMENTS

20. Other than in its First Submission, Brazil has never once contended that it had conformed its measures to the OECD Arrangement, or that it would do so in the future. On the contrary, it has consistently maintained that it would not do so. Brazil has insisted that it will not abide by the provisions of the OECD Arrangement in public statements by its officials, in its statements to the DSB and in every one of the six consultation and negotiation sessions that Canada and Brazil have held since the release of the original *Brazil – Aircraft* Article 21.5 Panel Report in May 2000.[19]

21. Thus, for example, as reported in the 31 August 2000 edition of the daily *Correio Braziliense*, Brazil's chief negotiator in this dispute, Ambassador José Alfredo GraHa Lima, described Brazil's position as follows:

> "We will only change the interest rates, for this was determined by WTO regulations." … . "However, we have no obligation before the WTO to change other aspects such as terms and the coverage of lending. This will not be done. That is the government's position."[20]

22. Later, when, in an effort to reach a negotiated settlement, Canada met with Brazil in Rio de Janeiro on 28 and 29 November 2000, just days before Brazil's PROEX III measures came into force, Brazil again refused to consider adjusting the PROEX scheme so as to abide by the interest rate provisions of the OECD Arrangement.

23. In fact, Brazil never did make the changes it now claims to have made. On 7 December 2000, the day after the relevant amendments to PROEX took effect, *Valor Económico*, Brazil's national daily business newspaper reported:

> However, resolution 2.799 from the Central Bank, which set the new rules, follows very closely the Brazilian interpretation of the final decision by the WTO dispute resolution system. This fact raises doubts about a possible Canadian retreat. That is to say, the text changes only equalization conditions, so that the final interest rate of financing should not be set below CIRR, which is set on a monthly basis by the OECD. Until December 14th, this rate will be set at 6.84%.
>
> The broader requests presented by Canada during negotiations were discarded. The Canadian government requested that the financing terms of Embraer's sales be limited to ten years and that equalization covered up to 85% of the amount financed.[21]

24. In January 2001, when Canada requested this Article 21.5 proceeding, Brazil's *Gazeta Mercantil* reported:

> The new PROEX takes as a reference for interest equalization the CIRR, (OECD's basic rate), whereas beforehand the reference was Libor plus 0.2%. With the

[18] See Article 21.5 Appellate Body Report, para. 66; *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, p. 16.

[19] These consultations took place in May 2000, in New York; in June 2000, in Geneva; in July 2000 in Montreal; in August 2000 in Sao Paulo; in September 2000 in New York and in November 2000, in Rio de Janeiro.

[20] "Tough Agreement with Canada," *Correio Braziliense* (31 August 2000). (Exhibit CDA-20)

[21] D.C. Marin, "Government changes PROEX interest rates," *Valor Económico* (7 December 2000). (Exhibit CDA-21)

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> adjustment, rates will never be set below CIRR. The Brazilian position is that this eliminates export subsidisation. Ottawa, however, says that the program will only be compatible with the rules if it reduces financing from 15 to 10 years and places a limit of 85% of the amount of sales, instead of the current 100% coverage. "These are OECD rules, and we are not going to accept them," Brazilian authorities reacted.[22]

25. Similarly, at neither of the DSB meetings at which Canada requested this Article 21.5 proceeding did Brazil state that it had conformed its measures to the OECD Arrangement. Instead, it claimed that it could comply by limiting its interest rate buy-downs to the CIRR alone. It then complained that Canada's position "would require Brazil to strictly adhere to OECD Consensus regulations that would severely and unfairly tilt the playing field against the Brazilian exporter".[23]

26. The question therefore, is not, as Brazil would have it, why Canada has again sought recourse to this Article 21.5 proceeding. The real question is why Brazil has until its First Submission been so reluctant to admit to a course of action that, if actually taken by 6 December as it now claims, would have largely resolved this dispute. The answer is that despite its claims, Brazil has not changed PROEX to comply with the OECD Arrangement. This conclusion is further supported by the statement of Brazil's own Foreign Minister Lampreia that: "For us, the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms."[24]

B. BRAZIL HAS ALREADY BEEN FOUND TO WAIVE ITS PROEX "REQUIREMENTS"

27. The second reason to doubt Brazil's claim that PROEX III conforms to the interest rate provisions of the OECD Arrangement is that Brazil has previously been found to waive the requirements that it now contends limit the terms of the financing it can offer. Brazil now claims that the maximum length of the financing term under PROEX III is 10 years, as required by Article 21 of Annex IV to the OECD Arrangement.[25] Brazil relies for this claim on the Central Bank of Brazil (BCB) Circular 2881 of 19 November 1999 and the 21 December 1999 Directive 374 of the Ministry of Development, Industry and Foreign Trade.

28. However, Brazil made the same claim on the basis of the same documents in the original Article 21.5 proceeding. That claim has already been rejected. Thus, in its 14 February 2000 response to Question 6 from this Panel in the original Article 21.5 proceeding Brazil acknowledged that, notwithstanding Circular Letter 2881, the 10-year term "was waived, and continues to be waived, however, for regional jet aircraft."

29. Accordingly, as Canada noted in its First Submission, this Panel found that, despite Circular 2881, the Committee on Export Credits, which administers PROEX:

> … has the authority to waive some of the published PROEX guidelines. In the case of regional aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.[26]

30. Similarly, Brazil claims that it conforms with Article 3 of the OECD Arrangement, which restricts export financing to 85 percent of the value of the export contract.[27] Brazil bases this claim on

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[22] A. Moreira and F. Paraguassu, "Canada requests condemnation of the new PROEX in the WTO," *Gazeta Mercantil* (20 January 2001). (Exhibit CDA-22)

[23] Statement by Brazil: DSB Meeting of 01 February 2001: Agenda Item 7. (Exhibit CDA-23)

[24] M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000). (Exhibit CDA-3)

[25] Brazil's First Submission, para. 47. Brazil refers to the 1992 version of the Arrangement. Article 21 is found in Annex III to the 1998 version.

[26] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, para. 2.4 [hereinafter "Article 21.5 Panel Report"].

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Article 5 of Directive 374.[28] However, Directive 374, which dates from 21 December 1999, is clearly not a measure taken to revise PROEX in the light of the recommendations and rulings of the DSB stemming from the original Article 21.5 proceedings. Not only does it predate those recommendations and rulings, but, as already noted, it applied to PROEX II.

31. Minister Lampreia's statement, previously cited, also appears to confirm that the Committee's waivers, both as to the term of financing and the percentage of the contract value financed, have continued since 1999 and to the present day.

C. PROEX III FINANCING SUPPORT OFFERED BY BRAZIL DEPARTS FROM THE OECD ARRANGEMENT

32. The third reason for doubting Brazil's claim of conformity with the interest rate provisions of the OECD Arrangement is the available evidence of the export financing for regional aircraft that has been offered by Brazil and that would be covered under PROEX III.

33. In recent negotiations to sell regional jet aircraft to Air Wisconsin Airlines Corporation, Embraer offered financing through BNDES at a rate equivalent to the CIRR[29] Although Brazil's initial offer predated the changes to PROEX, negotiations by Bombardier and Embraer continued past 6 December 2000. Accordingly, had Air Wisconsin accepted Embraer's offer, the financing support would have been governed by the 6 December 2000 changes to PROEX.

34. In response to Brazil's offer of financing support to Air Wisconsin, Canada, through its Export Development Corporation, proposed a comparable financing package for Air Wisconsin to acquire Bombardier regional jets. The Bombardier financing would have a term of 16.5 years, an interest rate equivalent to the CIRR and would cover up to 78 percent of the aircraft purchase price. As described in Exhibit CDA-24, Air Wisconsin has confirmed that the financing proposed by Bombardier is no more favourable than that offered by Embraer.[30] Although Air Wisconsin indicates in CDA-24 that it cannot offer further details due to confidentiality commitments to Embraer, the only reasonable inference that can be drawn from Air Wisconsin's statement is that the financing offered by Brazil through Embraer, is at, or very close to, a 16.5 year term.

35. Similarly, Fairchild Dornier, an aircraft manufacturer, has received information that in November 2000 during negotiations for a sale of regional jets to a South African airline, SA Airlink Embraer offered PROEX financing support for a period of 15 years[31] Embraer announced that sale on 14 December 2000, one week after the modifications made to PROEX in Resolution 2799.[32] Fairchild Dornier's information is substantially corroborated by the report froma Bonbardier sales executive, submitted as Confidential Exhibit CDA-XX.[33]

36. On the basis of all of the available evidence, it appears that either PROEX III itself does not conform to the interest rate provisions of the OECD Arrangement, or that Brazil is using another

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[27] Again, this is the 1992 version of the OECD Arrangement. The same requirement is found in Article 7 of the 1998 version.

[28] Brazil's First Submission, para. 42.

[29] Darnley Declaration. (Confidential Exhibit CDA-19)

[30] Letter from W.P. Jordan, Executive Vice President, Administration and General Counsel, United Express, operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001. (Exhibit CDA-24)

[31] Letter from Fairchild Dornier, dated 22 March 2001. (Confidential Exhibit CDA-25)

[32] "SA Airlink Selects the ERJ 135 and Purchases 70 Units," Embraer Press Release, 14 December 2000, available on the Embraer website at http://www.embraer.com/english/imprensa/index.htm. (Exhibit CDA-26)

[33] Declaration of Hormuzd Irani, dated 21 March 2001. (Confidential Exhibit CDA-27)

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export subsidy mechanism, apart from or in conjunction with PROEX, to offer regional aircraft financing on terms that depart from the OECD Arrangement.

37. In the light of the foregoing evidence, Brazil has failed to meet its burden of proving that it is in conformity with the interest rate provisions of the OECD Arrangement. If, however, this Panel chooses to seek additional information from Brazil, Canada asks that the Panel request from Brazil the specific terms of its offers of export financing for transactions involving Embraer regional aircraft in the months leading up to and following the 6 December 2000 revisions to the PROEX program. The relevant information would include the percentage of the interest rate buy-down, the resulting net interest rate, the term of the financing and percentage of the value of the aircraft covered by the financing and whether the financing has been offered under PROEX alone or in conjunction with BNDES.

38. If the Panel seeks this information and Brazil does not provide it, Canada asks that the Panel infer that the measures under which Brazil continues to offer export subsidies for regional aircraft do not qualify for the "safe haven" under the second paragraph of Item (k) and that accordingly, Brazil has failed to bring its measures into conformity with the recommendations and rulings of the DSB and with Article 3.1(a) and 3.2 of the SCM Agreement.[34]

IV. BRAZIL HAS OTHERWISE FAILED TO SHOW THAT PROEX MEETS THE REQUIREMENTS OF THE SECOND PARAGRAPH OF ITEM (K)

39. In its First Submission, Brazil appears to place its greatest faith in its second principal argument: that PROEX III qualifies for the "safe haven" in the second paragraph of Item (k) because Brazil has revised its PROEX III practices to bring them into conformity with the OECD Arrangement.

40. Brazil contends that, although PROEX III is a prohibited subsidy, it nevertheless meets the conditions of the second paragraph of Item (k) in Annex I of the SCM Agreement. Brazil further contends that the 1992 version of the OECD Arrangement – instead of the 1998 version – should be used as the yardstick to judge its alleged "conformity" with the "interest rates provisions" as specified in the Item (k), second paragraph, exception.

41. As Canada has already demonstrated, Brazil's measures do not conform to two of the key requirements of the OECD Arrangement: that export subsidies be limited to terms of ten years and that financing cover no more than 85 percent of the value of the goods financed. As these requirements are common to both the 1992 and the 1998 versions of the OECD Arrangement, Brazil's measures do not conform to the OECD Arrangement regardless of whether the 1998 version or the 1992 version is relevant for the purposes of the Item (k), second paragraph, exception.

42. Nevertheless, in the following sections, Canada will demonstrate in detail why PROEX III is not in conformity with the other "interest rates provisions" of either the 1998 or the 1992 versions of the OECD Arrangement. Although the issue is moot in this proceeding, Canada will also demonstrate that the 1998 Arrangement is the relevant one for the purposes of the exception in Item (k), second paragraph.

A. PROEX III IS NOT IN CONFORMITY WITH THE INTEREST RATE PROVISIONS OF THE 1998 OECD ARRANGEMENT

43. To meet the conditions of the Item (k), second paragraph exception, Brazil must prove that its measures conform to every element of the exception. The Article 21.5 Panel in the *Canada - Aircraft*

[34] The authority of a panel to draw adverse inferences has been recognized by the Appellate Body in *Canada – Aircraft*, Appellate Body Report, paras. 202-03.

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dispute,[35] after a thorough analysis, defined what it means to be "in conformity with" the "interest rates provisions" of the Arrangement, and therefore what is required to claim the exception. Although "interest rate provisions" arguably has a broader meaning than that given to it by the Panel in *Canada – Aircraft*, at a minimum, the interest rate provisions to which PROEX III must conform are those identified by the *Canada - Aircraft* Panel, namely the "applicable provisions of Articles 7-10 and 12-26 of the *Arrangement*; and of Articles 18-24 and Articles 27-29(a)-(c) of Annex III". [36]

44. PROEX III fails to meet each and every requirement. Thus, Brazil cannot claim the exception. Moreover, even if the "interest rates provisions" were limited to those identified by Brazil,[37] PROEX III fails to meet those provisions. Accordingly, Brazil's claim to the exception in Item (k), second paragraph, must fail.

45. Brazil claims that PROEX III is "in conformity with" *all* of the "interest rates provisions" in the OECD Arrangement, as defined by the Article 21.5 Panel in *Canada - Aircraft.*[38] However, Brazil offers no evidence to support its claim other than Resolution 2799 itself. Nor does its argument even mention most of the interest rate provisions in the Arrangement. Brazil mentions Articles 7 and 15 of the main text of the Arrangement and Articles 21, 22 and 29(a) of Annex III.[39] It completely disregards Articles 8, 9, 12-14 and 16-26 of the main text and Articles 18-20, 23, 24, 27-28 and 29(b) and (c) of Annex III.

46. Certain of these provisions are very significant and affect the very structure of the transaction, e.g., Article 13 entitled Repayment of Principal requires the "principal sum" to "be repaid in equal and regular instalments". This is not the same as a normal amortization where, although the payment amount stays the same, the principal and interest portions vary over the life of the repayment schedule. Article 13 requires the principal portion of each payment to be the same over the life of the repayment schedule. This provision eliminates balloon payments – a common tool used to make financing proposals more attractive.

47. Another provision of importance is Article 29(a)-(c) of Annex III on spare parts. Contrary to Brazil's claim, spare parts often comprise a significant portion of any given transaction.[40] Article 6 of Directive 374 allows for financing of up to 20 percent for spare parts,[41] whereas Article 29(a) of the Arrangement limits financing for spare parts to a maximum of 15 percent of the aircraft price for the first five aircraft and to 10 percent for the sixth and subsequent aircraft. Thus, the limit in Directive 374 explicitly exceeds that in the OECD Arrangement. Moreover, Brazil regularly uses its discretion to waive the limits on PROEX.

48. Even using Brazil's own interpretation of the "interest rates provisions",[42] Brazil offers no evidence of conformity with Articles 16-19 of the main text. Therefore, PROEX III is not "in conformity with" the "interest rates provisions" of the 1998 Arrangement. Its claim to the exception in Item (k), second paragraph, must fail.

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[35] C*anada – Measures Affecting the Export of Civilian Aircraft: Recourse by Brazil to Article 21.5 of the DSU*, Report of the Panel, WT/DS70/RW, adopted 4 August 2000, [hereinafter "*Canada – Aircraft*, Article 21.5 Panel Report"].

[36] See *id*., para. 5.147.

[37] 1998 OECD Arrangement, *supra* note 1, Articles 15-19 and Annex III, Article 22 as listed in Brazil's First Submission, para. 52.

[38] Brazil's First Submission, para. 53.

[39] *Id*., paras. 54-59.

[40] Declaration of George Stevens, dated 20 March 2001, pp. 3 and 4. (Confidential Exhibit CDA-28)

[41] Brazil's First Submission, para. 60.

[42] *Id*., para 52.

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B. PROEX III IS NOT IN CONFORMITY WITH THE INTEREST RATE PROVISIONS OF THE 1992 OECD ARRANGEMENT

49. Even if the 1992 Arrangement is used, PROEX III fails to meet the conditions of the exception in Item (k), second paragraph. Comparing the 1992 Arrangement to the findings of the Canada 21.5 Panel results in the following 1992 Arrangement provisions: Articles 3-7 of the main text, Articles 9, 17-22, 24 and 25 of Annex IV, and several definitions in Annex V. The 1992 Arrangement has no counterparts for the 1998 Arrangement's Articles 18-24 of the main text and Articles 27 (portions on used aircraft and service contracts), 28 and 29(b) and (c) in Annex III.

50. As Canada has already demonstrated, PROEX III does not conform to two of the key requirements of both the 1998 and 1992 versions of the Arrangement: that export subsidies be limited to terms of ten years and that financing cover no more than 85 percent of the value of the goods financed. This non- conformity in 1992 Arrangement terms corresponds to Article 21 of Annex IV and Article 3 of the main text, respectively. Thus, even using Brazil's limited definition of "interest rates provisions", i.e., Article 5 of the main text and Article 21 of Annex IV,[43] PROEX III is not "in conformity with" the "interest rates provisions" of the 1992 Arrangement.

51. Once again, besides a bald assertion that "PROEX III conforms with the corresponding interest rates provisions",[44] Brazil provides no evidence of conformity other than Resolution 2799. As previously noted, however, the nominal limitations in Resolution 2799 are the same as have been examined in every WTO proceeding in this dispute. Those nominal limitations have no meaning since Brazil demonstrably has the authority and continually uses the authority to waive these limits on terms and amounts financed. There is nothing to suggest that the waivers are not continuing under PROEX III.

52. Therefore, PROEX III is not "in conformity with" the "interest rates provisions" of the 1992 Arrangement. Its claim to the exception in Item (k), second paragraph, must fail.

C. THE 1998 VERSION OF THE OECD ARRANGEMENT, NOT THE 1992 VERSION, IS RELEVANT FOR THE PURPOSES OF THE SECOND PARAGRAPH OF ITEM (K)

53. Brazil's claim that the 1992 version of the OECD Arrangement is the relevant one relies on a textual interpretation of the exception in Item (k), second paragraph, that is untenable. The starting point for interpreting the exception in Item (k), second paragraph, is the general rule of interpretation in Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention").[45]

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[43] *Id*., para. 40.

[44] *Id*.

[45] *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, pp. 16-17. Article 3.2 of the WTO's *Understanding on the Rules and Procedures Governing the Settlement of Disputes* (DSU) requires WTO Agreements (including the SCM Agreement) to be interpreted in accordance with "customary rules of interpretation of public international law". These rules are set out in the Vienna Convention. ..Article 31 of the Vienna Convention reads as follows:

Article 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

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54. According to the general rule, treaty interpretation begins with a careful reading of the text. Treaty terms must be given their ordinary meaning unless the text indicates that a term is intended to have a special meaning. The ordinary meaning of a term is determined in the context of the treaty and in the light of the treaty's object and purpose. Given that Item (k), second paragraph, creates an exception to the SCM Agreement, it must be interpreted in the context of the SCM Agreement.

1. Brazil's Interpretation Rewrites The Item (k) Exception

55. The exception in Item (k), second paragraph, reads as follows:

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

56. The text at issue is "successor undertaking which has been adopted by those original Members". Brazil's argument relies on the phrase "has been". Using Brazil's logic, the text "has been" focuses on the past – i.e., 1 January 1995 – not the "time regarded as present".[46]

57. In its ordinary meaning, the phrase "has been" will always be in the present perfect tense because, e.g., an agreement or resolution, must be adopted – in the present – before it can take effect. The phrase requires a determination, at the time of the consideration of the application of Item (k) to a specific set of fact, whether there is a successor arrangement which "has", in the present, "been adopted."

58. This interpretation is confirmed by the context of the term "has been." For instance, under Brazil's approach, the phrase "if a Member is a party to an international undertaking" in Item (k) would only apply to Members who were parties to the OECD Arrangement as of 1 January 1995, excluding Members such as the Republic of Korea who have become parties since then. Simply stated, the Panel must determine whether a successor undertaking currently "has been adopted", not whether a successor undertaking *had* been adopted as of 1 January 1995.

59. Furthermore, the 1998 Arrangement is clearly a "successor undertaking" to the 1979 Arrangement. In its ordinary meaning, "successor" modifies "undertaking" and refers to "a … thing which succeeds another in … function"[47] or "one who replaces or follows another".[48] It is forward looking. The 1998 Arrangement "succeeds … in … function" and "replace[d]" the 1992 Arrangement, which in turn succeeded the 1979 Arrangement.

60. Moreover, Brazil's argument would lead one to believe that it was the entire original Membership of the WTO that adopted the 1992 Arrangement as of 1 January 1995. However, the text does not state this. The text refers to a: "successor undertaking which has been adopted by those *original* Members" (emphasis added). The word "original" is important because it links back to the

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> (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

[….]

4. A special meaning shall be given to a term if it is established that the parties so intended.

[46] See Brazil's First Submission, para. 20.

[47] *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 3128 ("successor"). (Exhibit CDA-29)

[48] *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 1446 ("successor"). (Exhibit CDA-30)

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"twelve original Members" earlier in the text. The linkage makes it clear that "those original Members" are the "twelve original Members" that were parties to an international undertaking, i.e., the OECD Arrangement, as of 1 January 1979. The text "adopted by those original Members" refers to Members that are also parties to the OECD Arrangement – not the entire original Membership of the WTO. It is only the Members that are parties to the OECD Arrangement that could adopt a successor undertaking of the Arrangement. The text recognizes this fact. This further reinforces that the ordinary meaning of the text refers to the 1998 Arrangement.

61. Brazil's quotation of the exception in Item (k), second paragraph, in paragraph 17 of its First Submission omits the word "original" from the text of "those original Members". Without the word "original", "those Members" could be referring to "Members to this Agreement" which is what Brazil would lead the Panel to believe. At a minimum, this omission – in conjunction with its argument implying that the word "original" refers to the entire original WTO Membership[49] – is misleading.

62. In addition, the text at issue should be understood as a reference to an evolving system of disciplines on officially supported export credits. As the drafters were no doubt aware, the OECD Arrangement is not static or frozen in time. It has developed since its inception and continues to do so. [50] This process of development had occurred many times before 1 January 1995, e.g., in 1987, 1991 and 1994.[51] The drafters could hardly have been unaware of such developments prior to 1 January 1995 when they drafted the language "successor undertaking which has been adopted by those original Members". On the contrary, the text specifically contemplates on-going evolution.

63. Finally, the text of the exception in Item (k), second paragraph, in the Illustrative List, tracks the text of the 1979 GATT Subsidies Code (the "GATT text"). The GATT text states:

> Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.[52]

64. Since the original OECD Arrangement was formed in 1978[53] – and no changes were made until 1981[54] – language that refers to a "successor undertaking" in 1979 must necessarily be forward looking. Brazil's retrospective interpretation does not reconcile with the 1979 GATT text because, in 1979, there was no "successor undertaking" to the 1978 Arrangement. Under Brazil's approach, the term "successor undertaking" in the 1979 GATT text would have no meaning. Thus, the 1979 GATT text supports the forward-looking interpretation of "successor undertaking" in the exception of Item (k), second paragraph, and provides further evidence that the drafters provided for the on-going evolution of the OECD Arrangement.

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[49] Brazil, in paras. 20-22 of its First Submission, creates the implication by not using the word "those" in its argument when it uses the phrase "adopted' by the original Members". The text reads "adopted by *those* original Members". See Item (k), second paragraph, of Annex I of the SCM Agreement [emphasis added].

[50] The OECD Arrangement was created in 1978. See *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), pp. 9 and 20-21 [hereinafter *The Export Credit Arrangement*]. (Exhibit CDA-31)

[51] See *id*., pp. 18-20.

[52] See "Illustrative List of Export Subsidies," Annex I to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("the Subsidies Code") in *The Texts of the Tokyo Round Agreements* (Geneva: GATT, August 1996). (Exhibit CDA-32)

[53] See *The Export Credit Arrangement*, *supra* note 50, p. 9.

[54] See *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), p. 24. (Exhibit CDA-33)

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65. Accordingly, the ordinary meaning of the text "successor undertaking which has been adopted by those original Members" is the most recent version that has been adopted by the OECD, i.e., the 1998 Arrangement.

2. The Drafters Could Have Referred To The 1992 Arrangement But Did Not

66. The *Marrakesh Agreement Establishing the World Trade Organization* (the "WTO Agreement") took effect on 1 January 1995, three years after the 1992 version of the Arrangement. If the drafters intended the 1992 Arrangement to apply, they simply could have said so. Instead, the drafters crafted the exception in Item (k), second paragraph, to ensure that all Members knew that the exception was not frozen in time. As Canada has shown, the text specifically contemplates that the Arrangement will evolve.

3. The *Canada-Aircraft* Article 21.5 Panel Used The 1998 Arrangement In Its Analysis Of The Exception In Item (k) Second Paragraph

67. Although Brazil did not argue the relevance of a particular version of the OECD Arrangement in the Article 21.5 proceeding in *Canada – Aircraft*, the Panel in that proceeding conducted a thorough analysis of the exception in Item (k), second paragraph, using the 1998 version of the Arrangement. The Panel was of the view that the text "successor undertaking" meant that the Arrangement had evolved and that it could evolve further. The Panel made numerous references to "successor undertakings" including past and future changes to the Arrangement.[55] Brazil did not challenge the Panel's interpretation in the Article 21.5 proceeding.

V. PROEX III DOES NOT QUALIFY FOR AN ALLEGED *A CONTRARIO* EXCEPTION UNDER THE FIRST PARAGRAPH OF ITEM (K)

68. In order to succeed in its alleged defence under paragraph 1 of Item (k) of the Illustrative List, Brazil must at a minimum present a *prima facie* case with respect to each element of its alleged defence. It has not done so.

A. ITEM (K) FIRST PARAGRAPH DOES NOT GIVE RISE TO AN *A CONTRARIO* INTERPRETATION

69. Brazil has failed to present a *prima facie* case with respect to the first element of its alleged exception – i.e., that an alleged *a contrario* exception exists in the first paragraph of Item (k). Brazil simply asserts without legal authority that an *a contrario* interpretation of the first paragraph of Item (k) is "required" and that the failure to permit an *a contrario* interpretation "effectively would render the material advantage clause inutile, contrary to the customary rules of interpretation of public international law."[56]

70. Brazil also notes in paragraph 66 of its submission that the Appellate Body "appears to take the view" that the first paragraph of Item (k) should be read *a contrario* to permit a subsidy that does not confer a material advantage. Nowhere does Brazil respond to Canada's arguments that the first paragraph of Item (k) does not give rise to such an *a contrario* interpretation.[57]

71. This Panel addressed Brazil's first assertion in the original Article 21.5 proceeding. It found that the first paragraph of Item (k) allows for the identification of certain export credits and payments that are considered *per se* prohibited export subsidies, and for which an independent showing of

[55] *Canada – Aircraft*, Article 21.5 Panel Report, note 69, note 71, para. 5.85, note 85, and note 91.
[56] Brazil's First Submission, para. 65.
[57] Canada's First Submission, paras. 29-61.

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subsidy and export contingency is, therefore, not necessary.[58] It properly found that such an interpretation did not render the first paragraph of Item (k) ineffective.[59]

72. With respect to Brazil's reference to the *obiter dictum* of the Appellate Body, as discussed in Canada's First Submission, the statement was made without interpreting footnote 5.[60] In Canada's view, it is impossible to reach a conclusion as to the existence of an *a contrario* exception in the first paragraph of Item (k) without interpreting the language of footnote 5.[61] Brazil fails to explain how, applying the relevant principles of treaty interpretation to Article 3.1, footnote 5 and the Illustrative List, a measure impliedly excluded from the illustrations (i.e., not referred to) in Annex I can be a measure "referred to in Annex I as not constituting an export subsidy".

73. Footnote 5 excludes the possibility of implied exceptions to the prohibition on export subsidies. Footnote 5 makes it clear that the only exceptions to Article 3.1 are those measures referred to as not constituting export subsidies in Annex I. Brazil's argument is based on the absence of reference to export credits or payments that do not confer a material advantage in the first paragraph of Item (k). Clearly, a thing cannot be referred to by failing to refer to it. There is simply no way to treat the absence of reference to a measure as a reference to that measure.

74. Accordingly, Brazil's position on the *a contrario* interpretation of the first paragraph of Item (k) is without merit.

B. PROEX III PAYMENTS ARE NOT PAYMENTS OF THE COSTS INCURRED IN OBTAINING CREDITS

75. In order to discharge its burden to establish that PROEX III support is the "payment … of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of Item (k), Brazil reverts to arguments it presented to the Panel in the original 21.5 proceeding.[62] However, Brazil's arguments have already been rejected by the Panel in that proceeding.

76. Brazil has offered no new arguments sufficient to establish that payments under PROEX III constitute the type of payment contemplated by the first paragraph of Item (k). Nor has it offered any arguments that would call into question the Panel's interpretation of the "payment" clause or its finding that PROEX payments are not payments of the costs incurred by exporters or financial institutions in obtaining credits, within the meaning of the clause.

77. Having failed to establish that PROEX III support is of the type covered by the first paragraph of Item (k), Brazil has failed to establish that PROEX III would qualify for its alleged *a contrario* exception under Item (k) first paragraph even if such an exception existed.

C. PROEX III SUPPORT IS USED TO SECURE A MATERIAL ADVANTAGE

78. Even if a proper interpretation of Item (k) did allow for Brazil's alleged *a contrario* exception and even if support under PROEX III did amount to the "payment … of all or part of the costs incurred by exporters or financial institutions in obtaining credits", Brazil has not presented a *prima facie* case that PROEX III is not "used to secure a material advantage in the field of export credit terms".

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[58] Article 21.5 Panel Report, para. 6.42.
[59] *Id*.
[60] Canada's First Submission, para. 49.
[61] *Id*., para. 50.
[62] Brazil's First Submission, paras. 67-71.

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79. In its First Submission, Brazil does not respond to the detailed argument presented by Canada in its First Submission.[63] Brazil simply cites the statement of the Appellate Body that "to establish that PROEX payments are not used to secure a material advantage, Brazil must prove *either* that the net interest rates under the revised PROEX are at or above the relevant CIRR … *or*, that an alternative market benchmark is appropriate" [emphasis in original].[64] Brazil then contends that since PROEX III stipulates that the net interest rates must be at or above the relevant CIRR, no material advantage is being provided.[65]

80. Brazil's argument ignores an important qualification established by the Appellate Body, namely that CIRR may not always accurately reflect the marketplace and therefore cannot be conclusive evidence of the absence of material advantage. The Appellate Body stated:

> The CIRR is a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets. Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions. Thus, the CIRR is not, necessarily, the *sole* "market benchmark" that may be used to determine whether a payment "is used to secure a material advantage in the field of export credit terms", within the meaning of Item (k) of the Illustrative List. [66] [emphasis in original]

81. As set out in Canada's First Submission, the CIRR is not a determinative benchmark.[67] The Appellate Body made this clear in the above-noted quotation and when it stated that "[t]he Article 21.5 Panel correctly concluded from our Report in *Brazil – Aircraft* that 'the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases'".[68]

82. In ascertaining whether CIRR is an "appropriate" benchmark in a particular transaction or transactions, the issue is whether CIRR "reflect[s] the rates available in the marketplace".[69] This determination turns on whether the CIRR rate is in fact equivalent to the rates available in the marketplace for "comparable" transactions.

83. In the original Article 21.5 proceeding, the Appellate Body stated that in "identifying an 'appropriate' 'market benchmark' below the CIRR, a WTO Member must show that the 'benchmark' on which it relies is based on evidence from relevant, comparable transactions in the marketplace" [emphasis added].[70]

84. Clearly, the terms and conditions of export financing transactions affect their comparability and the chosen benchmark must be comparable to the transaction(s) in question. Thus, where the CIRR rate varies from the rates available in comparable transactions in the marketplace, it is not an appropriate benchmark for the purposes of determining whether a "material advantage in the field of export credit terms" has been secured.

85. Beyond the issue of the interest rate itself, the export credit terms that must be considered in ascertaining whether export credit transactions are "comparable" have been, in part, articulated by the Appellate Body in the previous proceedings in this dispute and by this Panel in the original

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[63] See Canada's First Submission, paras. 73-97.
[64] Brazil's First Submission, para. 64.
[65] *Id*.
[66] Article 21.5 Appellate Body Report, para. 64.
[67] Canada's First Submission, paras. 84-97.
[68] Article 21.5 Appellate Body Report, para. 63.
[69] *Id*., para. 64.
[70] *Id.*, para. 74.

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proceeding. The Appellate Body stated that "the terms and conditions of export credit transactions in the marketplace vary considerably, depending on the circumstances of a particular export credit transaction, such as the product involved, the size or volume of the transaction, the type of export credit practice, the duration of the repayment term, the type of interest rate (fixed or floating) used, and when the transaction is concluded".[71]

86. Further, the Appellate Body has acknowledged that "the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity as well as the creditworthiness of the borrower".[72] This Panel stated that "in its ordinary meaning, the field of export credit terms would refer to items directly related to export credits such as interest rates, grace periods, transaction costs, maturities and the like".[73]

87. CIRR is not an appropriate benchmark for assessing whether PROEX III payments "secure a material advantage in the field of export credit terms" with respect to transactions involving regional aircraft because the CIRR rate usually varies significantly from the rates available in comparable transactions in the marketplace.

88. As discussed in paragraphs 78-79 of Canada's First Submission, the financing spreads required from airlines purchasing regional aircraft (as shown in the MSDW Report in Exhibit CDA-17) far exceed the spread incorporated in the U.S. dollar CIRR (a 100 basis point spread over the appropriate U.S. Treasury average). The spreads shown in the MSDW Report are for Enhanced Equipment Trust Certificates (EETCs). EETCs are a secured form of financing that feature a number of tranches with a varying level of priority claim over the aircraft. Each tranche will carry a rating that reflects the seniority of the claim on the aircraft as well as other credit enhancements that are designed to reduce risk.[74] As a result of these risk-reducing attributes, EETCs are tranches are usually rated well above the airline's unsecured debt rating. This enables the airlines (particularly those with lower credit ratings) to achieve lower overall debt pricing on aircraft financing. The initial loan-to-value ratios for the higher-rated EETC tranches are usually well below 70 percent of the initial fair market value, further reducing the risk profile associated with EETCs when compared to PROEX III support.[75] In its First Submission, Canada refers to an American Airlines EETC tranche trading at 135 basis points above U.S. Treasury rates. As the highest-rated EETC tranche for one of the highest rated U.S. airlines, this EETC tranche is a conservative relative benchmark when compared against the spreads required for financing regional aircraft, yet it is still 35 basis points higher than a rate achieved by the CIRR alone. A lender will certainly provide a borrower a material advantage if, by offering financing at the CIRR, it is permitted to offer a less credit-worthy borrower the same low interest rate as a more credit-worthy borrower.

89. The terms associated with the CIRR also vary significantly from the terms available in comparable transactions for regional aircraft. For example, the maximum term for the CIRR is ten years while the prevailing terms for financing regional aircraft are in the 15 year range.[76] Given the relationship between term and risk (the longer the term the higher the required spread),[77] a ten year CIRR rate cannot be a market benchmark for 15 year loans, nor is it comparable to financing prevailing in the regional aircraft market.

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[71] *Id.*, para. 73.

[72] Original Appellate Body Report, para. 182.

[73] *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999, para. 7.28.

[74] See discussion in Standard & Poor's Structured Finance, *Aircraft Securitizaton Criteria*, (New York: Standard & Poor's, 1999), pp. 3-22. (Exhibit CDA-34)

[75] MSDW Report, (Exhibit CDA-17), p. 13. At page 15 of the Standard & Poor's Report, it is stated that for every 5 percent reduction in loan-to-value, credit ratings increase one notch.

[76] See also the CIT Presentation, *supra* note 76, p. 21, which evidences terms of up to 18 years.

[77] F.J. Fabozzi and T.D. Fabozzi, eds, *The Handbook of Fixed Income Securities*, 4th ed. (Burr Ridge, Illinois: Irwin, 1995), pp. 780 and 803-804. (Exhibit CDA-37)

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90. Thus, it is clear that the CIRR is not an appropriate benchmark for transactions involving regional aircraft, as it very rarely reflects accurately the rates available in the marketplace. In this light, simply revising PROEX to set a floor based on the CIRR does not enable Brazil to establish a *prima facie* case that PROEX III payments do not secure a material advantage in the field of export credit terms.[78]

VI. CONCLUSION

91. Canada requests that the Panel find that PROEX III financing support, whether on its own or administered in conjunction with BNDES financing, is a prohibited export subsidy under Article 3 of the SCM Agreement. Canada further requests that the Panel find that PROEX support does not qualify for the "safe haven" in the second paragraph of Item (k) in Annex I to the SCM Agreement; that there is no *a contrario* exception under the first paragraph of Item (k); and that even if there were, PROEX support would not qualify for it. Canada requests that the Panel find accordingly that Brazil has failed to implement measures that would bring it into compliance with the recommendations and rulings of the DSB.

[78] However, as noted earlier in this submission, Canada agrees that if Brazil brings its export subsidy practices into conformity with the relevant provisions of the OECD Arrangement, leaving aside the matter of Brazil's ongoing non-compliance by continuing to grant prohibited subsidies under PROEX I and II, this long-standing dispute would be resolved.

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TABLE OF EXHIBITS

* Exhibits CDA-19, CDA-25, CDA-27, and CDA-28 are designated as "CONFIDENTIAL" pursuant to the Understanding on Rules and Procedures Governing the Settlement of Disputes, Appendix 3 - Working Procedures, para. 3; and *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU* (WT/DS46), Working Procedures for the Panel, para. 3.

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CDA-34. Standard & Poor's Structured Finance, *Aircraft Securitizaton Criteria*, (New York: Standard & Poor's, 1999), pp. 3-22, available at www.standardandpoors.com/ResourceCenter/RatingsCriteria/StructuredFinance/articles/pdf/critairw.pdf.

CDA-35. "CIT Structured Finance," Presentation to Aircraft Finance and Commercial Aviation Forum (February 2001).

CDA-36. Spread of Industrial Index over US CIRR Rate for Repayment Terms in Excess of 8.5 Years.

CDA-37. F.J. Fabozzi and T.D. Fabozzi, eds, *The Handbook of Fixed Income Securities*, 4th ed. (Burr Ridge, Illinois: Irwin, 1995), pages 780, 793-796, and 803-804.

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ANNEX A-3

ORAL STATEMENT OF CANADA

(4 April 2001)

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I. INTRODUCTION

1. This is the third time since 1998 that this Panel has been called upon to decide whether the financial support that Brazil provides to foreign purchasers of its Embraer aircraft is an illegal export subsidy. In the original panel proceeding, Brazil maintained that its PROEX program was fully consistent with its WTO obligations. This Panel and the Appellate Body found otherwise. In November 1999, Brazil made some modest changes to its PROEX program, changes that it insisted brought it into compliance with its WTO obligations. Again, this Panel and the Appellate Body found otherwise.

2. On 6 December 2000, Brazil made another modification to its PROEX program. Under the Central Bank of Brazil Resolution 2799, Brazil allegedly limited its PROEX interest rate buy-downs

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to the CIRR. Brazil has done nothing else to change the terms of its PROEX program since it was last found to be a prohibited export subsidy.

3. Brazil nevertheless claims that the revised PROEX scheme, PROEX III, is no longer a prohibited export subsidy. Alternatively, Brazil claims that even were it a prohibited export subsidy, PROEX III should be exempted from the disciplines of the SCM Agreement. According to Brazil, PROEX III qualifies for the so-called "safe haven" in the second paragraph of Item (k) of Annex 1 to the SCM Agreement. And if not there, Brazil asks this Panel to grant PROEX III a clean bill of health under an alleged *a contrario* exception in the first paragraph of Item (k).

4. In Canada's view, the single change that Brazil has made to its PROEX scheme fails to bring it into conformity with its WTO obligations. The only consistency in the arguments that Brazil has raised in its defence is Brazil's indefensible strategy of "buying time" while it continues to buy market share for Embraer.

5. In response, Canada has done two things. First, it has commenced this Article 21.5 proceeding to address Brazil's claim of conformity. Second, to limit the opportunity for Brazil to buy further market share while this proceeding runs its course, Canada has countered financing terms offered by Brazil to the Air Wisconsin Airlines Corporation by committing to provide equivalent financing, which would be offered through its Export Development Corporation.

6. In a separate proceeding, Brazil has called Canada's responsive commitment to do what Brazil is doing an illegal subsidy. We would be pardoned for considering that this indicates the real value of Brazil's claim of legality for PROEX III.

7. More fundamentally, Brazil's arguments fly in the face of the previous findings of law by this Panel, other panels and the Appellate Body and the overwhelming factual record. Brazil's arguments cannot be supported.

II. BENEFIT

8. First, Brazil contends that Canada has failed to establish that its PROEX III payments are prohibited subsidies. It asserts that its PROEX III payments are not subsidies at all because they do not confer a benefit.

A. CANADA HAS SATISFIED ITS BURDEN OF SHOWING PROEX III PAYMENTS ARE PROHIBITED SUBSIDIES

9. Brazil argues that Canada has the burden of proving that payments under PROEX III continue to be prohibited export subsidies. Brazil cites the Report of the Appellate Body in *Chile – Alcoholic Beverages* for the proposition that "PROEX III enjoys a presumption of compliance". It argues that the factual findings of the Panel and the Appellate Body on PROEX I and II are not relevant to a compliance assessment of PROEX III and that Canada has not otherwise presented sufficient evidence to discharge its burden[1]

10. At paragraph 20 of its First Submission, Canada has acknowledged that it bears the burden to establish that PROEX III continues to be a prohibited export subsidy. To meet this burden, Canada must present a *prima facie* case: (a) that PROEX III financing support is a financial contribution; (b) that it confers a benefit; and (c) that the subsidy is contingent upon export performance.

11. However, contrary to Brazil's claim, the statement of the Appellate Body in *Chile – Alcoholic Beverages* does not provide authority for a "presumption of compliance". Rather, the Appellate Body

[1] Second Submission of Brazil, 23 March 2001, paras. 9-10.

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found, in essence, that there should not be a presumption that a new measure is *non-compliant* simply because the measure it replaces was non-compliant. *Chile – Alcoholic Beverages* in no way modifies the burden of proof that applies to Canada in this case.

12. Brazil also contends that the factual findings by the Panel and the Appellate Body with respect to PROEX I and II are "irrelevant" to a compliance assessment of PROEX III. Brazil offers no basis for this assertion. The Appellate Body has made it clear that evidence relating to predecessor programs could be relevant to an Article 21.5 proceeding where the relevance of the evidence has been demonstrated by the complaining party[2]

13. The findings of the original Panel and Article 21.5 Panel referred to in footnotes 7, 9, 10, 21 and 22 and paragraph 23 of Canada's First Submission pertain to attributes of PROEX that have not been revised in PROEX III. PROEX payments still are grants to buy down commercial interest rates freely negotiated by the borrower. PROEX is still administered by the Committee, which retains the authority to waive all guidelines. PROEX payments to reduce the interest paid by a purchaser still are being provided in the form of NTN-I bonds.

14. Moreover, Brazil does not dispute that, just like its predecessors, PROEX III allows an aircraft purchaser to seek the best export credit terms available in the market, whether from a Brazilian or foreign financial institution, and then to receive a buy-down of that interest rate in the amount of the PROEX III payments.

15. Brazil contends that certain legal instruments, namely Central Bank of Brazil Circular 2881 and Directive 374, constrain the use of PROEX III. However, these instruments likewise applied to PROEX II. In the original Article 21.5 proceeding this Panel found that these instruments in no way constrained the terms on which Brazil could offer PROEX support. For Brazil to now simply assert again that these instruments constrain the terms on which Brazil can offer PROEX does not make it so.

16. The Panel's findings clearly remain relevant to whether PROEX III is consistent with the SCM Agreement. Moreover, they are corroborated by the other evidence that Canada has presented to the Panel.

17. In the legal arguments and evidence presented in paragraphs 23-25 of its First Submission and paragraphs 8-17 of its Rebuttal Submission, Canada has met the burden of proof that PROEX III subsidies are prohibited export subsidies. On its face and in practice, PROEX III support amounts to a financial contribution that confers a benefit. It therefore is a subsidy. It is *de jure* contingent upon export performance, something Brazil has not contested. Therefore, it is a prohibited export subsidy. Canada's argument applies equally whether PROEX III is provided alone or in conjunction with BNDES direct financing.

B. EVEN AT A CIRR FLOOR, PROEX III CONFERS A BENEFIT

18. At paragraph 13 of its Second Submission, Brazil argues that because PROEX III ostensibly establishes an interest rate floor based on the CIRR, this means that it confers no "benefit". Brazil also argues that prior statements by Canada regarding the relationship between the CIRR and commercial rates contradict Canada's position before this Panel that PROEX III continues to confer a benefit.

19. An examination of Canada's prior statements exposes Brazil's misrepresentation of Canada's position. Contrary to Brazil's contention, Canada never stated that it would not have brought this case

[2] Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, Report of the Appellate Body (WT/DS70/AB/RW), para. 50.

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if PROEX simply matched OECD rates and did not comply with the other relevant terms of the OECD Arrangement. In the passage to which Brazil refers, Canada was discussing the material advantage conferred by BNDES financing at interest rates above a LIBOR rate or the CIRR when combined with PROEX buy-downs of that rate to a still lower level. Canada indicated that it would not have brought this case if the combined effect of PROEX and BNDES was simply to achieve a rate above LIBOR or the CIRR[3] This does not mean that Canada considers that buy-downs to the CIRR alone do not confer a benefit.

20. Canada has recognized, at paragraphs 16 and 17 of its Rebuttal Submission, that in certain circumstances the CIRR may be representative of, or even above, market rates. However, this does not establish that PROEX III does not confer a benefit. As Canada demonstrated in its First Submission, the CIRR alone, divorced from the other terms of the OECD Arrangement, does not reflect market realities[4] Moreover, as Canada demonstrated in its Rebuttal Submission, the CIRR is substantially *below* market rates available to regional airlines for the purchase or lease of regional aircraft[5]

21. Finally, Brazil has offered nothing to refute the most obvious evidence that PROEX III confers a benefit: PROEX III is offered to purchaser/borrowers to buy down interest rates that they have already negotiated in the commercial marketplace. The resulting bought down interest rates, even at the CIRR, therefore must be below-market rates. This Panel has already recognized this. At footnote 47 to its Report in the original Article 21.5 proceeding, it stated: "…PROEX payments by definition allow a purchaser/borrower to obtain export credits at interest rates lower than it could obtain in the market with respect to the transaction in question".

22. There can be no doubt that, even at the CIRR, PROEX III confers a benefit. If it did not, it would serve no purpose.

III. BRAZIL'S REVISED POSITION ON PARAGRAPH 2 OF ITEM (K) OF THE ILLUSTRATIVE LIST

23. Brazil contends that even if PROEX III is a prohibited export subsidy, it nevertheless qualifies for the "safe haven" in the second paragraph of Item (k).

24. Since Brazil's claim amounts to an affirmative defence, it bears the burden of proof and must demonstrate that its measures meet all of the conditions of the second paragraph of Item (k) to claim the exception[6] Those conditions are, at a minimum, those specified by the *Canada-Aircraft* Article 21.5 Panel Report[7]

25. Brazil notes in its Second Submission that Canada did not address the second paragraph of Item (k) in its First Submission. There is good reason for this. In this entire dispute, Brazil had never raised it as a defence. Now, by changing PROEX to ostensibly use the CIRR rate, and by changing nothing else, Brazil claims that PROEX III all of a sudden is "in conformity with" the "interest rates provisions". This is simply not the case.

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[3] *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, para. 109.

[4] Canada's First Written Submission, 2 March 2001, paras. 77-83 and 94-95.

[5] Rebuttal Submission of Canada, 23 March 2001, paras. 87-90.

[6] Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU, (WT/DS46/AB/RW), para. 66.

[7] Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, Report of the Panel, (WT/DS70/RW), at para. 5.147.

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26. Specifically Brazil is asking this Panel to consider PROEX III to be "in conformity with" the "interest rates provisions" of the OECD Arrangement. When you consider Brazil's claim, recall the following:

- Brazil's claim flies in the face of its numerous public statements that it would not conform its measures to the OECD Arrangement;

- Brazil's claim ignores the fact that Brazil routinely waives any disciplines that its measures supposedly impose;

- Brazil's claim is at odds with the evidence from two recent cases that indicate that non-conforming terms were recently offered by Brazil through Embraer; and

- Brazil's claim ignores – and provides no evidence of "conformity" with – the vast majority of "interest rates provisions" as defined by the *Canada-Aircraft*, Article 21.5 Panel Report.

A. BRAZIL'S POSITION IS CONSISTENT WITH ITS DELAYING STRATEGY

27. Senior Brazilian officials have repeatedly stated that Brazil will not abide by the provisions of the OECD Arrangement in public statements, in statements to the DSU and in every one of the six negotiation and consultation sessions held between Canada and Brazil since the release of the original *Brazil – Aircraft* Article 21.5 Panel Report. Those statements are in Canada 's written submissions. We do not need to repeat them.

28. Brazil's new position – claiming conformity with the second paragraph of Item (k) – would require a complete reversal of policy. This alleged reversal makes sense in the context of a delaying strategy. From the beginning, Brazil's strategy has been to delay implementation as long as possible while buying market share at whatever cost.

29. One article in a Brazilian newspaper described the strategy as follows: "[b]ut the major victory of the MFA refers to the fact that it was able to extend the dispute with Canada for almost four years. Meanwhile, Embraer became one of the biggest aircraft manufacturer[s] in the world. Today, the company has half of the world market for small aircraft (with up to 70 seats). In order to extend negotiations as much as possible, the MFA contracted big advocacy companies abroad specialized in international trade.[8]

30. As Canada stated in its Rebuttal Submission, if Brazil had indicated its intention to be "in conformity with" the "interest rates provisions" during the months of negotiations, and then followed that up with legitimate disciplines, this dispute would largely be resolved[9] Instead, Brazil has refused to bring PROEX III into conformity and used the negotiations as a delaying tactic.

31. Two weeks ago, Canada put Brazil's claim of conformity with the OECD provisions to the test. On 22 March, Canada sent a letter by fax to Brazil's chief negotiator in this dispute. The letter states that: "[a] written commitment by Brazil that it has limited its export financing for regional aircraft to conform to the interest rate provisions of the OECD Arrangement would go a long way towards resolving this dispute. If Brazil is prepared to provide this commitment, Canada would

[8] Guilherme Barros, "Canada can retaliate against Brazil by US$1.3 billion" *Folha de Sao Paulo* (22 August 2000) (Exhibit CDA-38).

[9] At para. 19.

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propose the suspension of all current dispute settlement proceedings … and the resumption of negotiations….[10] Canada has not received a response.

B. BRAZIL HAS ALREADY BEEN FOUND TO WAIVE ITS PROEX "REQUIREMENTS"

32. Not only do Brazil's public statements point to non-conformity with the OECD Arrangement, but, as Canada noted at paragraph 28 of its Rebuttal Submission, Brazil has admitted to waiving so-called requirements that on their face might appear to limit the terms of the financing it can offer.

33. Brazil claims that Circular 2881 and Directive 374 limit the maximum length of the financing term to 10 years and the maximum percentage for interest rate equalization to 85% of the export value of the sale.

34. In the case of Circular 2881, Brazil is repeating an argument that was rejected by this very Panel in the previous Article 21.5 proceeding[11] Directive 374 applied to PROEX II and has not, to Canada's knowledge, been revised for PROEX III. These documents did not impose any disciplines on PROEX II. Nor do they impose any disciplines on PROEX III.

C. PROEX III FINANCING SUPPORT OFFERED BY BRAZIL DEPARTS FROM THE OECD ARRANGEMENT

35. Brazil's actual practice confirms its non-conformity with the "interest rates provisions" of the OECD Arrangement. In two recent cases, detailed in Canada's Rebuttal Submission, Brazil offered financing support through Embraer that was not "in conformity with" the "interest rates provisions" of the OECD Arrangement.

36. Brazil itself seems to believe that its measures do not conform to the interest rates provisions of the OECD Arrangement - for it offers no evidence of conformity. Although Brazil contends that its measures conform to either the 1998 or 1992 version of the Arrangement, it fails to even mention most of the 1998 articles. And with respect to the 1992 version, Canada has demonstrated that Brazil's measures do not even meet Brazil's own limited definition of interest rates provisions – specifically the 10 year term limitation.

D. THE 1998 VERSION OF THE OECD ARRANGEMENT IS RELEVANT FOR THE PURPOSES OF THE SECOND PARAGRAPH OF ITEM (K)

37. Brazil also claims that it is the 1992 version of the OECD Arrangement that is relevant to this Panel's enquiry. This is clearly at odds with the ordinary meaning of the second paragraph of Item (k). Brazil argues that the phrase referring to an international undertaking which "has been" adopted, refers to a "'time regarded as present' when the text became effective on 1 January 1995." This is not so. The ordinary meaning of the phrase requires a determination of whether a successor arrangement "has", in the present, "been adopted". With respect to PROEX III, this means that the 1998 OECD Arrangement applies. The U.S. and the European Communities support Canada in this interpretation[12]

38. Brazil further claims that interpreting Item (k) second paragraph to include post-1995 successor undertakings of the Arrangement would effectively result in an amendment, by a sub-group

[10] Letter from C. Carriere, Director General, General Trade Policy Bureau, Canada's Department of Foreign Affairs and International Trade, to Ambassador J.A. Graca Lima, Undersecretary General for Integration, Economic Affairs and Foreign Trade, Brazil's Ministry of Foreign Affairs, dated 21 March 2001 (Exhibit CDA-39).

[11] At para. 2.4.

[12] See Third Party Submission of the United States, 23 March 2001, paras. 4 – 10; and Third Party Submission by the European Communities, 23 March 2001, paras. 15 – 23.

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of Members, of the SCM Agreement. Again, Brazil's interpretation is erroneous. The text "successor undertaking" specifically contemplates that the Arrangement would evolve over time. The *Canada – Aircraft* Article 21.5 Panel shared this view. Moreover, this evolution is fair: it is exactly what Members accepted when they agreed to the WTO Agreements. Again, the U.S. and the European Communities support Canada in this conclusion[13]

39. Finally, it should be noted that since the WTO Agreement post-dates the 1992 Arrangement by three years, the drafters could have simply referred to the 1992 Arrangement if they had intended that it apply regardless of future changes. The use of the language in the second paragraph of Item (k) indicates the opposite – that the drafters knew that future changes to the Arrangement would occur and that they intended for those changes to apply when a Member claimed the second paragraph "safe haven".

IV. PROEX III DOES NOT QUALIFY FOR AN ALLEGED *A CONTRARIO* EXCEPTION UNDER ITEM (K), FIRST PARAGRAPH

40. Canada has already explained at length in its previous submissions why the first paragraph of Item (k) cannot be read as creating an *a contrario* exception and why, even if it could, PROEX III would not qualify. Still, a few contentions in Brazil's Second Submission call for a response.

A. THE FIRST PARAGRAPH OF ITEM (K) DOES NOT SUPPORT AN *A CONTRARIO* EXCEPTION

41. At paragraph 19 of its Second Submission, Brazil contends that the Panel must give meaning and effect to the material advantage clause in the first paragraph of Item (k). It then contends that the "ordinary, straightforward meaning" of the material advantage clause is that payments that are used to secure a material advantage are prohibited subsidies, whereas payments that are not so used are not prohibited. It argues that logically, the drafters of Item (k) intended that payments that did not secure a material advantage would not be proscribed.

42. The more straightforward reading of Item (k) is that payments that do not secure a material advantage are not *per se* prohibited export subsidies on the Illustrative List but may nevertheless be prohibited export subsidies. The language in the first paragraph of Item (k) distinguishes between payments that are used to secure a material advantage and those that are not. However, it does not follow that the ordinary meaning of the material advantage clause is the *a contrario* meaning that Brazil proposes. Nor is Brazil's interpretation required to give meaning and effect to the clause.

43. Instead, the ordinary meaning of the distinction created by the clause is that measures that secure a material advantage are to be considered *per se* prohibited subsidies, (as they are included on the Illustrative List of such subsidies), without regard to the tests set out in Articles 1 or 3.1 of the SCM Agreement. By contrast, if a measure does not secure a material advantage, it is not one of the *per se* prohibited subsidies on the Illustrative List, but that does not mean that it is not a prohibited subsidy. It is still a prohibited subsidy if the complaining Member establishes that it is a subsidy under Article 1 and contingent upon export performance under Article 3.1. This is a far more "straightforward" interpretation of the terms of the SCM Agreement, in their context, than that advocated by Brazil.

44. Nor, contrary to Brazil's assertion at paragraph 23 of its Second Submission, has Canada suggested that the material advantage clause is the result of inadvertence. The English case to which Lord McNair referred in *The Law of Treaties* stands for the principle that the *a contrario* maxim should be applied carefully, with due regard to context, and is not automatic in its application, a point

[13] See Third Party Submission of the United States, 23 March 2001, paras. 8 – 10; and Third Party Submission by the European Communities, 23 March 2001, paras. 24 – 33.

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with which Brazil seems to agree[14] In the present case, there are compelling reasons why Item (k) should not be interpreted *a contrario*. These reasons have nothing to do with inadvertence and everything to do with the context of Item (k) in the SCM Agreement.

45. Before turning to this context, Canada first notes that in the same paragraph of its Second Submission in which Brazil confuses Canada's reference to Lord McNair's text, Brazil also cites paragraph 20 of the original Report of the Appellate Body in this dispute for the proposition that the "material advantage" clause was deliberately added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been secured."

46. However, paragraph 20 of the original Appellate Body Report does not support the proposition for which Brazil has cited it. Paragraph 20 is in the section of the Report entitled "Arguments of the Participants and the Third Participants, Claims of Error by Brazil – Appellant". It is not a finding by the Appellate Body but rather, a description of Brazil's arguments.

47. In fact, the Appellate Body never made findings regarding the history of the first paragraph of Item (k) and the object and purpose of the "material advantage" clause. Moreover, there is no evidence to establish, or even suggest, that the material advantage clause was added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been secured".

48. The material advantage clause restricts the types of export subsidies that are "illustrated" in the Illustrative List. It does not – and cannot – circumscribe the conditions under which a subsidy is contingent upon export performance through the application of Articles 1 and 3.

49. In the eight or so paragraphs that follow paragraph 23 in its Second Submission, Brazil seeks to find support for its *a contrario* position in the negotiating history of Item (k). Brazil refers to the negotiating history to demonstrate that the material advantage clause was not added inadvertently, a claim that Canada has not made. Brazil's approach to the "material advantage" clause is wrong and its arguments regarding the negotiating history are misplaced because they ignore Articles 1 and 3 and footnote 5, three provisions of the SCM Agreement that were not part of the Tokyo Round Code. These provisions provide the critical context for the interpretation of Item (k) first paragraph.

50. As Canada noted in paragraph 47 of its First Submission, footnote 5 recognizes that Annex I contains certain exceptions to the general prohibition in Article 3. Footnote 5 is an explicit exclusionary clause. Brazil would interpret the Illustrative List to implicitly allow certain export subsidies *a contrario* simply because it identifies other types of measures as prohibited export subsidies. However, as this Panel recognized in its Report in the Article 21.5 proceeding, this would make footnote 5 redundant[15]

51. Brazil challenges Canada's characterization of footnote 5 as an explicit exclusionary clause because it does not contain the word "expressly". Brazil argues that Canada's position means that the word "expressly" should be read into footnote 5. It also argues that the Panel, in the original Article 21.5 proceeding, noted that the word "expressly" was dropped from an earlier draft of the language of footnote 5, which apparently broadened its meaning[16]

52. According to Brazil, because footnote 5 does not contain the word "expressly", as in "Measures *expressly* referred to in Annex I as not constituting exports subsidies shall not be prohibited…", footnote 5 is not meaningful context for the interpretation of Item (k) in Annex I. Brazil's arguments parallel an argument advanced by the United States and rejected by the Panel in

[14] Brazil 's Second Submission, para. 23.
[15] At para. 6.41.
[16] Second Submission of Brazil, para. 33.

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the original Article 21.5 proceeding[17] Brazil's arguments misconstrue both Canada's position and the finding of the Panel in its Article 21.5 Report.

53. In Canada's view, it was necessary for the drafters to remove the word "expressly" from footnote 5 because Annex I includes only one express reference to measures "not constituting export subsidies ". That reference is in the second paragraph of Item (k), which provides that an export credit practice which is in conformity with the interest rate provisions of a relevant undertaking "shall not be considered an export subsidy prohibited by this Agreement".

54. However, Annex I also includes affirmative statements that authorize the use of certain measures without explicitly stating that the measures do not constitute export subsidies. These statements are found in Item (h) and Item (i) and in footnote 59 to Item (e) of the Illustrative List. Had the drafters used the word "expressly" in footnote 5, it would have nullified the legal effect of these latter statements.

55. Canada's position is that in footnote 5, the "measures referred to in Annex I as not constituting export subsidies" are measures for which there is positive authorization in Annex I that a measure is not being categorized as a prohibited subsidy. Canada's position is consistent with the relevant finding of the Panel in the Article 21.5 proceeding:

> … the Illustrative List contains – and already contained at the time of *Cartland III* and *IV* – a number of provisions that include affirmative statements that arguably represent authorizations to use certain measures. The language of *Cartland III* ("expressly referred to") could have precluded asserting that footnote 5 applied to any of these provisions, and it may be that the purpose of the modification was to rectify this situation. If on the other hand the intention of the drafters in changing footnote 5 had been to extend the scope of that footnote to cover situations where the Illustrative List merely referred to things that *were* export subsidies, they might have been expected to modify the structure of the second part of the footnote, and not merely delete the word "expressly"[18]

56. The Panel's findings support Canada's position. By removing the word "expressly" from the text of footnote 5 the drafters avoided a reading of the Illustrative List that would have prevented Members from taking measures that were affirmatively authorized but were not expressly deemed not to be prohibited export subsidies. Far from making footnote 5 too vague to be useful in interpreting Annex I, by removing "expressly" the drafters clarified that under footnote 5 the measures affirmatively referred to in Annex I are not prohibited subsidies. Having done so, there is no reason why the drafters would have intended, as Brazil would have it, that subsidies also should not be prohibited when the are *not referred to* in Item (k).

57. At paragraph 36 of its Second Submission, Brazil argues that Canada' s interpretation of footnote 5 is undermined by item (i) of the Illustrative List, because Item (i) must also be interpreted *a contrario*. Brazil's explanation of Item (i) omits important aspects of the provision and it ignores the relationship between the items in the Illustrative List and other relevant provisions in the SCM Agreement and the GATT 1994. Item (i) demonstrates why Canada's approach to interpreting the Illustrative List within its context is the correct approach.

58. Brazil's *a contrario* approach focuses exclusively on the introductory language of Item (i). It ignores the relevant contextual elements of the provision. By its own terms, Item (i) must be interpreted in accordance with the guidelines in Annexes II and III of the SCM Agreement. By virtue of footnote 1 to the SCM Agreement, "in accordance with the provisions of Article XVI of GATT

[17] At para. 6.40.
[18] Para. 6.40.

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1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the… remission of duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy".

59. Thus, the non-excessive remission of import charges, to the extent that such charges are "duties" within the meaning of footnote 1, is not a subsidy. Contrary to Brazil's assertion, the negotiators could not have drafted Item (i) with a period or full stop after the word "charges" because it would have created an inconsistency with footnote 1 of the SCM Agreement.

60. Accordingly, it is not by reading Item (i) *a contrario* that one can determine that non-excessive remission does not amount to a prohibited export subsidy, but by referring to the other provisions of the SCM Agreement that clearly establish that such remissions do not amount to a subsidy. Standing alone, Item (i) would provide merely that non-excessive remission is not *per se* prohibited, i.e., that non-excessive remission is not illustrated on the Illustrative List. The same is true of Item (k).

B. PROEX III PAYMENTS ARE NOT "PAYMENTS" WITHIN THE MEANING OF THE FIRST PARAGRAPH OF ITEM (K)

61. The first paragraph of Item (k) refers to the payment of the costs incurred by exporters or financial institutions in obtaining export credits. In the original Article 21.5 proceeding, this Panel found, correctly in Canada's view, that PROEX payments do not cover the cost incurred by financial institutions or exporters in obtaining export credits. It found that interest-rate buy-downs for purchasers of Embraer aircraft are not payments of a lender's cost of obtaining export credits. It found further that even if the provision of export credits at below the cost of borrowing was a cost incurred in obtaining credits, PROEX payments, being paid to foreign banks, did not necessarily serve to reimburse these costs[19]

62. Brazil argues that PROEX payments do fit the definition of payments in the first paragraph of Item (k) and suggests that if they do not, Canada has failed to explain the kind of payments that are contemplated in that paragraph.

63. Canada has consistently argued that "payments" in the first paragraph of Item (k) refers to situations where an exporter or a financial institution incurs costs by obtaining credits at rates higher than those at which it lends to a purchaser, and a government pays for all or part of this difference[20] PROEX payments are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases. They are simply cash grants made for the benefit of purchasers of Brazilian exported regional aircraft. Therefore they do not fit within the first paragraph of Item (k).

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

65. Canada notes that the United States, in its third party submission, has taken the position that PROEX interest rate buy-downs constitute "payments" within the meaning of the first paragraph of

[19] At paras. 6.71-6.73.

[20] See e.g. Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU, Report of the Panel, at para. 6.70.

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Item (k). The United States acknowledges that there is very little guidance on the interpretation of the "payment clause". However, it contends that the intent of the clause is to reduce the risk to the exporter or the financial institution lending money to a borrower. The United States also acknowledges that interest rate buy-downs do not constitute a direct payment but argues that they reduce the risk incurred by the exporter or financial institution and therefore fall within what it considers to be the scope of the clause[21]

66. The interpretation of the payment clause suggested by the United States is inconsistent with the plain meaning of the terms in the first paragraph of Item (k). As noted by this Panel, the second part of the first paragraph of Item (k) refers only to payments made to cover the cost incurred in obtaining export credits. An interpreter is not free to read into the provision language to include any measure that might reduce the risks that exporters or the financial institutions incur in lending money. Interpreting the clause to cover costs not incurred in obtaining export credits would render meaningless the words "payment… of… costs… incurred in obtaining credits". It would mean that the first paragraph of Item (k) would extend to such other costs as loan guarantees. This would considerably expand the category of export subsidies that are *per se* prohibited under Item (k).

C. PROEX III SECURES A MATERIAL ADVANTAGE

67. Canada has explained in its First and Rebuttal Submissions, why PROEX III confers a material advantage. Canada has shown, with reference to the commercial marketplace, why PROEX III confers an advantage that is clearly material[22] Simply put interest rates that PROEX III makes available even to higher-rated aircraft purchasers are significantly lower than the rates available to the highest-rated purchasers using low-risk secured debt instruments to finance their purchases. *A fortiori*, the same is true of PROEX III support for lower-rated aircraft purchasers.

68. Canada has also demonstrated why the CIRR alone, stripped of the other disciplines of the OECD Arrangement and independent of the characteristics of applicable commercial transactions including the creditworthiness of the borrower, is not representative of any market and cannot be considered an appropriate benchmark[23]

69. Accordingly, even if the first paragraph of Item (k) did give rise to an *a contrario* exception – which it does not – and even if PROEX III payments were payments within the meaning of that paragraph – which they are not – PROEX III payments would still not qualify for the exception because they secure a material advantage in the field of export credit terms.

V. CONCLUSION

70. In this, the third proceeding to determine whether Brazil's PROEX scheme is consistent with its WTO obligations, Brazil has resorted to repeating arguments that have been previously rejected by this Panel and the Appellate Body, or to taking positions that are entirely at odds with the facts, or both.

71. Brazil's approach brings to mind an old story, in which Abraham Lincoln is asked, "If you call a horse' s tail a leg, how many legs does the horse have?". Mr. Lincoln's answer was, of course, "Four. Calling a tail a leg does not make it a leg. It is still a tail."

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[21] Third Party Submission of the United States, paras. 19-20.
[22] E.g. First Written Submission of Canada, paras. 73-83.
[23] E.g. First Written Submission of Canada, paras. 84-97.

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72. Brazil can claim that PROEX III does not confer a benefit. It can claim that it qualifies for the safe haven in the second paragraph of Item (k). And it can claim that it qualifies for an alleged *a contrario* exception in the first paragraph of Item (k). But claiming that it is so cannot make it so when the law and the facts show otherwise.

73. The latest version of Brazil's PROEX scheme is still a prohibited export subsidy. Canada requests that this Panel find accordingly.

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ANNEX A-4

RESPONSES BY CANADA TO QUESTIONS OF THE PANEL

(17 April 2001)

For Canada

Q15. Please explain precisely what measures you are challenging in these proceedings. Is it the legal framework of PROEX III in so far as it relates to financing the export of regional aircraft, i.e. PROEX III as such? Or payments under PROEX III?

1. As noted in Canada's oral response to this question, Brazil claims in its First Submission that by amending PROEX through BCB 2799, it has brought PROEX into conformity with the SCM Agreement. Brazil claims that by virtue of this amendment, PROEX III payments are no longer prohibited export subsidies. Canada disagrees. Canada is challenging the PROEX III scheme in so far as it relates to the financing of exports of regional aircraft because, however it is delivered,[1] it enables Brazil to continue to grant prohibited export subsidies. It is also challenging PROEX III payments made in support of regional aircraft exports. Payments under PROEX III remain prohibited export subsidies. Accordingly, Brazil has failed to comply with the recommendations and rulings of the DSB.

2. The situation is akin to that described by the Panel in its Report in the original (PROEX I) proceeding:

> … we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft … In order to analyse this contention, we are required to go beyond an examination of individual PROEX payments that have been identified and look more generally at the nature and operation of the PROEX interest rate equalization scheme which governs the payment of the alleged export subsidies".[2]

Q16. Canada cites Article 13 of the 1998 OECD Arrangement regarding repayment schedules. Article 13(a) however uses the term "normally". Please comment.

1. Article 13(a) defines the minimum repayment schedule that is expected for transactions that comply with the disciplines of the Arrangement. The term "normally" refers to the possibility that one may wish to establish a different repayment schedule under special circumstances, as envisaged in paragraph (c) of the same article. In that event, paragraph (c) requires that the appropriate notification procedures be followed (detailed in Article 49(a)2) of the Arrangement).

2. However, it is important to note that this flexibility does not apply to the timing of the first instalment of principal, which must be made at or before 6 months from the starting point of credit (as defined in Article 9) regardless of the repayment schedule. The term "normally" only qualifies the reference to "equal and regular instalments not less frequently than every six months". It does not qualify the "first instalment" language. This interpretation is confirmed by the context of this provision within the Arrangement, namely by the "No Derogation Engagement" of Article 27(a).

[1] See Canada's Rebuttal Submission, para. 2.

[2] *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999,.para. 7.2.

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3. Thus, the unlimited grace period allowed under Article 2 of Brazil's Directive 374 enables the Export Credit Committee to approve transactions that would not respect Article 13(a) of the Arrangement by approving transaction in which the first payment of principal is made more than six months after the starting point of credit.

Q17. Do you agree that PROEX III payments are "interest rate support" within the meaning of the 1998 OECD Arrangement? If not, why not?

1. The 1998 OECD Arrangement does not define "interest rate support". However, interest rate support practices of the Participants to the Arrangement have the following characteristics:

- The level of support is determined in relation to the interest rate prevailing in the market at the time when support is established;

- The amount paid by the government varies according to the difference between the short-term interest rate that prevails in the market during the period over which the financing is provided and the level at which the interest rate was fixed for the borrower. Theoretically the payment is therefore a two-way flow because there may be times at which the market rate will be below the rate at which support was fixed, which would require the financial institution to pay back part of the support; and

- Credit risk insurance or a guarantee is provided in association with interest rate support to limit the risk of non-repayment from the borrower because this risk is not covered by pure interest rate support. Participants provide credit risk insurance or guarantees in conjunction with interest support to cover that risk. This is done through the addition of a risk premium to the interest rate and the Arrangement defines minimum premium benchmarks to ensure that credit risk is appropriately covered.

2. Whether or not PROEX III payments are "interest rate support" within the meaning of the 1998 OECD Arrangement, they do not conform with the interest rates provisions of the 1998 OECD arrangement and are significantly different from the interest rate support practices of the Participants:

- The level of buy-down provided by PROEX is divorced from the interest rate that prevails in the market when the transaction is approved. In fact, BCB Newsletter No. 2881[3] indicates Brazil's intention to provide the maximum buy-down possible (2.5%) in cases where the term of the loan is over 9 years;

- PROEX III buy-downs constitute a one-way flow from the government to the lending institution, instead of the two-way flow associated with interest rate equalisation; and

- As previously mentioned, interest rate support does not cover the credit risk associated with a transaction. The lender therefore remains subject to the risk of non-payment by the borrower. Even if interest rate support is provided by a government, it is difficult to see why a lender would agree to extend a fixed rate loan without the possibility to cover itself for the credit risk it is taking, in particular if the transaction involves a fair amount of risk.

Q18. Canada contends that the "CIRR is not an appropriate benchmark … with respect to transactions involving regional aircraft because the CIRR rate usually varies significantly from the rates available in comparable transactions in the marketplace" (Canada's rebuttal submission, para. 87). Is Canada asserting that the Appellate Body was not aware of the financing spreads required from airlines purchasing regional aircraft when it stated, in its

[3] See Exhibit CDA-2.

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Article 21.5 report in Brazil – Aircraft, that Brazil, to discharge its burden of establishing that under the revised PROEX subsidies were not used to secure a material advantage, had to prove "either: that the net interest rates under the revised PROEX are at or above the relevant CIRR … or …"? (para. 67) If so, what is the basis for this assertion?

1. No. In this proceeding, Canada has challenged Brazil's selection of the CIRR as an appropriate benchmark. In the previous proceedings in this dispute, the Appellate Body did not have to pronounce on the "appropriateness" of the CIRR as a generalized benchmark because Brazil failed to make a *prima facie* case that the interest rates under PROEX I or PROEX II were at or above the relevant CIRR or some other benchmark.

2. While Canada cannot speak for the Appellate Body, Canada believes that the Appellate Body made clear that it considered the CIRR relevant because the Appellate Body thought that the CIRR was a market benchmark, not because the CIRR had any independent legal status. In Canada's view, the Appellate Body did not intend the CIRR to be a conclusive generalized benchmark if it were not a market benchmark. In its Report in the original proceeding, the Appellate Body recognized that: "[t]he fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms'". [underlining added][4]

3. However, the Appellate Body also stated that: "[i]n any given case, whether or not a government payment is used to secure a *material* advantage … may well depend on where the net interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available."[5]

4. Moreover, in its Report in the first Article 21.5 proceeding in this dispute, the Appellate Body acknowledged that "the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases".[6] This statement was in response to evidence that in some instances the market may be below the CIRR.

5. Canada has presented detailed argument and evidence before this Panel at paragraphs 84 to 97 of its First Submission and at paragraphs 78 to 90 of its Rebuttal Submission demonstrating that CIRR is not an appropriate benchmark in regional aircraft transactions because it does not appropriately reflect the rates at which regional aircraft financing is generally offered in the commercial marketplace.

6. The CIRR interest rate in most cases will be well below commercial rates available for regional aircraft transactions. For example, as demonstrated in paragraph 88 of Canada's Rebuttal Submission, the CIRR is 35 basis points lower than a rate achieved by the highest-rated EETC tranche for one of the highest rated U.S. airlines (American Airlines). Canada also demonstrated, at paragraphs 76-77 of its First Submission and in Exhibit CDA-16, that buy-downs in interest rates to the CIRR would confer a material advantage in favour of Brazilian regional aircraft exports.

7. Furthermore, such an advantage would exist even without taking into account the other "terms and conditions of export credit transactions in the marketplace", to use the Appellate Body's words.[7] As Canada has shown, for example at paragraphs 80-83 of its First Submission, PROEX III buy-

[4] *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 182.

[5] *Ibid*.

[6] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, para. 63.

[7] *Ibid.*, para. 73.

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downs to the CIRR, divorced from these other terms and conditions, are even less reflective of regional aircraft financing in the commercial marketplace.

8. In the light of this evidence, Brazil cannot, by allegedly limiting PROEX III buy-downs to the CIRR, establish a *prima facie* case that PROEX financing does not secure a material advantage.

Q19. How can Canada's assertion that a benchmark other than CIRR "must be used" in cases where "the CIRR rate is not an adequate proxy for market rates" (Canada's first written submission, para. 92; emphasis added) be reconciled with the Appellate Body's statement, in its Article 21.5 report in Brazil – Aircraft, that, where the CIRR does not reflect the rates available in the marketplace, a Member "should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative 'market benchmark'" (para. 64; emphasis added)?

1. Canada's position is consistent with the Appellate Body's statement. In accordance with paragraph 64 of the Appellate Body's Report, a Member, in that case a defending Member, may rely on evidence from the marketplace to demonstrate to a panel, as the trier of fact, that the CIRR is not an appropriate generalized benchmark in the circumstances, and that an alternative benchmark is appropriate.

2. It cannot be that this right to demonstrate that the CIRR is not an appropriate benchmark accrues only to a party complained against. In this proceeding, Canada, as the complaining party, has demonstrated that the CIRR is not an appropriate generalized market benchmark because it does not generally reflect the rates available in the commercial marketplace for the financing of regional aircraft. The burden remains on Brazil, as the party asserting an affirmative defence, to establish an alternative generalized benchmark that is appropriate. It has not done so.

Q20. Can it be inferred from paras. 67 and 73 of the Appellate Body's Article 21.5 report in Brazil – Aircraft that the CIRR is a generalized market benchmark applicable to all export credit transactions relating to regional aircraft? If not, why not?

1. No. In paragraphs 67 and 73 of its Article 21.5 Report, the Appellate Body was considering the CIRR as a generalized *market* benchmark. The CIRR can be a generalized market benchmark an applicable to all export credit transactions relating to regional aircraft only if, as a general matter, it accurately reflects market rates for such transactions. As discussed, *supra*, in Canada's response to Question 18 and in Canada's Rebuttal Submission at paragraph 80, the Appellate Body recognized this. It did not intend the CIRR to be used as a benchmark if it did not accurately reflect the market and it acknowledged that CIRR might not do so. Canada has demonstrated that the CIRR does not do so.

For both parties

Q21. On the assumption that the second paragraph of item (k) provides for an exception to the first paragraph thereof, would a Member invoking the second paragraph need to establish (i) that its internal law allows it to act in conformity with the interest rates provisions of the relevant OECD Arrangement or (ii) that its internal law requires it to act in conformity with the aforementioned interest rates provisions? If (ii) is correct, how does this view fit with the traditional distinction between mandatory and discretionary legislation in the GATT/WTO?

1. The traditional distinction in GATT and WTO jurisprudence between mandatory and discretionary legislation, at least until the Panel report in *United States – Section 301*, was that only legislation mandating a WTO inconsistency or precluding consistency could, as such, violate WTO

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provisions.[8] In the traditional view, it was not sufficient for a complaining Member to show that the impugned measure might allow the Member complained against to violate its WTO obligations but rather, that it the measure required, or would require, the Member to violate its obligations in at least some circumstances.

2. This distinction addressed the question of what a complaining Member had to show in challenging legislation, order to establish a violation of WTO obligations. The distinction did not address the question of what a Member complained against must show in order to establish an affirmative defence. It therefore is not applicable to the question of what a Member must do in order to invoke the second paragraph of Item (k) as an affirmative defence.

3. A Member invoking the second paragraph of Item (k) must establish that its challenged actions are in conformity with the interest rates provisions of the OECD Arrangement. A demonstration that the Member's internal law allows it to act in conformity with the interest rates provisions of the OECD Arrangement would be insufficient. The Member would not have met its burden of establishing its affirmative defence, because it would not have shown that its actions are in conformity with the interest rates provisions of the OECD Arrangement. Given the presumption that a Member will act in accordance with its domestic legal requirements, one way for a Member to meet its burden would be to show that its internal law requires it to act in conformity with the interest rates provisions of the OECD Arrangement.

4. In the present case, Brazil has not met its burden of establishing its affirmative defence. It has not shown that its internal law mandates that it act in conformity with the interest rates provisions of the relevant OECD Arrangement. Nor has it established, through other authoritative actions, that it is bound by the interest rates provisions of the OECD Arrangement.

5. Canada has established that PROEX III does not even address, let alone require conformity with, all of the interest rates provisions of Arrangement (regardless of which version of the Arrangement is the relevant one). Brazil has claimed that, in addition to the CIRR, it conforms to two of the interest rates provisions of the OECD Arrangement, namely the maximum length of the financing term and the loan-to-value limitation. However, as Canada showed at paragraphs 27 to 30 of its Rebuttal Submission, the documents on which Brazil relies for this contention were in effect under PROEX II, during which period Brazil routinely waived these terms for regional aircraft financing. Furthermore, as noted in Canada's response to Question 32, Directive 374 on its face allows Brazil to offer financing on payment terms that exceed the 10 year limit in the OECD Arrangement. In the course of the oral hearing in this proceeding, Brazil admitted that it retained the power to waive these two terms. Moreover, Brazil offered no assurances that it would not continue to do so, nor could it have credibly done so, given the array of public statements by Brazilian officials that Brazil will not comply with the interest rates provisions of the OECD Arrangement.[9]

6. In addition, at paragraphs 32-36 of its Rebuttal Submission, Canada submitted uncontroverted evidence that PROEX financing support has been offered on terms inconsistent with the interest rates provisions of the OECD Arrangement in the period since PROEX III took effect.

7. In the face of the evidence against it, Brazil has failed to show that PROEX III, however it is delivered, is in conformity with the interest rates provisions of the OECD Arrangement. It cannot meet its burden, regardless of any distinction between mandatory and discretionary legislation.

8. Even if the mandatory/discretionary distinction were relevant to an affirmative defence, Brazil would need to demonstrate that it is mandating to conform to the interest rates provisions of the

[8] *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted 27 January 2000, fn. 675.

[9] See Canada's Rebuttal Submission, paras. 20-26.

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relevant OECD Arrangement. However, as described in the preceding paragraphs, Brazil has stated publicly that it will not comply with the interest rates provisions, and there is unrebutted evidence that it has not complied. Finally, there is a well-established history of Brazil's non-compliance under the same instruments that it is now asserting establish its compliance. In these circumstances, there is no basis for finding that Brazil has brought its measures into compliance with its obligations in this dispute.

Q22. The Panel in United States – Section 301 (WT/DS152/R, para. 7.96) found legislation presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner. Do the findings of this Panel on this issue have any relevance to this dispute? Please elaborate?

1. As Canada noted in its answer to Question 21, the mandatory/discretionary distinction is not relevant in the present proceeding. Nevertheless, assuming that the findings of the *Section 301* panel on the mandatory/discretionary issue are correct, they are supportive of Canada's position in this dispute. As the question notes, the *Section 301* panel found legislation to be presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner.

2. In addition, the *Section 301* panel found, at paragraph 7.96 of its Report, that where legislation is WTO-inconsistent on its face, the fact that a Member can demonstrate that its implementing legislation allows for an application that is consistent with the Member's obligations may not be sufficient to demonstrate that the legislation is in fact consistent with those obligations. However in the present proceeding, Brazil has not even shown that its implementing legislation allows for an application that is consistent with Article 3 of the SCM Agreement.

Q23. What relevance, if any, does the language of Article 3.2 to the SCM Agreement ("A Member shall neither grant nor maintain subsidies referred to in paragraph 1") have to the consideration of PROEX III in this dispute?

1. With respect to the implementation of the recommendations and rulings of the DSB, Brazil's obligation is to withdraw its prohibited export subsidies. At a minimum, this means that Brazil must stop granting or maintaining such subsidies as required under Article 3.2 of the SCM Agreement. Even if Brazil had not actually granted additional prohibited export subsidies under PROEX III, the PROEX III scheme is the legal framework that enables Brazil to continue to grant illegal subsidies. By maintaining the PROEX III scheme, Brazil has failed to stop granting or maintaining prohibited exports subsidies and remains non-compliant with Article 3 of the SCM Agreement.

Q24. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?

1. When export credits are provided, the final interest rate charged to the borrower is composed of at least two elements: the basic interest rate and a risk premium. Premiums are charged to cover the risk of non-payment by the borrower, i.e., the credit risk.

2. Interest rate support is not mentioned in Article 20 because its provision does not remove the risk of non-repayment by the borrower for the lending institution. This risk can only be assumed when a government provides interest rate support in association with a guarantee or insurance in respect of the credit risk.

3. To ensure that risk is appropriately covered and that a level playing field is established, the Participants to the Arrangement have defined minimum premium benchmarks. Currently, these

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benchmarks are not available to non-Participants. Canada supports their disclosure, but any decision to release them requires the consensus of the Participants.

Q25. Please state clearly for the Panel your view regarding which provisions of the 1992 and 1998 Arrangement are "interest rates provisions" within the meaning of the second paragraph of item (k).

1. The following sets out Canada's view of which provisions are pertinent to regional aircraft financing in the 1998 text of the OECD Arrangement would constitute "interest rates provisions" within the meaning of Item (k) of Annex I of the SCM Agreement. The provisions described below affect what the interest rate and the amount of interest payable will be in a given transaction. Within limits, variations of certain of these provisions are permitted under the terms of the Arrangement. Canada notes that provisions in the Arrangement that are pertinent to sectors other than regional aircraft have not been listed. This list is thus without prejudice to Canada's position as far as other sectors are concerned. While Canada has not listed definitional provisions of the Arrangement, those provisions apply to the provisions listed below.

- **Article 2: Scope of Application**

This article restricts the scope of the Arrangement to officially supported export credits with repayment terms of two years or more, and to official support in the form of tied aid.[10]

- **Article 3: Special Sectoral Applications and Exclusions**

This article sets out the applicability of special guidelines to certain specific sectors. The guidelines applicable to the aircraft sector provide that in cases where provisions in the Sector Understanding on Export Credits for Civil Aircraft (Annex III) correspond with provisions in the Arrangement, the provisions of the Sector Understanding prevail.

The relevant provisions in the Sector Understanding are Articles 21, 22, 23, 24 and 25 of Annex III, Part 2, which covers new aircraft, and Articles 28, 29, 30 and 31 of Annex III, Part 3, which covers used aircraft, spare engines, spare parts, maintenance and service contracts.

- **Article 7: Cash Payments**

This article requires providers of official support to require purchasers of goods and services to make cash payments of a minimum of 15% of the export contract value of the goods or services, at or before the starting point of a credit (defined in Article 9 of the Arrangement).

- **Article 9: Starting Point of Credit**

This article requires that the repayment term begin by the actual date of delivery. However, depending on the complexity of the underlying export contract, other dates may be applicable.

- **Article 10: Maximum Repayment Term**

This article sets out the maximum term for repayment of the export credit, which can be either five years (with a possible extension to eight and a half), or ten years, depending on whether the recipient country is classified as a Category I or Category II country. (The category of country is determined by World Bank data based on GNP per capita).

[10] Tied aid support is not permitted for civilian aircraft, except for humanitarian purposes (Annex III, Article 24).

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- **Article 13: Repayment of Principal**

This article requires that the principle sum of the export credit is normally to be repaid in equal, and at least semi-annual instalments. It also permits equal, blended payments of principal and interest in the case of leases. Within limits, variations are allowed.

- **Article 14: Payment of Interest**

This article requires payments of interest to be made in at least semi-annual instalments during the repayment term. Within limits, variations are allowed.

- **Article 15: Minimum Interest Rates**

This article requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs), and sets out the principles by which CIRRs are established.

- **Article 16: Construction of CIRRs**

This article requires CIRRs to be set at a fixed margin of 100 basis points above their respective base rates. For most OECD Participants, the base rates are the yields of government bonds with terms that roughly correspond to the average life of the loan.

- **Article 17: Application of CIRRs**

This article provides that CIRRs can be held for 120 days at an additional cost of 20 basis points. When official financing support is provided for floating rate loans (rather than on a CIRR basis), the Participants must not grant the borrower the option of choosing the lower of CIRR or the short-term market rate throughout the life of the loan.

- **Article 19: Official Support for Cosmetic Interest Rates**

This article forbids the offering of artificially reduced interest rates, which give the borrower the illusion of obtaining more favourable financing terms than are envisaged under the Agreement.

- **Article 21. A): "Premium shall be risk based."**

Paragraph a) of Article 21 requires that premiums be risk-based. This is understood to mean that premiums must "not [be] inadequate to cover long term operating costs and losses" (as provided in Article 22.a)).

- **Article 26: Validity Period for Export Credits**

This article imposes a limit of six months on the length of time offers can remain outstanding for acceptance by the buyer/borrower.

- **Article 29: Matching**

This article permits the offering of terms and conditions that are outside of the Arrangement's rules, but only if such terms and conditions are matching another governments' offer with terms and conditions that are outside of the Arrangement's rules.

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- **The 1992 text of the Arrangement**

The interest rate provisions of the 1992 text of the Arrangement that correspond to those listed above are Articles 1, 3, 4, 5, 7(a), 9(d), 11 of the main text including the related definitions; Annex VIII; and Articles 21, 23, 24, 26 of Chapter II of Annex IV, as well as note 6 to that Annex.

Additional Question for Canada

Q31. Please indicate which group(s) or individual(s), other than those identified in your delegation list, have (had) access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings. Specifically, have employees or representatives of Canadian regional aircraft manufacturers been given access to such materials? If so, please explain the basis on which you believe that you were entitled to do so under the DSU and the Panel's Working Procedures.

1. Canada has not given access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings to any employees of Canadian regional aircraft manufacturers. Canada has shared these documents with members of a private law firm retained by a Canadian regional aircraft manufacturer. These individuals have served as advisors to the Government of Canada and are subject to a confidentiality agreement whereby they are not to disclose documents such as those to which the question refers, including to their client. Moreover, they would not receive any business confidential information had Brazil filed any in this proceeding.

2. As Canada noted in its statement on confidentiality to the Panel, Paragraph 13 of the Working Procedures provides in relevant part:

> The parties and third parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations, *as well as any other advisors consulted by a party or third party*, act in accordance with the rules of the DSU and the working procedures of this Panel, particularly in regard to the confidentiality of the proceedings.

3. Paragraph 13 recognizes that parties may consult advisors who are not members of their delegations. The only reason why parties should have the responsibility for these advisors in regard to the confidentiality of the proceedings is because a party may share submissions and other documents with these advisors. The Appellate Body confirmed this at paragraph 141 of its Report in the original *Canada – Aircraft* proceeding, where it recognized that: "a Member's obligation to maintain the confidentiality of these proceedings extends also to the individuals whom that Member selects to act as its representatives, counsel and consultants."

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4. The Panel in *Korea – Taxes on Alcoholic Beverages* also recognized this when it stated in its Report:

> We note that written submissions of the parties which contain confidential information may, in some cases, be provided to non-government advisors who are not members of an official delegation at a panel meeting. The duty of confidentiality extends … to all such advisors regardless of whether they are designated as members of delegations and appear at a panel meeting.[11]

5. For Brazil to suggest that its submissions may not be shared with a party's advisors who are not on its "delegation" is therefore wrong as a matter of law.

Brazil's position is also entirely arbitrary. According to the Appellate Body, it is for a WTO Member to decide who should represent it as members of its delegation.[12] Although the Appellate Body confined this finding to representation at appellate hearings, there is no logical reason why it should not be extended to other proceedings, and in practice it has been, as the composition of Brazil's delegation at the oral hearing in this proceeding attests. If parties could be deprived of the opportunity to share opposing parties' submissions with those persons most knowledgeable about the trade at issue because they were not "on their delegation", parties would protect their ability to make a full response by greatly expanding their delegations, as is their right.

Additional Question for Both Parties

Q32. With respect to Brazil exhibit 3, please confirm the accuracy of the English translation of Article 3, paragraph 2 of Directive 3.74. In particular, is the phrase "may be extended to" an accurate translation of "poderà ser ampliado, para até?

1. In Canada's view, the phrase "may be extended to" is *not* an accurate translation of the Portuguese original, "poderá ser ampliado para até ". According to the Canadian Government's Multilingual Translation Directorate, an accurate translation of Paragraph 2 of Article 3 is:

> The term for the equalization payment, mentioned in the annex hereto, may be extended *for* a maximum of ninety-six months, depending on the unit value of the good at the place of shipment, in accordance with the following schedule: [emphasis added]

2. The difference between "extended *for* a maximum of ninety-six months" and "extended *to* a maximum of ninety-six months" is significant. The former makes clear that the extension is in addition to the term indicated in the annex to Directive 374. The latter could be read to mean that the total term, including an extension, is ninety-six months.

3. Canada's is the only logical translation given the structure of Article 3. Article 3, paragraph 1 provides that the term cannot be greater than (I) the term that was agreed by the exporter (i.e. negotiated in the sales contract) and (II) the maximum term indicated in the annex to Directive 374 under the provisions of paragraph 2 of Article 3 (i.e. the schedule indicating an extension for a maximum of ninety-six months for goods valued in excess of US $130 thousand) and Article 4. The maximum term for payments for regional aircraft indicated in the annex (per NCM Heading 8802) is 120 months. Accordingly, paragraph 2 of Article 3 cannot be read as limiting financing payments to a total of ninety-six months without creating a conflict with the annex.

[11] WT/DS75/R; WT/DS84/R, adopted 17 February 1999. para. 10.32.

[12] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, para. 10.

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4. In that regional aircraft can be presumed to have a value in excess of US$130 thousand, the maximum term for financing payments for regional aircraft in accordance with Directive 374 appears to be 120 months in accordance with the annex which may be extended by an additional 96 months in accordance with paragraph 2 of Article 3. The total term may therefore be up to 218 months, or 18 years.

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ANNEX A-5

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

(20 April 2001)

I. INTRODUCTION

1. In this submission, Canada offers comments on certain aspects of Brazil's responses to the Panel's questions. In the interest of brevity and because Canada has addressed many of the issues discussed in Brazil's responses in its previous submissions, this submission does not specifically address each response or each element of a response. To this end, Canada relies on its previous submissions. The absence of comments should not be construed as concurrence with a particular response.

II. GENERAL COMMENTS ON BRAZIL'S RESPONSES

1. Brazil's responses to the Panel's questions confirm that PROEX III financing support is a prohibited export subsidy under Articles 1 and 3 of the SCM Agreement, and does not qualify for the safe haven of the second paragraph of Item (k).

2. While there are obvious inconsistencies among individual Brazilian responses to the Panel's questions, taken together, Brazil appears to be asserting that PROEX III payments are subject to two alternative limitations, either one of which, in Brazil's view, automatically assures conformity with the SCM Agreement in all circumstances. However, because PROEX III offers the most favourable of the terms indicated by the market, or the OECD Arrangement, or some combination of the two, it does not ensure conformity with either standard and therefore does not comply with the SCM Agreement. (See Canada's comment on Brazil's response to question 14, below).

3. The first alternative asserted by Brazil seems to be that, regardless of the creditworthiness of the borrower, PROEX III could be provided such that the interest rate to the purchaser is at the CIRR. Brazil seeks to justify such payments, even if they result in the borrower obtaining terms more favorable than those available to the buyer on the market, on grounds that Brazil considers that such terms conform with the exception in the second paragraph of Item (k). Brazil asserts this defense in its response to Questions 14 (e) and (g). However, as Canada has shown, these terms do not conform with the interest rates provisions of the OECD Arrangement.

4. Alternatively, Brazil acknowledges that PROEX III can be provided without regard to the CIRR pursuant to Article 8, paragraph 2 of Resolution 2799, which provides that the Committee administering PROEX shall "have as a reference the financing terms practiced in the international market" when "analyzing received requests for eligibility". Brazil acknowledges that this provision enables the Committee to depart from all of the notional limitations under PROEX III – the CIRR, the ten year term, and the 85 percent financing limit. However, Brazil asserts that "having as reference" the financing terms practiced in the international market means that the Committee must "conform to the financing terms of the international market" when it departs from these limits.

5. Brazil argues that when it has "as reference" the international market, even when the rate is below CIRR and on more favorable terms than under the OECD Arrangement, there is no benefit and thus no subsidy. Brazil does not explain in its responses: (a) how a "reference" to market terms means a requirement to conform with market terms; (b) what it means by the financing terms of the international market; (c) in what sense this precludes the Committee from providing terms to the borrower more favorable than those available to the borrower on the market; or (d) how the

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Committee will make this determination. This broad authority is insufficient to demonstrate that PROEX III precludes the Committee from conferring a "benefit" within the meaning of Article 1 of the SCM. Moreover, as Canada has shown, PROEX III confers a benefit *per se*.

6. In response to Questions 2 and 3, Brazil also seems to try to imply that the only subsidy is to the financial institution, not the exported product. However, Brazil's response to Question 4 appears to concede that Brazilian aircraft exports, and not just financial institutions, benefit from these subsidies. Indeed it is difficult to imagine that a country would grant a subsidy simply to benefit foreign banks.

III. COMMENTS ON SPECIFIC RESPONSES

Question 1

1. Brazil's response confirms that the PROEX program has not undergone any revision other than that achieved through BCB Resolution 2799. In its response, Brazil simply re-iterates arguments it has already presented to the Panel regarding the interpretation of Resolution 2799. Canada has responded to those arguments in its prior submissions.

2. In its response, Brazil contends that Article 8, paragraph 2 of Resolution 2799 restricts the provision of PROEX III to terms that are "consistent with the terms practiced in the international market". However, as discussed in Canada's general comments above, Article 8, paragraph 2 does nothing of the sort.

3. Even if Article 8, paragraph 2 did operate as the sort of discipline that Brazil contends it does, restricting the provision of PROEX III payments "consistent with the terms practiced in the international market" is meaningless given the very nature of PROEX payments. As discussed by Canada in its prior submissions, the financing that an Embraer customer would receive from a third-party lender prior to, or in the absence of, PROEX buy-downs is already on market terms. The addition of PROEX III in such circumstances is a *per se* departure from market terms. Canada discusses this in additional detail in its comments on Brazil's response to Questions 2 and 3.

Questions 2 and 3

1. In its response to Questions 2 and 3, Brazil alleges, on the basis of certain hypothetical situations, that PROEX III does not entail a *per se* departure from market terms, and by implication, that there are situations in which PROEX III does not confer a benefit on the purchaser of regional aircraft. Brazil's response is flawed for several reasons:

Brazil Ignores the Character of PROEX Buy-Downs

2. First, the response ignores the fundamental character of PROEX III as well as the character of its predecessor programs as interest rate buy-downs. In and of itself, PROEX III, like PROEX I, is not an export financing program whereby a principal amount is loaned to the recipient conditional on the repayment of the principal plus interest in accordance with the terms of the financing. As stated in paragraph 3 of Canada's First Submission, PROEX payments are direct transfers of funds. They do not have to be paid back. This attribute of PROEX has not changed in PROEX III. PROEX payments are essentially grants. Thus, unlike the case of financing, it is not necessary to compare the terms of PROEX payments to market benchmarks in order to determine whether a benefit has been conferred. Such payments *per se* confer a benefit (equal to the amount of the payment) irrespective of how the payments are used by the recipient.

Brazil's Hypotheticals Are Irrelevant

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3. Second, even if Brazil were correct that reference must be made to market benchmarks in order to ascertain the existence of a benefit, Brazil has admitted that under PROEX III it can in any case subsidize interest rates down to the CIRR without regard to the rates being offered by commercial banks. Alternatively, it can "have as reference" the terms practiced in the international market. Neither of those approaches involves limiting the amount of PROEX payments to the difference between what a borrower could obtain elsewhere in the market and the rate at its preferred bank.

Under Brazil's Hypotheticals a Benefit Is Conferred

4. Third, even if the situations identified by Brazil did exist, they would result in a benefit being conferred. The SCM Agreement does not restrict the meaning of "benefit" to a benefit that is purely financial. According to the Appellate Body, a "benefit" exists where the financial contribution makes the recipient "better off" than it would otherwise have been, compared to the marketplace.[1] The purchaser would benefit from a greater choice of banks to handle the transaction than would have been available in the marketplace – what Brazil describes in its first hypothetical situations as "added convenience" for the Embraer purchaser. Finally, in all of the situations described by Brazil, the use of PROEX III would result in Embraer winning a sale that it would not otherwise have received in the marketplace. While PROEX III takes the form of payments to the customer's lending bank, Brazil cannot dispute that Embraer is a beneficiary of the program. The fact that PROEX payments are conditional on the purchase of Brazilian aircraft would be illogical if the purpose of PROEX was simply to assist banks in Brazil and in foreign countries.

5. Furthermore, contrary to Brazil's contention it is simply not the case that in Brazil's first and second hypothetical situations, PROEX would not "place the buyer in any better situation." According to Brazil, if a potential purchaser of regional jets wished to use a Chinese or Brazilian bank for its financing, that bank would be able to offer financing at eight percent with PROEX support, if the purchaser acquired Embraer aircraft. However, Brazil's example ignores that if the same potential purchaser wished to finance a purchase of Canadian aircraft through the same banks (the buyer's preference according to the examples), that purchaser would face a higher interest rate (specified in the second example as ten percent). If a buyer does in fact prefer a Chinese or Brazilian bank, PROEX III therefore would give Embraer a commercial advantage. In both examples, Brazil contends that the resulting terms would be no better than those available in the "international" marketplace, which Brazil defines as certain large lenders outside of China and Brazil. However, this is a semantic sleight-of-hand. The question refers to the terms available in the "commercial" marketplace. The terms otherwise available in the commercial marketplace include those that would be offered by the purchaser's preferred banks in the absence of PROEX buy-downs.

6. Brazil's third hypothetical situation is either not plausible or is a restatement of the first situation. Aircraft financing is made available based on the buyer's credit. If the buyer were able to obtain international financial institution financing at eight percent for the purchase of aircraft from another manufacturer, that buyer could obtain the same financing from that institution for the purchase of Embraer aircraft. There would be no need for PROEX buy-downs to enable Embraer to offer financing at the same rate. If the issue is whether a Brazilian bank could offer financing at the same rate as an international bank, the situation is no different than in the first hypothetical.

Question 4

1. As noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III confers benefits on Embraer aircraft, the purchasers of Embraer aircraft and financial institutions. Brazil's response to Question 4 seems to imply, incorrectly, that these are mutually exclusive. However, the

[1] See *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 157.

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fact that PROEX may benefit foreign banks does not affect or determine whether PROEX confers benefits on Embraer aircraft and their purchasers. In fact, Brazil's response also appears to concede what experience has shown: that PROEX subsidizes exported Embraer aircraft, not just lending institutions.

Question 6

1. In the light of Brazil's ongoing failure to comply with the recommendations and rulings of the DSB in respect of PROEX I and II transactions, it is questionable that the Brazilian Executive has the duty under domestic law to comply with Brazil's WTO obligations. Even if it were the case that the Executive were required to comply with Brazil's WTO obligations as it interprets them, this would offer no more indication of the conformity of PROEX III with Brazil's WTO obligations than it did with respect to PROEX I or PROEX II.

Question 7

1. Brazil contends that PROEX III "addresses the way in which it will, as a matter of law, comply with its WTO obligations." As Canada has shown throughout its submissions in this proceeding, PROEX III does nothing of the sort. Saying it does not make it so.

2. Brazil claims in its response that it meets the "ensure" standard because PROEX III (allegedly) contains specific requirements that are consistent with the OECD Arrangement criteria. Brazil apparently does not contend that it has "ensured" that PROEX III will not confer a benefit, and thus, seems to concede that it is in violation of its obligations under the SCM Agreement unless the Panel finds that PROEX III "ensure[s] that financing under its terms qualifies for the safe haven of the second paragraph of item (k)."

3. However, as Canada demonstrated in its Rebuttal Submission, PROEX III ensures no such thing. PROEX III does not even address many of the interest rates provisions of the OECD Arrangement. Therefore, contrary to Brazil's assertion, PROEX III does not demonstrate that Brazil "will, as a matter of law, comply with its WTO obligations."

4. In its responses to subsequent questions, Brazil acknowledges that it can decide not to comply with the interest rates provisions of the OECD Arrangement, and instead provide financing on other terms "having as reference the financing terms practiced in the international market". As Canada has explained in its comments on Brazil's previous responses, this vague language imposes no disciplines on the terms that Brazil can offer under PROEX III.

Question 8

1. On page 12, paragraph (a), Brazil admits that it can depart from the 85 percent loan to value requirement pursuant to the authority in Article 8.2 of the Resolution "when interest rate support is provided on terms consistent with the international market" (i.e., the loan to value ratio prevailing in the market exceeds 85 percent). It justifies this departure on the basis that PROEX III would not confer a benefit in such circumstances.

2. In Canada's view, this is further evidence that PROEX III does not comply with the interest rates provisions of the OECD Arrangement. As to Brazil's position that PROEX III would not confer a benefit in such circumstances, as noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a benefit in all circumstances.

3. In part (c) of its response, Brazil does not deny that the newspaper reports submitted by Canada accurately report the statements of Foreign Minister Lampreia and Ambassador Graca Lima. Instead, Brazil argues that these statements "do not provide evidence of what PROEX III *actually*

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requires." However, given the broad discretion available to the Brazilian Executive when administering PROEX III, statements of how Brazil intends to interpret its law are important to this case. In particular, these statements demonstrate Brazil's intention not to comply with the interest rates provisions of the OECD Arrangement. When considered in the context of the historical application of PROEX and the fact that the most recent amendments to PROEX have not curtailed the discretionary authority of the Brazilian Executive, the probative value of these statements cannot be denied. Brazil has offered nothing to suggest that it will follow its own criteria under PROEX III any more than it followed the same criteria under earlier versions of PROEX, when they had the same status in Brazilian law.

Question 9

1. In parts (a) and (c) of its response, Brazil states that under Article 8, paragraph 2, it may only depart from the eligibility criteria in PROEX III "when interest rate support is provided on terms consistent with the international market". As Canada explained in its general comments and elsewhere, the wording of Article 8, paragraph 2 does not impose any such limitation. However, even if it did, this would mean that Brazil would depart from the ten year maximum when the duration of financing prevailing in the market exceeds 10 years. Again, Brazil claims justification for this departure on the basis that PROEX III would not confer a benefit in such circumstances.

2. However, as noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a benefit in all circumstances. In the light of Canada's evidence that the prevailing terms for financing regional aircraft significantly exceeds 10 years, Brazil's admission that it will waive the 10 year requirement in such circumstances is fatal to its argument that PROEX III complies with the interest rates provisions of the OECD Arrangement and therefore can benefit from the safe haven in the second paragraph of Item (k).

Question 10

1. Even if Brazil has not yet committed to PROEX III financing, this does not assist Brazil in establishing compliance. Since PROEX III *per se* confers prohibited export subsidies that are not saved by any exceptions in the SCM Agreement, it remains inconsistent with a covered agreement within the meaning of Article 21.5 of the DSU.

Question 11

1. With respect to PROEX III's alleged conformity with the specified Articles of the 1998 OECD Arrangement, Canada notes the following:

2. Article 21 of Annex III, which specifies Maximum Repayment Terms for all new aircraft except large aircraft, prevails over Articles 12 and 10 of the main text due to Article 3, also of the main text. PROEX III is inconsistent with Article 21 of Annex III in that it allows for a repayment term in excess of 10 years for regional jet aircraft as Brazil has admitted in its answer to Question 9(a) of the Panel and elsewhere. Furthermore, in Brazil's view the "interest rates provisions" do not include Article 21 (or, *inter alia*, Article 7 of the main text, i.e., requiring cash payments of a minimum of 15% of the export contract value – see Brazil's answer to Question 25 of the Panel). Therefore, Brazil can ignore these Articles and, in its view, still qualify for the safe haven of the second paragraph of Item (k). This is confirmed by Brazil's answer to Question 14(g) of the Panel where Brazil states that it "may approve financing at a net interest rate equal to the CIRR and still qualify for the safe haven … ." Such a position is erroneous. This requirement is one of the numerous requirements that must be complied with in order for Brazil to invoke the safe haven of the second paragraph of Item (k).

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3. Brazil provides incomplete, inaccurate or misleading descriptions of several of the Articles when comparing them to PROEX III:

- Article 13 requires much more than "repayment of principle in regular instalments not less than six months in frequency." Brazil omits that the instalments of principal should normally be equal and that the first instalment shall be made no later than six months after the starting point of credit. The unlimited grace period allowed under Article 2 of Directive 374 is inconsistent with Article 13 in that it allows transactions in which the first payment of principal is made more than six months after the starting point of the credit.

- Article 14 requires much more than "payment of interest on a six-monthly basis." Article 14 specifies that interest shall not normally be capitalized during the repayment period and that the first instalment must be made no later than six months after the starting point of credit. Also, it states that interest excludes: any payment by way of premium or other charge for insuring or guaranteeing supplier credits or financial credits; any other payment by way of banking fees or commissions relating to the export credit other than regular bank charges; and withholding taxes. To the extent that PROEX III is used to buy-down risk premiums, Brazil would not be providing interest rate support as envisaged by the 1998 OECD Arrangement (assuming, *arguendo*, that PROEX III payments are interest rate support).

- Brazil claims that Articles 16 and 17 govern the calculation of the CIRR. This is not the case – Article 17 covers how a country applies the CIRR for a specific transaction and not how it is calculated. Article 17 contains important conditions on how to define the interest rate that is appropriate for a given transaction. It states that the interest rate applying to a specific transaction shall not be fixed for a period longer than 120 days; that if the terms of official financing support are fixed before the contract is signed, a margin of 20 basis points must be added to the CIRR; and that the lender cannot offer the option of the lower of either the CIRR (at the time of the original contract) or the short-term market rate throughout the life of the loan if it is providing a floating rate loan.

  Brazil has offered no evidence of conformity with Article 17 and instead attempts to distance PROEX III on the irrelevant basis of non-Participant status. Whether or not a Member is a Participant to the Arrangement is irrelevant to how Article 17 is applied. Given the expansive discretion under PROEX III that is admittedly used on a routine basis, it can only be expected that Brazil would use this discretion in applying Article 17 and waive the 20 basis point margin if it were to apply. A bald statement "that the net interest rate for a PROEX-supported transaction may not be below the CIRR" is wholly insufficient to prove that PROEX III conforms with Article 17. (By the use of the word "may", it appears that Brazil could even use its discretion to go below the CIRR.)

4. Contrary to Brazil's claim, Articles 18 and 19 on Cosmetic Interest Rates are relevant to PROEX III – if PROEX III payments are "interest rate support" within the meaning of the 1998 Arrangement. Article 19(b) states that "official financing support" cannot be offered at a cosmetic interest rate. "Interest rate support" is one of the means that is referred to as "official financing support", as confirmed by the fourth paragraph of the Introduction to the 1998 OECD Arrangement and the first sentence of Article 15 on Minimum Interest Rates. If PROEX III payments are "interest rate support" within the meaning of the 1998 Arrangement, Articles 18 and 19 are relevant to PROEX III because the payments would constitute "official financing support".

5. Brazil cannot claim that PROEX III is in conformity with Article 19 of Annex III on the sole basis that PROEX III "requires a minimum interest rate of the CIRR." Article 19 of Annex III states that "[the provisions of this Chapter represent the most generous *terms* that Participants may offer

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when providing official support." [emphasis added]. Respecting the CIRR alone, as Brazil claims, is insufficient to conform with Article 19 of Annex III.

6. As the regional aircraft market matures, it is possible that Brazil could be in a position to market used aircraft in the future. Therefore, Articles 27 and 28 of Annex III would be relevant to PROEX III despite Brazil's claim of irrelevancy. Should Brazil decide to provide PROEX III buy-downs for used aircraft in the future, Brazil must respect these articles to be in conformity with the interest rates provisions of the 1998 OECD Arrangement.

Question 13

1. In practice, the administration of PROEX III on a case-by-case basis is no different from the administration of PROEX II. As described at paragraph 2.3 of the Article 21.5 Panel Report, the resolution establishing PROEX II stated that: "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."

2. Thus, the character of PROEX has not been changed. PROEX remains nothing more than a pure grant in the form of an interest rate buy-down. As before, the Committee retains broad discretion to determine the terms of the grant.

Question 14

1. Brazil admits in part (g) of its response to this question that the individual terms (e.g. net interest rate, loan-to-value ratio, financing term, etc.) under which PROEX III is offered, are the more favourable of those indicated by the market or the CIRR. It is not limited by the requirements of the OECD Arrangement. Under PROEX III, the net interest rate offered may be the lowest (i.e. the CIRR) and the loan-to-value ratio and financing term may be the highest (i.e., the market). In such circumstances, PROEX III does not comply with either the market or the OECD Arrangement. This admission therefore undercuts what appear to be Brazil's alternative assertions, as described above under General Comments.

2. This was the factual situation facing Canada in the Air Wisconsin transaction, where as an inducement to purchase Embraer aircraft, Air Wisconsin was offered a net interest rate at the CIRR for a maturity term exceeding 10 years. Brazil's response to Question 1 from Canada that it has "not received an application for interest rate support for sales by Embraer to Air Wisconsin and has not approved any support for this transaction" does not answer the question of whether PROEX III was *offered* in conjunction with that transaction.

3. Canada also notes that parts (a) and (c) of Brazil's responses contradict its response to Questions 2 and 3. Brazil claims in part (a) that the term "international market" refers "to the market in which the product for which PROEX support is requested competes." This would mean, for example, that in a sale by Embraer to a Chinese airline, the relevant "financing terms practiced in the international market" would be those practiced in China. However, according to Brazil's second examples in response to Questions 2 and 3, PROEX III is used, *inter alia*, to buy down interest rates to below those available in China.

4. In part (c) of its response, Brazil asserts that the financing terms practiced in the "international market" refers to "the terms that would be available for a comparable transaction for that buyer in the commercial marketplace." PROEX III does not say this. Moreover, as Canada has noted in its comments on Brazil's response to Questions 2 and 3, in that response Brazil defined the "international" marketplace as certain large lenders outside of the market where its subsidized aircraft are being sold.

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5. Thus, not only does Brazil offer no assurances that the interpretation of PROEX III that it advances in response to Question 14 will be followed in practice by the Committee when administering PROEX III, but this interpretation is contradicted by its previous responses.

6. As Canada notes in its General Comments, Brazil asserts in part (e) of its response, that the phrase "shall have as reference" "prevents the Committee from approving financing on terms more favorable than those prevailing in the international market." However, PROEX III does not say this. Rather, it only requires the Committee to have the international market as a "reference." If Brazil has a more restrictive intention, then it needs to revise PROEX again.

7. In this regard, Brazil's argument in part (i) of its response is beside the point. Brazil emphasizes that Article 8, paragraph 2 of Resolution 2799 uses the mandatory verb "shall". However, all that is mandated is that the Committee "shall" use the international market as a "reference". PROEX III does not require the Committee to ensure that any PROEX support does not provide a benefit compared to the terms otherwise available to the particular buyer. Moreover, given that the Committee can go below the market (see Brazil's responses to 14(e) and (g)), this is clearly not a meaningful limitation.

8. Finally, Brazil's response to part (f) of the question assumes that CIRR is an "appropriate" benchmark in all circumstances, including when financing terms exceed those of the OECD Arrangement. Clearly, as demonstrated by Canada, this assumption cannot be supported. Furthermore, in suggesting that the "Committee would have to consider any proposal for financing that deviated from the CIRR," even when another term greatly exceeds the OECD Arrangement (e.g. a 15 year financing term), Brazil implies that the CIRR is not an interest rate "floor", but a "ceiling". Brazil confirms this in its response to part (g) of the question, where it admits that the Committee may approve financing at the CIRR even when financing terms practiced in the international market would indicate an above-CIRR rate.

Question 21

1. Brazil contends (1) that PROEX requires conformity with the SCM Agreement, and (2) even if it does not, it gives the Committee discretion to act in conformity with the SCM Agreement, *i.e.* it does not *require* a violation of the SCM Agreement.

2. As Canada has demonstrated, the authority granted to the Committee under PROEX III does not require conformity with the SCM Agreement any more than it did under PROEX I or II. On the contrary, PROEX III payments necessarily involve a financial contribution by a government, which confers a benefit. They therefore are subsidies. PROEX III payments are contingent upon export performance. They therefore are prohibited export subsidies.

3. In an Article 21.5 proceeding, the complaining Member satisfies its burden if it establishes a *prima facie* case that the defending Member has not complied with its WTO obligations. The evidence submitted by Canada satisfies this burden. Once the complaining Member has satisfied its burden, it is for the defending Member to establish that it is complying with its obligations. In this context, it is not sufficient for the defending Member to demonstrate that it has *discretion* to comply with its obligations. Such discretion does not overcome the existing *prima facie* case of non-compliance, particularly when, as in the present case, the defending Member has admitted that it will use that discretion in a non-compliant manner, it has done so in the past, and there is evidence that it continues to do so. Instead, the defending Member must show that it is *required* to comply with its obligations, in order to overcome the existing *prima facie* case.

4. None of the GATT cases cited by Brazil on the mandatory/discretionary distinction involved a situation where the complaining Member had already established a *prima facie* case that the defending Member's measures violated its obligations. In the absence of such a *prima facie* case,

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those GATT panels required the complaining member to show that the defending Member was mandated to violate its GATT obligations. Brazil also attempts to analogize the present proceeding to its challenge of Canada's programs in *Canada – Aircraft*. However, the analogy fails. Those programs involved direct financing. As discussed in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a subsidy, unlike direct financing which only confers a subsidy in circumstances where the terms of the financing are more favourable than those available for comparable financing in the market.

Question 25

1. In its answer to Question 25, Brazil argues for a narrow interpretation of "interest rates provisions". In response, Canada notes the following:

2. The most logical interpretation of the term "interest rates provisions" includes all provisions that affect what the interest rate and the amount of interest payable will be in a given regional aircraft transaction. This interpretation of "interest rates provisions" flows from the plain meaning of the words. The text of the second paragraph of Item (k) refers to "interest rates provisions" and not simply to "interest rate". Thus, it must refer to more provisions than those that only affect the interest rate itself.

3. If the term "interest rates provisions" were applied to those provisions that only affect the interest rate itself, the benefit of the exception in the second paragraph of Item (k) would be extended to financing transactions that apply the CIRR but that do not abide by any of the other Arrangement disciplines – specifically those provisions that affect the amount of interest payable in a given regional aircraft transaction. A financing transaction that applied a naked interest rate alone – one that is divorced from the other terms and conditions that affect the amount of interest payable, and are generally a part of any financing transaction – could easily circumvent the minimum interest rate rule found in Article 15 of the 1998 OECD Arrangement. Using the CIRR alone would therefore result in allowing transactions that had *effective* interest rates *below* the CIRR to qualify for the second paragraph of Item (k). Any discipline that Articles 1 and 3 of the SCM Agreement provide for export subsidies would be completely negated. The export subsidy floodgates would be opened.

IV. QUESTIONS FROM CANADA TO BRAZIL

Question 1

1. Brazil does not indicate whether PROEX III was "offered" in the transaction nor does it acknowledge seeking Embraer's consent to waiving the confidentiality commitments.

Question 2

1. Again, Brazil does not answer the question, which was motivated by the evidence, as described in Canada's Rebuttal Submission, that Brazil is granting PROEX III subsidies in conjunction with or subsumed into BNDES financing.

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ANNEX B

SUBMISSIONS OF BRAZIL

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ANNEX B-1

FIRST SUBMISSION OF BRAZIL

(16 March 2001)

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I. INTRODUCTION

1. On 4 August 2000, the Dispute Settlement Body ("DSB") adopted the report of the Appellate Body in the previous Article 21.5 proceedings in this matter.[1] In its report, the Appellate Body found that Brazil had failed to establish that the steps it had taken to amend the measure at issue in this case, the *Programa de Financiamento às Exportações* (PROEX), brought that measure into conformity with the previous rulings and recommendations of the DSB. Accordingly, on 12 December 2000, Brazil advised the DSB of additional amendments to PROEX that it had taken to bring the measure fully into conformity with Brazil's obligations under the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement" or "Agreement").

2. On 19 January 2001, Canada notified the DSB of its intention once again to seek recourse to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") in these proceedings. Canada's decision not to seek consultations concerning the steps Brazil had taken to amend PROEX has meant that Brazil has not had an opportunity to explain the measure to Canada. At its meeting on 16 February 2001, the DSB referred the matter to the original Panel.

3. In this submission, Brazil will demonstrate first, that PROEX interest rate support payments for aircraft no longer constitute a subsidy within the meaning of Article 1 of the SCM Agreement. Assuming *arguendo*, however, that PROEX interest rate support payments are a subsidy within the meaning of Article 1, Brazil also will demonstrate that they are not prohibited by Article 3 because they comply with the interest rate requirements of the *Arrangement on Guidelines for Officially Supported Export Credits* of the Organization for Economic Cooperation and Development ("*OECD Arrangement*," or "*Arrangement*"). Therefore, they are eligible for the "safe haven" of the second paragraph of item (k) to Annex I of the Agreement. Further, even if PROEX interest rate support payments for aircraft are considered to be a subsidy, and, assuming also that they do not comply with the requirements of the second paragraph of item (k), they, nevertheless, are payments that are not used to secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k), and, therefore, do not constitute a prohibited subsidy.

4. Brazil also will establish that the version of the *OECD Arrangement* that is relevant to these proceedings is the 1992 version that was in effect on 1 January 1995 when the *Marrakesh Agreement Establishing the World Trade Organization* ("Marrakesh Agreement" or "WTO Agreement") became effective. However, Brazil also will show that PROEX interest rate support payments for aircraft comply with both the 1992 version of the *Arrangement* that was in effect on 1 January 1995, and with the 1998 version, which is currently in effect.

II. THE HISTORY OF THESE PROCEEDINGS

5. Before the original Panel and the Appellate Body, and also before the first Article 21.5 Panel, Brazil contended that – even though the initial PROEX and its first revised version, PROEX II, were subsidies contingent upon exports – they were not prohibited because they fell under the exception of the first paragraph of item (k), and did not confer a "material advantage" within the meaning of that paragraph. The Article 21.5 Panel, however, disagreed. It concluded that PROEX payments could not be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining [export] credits," as required by the first paragraph of item (k).[2] Further, it held that Brazil had not provided sufficient evidence that export credits at fixed interest rates in respect of regional aircraft were provided in the commercial market at the benchmark

[1] Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU ("Original 21.5 Report"), WT/DS46/RW (9 May 2000).

[2] *Id*., para. 6.72.

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rate established by Brazil in PROEX II.[3] Finally, the Panel concluded that the first paragraph of item (k) "cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1.(a) is 'permitted'."[4]

6. The Appellate Body agreed with the 21.5 Panel that "Brazil has failed to demonstrate that PROEX payments are not 'used to secure a material advantage in the filed of export credit terms' within the meaning of the first paragraph of item (k)" of the Illustrative List of Export Subsidies.[5] Because that finding was sufficient to overcome Brazil's defense under the first paragraph of item (k), the Appellate Body found it unnecessary "to examine the issue of whether export subsidies under the revised PROEX are 'payments [by governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits' within the meaning of the first paragraph of item (k)."[6] The Appellate Body, however, stated that it "would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List" if Brazil had demonstrated that that the payments under PROEX II were "payments" within the meaning of the first paragraph of item (k) and that they were not used to secure a material advantage.[7] In light of the rulings and recommendations of the DSB, Brazil has again revised PROEX.

III. DESCRIPTION OF THE REVISED PROEX

7. On 6 December 2000, the Central Bank of Brazil adopted Resolution No. 002799, which "Modifies the applicable criteria for operations under the interest rate equalization system of the Export Finance Program – PROEX."[8] For convenience, the revised PROEX programme arising out this resolution shall be referred to as "PROEX III." Article 1 of the Resolution states:

> In export financing operations for goods and services, as well as for software, in compliance with Law 9,606, dated February 19, 1998, the National Treasury may provide to the finance or re-financing agency, as the case may be, equalization enough to render financing costs compatible with those practiced in the international market.

Regarding interest equalization for exports of regional jet aircraft, Article 1, paragraph 1 of the Resolution provides:

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

Even though Brazil, as a developing country, is not a member of the OECD and hence is not a party to the *Arrangement*, the Resolution commits Brazil to comply with the CIRR for transactions involving aircraft.

8. PROEX III interest rate equalization remains subject to the maximum percentages established by the Central Bank of Brazil in its Circular Letter No. 002881, dated 19 November 1999. Circular

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[3] *Id*., para. 6.104.
[4] *Id*., para. 6.67.
[5] Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, AB-2000-3 ("Appellate Body 21.5 Report"), WT/DS46/AB/RW (21 July 2000), para. 77.
[6] *Id*., para. 78.
[7] *Id*., para. 80.
[8] The original Portuguese version and the official English translation of Resolution No. 002799 are attached as Exhibit Bra-1.

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Letter No. 002881 sets the maximum allowable interest equalization payment at 2.5 percent.[9] This maximum amount is subject to the stipulation of Article 1, paragraph 1 of Resolution 00279 that interest rate equalization for regional aircraft must comply with the terms of the CIRR established under the *OECD Arrangement*.

9. In addition, PROEX III interest rate equalization remains subject to the requirement that interest rate equalization may be provided for only 85 percent of the value of the sale, pursuant to Article 5, paragraph 1 of Directive number 374 of the Ministry of Development, Industry, and Foreign Trade, dated 21 December, 1999.[10] Directive 374 also establishes a maximum financing term of 10 years for regional jet aircraft.[11]

IV. PROEX IS NOT A SUBSIDY WITHIN THE MEANING OF ARTICLE 1

10. The threshold issue for this Panel is whether PROEX III is an export subsidy within the meaning of Article 1 of the SCM Agreement. A negative answer to that question obviates any need to consider the measure under either paragraph of item (k).

11. A subsidy is a financial contribution by a government that confers a benefit. However, a financial contribution that does *not* confer a benefit is *not* a subsidy.[12] The Appellate Body has held that CIRR is a commercial rate.[13] Indeed, Canada itself – in a belated admission that "struck" the Panel in the previous Article 21.5 review – has admitted that commercial rates may be below CIRR and therefore not confer a benefit within the meaning of Article 1.[14]

12. Canada is not alone in this opinion. The current (7 March 2001) web page for Eksportfinans, the Norwegian Export Credit Agency, offers 8.5 year or longer United States dollar financing at the CIRR, which it lists as 6.13 percent. It also offers a "fixed market" rate for 7.0 years or longer of 5.8 percent.[15] Thus, for 10 year support, the Norwegian export credit agency offers a market rate that is 33 basis points below the CIRR. As noted above, PROEX III, by its terms, is limited to loans up to a maximum of 85 percent of the cost of the aircraft, for a period of 10 years at the CIRR or above the CIRR. Since these terms conform fully with what is offered in the market, PROEX III, on its face, cannot be found to confer a benefit.

13. There is additional evidence in support of this conclusion. David Stafford, former Chairman of the OECD Participants' Nuclear Sector and Aircraft Sector Groups, observes: "The CIRR system … does provide a reasonable compromise in trying to formulate a proxy market rate … My experience suggests that the CIRRs are about right or, if anything, marginally high."[16] In addition, Mr. Fumio Hoshi, Director-General of the International Finance Policy Department of the Japan Bank for International Cooperation, noted in his presentation at the EXIMBANK 65th

[9] The original Portuguese version and the official English translation of Circular Letter No. 002881 are attached as Exhibit Bra-2.

[10] The original Portuguese version and the official English translation of Directive 374 are attached as Exhibit Bra-3.

[11] *Id.*, Annex, NCM Heading 8802 (attached as Exhibit Bra-3).

[12] Canada – Measures Affecting the Export of Civilian Aircraft, AB-1999-2, WT/DS70/AB/R (2 August 1999), para. 157.

[13] *Brazil – Export Financing Programme for Aircraft*, AB-1999-1, WT/DS46/AB/R (2 August 1999), para. 182.

[14] Original 21.5 Report, para. 6.99.

[15] <http://222.eksportfinans no/eprise/main/EF/content/english/Inngangs> (visited 7 March 2001) (copy attached as Exhibit Bra-4).

[16] David Stafford, *Wallen, Helsinki, Schaerer et al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998). The text of the article is attached as Exhibit Bra-5.

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Anniversary Conference in May 2000 that the CIRR may actually be "excessively high."[17] Thus, the CIRR reflects with reasonable precision the market rate or, according to some, is in fact higher than the market rate. Either way, interest rate support at or above the CIRR does not confer a benefit.

14. Brazil notes that by conforming PROEX III to comply with the CIRR, Brazil appears to have complied with Canada's claimed objective in these proceedings of requiring Brazil to conform to the CIRR. Indeed, in its Second Oral Submission to the original Panel, Canada stated unequivocally that it "would not have brought this case" if only "PROEX simply reduced the interest rate offered to an airline to one that is above LIBOR or OECD rates."[18] Despite achieving its original stated goal, Canada has once again raised the bar, now seeking to impose on Brazil standards that, on their face, are more onerous than both those specified in the SCM Agreement and, more importantly, those used in practice by developed countries such as Canada itself.

15. Finally, as shown below, PROEX III complies with the interest rates provisions of the *OECD Arrangement*. Because PROEX III provides interest rate support in conformity with the *Arrangement*, it does not confer a benefit. In addition, Article 8, para. 2 of Resolution 002799 requires the Committee on Export Credits that co-administers PROEX III (the "Committee") to use "as reference the financing terms practiced in the international market." Thus, when the Committee does so, it will be required to make sure that no benefit is conferred.

V. PROEX MEETS THE REQUIREMENTS OF THE "SAFE HAVEN" OF ITEM (K) SECOND PARAGRAPH

16. Brazil has shown that PROEX III, by its terms, does not confer a benefit and, therefore, is not a subsidy. Assuming *arguendo*, however, that PROEX III does confer a benefit and, therefore, is a subsidy, it nevertheless qualifies for the "safe haven" of item (k) second paragraph.

17. The second paragraph of item (k) provides:

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

18. The *OECD Arrangement* is the only "international undertaking on official export credits" under the second paragraph of item (k).[19] Brazil, like most Members of the WTO, is not a party to the *Arrangement* and has no voice in establishing its provisions. That is a privilege that is available only to the 23 Participants in the *Arrangement*. Accordingly, Brazil is covered by the second clause of the second paragraph because, "in practice," Brazil – through PROEX III – "applies" the interest rates provisions of the 1992 version of the *Arrangement* – the version that was incorporated by reference into the SCM Agreement on 1 January 1995.

[17] Presentation by Mr. Fumio Hoshi, Director-General, International Finance Policy Department, Japan Bank for International Cooperation, at the EXIMBANK 65th Anniversary Conference, May 2000. The text of the presentation is attached as Exhibit Bra-6.

[18] *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, at para. 109.

[19] Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU, ("Canada -- Aircraft 21.5 Report"), WT/DS70/RW (9 May 2000), para. 5.78.

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A. THE PANEL SHOULD MEASURE PROEX III AGAINST THE VERSION OF THE *OECD ARRANGEMENT* THAT WAS IN EFFECT ON THE DATE OF ENTRY INTO FORCE OF THE SCM AGREEMENT

19. An interpretation of the text of the second paragraph of item (k), under the *Vienna Convention on the Law of Treaties* (the "Vienna Convention"), leaves no doubt that the last version of the *OECD Arrangement* which became effective prior to the entry into force of the SCM Agreement is "the relevant undertaking" for the purposes of the second paragraph of item (k). This is the 1992 version of the *Arrangement*.

20. Article 31 of the Vienna Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The first step therefore is to interpret the second paragraph of item (k) in accordance with the ordinary meaning of its terms.

1. The text of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.

21. The text of item (k) second paragraph refers not only to the *OECD Arrangement* as it existed in 1979, but also to a "successor undertaking which *has been* adopted" by the original Members (emphasis supplied). The phrase "has been" is central to the interpretation of item (k) second paragraph. In its ordinary meaning, the present perfect tense – "*has* been" – refers to a "time regarded as present" when the text became effective on 1 January 1995. [20] It is a reference to a successor undertaking *already in existence* – an undertaking that "*has* been adopted."

22. The alternative interpretation – that any and every later "successor undertaking" prevails, even if adopted after the entry into force of the SCM Agreement – is not in accordance with the ordinary meaning of the text. If the text envisaged that all future versions of the *OECD Arrangement* adopted *after* the entry into force of the SCM Agreement would also be "relevant undertakings," it would have used the future tense. It would have referred to a successor undertaking which "*will* be adopted" or "which *may* be adopted." That the text uses the present perfect "has," and not the future "will" or the conditional "may," makes clear that the negotiators were referring only to a version of the *Arrangement* in existence at that time.

23. The only "successor undertaking" that "*has* been adopted" by the original Members in "a time regarded as present" when the SCM Agreement became effective is the 1992 version of the *Arrangement*. Any versions adopted after the entry into force of the SCM Agreement are not undertakings that have been adopted by the original Members at the time the SCM Agreement became effective.

2. The context of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.

24. If amendments made to the *Arrangement* subsequent to 1 January 1995 were incorporated by reference into item (k) second paragraph, the effective result would be amendment of the SCM Agreement itself – an amendment made by the 23 or so participants in the *Arrangement* (out of 30 OECD member countries), not by the approximately 141 Members of the WTO. The context of item (k) second paragraph makes clear that *sub rosa* amendment of a WTO agreement was not intended.

25. Article 31.2 of the Vienna Convention provides that the context for the purpose of the interpretation of a treaty comprises "any agreement relating to the treaty" made between the parties

[20] The New Shorter Oxford English Dictionary 2158 (1993).

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"in connexion with the conclusion of the treaty." It can hardly be disputed that all WTO agreements – including the Marrakesh Agreement itself, and the DSU – provide the context for the proper interpretation of the SCM Agreement.

26. The process of amendment is extremely important in the WTO Agreement, as it is in any treaty. The terms of a treaty are carefully negotiated, and are not changed lightly or casually. Article X of the Marrakesh Agreement reflects the importance of amendments to the WTO by providing a detailed and precise system for their adoption, a system designed to protect the interests of all Members.

27. Article X:1 of the Marrakesh Agreement specifies that a decision even to submit a proposed amendment to the Members shall itself be taken by consensus of the entire WTO membership. If consensus is not reached within a specified period, the decision whether to submit a proposed amendment shall be taken by a two-thirds majority of the Members. If the two-thirds majority decides to submit the amendment to the Members, paragraph 3 provides that, in most circumstances, if two-thirds accept, the amendment shall take effect only as to those that have accepted it.

28. Article X:3 of the Marrakesh Agreement further requires that any amendments to an Agreement in Annex IA (which includes the SCM Agreement) "that would alter the rights and obligations of the Members" take effect only "for the Members that have accepted them." The only exception is provided with respect to amendments that "would not alter the rights and obligations of the Members." Those amendments, under Article X:4, "take effect for all Members upon acceptance by two thirds of the Members."

29. An interpretation of item (k) that envisages the possibility of a handful of OECD countries amending the scope of the exception for the entire WTO membership, *after* the entry into force of the SCM Agreement, would evade the amendment process entirely, and could lead to significant alteration of the rights and obligations of the Members of the WTO in regard to export credits.

30. Further, Article 3.2 of the DSU provides that, "Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." This provision is intended, *inter alia*, to further the predictability of the multilateral trading system, to which the dispute settlement system is a central element. It cannot be disputed that, through amendment to the *Arrangement*, its participants could "diminish the rights and obligations provided in the covered agreements" with regard to export credits, if subsequent versions of the *Arrangement* were incorporated by reference into item (k) second paragraph. This further confirms that the text of item (k) refers to the version of the *Arrangement* in effect on 1 January 1995, and to no later version or versions.

31. In addition, Article 31.3© of the Vienna Convention requires that "any relevant rules of international law" be taken into account together with the context. The law of treaties does not rule out that governments may agree, pursuant to the provisions of an existing treaty, to be bound by the provisions of a future treaty. However, such an agreement must be explicit and unambiguous; under Article 30(2) of the Vienna Convention, the existing treaty must "specify that it is subject to" a later treaty. The second paragraph of item (k) does not meet that requirement; its text makes it clear that it is subject to only an undertaking that "*has* been adopted," *i.e.*, an existing undertaking, not a future one.

32. Finally, a determination that the OECD may amend a crucial provision of the SCM Agreement at will, regardless of the views of the remainder of the WTO membership, would have serious constitutional implications for Members – like Brazil – that incorporate the WTO Agreements into their domestic law. No nation would confer *carte blanche* on non-citizens or other governments to effect changes in its domestic law. The second paragraph of item (k) should not be interpreted to say that Members of the WTO have done so.

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3. The object and purpose of item (k) second paragraph establishes that the 1992 version of the *Arrangement* applies.

33. The final stage of the analysis under Article 31 of the Vienna Convention requires an interpretation of the terms of a treaty in light of its object and purpose. The object and purpose of the SCM Agreement include establishing disciplines for the conduct of Members in providing subsidies to their industries that would be clear, transparent, fair, binding on all Members, and enforceable.

34. It is one thing to say that, when the WTO Members negotiated and gave effect to the SCM Agreement, they knew the terms of the most recent version of the *OECD Arrangement*, and were willing to incorporate by reference its interest rates provisions into item (k). It is quite another thing to say that they intended to give the OECD *carte blanche* to amend the SCM Agreement, and to add to or diminish the rights and obligations provided by that Agreement.

35. The Panel in *Canada – Aircraft* explicitly ruled that the second paragraph of item (k) should "not be interpreted in a manner that allows that subgroup of Members [the OECD Members] to create for itself *de facto* more favourable treatment under the SCM Agreement than is available to all other WTO Members. The *OECD Arrangement*, as a plurilateral arrangement to which most WTO Members are not Participants, clearly has the *potential* to give rise to the discretion of individual Members or group of Members."[21]

36. This statement is extremely important. For example, nothing Brazil or the WTO might say or do could prevent the OECD from amending the *Arrangement*'s provisions regarding regional aircraft in a manner that specifically disadvantaged Brazil and Embraer. They could, for example, specify that interest rate support may not be used for exports of regional aircraft. An interpretation of item (k) that allowed even for the possibility of a WTO agreement's being amended in such a fashion should be avoided unless absolutely compelled. Nothing in item (k) permits, let alone compels, such an interpretation.

4. A different interpretation of the second paragraph of item (k) leads to a result that is manifestly absurd and unreasonable.

37. Article 32(b) of the Vienna Convention provides that an interpretation that "leads to a result which is manifestly absurd or unreasonable" should be avoided. It would be unreasonable to interpret the text of the second paragraph of item (k) to mean that 141 WTO Members have agreed to allow 23 OECD countries to amend the scope of the "safe haven" at their will. It would be absurd to interpret an agreement subject to strict and detailed amendment requirements as permitting a small group of outsiders to amend a vital part of its provisions, thereby adding to or diminishing the rights and obligations of its Members. It would be manifestly unreasonable and absurd to interpret the text to mean that those WTO Members that incorporate the Agreements into their domestic law have given the *OECD Arrangement* Participants authority to amend that law.

38. If the OECD had the right to amend the SCM Agreement through the *Arrangement*, the consequences truly would be bizarre. The 23 Participants in the *Arrangement* would be authorized to impose binding obligations on some 141 WTO Members by means of adopting instruments that are not even binding within the OECD itself. The *Arrangement*, it will be recalled, is simply a "Gentlemen's Agreement," with no enforcement provisions.

39. Moreover, the Participants in the *Arrangement* would be authorized to include in the scope of the "safe haven" export credit practices they engage in while excluding export credit practices of other WTO Members who are not members of the OECD. Simply stating these possibilities demonstrates conclusively that an interpretation that post-1995 versions of the *Arrangement* are relevant to item (k)

[21] *Canada – Aircraft* 21.5 Report, para. 5.132.

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second paragraph is an interpretation that leads, in the words of Article 32(b) of the Vienna Convention, "to a result which is manifestly absurd and unreasonable."

40. Accordingly, for all these reasons, Brazil submits that the Panel must examine the issue of whether PROEX III is in conformity with the interest rate provisions of an international undertaking on official export credits by reference to the text of the 1992 version of the *OECD Arrangement*, not any later version.

B. PROEX III IS IN FULL CONFORMITY WITH THE RELEVANT INTEREST RATE PROVISIONS OF THE 1992 *OECD ARRANGEMENT*

41. The second paragraph of item (k) makes reference only to the "interest rates provisions" of the *Arrangement*, not to the provisions governing the terms and conditions of export credits, which are broader. The interest rates provisions of the 1992 *Arrangement* are those set out in Article 5 of the main text and Article 21 of Annex IV: Sectoral Understanding on Export Credits for Civil Aircraft.[22] PROEX III conforms with these provisions of the *Arrangement*. Brazil does not agree with the approach of the Panel in *Canada – Aircraft*, which used a broad approach to identify what it believed were the interest rates provisions of the 1998 *OECD Arrangement*.[23] However, even if the same broad approach is applied to the 1992 *OECD Arrangement*, Brazil conforms with the corresponding interest rates provisions: Articles 3 through 7 of the main text, and Articles 17 through 22 and Articles 24 and 25 of Annex IV. Brazil, under PROEX III, applies in practice those provisions of the 1992 *OECD Arrangement* as required by the second paragraph of item (k).

42. PROEX III conforms with the 1992 *OECD Arrangement* because all PROEX III supported transactions in the regional aircraft sector take the form of official financing support with a repayment term of two years or more, as required by Article 1 of the *Arrangement*.

43. PROEX III complies with Article 3 of the *Arrangement*, which requires that purchasers make cash payments equal to a minimum of 15 percent of the export contract value; the maximum percentage allowed under PROEX III for the purpose of interest rate equalization is 85 percent of the export value of the sale.[24]

44. Article 4 of the *Arrangement* relates to the terms of repayment. However, pursuant to Articles 1(b) and 9(d) of the *Arrangement*, these provisions are superseded by Article 21 of Annex IV dealing specifically with the aircraft manufactured by Embraer. PROEX III is in conformity with the provisions of that Article, as discussed below.

45. Article 5(a) of the *Arrangement* fixes the minimum interest rate at the relevant CIRR. The official financing support to the regional aircraft industry under PROEX III is at fixed interest rates only.[25] The net interest rates of all transactions in the regional aircraft sector under PROEX III are at or above the relevant CIRR.[26]

46. Articles 6 (Local Costs) and 7 (Maximum Period of Validity of Commitments, Prior Commitments and Certain Aid Commitments) are not relevant to PROEX III because no aircraft credits are granted, financed, refinanced, guaranteed or insured under PROEX III. Article 1 of Resolution 002799 explicitly states that PROEX III provides only interest rate support "enough to render financing costs compatible with those practiced in the international market" and that the financing to the regional aircraft industry is in the form of interest rate support in compliance with the

[22] The text of the 1992 *OECD Arrangement* is attached as Exhibit Bra-7.
[23] *Canada -- Aircraft* 21.5 Report, para. 5.147(d).
[24] Article 5 of Directive No. 374.
[25] Article 1, para. 2 of Resolution No. 002799.
[26] Article 1, para. 1 of Resolution No. 002799. As will be discussed below, the SDR-based rates referred to in Article 5(b) of the *Arrangement* are no longer relevant.

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CIRR.[27] Moreover, Article 5 of Directive 374 explicitly limits the interest rate support to 85 percent of the export value of the contracted sale, thus clearly excluding additional local costs.

47. Articles 17 through 20 of Annex IV to the *Arrangement* describe the scope of Chapter II of Annex IV relating specifically to aircraft other than large commercial aircraft. PROEX III falls within that scope and is therefore covered by the interest rates provisions of that Chapter.

48. Article 21 of Annex IV requires that the maximum length of the financing term is 10 years at the respective CIRR. The maximum length of the financing term under PROEX III is 10 years.[28]

49. Article 21 of Annex IV of the 1992 *OECD Arrangement* provides an alternative benchmark for the maximum term of financing: "ten years at SDR-based rate for recipient countries classified in category III." This alternative benchmark, however, was removed from the *Arrangement* in 1994 when the OECD adopted a set of guidelines, referred to as the "Schaerer Package." This abolished the SDR-based interest rates "so that the CIRR system, intended to reflect market rates more closely, would apply for all countries."[29] At any event, the SDR-based system is not relevant in the context of PROEX III because PROEX III is in compliance with the specified term of 10 years at the relevant CIRR.

50. Articles 22 (Sales or Leases to Third Countries (relay countries)), 24 (Insurance Premiums and Guarantee Fees) and 25 (Tied Aid Credit Prohibitions) are not relevant to PROEX III because PROEX III does not provide for such practices.

51. For these reasons, PROEX III, measured against the relevant provisions of the 1992 *OECD Arrangement*, qualifies for the "safe haven" of the second paragraph of item(k).

C. PROEX III IS IN FULL CONFORMITY WITH THE RELEVANT INTEREST RATE PROVISIONS OF THE 1998 *OECD ARRANGEMENT*

52. While Brazil will, through PROEX III, in practice apply the interest rates provisions of the version of the *Arrangement* that was incorporated by reference into item (k) second paragraph, it is clear that the same is true for the latest (1998) version of the *Arrangement* as well.[30] The difficulty, however, as noted above, is that the OECD could change these requirements tomorrow – without notice to Brazil, without notice to the WTO, without notice to anyone. Indeed, insofar as Brazil is aware, there has been no official notification to the WTO or any of its Members by the OECD or any of its members of the issuance of the 1998 version of the *Arrangement*. Thus, if the participants in the *Arrangement* decide to change the requirements, Brazil and any other non-OECD participant, unknowingly, would no longer be applying the interest rates provisions of the *Arrangement*.

53. In the view of Brazil, the relevant interest rates provisions of the 1998 *OECD Arrangement* are Articles 15 through 19 of the main text and Article 22 of Annex III. PROEX III conforms to all these provisions.

54. The Panel in *Canada – Aircraft* identified Articles 7 through 10 and 12 through 26 of the main text and Articles 18 through 24 and Articles 27 through 29(a)-(c) of Annex III as the applicable provisions of the 1998 *OECD Arrangement*.[31] Brazil disagrees with this finding of the Panel, and believes that the relevant interest rates provisions are limited to Articles 15 through 19, as noted above. However, even assuming that the conclusion of the Panel in *Canada – Aircraft* was correct,

[27] Article 1 of Resolution No. 002799.

[28] Circular-Letter No. 002881 and Annex to Directive No. 374.

[29] A summary of the Schaerer Package provided in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES, 1978-1998 (OECD, 1998), at p. 20, is attached as Exhibit Bra-8.

[30] The text of the 1998 *OECD Arrangement* is attached as Exhibit Bra-9.

[31] *Canada – Aircraft* 21.5 Report, para. 5.147.

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PROEX III conforms to all of these provisions, including both the minimum interest rates and "all other applicable" provisions of the 1998 *OECD Arrangement* that "operate to support or reinforce the minimum interest rate"[32] with one arguable exception.

55. PROEX III transactions are official financing support with a repayment term of two years or more, as required by Article 2 of the 1998 *Arrangement*. In fact, PROEX III complies fully with the requirements of Annex III, Article 21, which provides that the maximum repayment term for Category A aircraft (which includes Embraer's jets), is 10 years.[33] PROEX III support is also limited to fixed interest rate transactions.[34]

56. PROEX III complies with the requirements of the 1998 *Arrangement* regarding minimum interest rates. The 1998 *Arrangement* provides in Annex III, Article 22, "the Participants providing official financing support shall apply minimum interest rates; the Participants shall apply the relevant CIRR set out in Article 15 of the *Arrangement*." Article 15 in turn provides that the Participants providing official financing support through direct credits/financing, refinancing, or interest rate support shall apply the CIRR rates and lays out the relevant principles to be used in calculating the CIRRs. By requiring compliance with the CIRR, Resolution 002799 clearly conforms with the basic requirements of the 1998 *OECD Arrangement*.

57. PROEX III also complies with the other relevant provisions of the 1998 *Arrangement*. PROEX III interest rate support is limited to 85 percent financing of the value of the sale. Again, this conforms with Article 7 of the 1998 *Arrangement* (as well as Annex III, Article 6.a., though this applies only to large aircraft and not Category A aircraft). In addition, as explained above, PROEX III provides interest rate support at fixed interest rates for a maximum repayment term of 10 years.

58. As is the case with the 1992 *Arrangement*, some of the interest rates provisions of the 1998 *Arrangement* are not relevant to PROEX III because PROEX III does not provide for granting, financing, refinancing, guaranteeing or insuring credits to the regional aircraft industry. As explicitly stated in Article 1 of Resolution 002799, PROEX III provides only interest rate support "enough to render financing costs compatible with those practiced in the international market."[35]

59. The only possible exception is the provision of Article 29(a) of the Annex dealing with spare parts. That provision was in the section dealing with large aircraft in the 1992 *Arrangement*. It was moved to a separate section to cover both large and "other" aircraft *in 1998*. Thus, in 1996, when this case began, Brazil was in compliance with this particular provision. Without notice to the WTO and without notice to Brazil, the requirement was expanded in 1998 – *two years after this dispute began* – to cover "other" aircraft as well. This is a perfect illustration of the point that interpreting the second paragraph of item (k) to allow the OECD to amend the requirements of the "safe haven" leads to a result that is manifestly absurd, unreasonable and unfair.

60. Article 29(a) limits financing for spare parts to a maximum of 15 percent of the aircraft price for the first five aircraft and to 10 percent for the sixth and subsequent aircraft. Article 6 of Directive 374 provides that "Parts and spares may be included in a transaction, in a consolidated form up to a limit of twenty percent (20%) of the aggregate value of the other goods." In the view of Brazil, however, this provision of PROEX III conforms to the requirements of the interest rates provisions of the 1998 *OECD Arrangement*.

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[32] *Id.*, para. 5.114.

[33] Article 3(c) of the *Arrangement* provides that provisions of the Sector Understanding shall prevail over corresponding provisions of the *Arrangement*; Article 21 of Annex III supercedes Article 7 of the main text of the *Arrangement*.

[34] Article 1, para. 2 of Resolution No. 00279.

[35] Article 1 of Resolution No. 00279.

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61. First, Brazil disagrees with the *Canada – Aircraft* Panel and believes that Article 29 is not an interest rate provision. The interest rates provisions of the 1998 *Arrangement* are Articles 15 through 19 of the main text and Article 22 of the Annex. PROEX III fully conforms with those provisions. While Article 6 of Directive 374 gives the Committee the discretion to finance up to 20% of the spare parts included in a transaction, the Committee is not required to do so and will not do so with respect to regional aircraft because of the insignificant percentage of the value of the spare parts included in regional aircraft export sales.[36] This is a discretionary, not a mandatory, provision. Brazil, therefore, in practice applies the interest rates provisions of the 1998 *Arrangement*.

62. For all these reasons PROEX III conforms with all the provisions of the 1998 *Arrangement* and its relevant Sector Understanding that the *Canada –Aircraft* Panel described as reinforcing the minimum interest rate for Brazil's regional jet transactions and hence as the "interest rate provisions" of that *Arrangement*. The Panel should therefore find that PROEX III qualifies for the "safe haven" of the second paragraph of item (k).

VI. PROEX III IS NOT USED TO CONFER A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

63. Brazil has demonstrated that PROEX does not confer a benefit within the meaning of Article 1 of the SCM Agreement, and therefore is not a subsidy. Brazil also has demonstrated that – assuming *arguendo* that PROEX is a subsidy – it qualifies for the safe haven of item (k) second paragraph. In addition, however, it is Brazil's contention that PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph. In this portion of this submission, Brazil will demonstrate why this is the case.

A. PROEX DOES NOT PROVIDE A MATERIAL ADVANTAGE

64. Even if the Panel determines that PROEX III does not qualify for the safe haven of the second paragraph of item (k), Brazil submits that PROEX III equalization support is not a prohibited export subsidy, because PROEX III payments do not confer a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k).

65. As noted above, in the first Article 21.5 proceedings in this matter, the Appellate Body found that Brazil had failed to show that PROEX II was not used to secure a material advantage in the field of export credit terms. The Appellate Body stated that to establish that PROEX payments are not used to secure a material advantage, Brazil must prove *either* that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific 'market benchmark' identified in the original dispute as an 'appropriate' basis for comparison; *or*, that an alternative 'market benchmark is appropriate."[37] PROEX III stipulates that the net interest rates must be at or above the relevant CIRR. Thus, PROEX III complies fully with the CIRR, a benchmark determined by the Appellate Body not to confer a material advantage. In addition, Article 8, para. 2 of Resolution 002799 requires the Committee to use "as reference the financing terms practiced in the international market." Thus, when the Committee does so, it will be required to make sure that no material advantage is provided.

[36] The value of spare parts in Embraer's regional aircraft sales transactions is *de minimus*. The arbitrators in the 22.6 proceedings in *Brazil – Aircraft* concluded that "there is no financing for spare parts under PROEX for the ERJ-135" and that the "approximate average figure" for spare parts per ERJ-145 is $20,000. Thus, on average, according to the arbitrators, the value of spare parts does not exceed 0.5% of the price of the aircraft. *Brazil – Export Financing Programme for Aircraft*, Decision of the Arbitrators, WT/DS46/ARB (28 August 2000), paras. 3.68-3.72. *De minimus non curat lex*.

[37] Appellate Body 21.5 Report, para. 67.

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B. AN *A CONTRARIO* INTERPRETATION OF ITEM (K) FIRST PARAGRAPH IS REQUIRED

66. Brazil submits that the material advantage clause should be interpreted *a contrario* such that a payment that is *not* used to secure a material advantage within the meaning of the first paragraph is *not prohibited*, and is therefore *permitted*, under the SCM Agreement. The failure to permit an *a contrario* interpretation effectively would render the material advantage clause inutile, contrary to the customary rules of interpretation of public international law.

67. In reviewing this issue in the original Article 21.5 proceedings, the Appellate Body began its analysis by considering whether PROEX II in fact conferred a material advantage.[38] As noted above, the Appellate Body concluded that Brazil had not discharged its burden of showing that PROEX III did not confer a material advantage. Regarding Brazil's *a contrario* argument, however, the Appellate Body went on to say that if Brazil had discharged this burden, the Appellate Body *"would have been prepared to find"* that an *a contrario* interpretation of the material advantage clause could be used to justify PROEX payments.[39] Thus, as a legal matter, the Appellate Body appears to take the view that assuming the other legal conditions are met, the first paragraph of item (k) should be read *a contrario* to permit a subsidy that does not confer a material advantage. This Panel should reach the same conclusion.

C. PROEX IS A "PAYMENT" WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

68. PROEX III interest rate support is a "payment by [Brazil] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of item (k) first paragraph.

69. Neither exporters nor financial institutions wish to obtain credits in order to hoard them; they wish to "obtain" credits only to "provide" them. Before credits can be provided, they must be obtained – obtained at a cost, and, in the case of a developing country like Brazil, a considerable cost.

70. When the lending institution is outside of the country, Embraer, the Brazilian exporter, faces costs in obtaining for its customer a financial package that is competitive in the market, including a market in which "market window" operators, such as Canada, are offering rates below the CIRR. If Embraer could not obtain a competitive financial package for its customer, it would be forced to take other costly action, such as paying for a commercially-available loan guarantee at a high premium. When the lender is inside the country, however, it is the lender itself – the bank in Brazil – that must obtain dollars in the market in order to provide dollar credits. This analysis was effectively confirmed by the original Article 21.5 Panel, which observed that "developing countries' costs of borrowing are almost inevitably higher than those of developed counties."[40]

71. PROEX interest rate support payments are payments designed to offset, at least partially, the added costs faced by Brazilian institutions in obtaining the credits they provide.

72. If PROEX payments do not fit the definition of "payments" contemplated by item (k), it is impossible to contemplate exactly what kind of payments in the export credit field the drafters of this provision had in mind. The original Article 21.5 Panel stated that "a payment by Brazil that allowed a Brazilian financial institution to provide export credits" could be permitted under the first paragraph of item (k).[41] This Panel should follow the logic of that statement and find that PROEX III payments are "payments" within the meaning of the first paragraph of item (k).

[38] *Id.*, para. 58.
[39] *Id.*, para. 80.
[40] Original 21.5 Report, para. 6.73.
[41] Original 21.5 Report, para. 6.44.

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VII. CONCLUSION

73. Brazil does not understand Canada's purpose in again seeking recourse to Article 21.5, especially without first seeking consultations with Brazil on its concerns regarding PROEX III. As noted above, Canada has previously described its purpose in these proceedings as seeking to ensure that Brazil would provide PROEX support only at or above the CIRR. As the Panel is aware, Brazil is of the view that – as, indeed, Canada has admitted – transactions in the regional jet market occur below the CIRR, and that Brazil should therefore not have to comply with standards that are honoured more in breach than in observance by the group of developed country Members who themselves developed those standards. Nevertheless, in response to the rulings and recommendations of the DSB, Brazil has complied with Canada's stated wishes and conformed PROEX to the interest rate provisions of the *Arrangement*, as required by the second paragraph of item (k) of the SCM Agreement. The sole issue before this Panel is whether the regulations governing PROEX conform to the relevant provisions of the *Arrangement*. The Panel should answer this question in the affirmative and not yield to Canada's efforts once more to move the goalposts for Brazil.

74. Accordingly, Brazil requests that the Panel find and determine that Canada has not established that PROEX III confers a benefit within the meaning of Article 1 of the SCM Agreement and, accordingly, that Canada has not sustained its burden of proving that PROEX III is a subsidy.

75. However, even if the Panel should find that PROEX is a subsidy within the meaning of Article 1, contingent upon export within the meaning of Article 3, PROEX is nevertheless not prohibited because:

(a) Brazil in practice applies the interest rates provisions of the relevant undertaking – the 1992 version of the *Arrangement on Guidelines for Officially Supported Export Credits* of the OECD;

(b) Brazil in practice applies the interest rates provisions of the 1998 version of the *Arrangement on Guidelines for Officially Supported Export Credits* of the OECD;

(c) PROEX interest rate support is not used to provide a material advantage in the field of export credit terms.

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LIST OF EXHIBITS

BRA-1. Resolution No. 002799 of the Central Bank of Brazil, 6 December 2000 (Portuguese and English versions)

BRA-2. Circular letter No. 002881 of the Central Bank of Brazil, 19 November 1999 (Portuguese and English versions)

BRA-3. Directive No. 374 of the Ministry of Development, Industry and Foreign Trade, 21 December 1999, and selected pages of the Annex thereto (Portuguese and English versions)

BRA-4. Printout of http://222.eksportfinans.no/eprise/main/EF/content/english/Inngangs

BRA-5. David Stafford, *Wallen, Helsinki, Schaerer et al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998)

BRA-6. Presentation by Mr. Fumio Hoshi, Director-General, International Finance Policy Department, Japan Bank for International Cooperation, at the EXIMBANK 65th Anniversary Conference, May 2000

BRA-7. 1992 *OECD Arrangement* on Guidelines for Officially Supported Export Credits

BRA-8. Summary of The Schaerer Package, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998)

BRA-9. 1998 *OECD Arrangement* on Guidelines for Officially Supported Export Credits

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ANNEX B-2

SECOND SUBMISSION OF BRAZIL

(23 March 2001)

TABLE OF CONTENTS

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I. INTRODUCTION

1. In its First Submission of 2 March 2001, Canada asserts that Brazil's *Programa de Financiamento às Exportações* ("PROEX III") is a prohibited export subsidy within the meaning of Articles 1 and 3 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement" or "Agreement). Next, Canada examines PROEX III in light of the first paragraph of item (k) of Annex I to the SCM Agreement, and concludes that PROEX III does not qualify for any exemption that paragraph may offer. Canada does not address the second paragraph of item (k) which provides that, when Members "in practice" "apply" the interest rates provisions of the *Arrangement on Guidelines for Officially Supported Export Credits* of the Organization for Economic Cooperation and Development ("*OECD Arrangement" or "Arrangement"*), they are not providing prohibited subsidies.

2. The practical consequence of Canada's position is that high-technology industries like aircraft are the exclusive preserve of the developed countries; developing countries should stick to light manufactures and commodities. This is because, historically, the developed countries have supported industries, such as aircraft, with export credits that provide better terms than those available on the market. The result is that trade in aircraft depends not only on the price and quality of the product, but also on which government grants the more favourable financing terms. Because developed country governments enjoy better credit ratings and a lower cost of funds than do developing country governments, they are able to provide their exporters with more favorable export credits than are developing countries – credits that can overcome product price and quality differences.

3. In previous proceedings Brazil has shown, and the first Article 21.5 Panel has found, that developing countries, such as Brazil, simply are not able to compete with the credit ratings of developed countries in offering loan guarantees, and are not able to compete with the treasuries of developed countries in offering direct financing.[1] They are forced, by default, to rely largely on interest rate support in supplying export credits.[2]

4. Meanwhile, developed countries, such as Canada, are free not only to offer direct financing, but to do so through their so-called "market window" operations. The Head of the OECD Trade Directorate and a specialist in the OECD Export Credit Division have characterized these "so-called 'market window' operations" as "institutions related to governments which are able to raise finance and lend at very low rates but which may not currently follow all the provisions of the Arrangement."[3]

5. Using the "very low rates" that do not "follow all of the provisions of the Arrangement," Canada, and some other developed countries, may make financing available at rates that are below the Commercial Interest Reference Rate ("CIRR") of the *Arrangement*. But, the argument continues, these rates are "commercial."[4] Further, developed countries may make financing available for periods that exceed the limits of the *Arrangement*, but these, too, are called "commercial."[5] In Canada's view, there appears to be one set of rules for one group of Members, and another, more stringent set of rules for another group of Members. For the reasons explained below, this view is wrong, as a matter of law as well as policy.

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[1] Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW (9 May 2000) ("Original 21.5 Report"), para. 6.58-59.

[2] *Id*., para. 659.

[3] Steve Cutts and Janet West, "The Arrangement on Export Credits," *The OECD Observer* No. 211, April/May 1998 at 12, 14 (Exhibit Bra-10).

[4] Original 21.5 Report, para. 6.99: "We were, however, struck by Canada's assertion that export credits provided by EDC through the 'market window,' even at interest rates below CIRR, were nevertheless 'commercial' export credits that did not confer a benefit within the meaning of Article 1."

[5] *Id.*, at page 94 (Canada's Answer to question 8 of The Panel's Further Questions).

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II. QUESTION PRESENTED

6. The question presented to this Panel is "whether the measures taken by Brazil to comply with the rulings and recommendations of the DSB bring Brazil into conformity with the provisions of the SCM Agreement and result in the withdrawal of the export subsidies to regional aircraft under PROEX."[6]

7. During the Article 22.6 Arbitration proceedings,[7] Canada was authorized to suspend concessions to Brazil in the amount of C$344.2 million per year as appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement. This authorization was based on a calculation of the amount of subsidies under PROEX I and II deemed to be prohibited in the previous Panel proceedings. Accordingly, Brazil distinguishes between the so-called "undelivered aircraft" – aircraft subject to the calculation of the level of authorized countermeasures in the Article 22.6 proceedings – and any new PROEX III commitments. Brazil has stated repeatedly that it is unable to default on commitments it made to private parties who have relied, in good faith, on Brazil's commitments for the undelivered aircraft. The sole issue before this Panel, therefore, is whether PROEX III now complies with the requirements of the SCM Agreement for new orders.

III. BURDEN OF PROOF

8. In its submission, Canada asserts that it has presented evidence that satisfies its burden of proving that payments under PROEX III "continue to be prohibited export subsidies."[8] Canada has done nothing of the kind.

9. Under the standard articulated by the Appellate Body in *Chile – Alcoholic Beverages*, PROEX III enjoys a presumption of compliance:

> Members of the WTO should not be assumed, in any way, to have *continued* previous protection or discrimination through the adoption of a new measure. This would come close to a presumption of bad faith.[9]

10. Canada's assertion that it has met this legal and evidentiary burden is incorrect. Its "proof" that PROEX III is a subsidy is based entirely on its assertion that, "as has been confirmed twice before by both the Panel and the Appellate Body, PROEX payments *continue* to involve a direct transfer of funds from the Government of Brazil that confers a benefit."[10] Yet as Canada itself has acknowledged, "this second Article 21.5 proceeding is to consider only whether PROEX III is consistent with the SCM Agreement."[11] Since neither the Panel nor the Appellate Body has previously examined PROEX III, Canada's references to the prior findings regarding PROEX I and PROEX II are irrelevant. These references to past measures do not discharge Canada's threshold burden to establish that the programme now before this Panel – PROEX III – constitutes a prohibited export subsidy. Moreover, Canada's legal arguments regarding PROEX III are insufficient to discharge this burden.

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[6] WT/DS46/26 (22 January 2001).

[7] Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.10 of the SCM Agreement, Decision by the Arbitrators, WT/DS46/ARB (28 August 2000).

[8] Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU, First Submission of Canada (2 March 2001) ("Canada First Submission"), para 20.

[9] *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R (13 December 1999) (Adopted 12 January 2000), para. 74 (emphasis in original).

[10] Canada First Submission, para. 23 (emphasis added).

[11] *Id.*, para. 19.

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IV. LEGAL ARGUMENT

A. CANADA HAS NOT ESTABLISHED THAT PROEX III INTEREST EQUALIZATION PAYMENTS FOR AIRCRAFT CONSTITUTE A SUBSIDY

11. Canada claims that "Brazil continues to acknowledge that PROEX [III] subsidies are prohibited export subsidies."[12] This statement is incorrect. Brazil acknowledges no such thing. Canada's added claim, in footnote 22 to its First Submission, that Brazil has acknowledged that PROEX payments were "prohibited export subsidies" also is incorrect. Brazil has acknowledged nothing of the sort. What Brazil has argued in the past is that PROEX interest equalization payments, as they were constituted in the prior proceedings, were subsidies contingent upon export, but that they were not "prohibited" under the SCM Agreement.

12. Canada has presented no evidence that would establish that PROEX III confers a benefit in the sense that, in the words of the Appellate Body, it confers "terms more favorable than those available to the recipient in the market."[13] A financial contribution that does not confer a benefit is not a subsidy.[14] Canada's argument appears to be based solely on the premise that providing equalization at the CIRR confers a benefit or provides terms more favorable than those available to the recipient in the market. [15] As an attempt to discharge an evidentiary burden, this argument is wholly insufficient.

13. Moreover, it is completely contradicted by Canada's position in the previous two stages of these proceedings. Before the Original Panel, Canada stated that it would have not brought the case if PROEX simply matched OECD rates, *i.e.* the CIRR.[16] Before the Article 21.5 Panel, Canada admitted that it provides export financing at rates *below* the CIRR, and claimed that those rates were nevertheless "commercial."[17] Yet Canada now seeks to impugn PROEX III – which establishes the CIRR as a benchmark – as providing terms that are more favorable than those available in the marketplace. This allegation is inconsistent both with Canada's prior statements and with its own admitted practice. In the circumstances, Canada cannot be found to have discharged even a minimum legal and evidentiary burden of showing that PROEX III constitutes a prohibited export subsidy.

14. Canada is under a burden to establish that PROEX III, on its face, constitutes a prohibited export subsidy. Canada has provided no factual or legal evidence that satisfies this burden. The Panel therefore should deny Canada's request for relief in this proceeding.

B. CANADA HAS FAILED TO SHOW THAT PROEX III CONFERS A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

15. Even though PROEX III, by its terms, specifically provides that all interest equalization shall conform to the CIRR, Canada, in its First Submission to the Panel, does not address the issue whether Brazil qualifies for the safe haven of the second paragraph of item (k). Canada's First Submission challenges PROEX III solely on the ground that Brazil cannot establish that PROEX III does not confer a material advantage within the meaning of the first paragraph of item (k). Brazil, for the

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[12] *Id.*, para. 24.

[13] Canada – Measures Affecting the Export of Civilian Aircraft, AB-1999-2, WT/DS70/AB/R (2 August 1999), para. 157.

[14] *Id.*

[15] Canada acknowledges that the ongoing PROEX I and II payments on the so-called "undelivered" aircraft that were at issue in the Article 22.6 proceedings in this matter are not at issue in this Article 21.5 proceeding. Canada First Submission, para. 18. However, Canada has not provided any evidence regarding any actual transactions under PROEX III.

[16] *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, para. 109.

[17] Original 21.5 Report, pages 82, 89 (Responses by Canada to Questions of the Panel).

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reasons explained in its First Submission, submits that PROEX III conforms with the relevant interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven of the second paragraph of item (k). Brazil also believes, however, that PROEX III is not used to secure a material advantage within the meaning of item (k) first paragraph. Brazil explains why this is so in this section of its submission.

16. Brazil agrees with Canada that in order to prevail under item (k) first paragraph, Brazil must establish three elements.[18] First, Brazil must show that item (k) first paragraph may be interpreted *a contrario* such that a payment that is *not* used to secure a material advantage within the meaning of the first paragraph is *not prohibited*, and therefore is *permitted*, under the SCM Agreement. Second, Brazil must show that PROEX III payments fall within the definition of "payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining credits," within the meaning of the first paragraph of item (k). Third, Brazil must show that PROEX payments are not used to "secure a material advantage in the field of export credit terms." Canada's arguments on each of these three points are unavailing, and the Panel should find that PROEX III payments are not prohibited export subsidies.

2. The First Paragraph of Item (k) Must Be Given an *A Contrario* Interpretation

17. Item (k) of Annex I to the *SCM Agreement* provides, in relevant part, that certain governmental payments are prohibited export subsidies "in so far as they are used to secure a material advantage in the field of export credit terms." The addition of this "material advantage" clause where the paragraph would otherwise conclude necessarily affects the meaning of the paragraph. For the following reasons, the Panel should interpret this clause to mean that payments *not* used to secure a material advantage are *not* prohibited.

(b) Standard Principles of Treaty Interpretation Favor Brazil's Interpretation

18. The first paragraph of item (k) should be interpreted in accordance with the provisions of Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention"), which provides that a treaty shall be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. Moreover, this Panel "must give meaning and effect to all the terms of the treaty."[19] While these principles appear straightforward, there nevertheless remains considerable dispute as to the "ordinary meaning" of the material advantage clause.

19. In Brazil's view, the issue is quite simple. The Panel must give meaning and effect to the material advantage clause. The minimum meaning and effect that can reasonably be given is that the clause qualifies the preceding language of the first paragraph. This must mean that the "payments" described in the preceding clauses are not all or entirely prohibited. Put another way, the language plainly calls for a distinction between payments that are used to secure a material advantage and those that are not. Thus, the ordinary, straightforward meaning of the material advantage clause is that payments that are used to secure a material advantage are prohibited subsidies, whereas payments that are not so used are not prohibited. Canada's submission contains no reading of the clause that would give the language its ordinary meaning and reach a different result.

(c) The Maxim *Expressio Unius Est Exclusio Alterius* Supports Brazil's Interpretation

20. Canada describes the *a contrario* rule as another way of referring to the maxim *expressio unius est exclusio alterius*, which means, in effect, that by stating one proposition in a text, the

[18] Canada First Submission, para. 27.

[19] Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R (12 January 2000), para. 80.

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drafters necessarily excluded another proposition. Brazil agrees with Canada that the *a contrario* rule is related to the *expressio unius* maxim. However, Brazil disagrees with Canada that the maxim is unhelpful here. To the contrary, the *expressio unius* principle, as interpreted by the authorities relied upon by Canada, supports Brazil's construction of the first paragraph of item (k).

21. Put simply, the expressio *unius* maxim, in this case, means that by describing as prohibited subsidies payments "in so far as they are used to secure a material advantage," the drafters of the SCM Agreement necessarily intended that payments would *not* be prohibited export subsidies in so far as they are *not* used to secure a material advantage. The maxim is a "rule of both law and logic and applicable to the interpretation of treaties as well as municipal statutes and contracts."[20] In this instance, as a rule of law, the maxim corresponds with the principles of Article 31 of the Vienna Convention. The ordinary meaning of the language suggests that payments are prohibited only if they are used to secure a material advantage.

22. As a rule of logic, the maxim also supports Brazil's interpretation. Logically, had the drafters of the first paragraph intended to describe all "payments" as prohibited export subsidies, they simply would have ended the first paragraph right before the "in so far as" clause. The drafters did not so. Logically, therefore, they intended to qualify the description of payments that would be considered as prohibited subsidies so that *only* those payments described in the additional clause – those that are used to secure a material advantage – would be described as prohibited. Again logically, this means that the drafters intended that payments that did not fit that description – those that do not secure a material advantage – would not be proscribed.

23. Canada attempts to avoid this compelling logic by arguing that the maxim must be applied with caution. Canada quotes from a decision of an English court which stated that "the exclusio [i.e., the thing not expressly mentioned] is often the result of inadvertence or negligence, and the maxim ought not to be applied . . ."[21] This concern regarding the application, though no doubt valid, is not present here. It is impossible that the *exclusio* in this case was a result of inadvertence or negligence. To the contrary, the history of the first paragraph and the "material advantage" clause – the *expressio* in this case – makes clear that the clause was deliberately added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been 'secured.'"[22]

24. The language that now comprises the first paragraph of item (k), *without* the material advantage clause, had its origins in rules adopted in 1958 by the Organization for European Economic Cooperation (the "OEEC"), the predecessor of the OECD, which prohibited:

> (g) The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;
>
> (h) The government bearing all or part of the costs incurred by exporters in obtaining credit.[23]

25. These provisions were included *verbatim* in a 1960 Report of a GATT Working Party on Subsidies as examples of export subsidies.[24] Subsequently, they provided the basis for the Illustrative List that eventually was included in the Tokyo Round Subsidies Code. It is significant, however, that

[20] *United States v. Germany*, 7 R.I.A.A. 91, 111 (1924) (the *Life Insurance Claims* arbitration).
[21] Colquhoun v. Brooks, 21 QBD 52, 65.
[22] *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R (2 August 1999), ("Appellate Body Report"), para. 20.
[23] John E. Ray, Managing Official Export Credits – The Quest for a Global Regime, Institute for International Economics (1995), at 35 (Exhibit Bra-11).
[24] BISD 9S/185 (Report adopted on 19 November 1960).

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in their first appearance in a GATT document, and for the next 18 years, these provisions contained no material advantage clause.

26. Meanwhile, the *OECD Arrangement* was agreed upon in 1978, close to the 1979 conclusion of the Tokyo Round.[25] This presented a conflict. The *Arrangement* expressly permitted governmental action with regard to export credits – interest rate support, for example – that would fall within the definition of an export subsidy in the 1960 Working Party Report and Article XVI of GATT, which were the basis of the contemporaneous Tokyo Round negotiations. Gary Hufbauer, one of the Tokyo Round negotiators, in recounting this history, noted that, "many countries were unwilling to condemn as export subsidies those practices condoned in the OECD."[26] An exception, therefore, was inserted in the Code, and what is now the second paragraph of item (k) – the safe haven clause for practices that conform to the interest rates provisions of the *Arrangement* – was added.[27] Initially, this was all the Tokyo Round negotiators did. They did not add a material advantage clause.

27. On 10 July 1978, an *Outline of an Arrangement*, prepared by the delegations of Canada, the European Communities, Japan, the Nordic countries, and the United States, was circulated to the Sub-Group on Subsidies and Countervailing Measures of the Negotiating Group on Non-Tariff Barriers.[28] This Sub-Group comprised the GATT negotiators whose efforts produced the Tokyo Round Subsidies Code. The draft contained a description of an Annex A, which would set forth an illustrative list of export subsidies:

> A list of export subsidies illustrative of the obligations in GATT Article XVI:4, as supplemented by the Arrangement. In this connexion, work should build upon the 1960 Illustrative List, taking into account other work on this subject undertaken in the GATT.[29]

28. This description explicitly takes account of the *OECD Arrangement*, but does not mention a material advantage clause which, as of that date, had not appeared in any previous iteration of the Illustrative List, either in the OECD or in GATT. The first appearance of the material advantage clause in a GATT document did not occur until 19 December 1978, some 20 years after the other relevant language was included in the first Illustrative List of the OEEC. This document, also an Outline of an Arrangement, contained the language that was included in the Tokyo Round Subsidies Code and eventually became Item (k):

> The grant by governments (or special institutions controlled by [and/or acting under the authority of] governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed, or the payment by them of all or part of the costs incurred by exporters *or financial institutions* in obtaining credit, *insofar as they are used to secure a material advantage in the field of export credit terms*.[30]

29. Thus, sometime after deciding to include the OECD safe haven clause, the GATT negotiators then made two additional significant changes to the language contained in the 1960 Working Party

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[25] Ray, *supra*, at 40 (Exhibit Bra-11).

[26] GARY CLYDE HUFBAUER AND JOANNA SHELTON ERB, SUBSIDIES IN INTERNATIONAL TRADE 70 (Washington, D.C., Institute for International Economics 1984) (Exhibit Bra-12).

[27] Ray, *supra*, at 36-38 (Exhibit Bra-11).

[28] General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/ COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/168, 10 July 1978 (Exhibit Bra-13).

[29] *Id*. page 23.

[30] General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/ COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/210, 19 December 1978, page 26 (emphasis added) (Exhibit Bra-14).

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report. First, they added the phrase "or financial institutions," and second, they added the material advantage clause: "insofar as they are used to secure a material advantage in the field of export credit terms."

30. These additions were the last changes made in the language of item (k). They were made deliberately, and were intended by their drafters to have genuine meaning and effect. In Hufbauer's words, the material advantage clause was intended to provide "a weak injury test in the event of a departure from the basic GATT standard."[31]

31. This history makes clear that the *expressio* – the material advantage clause – was added intentionally as a restriction on the definition of a prohibited export subsidy. Accordingly, the *exclusio* – payments that do *not* secure a material advantage – cannot have been inadvertent, as Canada suggests. Instead, the *exclusio* must be given full effect to interpret the language as it was intended – which is to exclude from the definition of prohibited subsidy instances where no material advantage is secured.

(d) Footnote 5 Does Not Control the Meaning of the First Paragraph of Item (k)

32. Canada continues to rely on footnote 5 to the Agreement, which it claims is "particularly important" to Brazil's *a contrario* argument.[32] Footnote 5 provides that "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." Canada claims "it is impossible to reach a conclusion as to the existence of an *a contrario* exception without interpreting the language of footnote 5."[33]

33. Brazil does not dispute that footnote 5 directs the reader to Annex I of the SCM Agreement. But that is not at issue. Rather, the issue is whether the language of footnote 5 provides any elaboration as to which measures in fact are referred to in Annex I as not constituting export subsidies. Canada believes it does, based on its view of the meaning of the words "referred to." Canada would like to read the word "expressly" into the language of footnote 5. However, as the Article 21.5 Panel noted, the word "expressly" was dropped from an earlier draft of the language of the footnote, which apparently "broadened" its meaning.[34] Nevertheless, Canada offers the dictionary meaning of the phrase "refers to" as "direct to . . . by drawing attention to" and synonyms such as "mentioned, cited, named."[35] Canada's problem is that none of these definitions is in any way inconsistent with an *a contrario* interpretation of the material advantage clause. Thus, if on review of the ordinary meaning of the language of the first paragraph, the Panel were to conclude that an *a contrario* interpretation of that language is appropriate, it would be entirely proper to consider payments that do not secure a material advantage as a "measure referred to in Annex I as not constituting [an] export subsid[y]" within the meaning of footnote 5. In short, nothing in the language of footnote 5 determines the plain meaning of item (k) first paragraph. To the contrary, that paragraph must be interpreted based on its own provisions and according to its own ordinary meaning and purpose. Once item (k) is given such an interpretation it will accord naturally with the language of footnote 5.

34. Canada attempts to avoid this analysis by bolstering the language of footnote 5, which it describes as an "explicit" exclusionary clause. But footnote 5 is not explicit in the sense used by Canada. It does not describe measures "*specifically*" or "*directly*" referred to in Annex I. Instead, it simply describes, in Canada's own words, "measures *mentioned* or *draw[n] attention to*" in Annex I.[36]

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[31] HUFBAUER, *supra*, note 26 at 70.
[32] Canada First Submission, paras. 47-55.
[33] *Id.*, para. 50.
[34] Original 21.5 Report, paras. 6.39-40.
[35] Canada First Submission, para. 52.
[36] *Id.*, para. 52.

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Again, it does not make sense to say that item (k) "draws attention to" payments that secure a material advantage and at the same time allege that it says nothing at all about payments that do *not* secure a material advantage. For this reason also, Brazil's interpretation is more consistent than Canada's with the statement of the Appellate Body in *United States – Foreign Sales Corporations* (to which Canada cites) that footnote 5 applies "where the Illustrative List *indicates* that a measure is not a prohibited subsidy."[37] It is precisely Brazil's position that by limiting the description of prohibited subsidies to payments that secure a material advantage, item (k) *indicates* that payments that do not do so are not prohibited subsidies.

35. Canada seeks to elevate the importance of footnote 5 to avoid the ordinary meaning of the material advantage clause of item (k). In the words of the Appellate Body in its original opinion in this case, "[a]s a matter of treaty interpretation, this cannot be so."[38] Instead, the Panel should follow the Appellate Body's approach: "examine the terms of the provision at issue, in this case, the 'material advantage' clause of item (k). We look first to the ordinary meaning of the language used."[39]

36. Canada's arguments regarding the impact of footnote 5 on the interpretation of Annex I are undermined by the logical interpretation of other provisions of the Annex. In this regard, item (i) specifies that the remission by governments of import charges, "in excess of those levied on imported inputs," are prohibited export subsidies. *A contrario*, of course, this must mean that the remission of import charges *not* in excess of those levied on imported inputs are *not* prohibited. As with the material advantage clause of item (k), no other interpretation is reasonable. If the negotiators had intended that the remission by governments of all import charges were prohibited subsidies, item (i) simply would have been drafted with a period, or full stop, after the word "charges."[40]

37. In conclusion, the denial of an *a contrario* interpretation to the material advantage clause would effectively render the clause superfluous. Without an *a contrario* interpretation, the clause is totally unnecessary in the first paragraph of item (k). This reduction of the material advantage clause to inutility is not permissible under the customary rules of interpretation of public international law.[41] Moreover, this inutility is not avoided by reference to footnote 5, which says nothing that qualifies the meaning of the text of the material advantage clause.

38. In its opinion in the Article 21.5 proceeding, the Appellate Body stated that it "would have been prepared to find" that an *a contrario* interpretation of the material advantage clause could be used to justify PROEX payments, had Brazil been able to prove that PROEX interest rate support payments did not confer a material advantage.[42] Thus, as a legal matter, the Appellate Body appears to believe that the first paragraph of item (k) may be read *a contrario* to permit a payment that is not used to secure a material advantage. This Panel should reach the same conclusion.

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[37] *Id.*, para. 53, citing *United States – Tax Treatment for "Foreign Sales Corporations,"* WT/DS108/AB/R (20 March 2000), para. 93 (emphasis added).

[38] Appellate Body Report, para. 179 and footnote 110, quoting *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (29 April 1996) (Adopted 20 May 1996), pg. 23 ("[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility").

[39] Appellate Body Report, para. 177.

[40] Brazil does not allege, and the Panel need not decide, that *every* item in the Illustrative List is susceptible to an *a contrario* interpretation.

[41] Appellate Body Report, para. 177.

[42] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46AB/RW (21 July 2000) ("Article 21.5 AB Report"), para. 80.

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3. PROEX III Payments Are "Payments" within the Meaning of the First Paragraph of Item (k)

39. Canada argues that PROEX III payments are not payments within the meaning of item (k) first paragraph. Canada draws a distinction between *providing* export credits, and payment of all or part of the costs of *obtaining* export credits.[43] This distinction forms the basis of Canada's arguments that PROEX III interest rate support payments are not "payments" within the meaning of the first paragraph. As explained below, this distinction makes no sense in the context of the market for regional jet aircraft. Moreover, if PROEX payments do not fit the definition of "payments" contemplated by item (k), Canada fails to explain exactly what kind of payments in the export credit field the drafters of this provision had in mind.

40. The original Article 21.5 Panel stated that, "a payment by Brazil that allowed a Brazilian financial institution to provide export credits" could be permitted under the first paragraph of item (k) provided no benefit is conferred.[44] This would appear to contemplate that PROEX payments fell within the definition of the first paragraph, in that by enabling the Brazilian financial institution to *provide* export credits, it first had to pay the costs of *obtaining* the credits. This interpretation also would appear to be consistent with the ordinary meaning and purpose of the definition of "payments" in the first paragraph.[45] Canada has failed to provide any reasoned explanation why this interpretation is not appropriate.

41. The distinction between "obtaining" and "providing" credits fails for another reason. The first paragraph of item (k) refers, *inter alia*, to costs "incurred by exporters or financial institutions in obtaining credits." The language clearly contemplates that exporters and financial institutions "obtain" credits. But neither wants to "obtain" credits simply to hoard them. Both "provide" to export purchasers the credits they previously "obtain." That is the reason they are obtained. The fact that an exporter or a financial institution also provides credits does not mean that it does not obtain them at a cost.

42. The first sentence of item (k) first paragraph supports this conclusion. It deals with the grant by governments "of export credits at rates below those which they actually have to pay for *the funds so employed*." Just as the use of the term "export credits" in the first part of the paragraph justifies an interpretation of "credits" as meaning the same in the latter part, so also the reference to "the funds so employed" in the first part justifies an interpretation of the word "obtaining" in the second part as meaning "obtaining the funds [that are] so employed" when they are subsequently provided to export purchasers. This suggests that the language was intended to cover the provision of export credits to borrowers at a cost that is less than the borrower might otherwise have to pay. PROEX reduces the net interest rate to the borrower at a cost to the provider. The language of the first paragraph appears to have been designed to address precisely this type of programme.

43. Canada argues that Embraer itself does not provide export financing, and that non-Brazilian financial institutions sometimes do so. While both of these statements are factually correct, the legal conclusions reached by Canada do not follow. Canada's analysis fails totally to distinguish between situations in which the lender is a financial institution *outside* Brazil and situations in which the lender is a financial institution *inside* Brazil. Both in the original proceeding and in the Article 21.5 proceeding, Brazil carefully distinguished between these two situations, and offered very different legal justifications for each.

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[43] Canada First Submission, paras. 67-69.

[44] Original 21.5 Report, para. 6.44 .

[45] THE NEW SHORTER OXFORD ENGLISH DICTIONARY 2130 (1993) (A "payment is "a sum of money paid").

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44. *When the lending institution is outside Brazil*, Embraer, the exporter, faces costs in obtaining for its customer a financial package that is competitive in the market. If it cannot obtain a competitive financial package for its customer, it would be forced to take other costly action such as paying for a commercially available loan guarantee at a high premium. *When the lender is inside Brazil*, it is the lender itself who must obtain the dollars on the market.[46] These separate justifications required separate analyses, a fact that Canada's arguments ignore. Moreover, while the question whether a payment is made to an institution inside or outside Brazil may have a bearing on the issue of material advantage, it has no bearing on the issue of payment. The payment is the same in either case.

45. Brazil risk is a genuine phenomenon that seriously handicaps financial institutions in Brazil in raising funds internationally, just as a similar risk handicaps comparable institutions in virtually all developing countries. The Article 21.5 Panel confirmed this, noting that, "developing countries' costs of borrowing are almost inevitably higher than those of developed countries."[47] It observed, in a footnote appended to this statement, that "[a]ccording to Brazil – and Canada has not challenged Brazil's assertion – Brazil's cost of borrowing as of 1 February 2000, based on 10-year bond yields – was more than twice that of Canada."[48]

46. Brazil justifies PROEX, when the lender is outside Brazil, on grounds that are totally different from those used to justify PROEX when the lender is inside Brazil. A conclusion that Brazil's justification in one instance must be rejected says nothing about Brazil's justification in the other instance. For all of these reasons, the Panel should conclude that payments under PROEX are "payments " within the meaning of the first paragraph of item (k).

4. PROEX III Does Not Secure a Material Advantage

47. The heart of Canada's argument is that even when the net interest rate for PROEX supported transactions does not fall below the CIRR, PROEX nevertheless is used to secure a material advantage in the field of export credit terms. Contrary to Canada's arguments, PROEX III payments do not confer a material advantage in the field of export credit terms on the recipient within the meaning of item (k) first paragraph.

48. Brazil already has noted that this position directly contradicts the approach taken by Canada in the previous stages of these proceedings, where Canada sought to require Brazil to limit PROEX to the CIRR, even though Canada took advantage of perceived loopholes (so-called "market window" operations) in the *Arrangement* to provide official support for transactions at rates that were below the CIRR. Thus, in its answers to the questions of the first Article 21.5 Panel, Canada unambiguously stated that "the relevant benchmark against which a net interest rate must be compared to determine whether a material advantage has been secured is CIRR."[49] This Panel should hold Canada to that statement.

49. In the first Article 21.5 proceedings in this matter, the Appellate Body stated that, to establish that PROEX payments are not used to secure a material advantage, Brazil must prove "*either* that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific 'market benchmark' identified in the original dispute as an 'appropriate' basis for comparison; *or*, that an alternative 'market benchmark is appropriate."[50] PROEX III stipulates that the net interest rates must

[46] Original 21.5 Report, Annex 2-3, para. 37 (emphasis added).
[47] *Id.*, para. 6.58.
[48] *Id.*, para. 6.58, footnote 56.
[49] *Id.*, page 89 (Canada's Response to Question 12 of the Panel)
[50] Article 21.5 AB Report, para. 67 (emphasis in original).

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be at or above the relevant CIRR.[51] Thus, PROEX III complies fully with the CIRR – the preferred benchmark of Canada, and one determined by the Appellate Body not to secure a material advantage.

50. Canada's present claim that the CIRR provides a material advantage does not withstand scrutiny. In the first Article 21.5 proceedings, Canada admitted that the CIRR was sometimes above market rates. Moreover, Canada asserted that when it offered official support at rates below the CIRR, it nevertheless was operating at market terms.[52] It is difficult to understand, therefore, how Canada can maintain that the CIRR is no longer an appropriate benchmark for determining whether or not PROEX III secures a material advantage.

51. Moreover, nothing in Canada's First Submission contradicts the evidence provided in Brazil's First Submission showing that the CIRR was intended to represent a market rate. Indeed, Brazil submitted evidence that, consistent with Canada's statements in the previous Article 21.5 proceedings, the CIRR presently is above the market rates, and that expert observers believe the CIRR may from time to time be higher than the market.[53]

52. Canada nevertheless argues that PROEX secures a material advantage because it does not reflect the rates available in the marketplace, which Canada claims demand "spreads" that put the rates available to buyers at or above the CIRR rates. This argument must fail, for several reasons. First, Brazil is entitled – indeed, effectively is required – to establish a benchmark rate and to use that rate as the benchmark in assessing applications for PROEX assistance. Canada's reaction to Brazil's decision to limit PROEX III equalization to the CIRR highlights the double standard Canada seeks to impose in these proceedings.

53. Canada also argues that PROEX III secures a material advantage because it does not comply with the other terms and conditions of the *Arrangement* governing the length of the loan and the amount of the financing. Brazil notes that it has explained in its First Submission how PROEX III complies with all applicable interest rate provisions of the *Arrangement* and therefore falls within the safe haven of the second paragraph of item (k). This includes compliance with the maximum financing amount of 85 percent of the transaction value, and with the maximum financing term of 10 years for regional jet aircraft. Thus, Canada errs in stating that PROEX III provides for 100 percent financing and an unlimited repayment period.[54] The terms of PROEX III, on their face, demonstrate that Canada's characterization of the measure simply is wrong.

54. Moreover, even though PROEX III by its terms is limited to 10 years, Canada is wrong to suggest that a longer term would necessarily mean that PROEX III secures a material advantage. In the previous Article 21.5 proceedings, the Panel indicated that the test of material advantage within the meaning of the first paragraph of item (k) differs from the safe haven of item (k) second paragraph, and does not require compliance with all of the provisions of the *OECD Arrangement*.[55]

55. By conforming to the CIRR, Brazil has established a minimum threshold that is transparent, and is set at rates that are, in the words of one expert, a "reasonable compromise in trying to formulate a proxy market rate."[56] As noted above, Brazil has no control over these rates or the methodology used to establish them. To the extent that the CIRR is a "proxy market rate," Brazil does not secure

[51] Resolution No. 002799, Art. 1, para. 1 (Exhibit Bra-1).

[52] Original 21.5 Report, page 82 (Canada's Response to Questions of the Panel).

[53] See David Stafford, *Wallen, Helsinki, Schaerer et. Al.: Some Major Achievements, Some Challenges to Meet*, in THE EXPORT CREDIT ARRANGEMENT, ACHIEVEMENTS AND CHALLENGES 1978-1998 (OECD, 1998) (First Submission of Brazil, at Exhibit Bra-5); Presentation by Mr. Fumio Hoshi, Director-General International Finance Policy Department, Japan Bank for International Cooperation, at the Eximbank 65th Anniversary Conference, May 2000 (First Submission of Brazil, at Exhibit Bra-6).

[54] Canada First Submission, para. 82.

[55] Original 21.5 Report, para. 6.87.

[56] See Stafford, *supra*, Exhibit Bra-5; Article 21.5 AB Report, para. 67.

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any advantage by providing equalization at the CIRR. Even if the market were to fluctuate slightly, Brazil does not secure a *material* advantage by providing equalization at this level. The ordinary market definition of "material" is "serious, important, of consequence."[57] Minor market deviations from the CIRR that are not "serious, important, of consequence" are not "material." The Appellate Body has noted that the term "material" cannot be read out of the language of the first paragraph.[58] Canada's analysis would do exactly that.

56. Finally, Canada states that the provisions of Resolution 002799, which it describes as providing for rates "in accordance with" the CIRR, do not necessarily prohibit PROEX III from supporting a minimum interest rate below the CIRR.[59] Brazil notes that the translation of Resolution 2799 requires interest rates "complying with" the CIRR.[60] Brazil reiterates that the minimum interest rate specified in PROEX III is the CIRR. This is the purpose of the Resolution. However, the CIRR is not necessarily the ceiling – Article 8, para. 2 of Resolution 002799 provides that the Committee on Export Credits is to use "as reference the financing terms practiced in the international market."[61] This provides additional assurance that PROEX III support will not secure a material advantage.

57. For these reasons, the Panel should conclude that PROEX III does not secure a material advantage in the field of export credit terms and that Brazil has therefore affirmatively shown that PROEX III is not a prohibited subsidy within the meaning of the first paragraph of item (k) of the SCM Agreement.

C. CANADA HAS FAILED TO SHOW THAT PROEX III DOES NOT QUALIFY FOR THE "SAFE HAVEN" OF THE SECOND PARAGRAPH OF ITEM (K)

58. In its First Submission of 16 March 2001, Brazil explained that PROEX III qualifies for the "safe haven" of the second paragraph of item (k) of the Illustrative List in Annex I of the SCM Agreement, and is therefore not a prohibited export subsidy within the meaning of the SCM Agreement. Brazil explained that PROEX III conformed to the minimum interest rate provision of the *Arrangement* – by requiring that all PROEX equalization comply with the CIRR – and also to the provisions governing the term and amount of financing – whether judged against the provisions of the 1992 *Arrangement* (as Brazil believes proper) or the provisions of the 1998 *Arrangement*.

59. As noted above, Canada does not in its First Submission address the issue whether PROEX III qualifies for the safe haven of the second paragraph. Instead, Canada addresses only the issues raised by item (k) first paragraph. However, the two paragraphs are not coterminous, and Brazil's arguments regarding the second paragraph are not undermined by Canada's arguments regarding the first paragraph.

60. The three points at issue under the first paragraph do not arise under the second paragraph. There is no need for an *a contrario* interpretation of the second paragraph, which states affirmatively that "if in practice a Member applies the interest rate provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement." Accordingly, Canada's arguments regarding the *a contrario* issue are not relevant to the issue whether PROEX III qualifies for the safe haven of the second paragraph of item (k).

61. Similarly, the "payment" issue raised by Canada regarding the first paragraph of item (k) is irrelevant in the context of the second paragraph. Regardless of whether PROEX III meets the

[57] The New Shorter Oxford Dictionary 1713-14 (1993).
[58] Appellate Body Report, para. 177.
[59] Canada First Submission, para. 71.
[60] First Submission of Brazil, para. 7, Exhibit Bra-1.
[61] Id.

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definition of "payments" within the first paragraph, PROEX III is indisputably an "export credit practice" as contemplated by the second paragraph of item (k). As the Article 21.5 Panel in *Canada – Aircraft* stated, "we can conceive of no basis to consider any practice associated with export credits as *a priori* not constituting an 'export credit practice' in the sense of the second paragraph of item (k)."[62] It is not disputed that Brazil's practice of providing interest rate support is an "export credit practice" of the kind long practiced by various members of the OECD.[63]

62. Finally, the issue whether the PROEX III payments are used to "secure a material advantage in the field of export credit terms" does not arise under item (k) second paragraph. There the issue is not whether the PROEX interest rate support payments are used to secure a material advantage, but rather whether Brazil complies with the interest rates provisions of the *Arrangement*. Canada's arguments that the CIRR may not accurately reflect the market[64] are quite simply irrelevant to the issue whether PROEX III, by its terms, conforms with the interest rate provisions of the *Arrangement* and therefore qualifies for the safe haven of the second paragraph of item (k).

V. CONCLUSION

63. For all of the reasons given in Brazil's First Submission and in this Submission, the Panel should conclude that:

(a) Canada has not sustained its burden of proving that PROEX III is a subsidy within the meaning of Article I of the SCM Agreement;

(b) Alternatively, even if PROEX III were considered to be a subsidy, it complies with the interest rates provisions of the relevant *OECD Arrangement* and is, therefore, covered by the "safe haven" of item (k) second paragraph;

(c) Further, even if PROEX III were considered to be a subsidy, and even if it were not eligible for the safe haven of item (k) second paragraph, PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph.

[62] Canada – Measures Affecting the Export of Civil Aircraft – Recourse by Brazil to Article 21.5 of the DSU, Report of the Panel, WT/DS70/RW (9 May 2000), para 5.81.

[63] Ray, *supra*, at pp. 22-24.

[64] The OECD members clearly intended that the CIRR would indeed reflect market rates. Members that are not participants in the *OECD* Arrangement, such as Brazil, have no control over these rates and should not be punished when they comply with the rates only to have OECD participant Members decide that the CIRR rates do not suit their purpose after all.

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LIST OF EXHIBITS

BRA-10. Steve Cutts and Janet West, "The Arrangement on Export Credits," *The OECD Observer* No. 211, April/May 1998

BRA-11. JOHN E. RAY, MANAGING OFFICIAL EXPORT CREDITS – THE QUEST FOR A GLOBAL REGIME, Institute for International Economics (1995)

BRA-12. GARY CLYDE HUFBAUER AND JOANNA SHELTON ERB, SUBSIDIES IN INTERNATIONAL TRADE 70 (Washington, D.C., Institute for International Economics 1984)

BRA-13. General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/168, 10 July 1978

BRA-14. General Agreement on Tariffs and Trade, Multilateral Trade Negotiations, Group "Non-Tariff Measures," Sub-Group "Subsidies and Countervailing Duties," SUBSIDIES/COUNTERVAILING MEASURES, Outline of an Arrangement, MTN/NTM/W/210, 19 December 1978

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ANNEX B-3

ORAL STATEMENT OF BRAZIL

(4 April 2001)

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1. Mr. Chairman, Brazil welcomes this opportunity to present its views to the Panel, and to answer any questions that you may have. We very much appreciate your continuing efforts in this complicated and prolonged dispute, and we hope that this review will be the end of your – and our – work on this matter.

2. The issue before you is a straight forward legal issue: is PROEX III – by its terms, on its face, as a matter of law – consistent with Brazil's obligations under the *Agreement on Subsidies and Countervailing Measures*?

3. In its First Submission, Brazil has presented three reasons why PROEX III is in conformity with the Subsidies Agreement:

> *First*, PROEX III does not confer a benefit, and therefore is not a subsidy within the meaning of Article I of the Agreement;
>
> *Second*, totally apart from the question of benefit, PROEX III is entitled to the "safe haven" of the second paragraph of item (k) of Annex I to the Agreement;
>
> *Third*, totally apart from the question of benefit and the safe haven, PROEX III does not secure a material advantage in the field of export credit terms, within the meaning of the first paragraph of item (k).

I. CANADA HAS NOT ESTABLISHED THAT PROEX III IS A SUBSIDY

4. Let me first address the question of subsidy – the benefit issue. It is for Canada to prove, by positive evidence, that PROEX III, on its face, confers a benefit and therefore constitutes a subsidy. It

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is not Brazil's obligation to prove the negative, to prove that PROEX III does not confer a subsidy. Canada has failed to sustain its burden of proof on the question of benefit, and the efforts of the European Communities and the United States, as third parties, to support Canada on this question are not successful.

5. Canada's "proof" as to benefit consists of several descriptive statements about PROEX I and PROEX II, which are not relevant to this proceeding, and allegations concerning Brazil's development bank, Banco Nacional de Desenvolvimento Economico e Social ("BNDES"). We are somewhat confused by Canada's reference to BNDES, Mr. Chairman, and by the point Canada attempts to make. BNDES has never been within the terms of reference of this dispute. In any event, statements about PROEX I, PROEX II, or BNDES are not evidence establishing that PROEX III confers a benefit.

6. In the absence of evidence, Canada resorts to faulty logic. For example, at paragraph 12 of its Second Submission, Canada argues that "PROEX III, like its predecessor schemes, is constructed as a buy-down of interest rates that have already been freely negotiated by the recipients – Embraer's customers – in the marketplace." Canada then concludes that "*any* buy-down below those freely negotiated rates will *necessarily* result in net interest rates on terms more favourable than those available to Embraer's customers in the market."

7. It is misleading, if not inaccurate, to say that PROEX III is a buy-down of interest rates that have already been freely negotiated by the recipients in the market place. PROEX III is limited, on its face, to a maximum payment of 2.5 percent, with a minimum rate of the CIRR, and is, further, subject to being "compatible with [financing costs] practiced in the international market." PROEX is *not* a system, as Canada seems to suggest, whereby the customer negotiates for the most favorable rate, and then receives a "buy-down" of 2.5 percent. To the contrary, PROEX is part of the transaction itself – a transaction that is *limited* by the market, as reflected in the CIRR, a 10-year term, and 85 percent maximum financing, and by the requirement that the resulting transaction be compatible with the international market.

8. Thus, PROEX most certainly does *not* "*necessarily* result in net interest rates terms more favourable than those available to Embraer's customers *in the market*." Whether the resulting net interest rate terms are or are not more favourable than those a customer could obtain "in the market" is a question of fact. PROEX III does not provide for rates that are more favorable than those a customer could obtain "in the market." The theoretical possibility that more favourable terms could be offered in some future transaction is not evidence that they would be offered, and is not relevant to the question of what PROEX III, on its face, as a matter of law, provides.

9. The Panels in the *Canada – Aircraft* cases, for example, pointed out that the fact that Canada's export credit agency, the Export Development Corporation – "EDC" – *could* provide financing on a preferential basis, does not mean that it *would* do so. Those Panels also pointed out that the mere fact that Canada's Technology Partnerships Canada *could* provide a subsidy contingent on export, does not mean that it *would* do so. Likewise, the theoretical possibility that PROEX III *could* provide terms more favorable to a customer than could be obtained in the market does not mean that PROEX III *would* so provide.

10. Canada claims that financing being provided by BNDES – which, as I have already noted, is not and never has been within the terms of reference for this dispute – is being offered "in conjunction with PROEX III." There are several problems with this claim. First, it is simply irrelevant whether BNDES is involved in financing Brazilian aircraft transactions. The second is that Canada's "evidence" in support of its claim is a statement by a Bombardier employee reporting on what an airline official allegedly told the Bombardier employee that Embraer allegedly offered to the airline.

11. In law, this kind of evidence is what is referred to as "hearsay" – that is, it is the mere repetition of what someone claims to have heard another say. In this case, what Canada is offering is

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"triple hearsay" – (1) Canada's statement of what a Bombardier employee said about (2) what an airline official said about (3) what Embraer said.

12. Now, Brazil is willing to acknowledge, Mr. Chairman, that just because evidence is hearsay, even triple hearsay, does not necessarily mean that it is always wrong. But Brazil does suggest that the possibility for error in such a lengthy transmission is high, particularly given the fact that an airline, in this situation, might be said to have an incentive to exaggerate in its statements to one potential vendor about what another potential vendor is offering.

13. Finally, there is an overriding reason why this evidence is not relevant. It is at most evidence of what an *Embraer sales person* said. The Government of Brazil cannot take responsibility for the alleged statements of Embraer sales persons.

14. Canada concludes its "evidence" on benefit with the statement, in paragraph 17, that "Canada demonstrated in its First Submission that the CIRR alone, divorced from the other terms and conditions of the OECD Arrangement such as the ten-year term limit and the limit on financing to 85 percent of the value of the contract, in no way reflects market realities. Brazil has not rebutted Canada's evidence and submissions on this point."

15. This is a rather surprising statement, Mr. Chairman. As I thought we made clear in our First Submission, PROEX III is not "divorced" from the 10-year term limit and the limit on financing to 85 percent of the value of the contract. PROEX III specifically includes these requirements.

16. Indeed, if another piece of Canada's hearsay evidence is to be believed, Brazil is financing considerably less than 85 percent of the value of the contract. Canada's Exhibit 27 is more triple hearsay – a statement of (1) what another Bombardier employee said that (2) another airline official said about (3) what Embraer allegedly offered. This evidence shows, however, that the amount of the financing allegedly offered by Embraer was far less than 85 percent. This hardly seems to be a "benefit," even under Canada's definition.

17. Canada is also incorrect to say that the only change in PROEX III is to e nsure compliance with the CIRR. To the contrary, PROEX III now also requires that the Committee on Export Credits use "as reference the financing terms practiced in the international market."

18. In paragraph 10 of its Second Submission, Canada accused Brazil of failing to recognize the "critical distinction" between "benefit" and "material advantage." In paragraph 17 of that same submission, Canada states that paragraphs 87 to 90 of its First Submission demonstrate that PROEX III confers a benefit. However, the heading to the section of Canada's First Submission that contains paragraphs 87 to 90 refers only to "material advantage." It does not refer to "benefit." Thus, to employ the "critical distinction" between "benefit" and "material advantage," paragraphs 87 to 90 of Canada's First Submission do not bear upon the issue of "benefit" at all.

19. More importantly, paragraphs 87 to 90 of Canada's First Submission do not contain any factual evidence regarding PROEX III. They contain only assertion and argument. The only one of those paragraphs remotely referring to anything specific is paragraph 88, which asserts that the CIRR "cannot be conclusive on the issue of material advantage because it does not … take into account other aspects of the transaction, (*i.e.*, maturity, the loan-to-asset value or minimum cash payment to be made, etc.) and the creditworthiness of the borrower."

20. But PROEX III does take these factors into account, Mr. Chairman. By its terms, PROEX III has a 10-year maximum repayment term. By its terms, PROEX III is available only for 85 percent of the value of the transaction. By its terms, PROEX III transactions must be compatible with the terms available in the international market, which includes the creditworthiness of the borrower. Canada simply has not carried its burden of proving the contrary.

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21. The arguments of the third parties do not advance Canada's case. The European Communities, at paragraph 12 of their submission, repeat Canada's claim that PROEX is used to reduce a commercially negotiated contract by 2.5 percent. I have already pointed out why this reasoning is wrong. At paragraph 14, the European Communities claim that the CIRR is a rate that would be available to borrowers only in the presence of a guarantee or other security. But all transactions involving aircraft are secured – by the aircraft themselves, if not by other means, such as residual value guarantees.

22. The United States, at paragraph 11, "wishes to note only that interest rate support at or above CIRR does not, *ipso facto*, mean no benefit is conferred." This formulation reverses the issue. It is not for Brazil to show that no benefit is conferred. It is for Canada to show, affirmatively and by positive evidence, that a benefit *is* conferred.

23. The United States, at paragraph 12, also raises the point of the creditworthiness of the borrower, a subject I already have addressed. To support its position, in paragraph 13 the United States refers to Article 14(b) of the Agreement. However, as a matter of substance, PROEX III does not provide a loan below a comparable commercial loan which the borrower could actually obtain on the market, as the United States claims. PROEX III, by its terms, must be compatible with the market. Neither Canada, nor the United States, nor the European Communities has provided any evidence to support their claims. On a more technical point, Article 14 is part of Part V of the Agreement, dealing with countervailing duties. The *chapeau* of Article 14 specifies that it applies only "For the purpose of Part V …" By definition, therefore, it does not apply to Part I of the Agreement, dealing with the existence of a subsidy.

II. BRAZIL QUALIFIES FOR THE "SAFE HAVEN" IN ITEM (K) SECOND PARAGRAPH

A. THE 1992 VERSION OF THE *OECD ARRANGEMENT* IS THE RELEVANT VERSION

24. I would like to turn now, Mr. Chairman, to the safe haven provisions of t he second paragraph of item (k). While PROEX III does not confer a benefit, it also applies in practice the interest rates provisions of the *OECD Arrangement on Export Credits* that are referred to in the second paragraph. PROEX III therefore qualifies for the safe haven.

25. The first issue presented by the second paragraph is: What version of the *Arrangement* applies? Is it the version that was in effect at the time it was incorporated by reference into the SCM Agreement, or is it any future version that the OECD issues?

26. In its First Submission, Brazil has demonstrated that the version of the *Arrangement* that is relevant to this dispute is the 1992 version, the version that was in effect at the time of adoption of the SCM Agreement. I will not repeat those arguments in detail, but let me just mention the main points.

27. Following Article 31 of the Vienna Convention, Brazil first addressed the relevant text of the second paragraph. Brazil pointed out that the second paragraph refers to a "successor undertaking which *has been* adopted" by the original Members of the *Arrangement*. The crucial phrase, "has been," is in the present perfect tense and refers to a time present, not to a future time. It says "has been," not "will be" or "may be." Therefore, the reference is to the version in existence at the time it was incorporated by reference into the SCM Agreement.

28. Second, Brazil examined the context of the second paragraph, a context that includes the detailed requirements for amending any of the WTO agreements, including the SCM Agreement, and a context that provides, through Article 3.2 of the Dispute Settlement Understanding, that rulings and recommendations of the Dispute Settlement Body "cannot add to or diminish the rights and obligations" of Members. Brazil also pointed out that Article 30 of the Vienna Convention provides

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that an existing treaty *may* be subject to the terms of a later treaty, but only when the terms of the existing treaty "specify" that this is the case.

29. Further, as part of the context, Brazil referred to the fact that, in the case of Members that incorporate the WTO Agreements into their domestic law, serious constitutional questions would be raised if later versions of the *Arrangement* were included in the second paragraph of item (k). This would amount to a *carte blanche* to non-citizens to change the domestic law of these Members. It is not only Brazil that would be in this position, Mr. Chairman. A substantial number of Members incorporate WTO Agreements directly into their domestic law.

30. Third, Brazil noted the object and purpose of the SCM Agreement. While the Agreement does not, on its face, contain a statement of its object and purpose, there can be little dispute that these include establishing disciplines for the conduct of Members in providing subsidies – disciplines that are clear, transparent, and fair.

31. There is nothing clear, transparent or fair about an interpretation of the second paragraph that would permit a small group of developed countries to change the terms of the SCM Agreement anytime they choose, in whatever way they choose. Certainly there is nothing fair about an interpretation that, for example, would allow Canada and the other participants in the *Arrangement* to provide that interest rate support may not be used for regional aircraft. Canada, however, seems to think there is nothing wrong with this.

32. This is not a theoretical risk, Mr. Chairman. I will have more to say about the question of spare parts shortly, but for now let me just note that the handling of spare parts by the participants in the *Arrangement* is a clear example of how Canada would have the system work. Under the 1992 version of the *Arrangement*, its spare parts provisions did not apply to regional aircraft. Under the 1998 version, they do apply – and Canada is citing those provisions as grounds for excluding Brazil from the safe haven of the second paragraph.

33. The sequence of events in this dispute and in the change in the terms of the *Arrangement* is very significant. Let's assume, for purposes of analysis of these events, that the spare parts provision of the *Arrangement* is an interest rate provision, and that PROEX III does not in practice apply that provision – (as I will explain later, Brazil does not agree with either of these assumptions).

34. In 1995, when the SCM Agreement was adopted, Brazil would not have had to apply the spare parts provision in order to be in compliance with the second paragraph, since the provision explicitly did not apply to regional aircraft in the version of the *Arrangement* in effect at that time. In 1996, when Canada began this dispute with its request for consultations, Brazil still would not have had to apply the provision, since the 1992 version remained in effect.

35. In 1997, while Brazil and Canada were engaged in negotiations with a view to settling these disputes without formal proceedings, Canada was also engaged in negotiating a new version of the *Arrangement* which came into effect in 1998, the year this case began. Brazil had no knowledge of these OECD negotiations or of their results. Brazil had no knowledge that the rules Canada – as well as the EC and the US – say apply to Brazil under the second paragraph had been changed, by, among others, Canada, the EC, and the United States.

36. Even today, Mr. Chairman, Brazil understands that the OECD participants are discussing rules governing export credits that employ floating rates that would be added to the *Arrangement*. Brazil's understanding, I must emphasize, does not come from any official notification, but merely from press reports. Brazil, the WTO, and non-participants are not notified whether the participants in the *Arrangement* are discussing floating rates, or any other issue, and have no say in formulating the rules that Canada argues would be binding on all of them.

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37. From further press reports, Mr. Chairman, Brazil has learned that environmental and labour standards are on the agenda of the participants in the *Arrangement*. The Panel should not adopt an interpretation of the second paragraph of item (k) that would permit participants in the *Arrangement* to smuggle environmental or labour standards into "interest rates provisions" by, for example, permitting concessionary financing for aircraft or other products that are "environmentally friendly" or that are made under "fair" labour standards.

38. These events led to the fourth point Brazil made on the question of which version of the *Arrangement* is relevant. Brazil referred to Article 32(b) of the Vienna Convention, which provides that an interpretation that "leads to a result which is manifestly absurd or unreasonable" should be avoided. I shall have more to say about this in a moment. First, let me deal with the replies of Canada and the third parties to Brazil's first three points – the text, the context, and the object and purpose of the relevant treaty language.

B. THE ARGUMENTS OF CANADA, THE EC AND THE US DO NOT REBUT BRAZIL'S ARGUMENT THAT THE 1992 VERSION OF THE *OECD ARRANGEMENT* IS RELEVANT

39. What is Canada's answer to these arguments? First, Canada argues that the phrase "has been" refers to the "time regarded as present" when the financing in question takes effect, not when the *Arrangement* was incorporated into the SCM Agreement. Thus, Canada views "has been" as a perpetually moving goal post that will always be in the present tense. Canada's interpretation requires the conclusion that the negotiators adopted this convoluted approach instead of saying "will be adopted" or "may be adopted." There is no justification for such an interpretation.

40. Canada makes much of the fact that the second paragraph refers to a successor undertaking that has been adopted by the *original* 12 Members of the *Arrangement*. Brazil is happy to concede this point. Brazil had suggested, in its First Submission, that under Canada's approach the 23 participants in the *Arrangement* would have the power to change the terms of the SCM Agreement for the entire 140-plus Membership of the WTO. We are now informed that the situation is worse than that, and that if Canada and the EC and the US have their way, it will take only 12 participants in the *Arrangement* to make the change, 12 that include, by coincidence, Canada, the US and many Member States of the EC.

41. Canada also makes much of the fact that the text of the second paragraph appears in the 1979 GATT Subsidies Code. This is true, but it begs the question of which version applies to the WTO. In fact, it also begs the question of which version applied in GATT, since that issue was never presented to a GATT panel or to the CONTRACTING PARTIES for interpretation.

42. Canada concludes its rebuttal to Brazil's argument by stating that the drafters could have referred to the 1992 version, but did not do so, and that the *Canada-Aircraft* Article 21.5 Panel assumed that the 1998 version applied. Both of these statements are accurate, but they hardly resolve the issue.

43. What the drafters *could* have said does not address the meaning of what in fact they did say. They said, "has been" adopted – in the present perfect tense, meaning at a time present on 1 January 1995. As to what they *could* have said, I have already noted they could have said "will be" adopted or "may be" adopted, if that is what they meant. They did not use those terms – they said "*has been*."

44. Brazil notes that the Spanish and French versions of the SCM Agreement support the argument that item (k) refers to a situation that occurred before 1 January 1995. The "*has been adopted*" expression is found in the Spanish text in a past tense construction (*pretérito perfecto de subjuntivo*): "*haya sido aceptado*." Similarly, the French text uses the *passé composé* formulation: " *a été adopté*." It is evident that both texts, in using the past tense formulation, support Brazil's interpretation that a reference is being made to an event that happened before the Agreement entered

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into force. Once again, the drafters could have said "will be," or "may be" adopted. But they said "has been," "haya sido," "a été" adopted.

45. While the *Canada-Aircraft* Panel did discuss the 1998 version of the *Arrangement*, the question of which version was relevant was never at issue in that proceeding. The parties neither briefed nor argued the question. It was not discussed by the parties in their meetings with the Panel. Consequently, that Panel's assumptions, which are not binding on this Panel, were clearly for the purpose of addressing the issue before it. That issue is not the issue here.

46. This ends Canada's rebuttal to Brazil's arguments. Canada did not address Brazil's arguments regarding the context of the second paragraph, particularly in light of the amendment provisions of the WTO Agreement. Canada did not address the object and purpose of the SCM Agreement, which, at a minimum, includes clarity, transparency, and fairness. Canada did not address Brazil's argument under Article 32(b) of the Vienna Convention that an interpretation of the second paragraph that applies the 1998 and all later versions of the *Arrangement* leads to a result that is manifestly absurd and unreasonable.

47. Even assuming that the interpretation advocated by Canada is a possible interpretation of the "has been adopted" clause of item (k) second paragraph, there can be no dispute that, at the very least, the interpretation advocated by Brazil also is a possible interpretation of that clause. In such circumstances, the Panel should adopt the interpretation that avoids an absurd or unreasonable result. There is nothing in the text of item (k) that unequivocally specifies that WTO Members have given a few countries the right to *perpetually* legislate on behalf of the overwhelming majority of the membership.

48. The third parties do not salvage the situation for Canada. The United States repeats Canada's moving goal post argument, that "has been" refers to the time when an export credit is granted. The United States then goes on to say, at paragraph 7, that Brazil's interpretation is illogical "since it would suggest that a Member could grant export credits that are not in compliance with the most recent version of the *Arrangement*, and yet still benefit from the safe harbour in item (k)."

49. Brazil sees nothing illogical at all in this, Mr. Chairman. There is nothing illogical in an interpretation of the second paragraph to mean that all WTO Members are bound by the version of the *Arrangement* in effect at the time when it was incorporated into the SCM Agreement. If other Members – whether 23 of them or only the original 12 – wish to agree to stricter standards among themselves, then by all means they are free to do so. What is illogical, Mr. Chairman, is an interpretation of the second paragraph that would permit 12 or 23 OECD participants to change the terms of the SCM Agreement for all of the WTO Members.

50. The United States addresses Brazil's fairness point by referring to Article 27 and its temporary exemption from Article 3's prohibition for developing countries. Article 27 is hardly relevant to the interpretation of the second paragraph of item (k). Moreover, as the Panel knows, Article 27 has strict conditions for the exemption. Further, the exemption expires in two years, as the United States admits. Article 27 does not justify permitting 12 or 23 OECD participants to make rules for the entire WTO.

51. The United States further argues that the drafters of the Tokyo Round Subsidies Code, referring to the *Arrangement* as of 1 January 1979, and then to a "successor undertaking," clearly referred to a successor undertaking adopted after the Tokyo Round. Following the very same logic, however, the drafters of the Uruguay Round Subsidies Agreement should have referred to the *Arrangement* "as of 1 January 1995" and then to a "successor undertaking." They did not do that. Thus, what may have been clear and explicit in 1980 (and Brazil does not agree that it was) is at best unclear and ambiguous in 1995. In fact, the Tokyo Round Code came into effect on 1 January 1980, a full year after the 1 January 1979 effective date of the *Arrangement*. The reference in item (k) of the

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Tokyo Round Code to a "successor undertaking," in Brazil's view, is a reference to any possible further action within the OECD that might have been taken during that year.

52. The European Communities repeats the arguments raised by Canada and the US, and then adds two of its own. First, the EC argues that a change in the *Arrangement* does not amend the SCM Agreement since the text of the second paragraph itself is not changed by action in the OECD. This argument ignores the fact that, by virtue of the second paragraph, the *Arrangement* becomes a WTO text, just as the major intellectual property conventions are WTO text (in their 1995 versions only), and just as the Lomé Convention was found to be a WTO text by the Panel in *Bananas* because it was incorporated by reference into the WTO by means of a waiver. A change in these documents is a change in the relevant WTO text. Indeed, the EC concedes as much. At paragraph 30, the EC observes, "It may appear strange that the WTO Members should have agreed to apply a *text* that could only be changed by a small number of them." That it is a *text* that applies to the WTO that is being changed cannot be doubted.

53. I have already given a concrete example of how, under Canada' s theory, WTO obligations could be changed by a change in the *Arrangement* – the example of the spare parts provisions, which indisputably did not apply to regional aircraft in the version in existence on 1 January 1995, and which undisputedly do apply to regional aircraft in the current version. It is difficult to imagine a clearer example of an effective change in a WTO text. The fact that a text was adopted by the WTO, rather than being written by it, does not mean that it is not a WTO text.

54. The second argument made by the EC that differs from the arguments made by Canada and the US concerns other parts of the WTO Agreements that may authorize action by other international organizations. The EC points to Article XXI of GATT 1994, which allows Members to take action in pursuance of their obligations under the United Nations Charter for the maintenance of international peace and security. It also points to the TBT and SPS Agreements, which require Members to take international standards into account in setting their own standards. For that matter, the EC could have pointed to Articles XIV and XV of GATT 1994, which make certain decisions of the International Monetary Fund applicable to WTO Members.

55. These are all true and, equally, these are all irrelevant for the issue before you concerning the second paragraph of item (k).

56. Brazil has never disputed that international organizations *may* specify that the provisions or decisions of other treaties or organizations shall apply. The question is whether, in a particular instance, this has been done. In the case of giving overriding authority to the United Nations on matters of peace and security there can be little argument. GATT 1994 explicitly does so specify. It is worth pointing out, as well, that all Members of the WTO are eligible for membership in the UN, and most, if not all of them, are members. Similarly, GATT 1994 gives certain powers to the International Monetary Fund. These powers relate to balance of payments issues and were included in GATT 1947 in the context of the entire Bretton Woods system, which sought to combine freer trade with fixed exchange rates. There was an obvious need for cooperation among the organizations, as fixed exchange rates and import quotas established to protect those rates, could have had an obvious impact on the trading system. Again, it is worth pointing out that all Members of the WTO are eligible for membership in the IMF, and most, if not all of them, are members.

57. With regard to the TBT and SPS Agreements, the EC greatly overstates its case. It is true, as the EC states, that provisions of both Agreements call upon Members to base their standards on international standards. But it is also true that each of those provisions contains exceptions; Members are not required to follow international standards in order to comply with their WTO obligations. It is further true that other paragraphs of the same articles of those Agreements, cited by the EC, call upon WTO Members to play a full part in the international standard-setting organizations, which are open to membership by all nations. There are no comparable exceptions in the second paragraph of

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item (k), and all WTO Members most certainly are not called upon by that paragraph to play a full part in the OECD. Most WTO Members are not eligible to join the OECD and, even if eligible, any effort to join would be rejected.

58. Finally, the EC disagrees with Brazil's argument that changes in the *Arrangement* occur in a non-transparent manner. "The current version of the *OECD Arrangement* is publicly disclosed by the OECD, " the EC writes at paragraph 29, "and is available on the OECD web site." In a footnote to this statement, the EC is good enough to supply the internet address of the OECD.

59. Mr. Chairman, it is Brazil's position that Members of the WTO should not be required to check the web site of the OECD to learn what their WTO obligations are. An interpretation of the second paragraph of item (k) that results in such a requirement would, in the view of Brazil, be a result that is manifestly absurd and unreasonable within the meaning of Article 32(b) of the Vienna Convention. That interpretation should be rejected.

C. PROEX III COMPLIES WITH THE INTEREST RATES PROVISIONS OF BOTH THE 1992 AND 1998 VERSIONS OF THE *ARRANGEMENT*

60. Mr. Chairman, I will not take the time to repeat here the points made in Brazil's First Submission that demonstrate that Brazil is in compliance with the interest rates provisions of both the 1992 and the 1998 versions of the *Arrangement*. Instead, I will address only the points raised by Canada regarding Brazil's alleged failure to apply those provisions, in practice, through PROEX III. The third parties, I note, did not address the specifics of Brazil's argument concerning its application of the interest rates provisions, but rather addressed the broader question of what, in fact, are the interest rates provisions – a subject Brazil addressed in its First Submission.

61. At paragraph 50 of its Second Submission, Canada claims that PROEX III does not conform to what it calls two of the key requirements of both the 1998 and 1992 versions of the *Arrangement*. These are the requirements that support be limited to terms of 10 years and cover no more than 85 percent of the value of the goods financed.

62. But PROEX III, on its face, complies with these requirements. As Brazil noted in paragraph 9 of its First Submission, and as set out in Brazil's Exhibit 3, Directive 374 limits PROEX interest rate equalization to 85 percent of the value of the transaction, and establishes a maximum financing term of 10 years for regional jet aircraft. Thus, even by Canada's definition, Brazil in practice applies the interest rates provisions of the 1992 version of the *Arrangement* – and also applies at least these two provisions of the 1998 version as well.

63. The only other specific provisions of the 1998 version cited by Canada as not being addressed by PROEX III are Article 13 regarding repayment of principal and Article 29(a)-(c) of Annex III regarding spare parts. Let me address each of these in turn.

64. Article 13 of the *Arrangement* is entitled "Repayment of Principal." It does not even deal with interest – it deals only with principal. Even the *Canada-Aircraft* Panel, which took, in our opinion, an overly-broad view of the term "interest rates provisions" did not include Article 13 among them. Very plainly, Article 13 is not an interest rate provision.

65. The *Canada-Aircraft* Panel did identify Article 29(a)-(c) as among the interest rates provisions of the *Arrangement*. Brazil disagrees in part. Only the first sentence of Article 29(a) deals with interest rates, providing that the financing of spare parts "when contemplated as part of the original aircraft order may be on the same terms as for the aircraft." Brazil complies with this provision. To the minimal extent that spare parts are part of an Embraer order, PROEX III provides that they should be financed on the same terms as the aircraft – at the CIRR, with a maximum of 85 percent financing, for 10 years.

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66. However, the remainder of Article 29(a) as well as all of (b) and (c) do not deal with interest rates. The remainder of (a) deals with the size of the fleet of each aircraft type, which has nothing to do with interest rates. Similarly, paragraphs (b) and (c), like Article 13 of the *Arrangement*, deal with repayment terms. These also have nothing to do with interest rates.

67. Canada's remaining objections to Brazil's compliance with the 1998 version concerns Brazil's alleged failure to conform to Articles 16 through 19 of the *Arrangement*. Canada offers no evidence, argument or explanation for its contention, no doubt because Canada cannot do so. The contention is without merit.

68. Article 16 deals with the construction of CIRRs. Brazil does not construct CIRRs. It follows and applies them, particularly the CIRR constructed by the United States for the dollar. Article 17, at first glance, may appear more relevant since it deals with the application of CIRRs. However, Article 17(a) is not relevant because PROEX does not fix the interest rate. Article 17(b) also is not relevant, as it deals with floating rates and PROEX III, by its terms, applies only to fixed rates. Articles 18 and 19 concern cosmetic interest rates, which are at rates below the CIRR. PROEX III, by its terms, sets the CIRR as the minimum. In Brazil' s view the term "cosmetic interest rates" might better be applied to the so-called "market window" operations engaged in by Canada in order to evade its obligations under the *Arrangement* than to an interest rate, like PROEX III, that, on its face, is limited by the CIRR.

69. Brazil has addressed the question of just what are the interest rates provisions of the *Arrangement* in its First Submission. In Brazil's view, the term should be interpreted narrowly primarily because the text itself calls for a narrow interpretation. But if the Panel were to conclude that the 1998 version of the *Arrangement* is the relevant version, the case for a narrow interpretation would be all the more compelling.

70. Accordingly, Mr. Chairman, Brazil, through PROEX III, "in practice" "applies" the interest rates provisions of both the 1992 and the 1998 versions of the *OECD Arrangement.*

III. PROEX III DOES NOT SECURE A MATERIAL ADVANTAGE WITHIN THE MEANING OF ITEM (K) FIRST PARAGRAPH

71. Finally, Mr. Chairman, I will turn – briefly – to the first paragraph of item (k). This is a subject we all have been through many times, so I will attempt to minimize repetition of points that are familiar to us all.

72. The parties, and the Panel in its previous reports, appear to agree that in order for Brazil to invoke the first paragraph of item (k) successfully, it must establish three points. First, as a matter of legal interpretation, the first paragraph may be interpreted *a contrario*. Second, that a PROEX payment is a "payment" within the meaning of the first paragraph. And third, that the payment is not used to secure a material advantage in the field of export credit terms.

73. On the question of an *a contrario* interpretation: Brazil has pointed out in its submissions in this proceeding and in prior proceedings, that failure to interpret the first paragraph of item (k) *a contrario* renders treaty language superfluous. This is not a permissible interpretation under the tests established by the Appellate Body. Korea has made this point in its Third Party Submission. And Korea has noted, as did Brazil in its Second Submission, that the Appellate Body, in its report in the original Article 21.5 dispute, indicated that it was prepared to interpret the first paragraph *a contrario*. The Panel should do the same.

74. On the question of payment: Brazil also has pointed out in its prior submissions that PROEX is a payment of all or part of the costs of exporters or financial institutions in *obtaining* the credits they *provide*. Material advantage occurs, if it occurs at all, when those credits are provided to the

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customers. This interpretation is supported by the structure and logic of the first paragraph of item (k), which addresses two kinds of subsidies. The first kind of subsidy is the grant by a government itself of credits below its own cost of funds. The relevant issue here is the cost to the government in obtaining the funds *it* provides. The second kind of subsidy is governmental assistance to defray all or part of the costs incurred by exporters or financial institutions in obtaining the funds *they* provide. In both situations, funds provided are first obtained. In fact, the parenthetical clause in the first paragraph, describing the proper measure of the government's cost in obtaining funds is a description of the costs incurred by exporters or financial institutions in obtaining credits that PROEX is intended to address. This clause refers to costs that actually are paid or would have to be paid "on international capital markets in order to obtain funds of the same maturity … denominated in the same currency as the export credit." Almost all PROEX payments are made to banks in Brazil that incur costs in obtaining dollars on international capital markets.

75. The United States supports Brazil's position on the definition of "payment" in the first paragraph of item (k). The United States points out that the term covers not only direct payments, but also payments that reduce the risk incurred by the exporter or the financial institution. Therefore, in the view of the United States, PROEX interest rate support is a "payment" under the first paragraph of item (k). Brazil agrees. In addition, the United States correctly observes that the first paragraph of item (k) should be interpreted within the context of the Agreement and general export credit practice. Interest rate support payments, like PROEX, reduce the risk incurred by exporters or financial institutions, just as such practices as insurance and guarantees reduce the risk.

76. In Brazil's view, one way to look at the payment issue is to go back to the original 1958 language of the OEEC, which is set out in paragraph 24 of its Second Submission: "The government *bearing all or part of the costs* incurred by exporters in obtaining credits."

77. This was the initial description of an export subsidy, that eventually found its way into item (k) first paragraph. One of the 1979 additions to this language was the inclusion of "financial institutions" as well as exporters as the target recipients of what were deemed export subsides. This extended the original 1958 prohibition, which covered only suppliers' credits, to buyers' credits as well. Thus, as modified by this single change, the 1958 example of an export subsidy was: "The government *bearing all or part of the costs* incurred by exporters [or financial institutions] in obtaining credits."

78. The Panel should ask itself, if this language appeared, as it is, without any qualification, in Annex I to the SCM Agreement, would it apply to PROEX III? In Brazil's view, there can be little doubt that it would. With PROEX III, the Government of Brazil, in making PROEX payments, *bears all or part of the costs* incurred by exporters or financial institutions in obtaining credit. If this were all that was encompassed by the first paragraph of item (k), PROEX III would be prohibited.

79. But item (k) says more. It says, "in so far as they are used to secure a material advantage in the field of export credit terms." When this language is given full and complete effect by an *a contrario* interpretation, it leaves unresolved only the third point that Brazil must establish: material advantage.

80. In its August 1999 Report, at paragraph 181, the Appellate Body concluded that interest rates at or above the CIRR do not confer a material advantage. In paragraph 6.87 of its May 2000 Report in the original Article 21.5 Review, the Panel found that the Appellate Body did not intend to duplicate, in the first paragraph, all of the elements that were necessary to secure the safe haven of the second paragraph. PROEX III employs the CIRR as a floor, a floor that may be elevated, as necessary, to be compatible with the international market. Thus, under the test established by the Appellate Body and the Article 21.5 Panel, PROEX III is not used to secure a material advantage.

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81. In fact, Mr. Chairman, PROEX III does more than the Appellate Body and the Article 21.5 Panel said was necessary to avoid conferring a material advantage because, on its face, PROEX III is limited not only by CIRR, but by the international market, and by 85 percent maximum financing and a 10-year limit.

IV. CONCLUSION

82. For all of these reasons, Mr. Chairman, Brazil asks that the Panel find and determine that:

(a) Canada has not carried its burden of establishing that PROEX III is a subsidy within the meaning of Article 1 of the SCM Agreement;

(b) With PROEX III, Brazil in practice applies the interest rates provisions of the 1992 version of the *OECD Arrangement*, the version of the *Arrangement* incorporated by reference into the second paragraph of item (k) of Annex I of the Agreement;

(c) With PROEX III, Brazil in practice also applies the interest rates provisions of the 1998 version of the *Arrangement*;

(d) PROEX III is not used to secure a material advantage in the field of export credit terms.

83. This concludes Brazil's oral presentation, Mr. Chairman. We will do our best to answer any questions you may have.

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ANNEX B-4

CLOSING STATEMENT OF BRAZIL

(5 April 2001)

1. [Minister Patriota] Good afternoon, Mr. Chairman. I would like to thank the Panel for the opportunity to present these closing remarks this afternoon. There are just two points I would like to make before asking my colleague Mr. Azevedo to address some additional points.

2. Mr. Chairman, it was a difficult job to change PROEX III. As you heard this morning from Mr. Azevedo, who was at the meetings in Brasilia and was involved in the process, there was opposition in Brazil to making the changes. Indeed, I would go so far as to say that there was bitterness and anger in some quarters. Some people did not want to make the necessary changes in response to the previous findings. Nevertheless, we got the job done and what you have before you is PROEX III. This is what you must review.

3. I would also like to address an issue that is very important to Brazil. This is the issue of what version of the *OECD Arrangement* applies. We believe that the Panel should apply the 1992 version instead of the 1998 version. As we explained in our oral statement, we do not think that the Panel should prefer an interpretation of the SCM Agreement that would give a small number of members of the OECD the perpetual power to change the rules for the remaining Members of the WTO. The Panel should not follow an interpretation that would lead to such an unfair result. You know our views on this, and I would sum up by simply repeating a sentence from paragraph 47 of our oral statement yesterday: there is nothing in the text of item (k) that unequivocally specifies that WTO Members have given a few countries the right to perpetually legislate on behalf of the overwhelming majority of the membership. This is of particular concern if we are to bear in mind that these few countries would be acting within the framework of an organization, the OECD, which is not open to universal accession.

4. I would now ask Mr. Azevedo to make the remainder of Brazil's points.

5. [Counselor Azevedo] Thank you. I would first like to address an issue that we have not previously talked about but which I think is important. It arises out of one of the questions posed by the Panel, which is based on an apparent assumption that the second paragraph of item (k) is an exception to the first paragraph of item (k). We are not sure whether the question intended to give meaning to such an assumption, but we think it is important that we clarify that we do not agree with the assumption.

6. The second paragraph of item (k) is separate from the first paragraph, which ends with a full stop. Thus, while the second paragraph begins "Provided that, however," it is a separate sentence from the first paragraph. Also, the first and the second paragraph talk about two different things. The first paragraph talks about one form of direct financing and about "payments" of the costs of obtaining export credits. As we have seen, there is much discussion about what this means. Regardless of what this means, however, the second paragraph talks about something different. It talks about "export credit practices." This is a much broader category than the specific items included in the first paragraph. For this reason, the second paragraph cannot simply be seen as an exception to the first paragraph. It has a broader scope than the first paragraph.

7. I would also like to address another important point that we have not discussed that was raised by the EC in its oral statement this morning. This is the definition of "export credits." The EC claimed in paragraph 26 of its oral statement that PROEX III interest rate support does not fit the

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definition of export credits. But the EC's statement just stops there. The EC does not give any reason why PROEX III does not fit the definition.

8. PROEX III is a form of interest rate support, which is a form of export credits. The *OECD Arrangement* does not define "interest rate support." In fact, it says that the Participants themselves do not agree on the definition of the term. We have tried to find out what they mean by the term. I called Ms. West at the OECD and got no answer as to the meaning of the term. We sent cables to our embassies in all of the OECD members countries asking them to try to find out how each member interpreted the term. No one could tell us the answer. Some referred to internet sites or public documents that were unhelpful since they did not explain how the countries' mechanisms worked in practice. Some other members did not even want to talk about what it meant.

9. Anyway, Mr. Chairman, PROEX III payments support the interest rate for a given transaction. They are clearly interest rate support within any reasonable definition of the term.

10. Mr. Chairman, one issue that arose this morning – a question that the Panel asked and Brazil answered – is worth emphasizing again. It is this: The rules of PROEX III are clear and unambiguous. Interest rates support can be provided for up to 85 percent of the value of the contract, for a period no longer than 10 years and at a rate no lower than the applicable CIRR. The Committee administering PROEX III is permitted to depart from those rules only in cases where the Committee is satisfied that the terms of interest rates support provided under PROEX III are terms that are compatible with the terms available in the international market. The applicant requesting interest rates support will have to persuade the Committee that the terms requested are terms that are consistent with the international market. If the applicant fails to persuade the Committee, if the Committee is not satisfied that the terms requested comply with that requirement, the Committee will have no authority to use the exception and to approve the application on terms different from those provided in the general rules. The Committee members are subject to review by the Brazilian government's *Tribunal de Contas da União*, which is responsible for ensuring that Brazilian government agencies do not spend public monies except in accordance with law.

11. I am not in a position today to say exactly what the Committee will look at, exactly how this determination will be made, but I can clearly state that this is the standard. In sum, the Committee, operating under PROEX III will either operate under the safe haven of the second paragraph of item (k) or, when providing terms of interest rates support consistent with the market under the exception, will confer no "benefit."

12. Mr. Chairman, Canada has admitted that it bears the burden of proof to show that Brazil is in breach of its obligations under the SCM Agreement. Further, Canada has admitted that the issue before this Panel is PROEX III, *i.e.*, whether PROEX III is in conformity with the provisions of the SCM Agreement. To meet its burden of proof, Canada has submitted only press reports and affidavits about what Embraer sales persons allegedly offered in the context of a transaction that did not take place. By contrast, Brazil has submitted all of the documents that, taken together, constitute PROEX III. It is the review of these documents that, in our view, is the primary task of the Panel because, again – as Canada has itself admitted – the issue before the Panel is the conformity of PROEX III to the SCM Agreement. The evidence that the Panel has is, on the one hand, PROEX III, submitted by Brazil, and, on the other hand, press reports, submitted by Canada. It is up to the Panel to evaluate the evidence on the merits and decide what is the weight and significance of the evidence submitted by each of the Parties. It is the view of Brazil, however, that no press report can rebut the provisions of PROEX III, the very programme that this Panel must examine and evaluate.

13. I also would like to point out again that Brazil denies that any PROEX III assistance was offered by Brazil under the terms alleged by Canada through the "evidence" Canada submitted: the claims of sales persons and the press reports. In addition, once again, I would like to note that, even if some of the hearsay evidence submitted by Canada were true, Brazil is not responsible for what a

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sales person might offer to a customer. Brazil is only responsible for interest rates support approved under PROEX III. A sales person might offer terms that would not be subsequently approved by the Committee. An offer in itself, even if such an offer were made by a sales person, is not in itself evidence of breach of Brazil's obligations under the SCM Agreement.

14. In conclusion, Mr. Chairman, Brazil would like once again to emphasize that PROEX III conforms to Brazil's WTO obligations. PROEX III confers no benefit and, therefore, is not a subsidy. Alternatively, through PROEX III, Brazil in practice applies the interest rates provisions of the *OECD Arrangement* and, therefore, PROEX III is covered by the safe haven of the second paragraph of item (k) of the Illustrative List. Finally, in case the Panel disagrees with both of these arguments, PROEX III is a payment under the first paragraph of item (k) which is not used to provide material advantage and, consequently, is not a prohibited subsidy.

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ANNEX B-5

RESPONSES BY BRAZIL TO QUESTIONS OF THE PANEL AND CANADA

(17 April 2001)

For Brazil

Q1. Please address whether, compared to the PROEX programme under consideration in the first Article 21.5 proceedings, the legal framework of the PROEX programme has undergone any revision other than that effectuated through BCB Resolution 2799, in so far as it relates to financing the export of regional aircraft. If so, please submit relevant evidence.

BCB Resolution 002799 makes significant changes to PROEX III. One of the most important changes is the requirement that interest rate support should not bring the interest rate below the CIRR. This requirement, coupled with the previous amendment, reflected in Circular-Letter 002881, that the maximum percentage of interest rate support shall not exceed 2.5 percent, may in fact often produce a result where, after the interest rate support is provided, the resulting interest rate is still above the CIRR. Moreover, the Resolution specifically allows the Committee on Export Credits to establish the terms of interest rate equalization for exports of regional aircraft on a case-by-case basis, at levels that may vary according to the specifics of each transaction, but always in compliance with the CIRR. Thus, BCB Resolution 002799 does not require that the resulting interest rate shall be always at the CIRR; instead, it sets the CIRR as the floor and anticipates that interest rate equalization will be provided at or above the level of the CIRR.

Another important change introduced by Resolution 002799 (Article 8, para. 2) is the requirement that the Committee shall use "as reference the financing terms practiced in the international market" when "analyzing received requests for eligibility." This provision has a twofold effect. On the one hand, it requires the Committee to use the terms practiced in the international market as an additional criterion even when all the other eligibility criteria are met. In other words, when the Committee evaluates requests for interest rate equalization, it must use the market as a reference, in addition to the specific eligibility criteria of PROEX III. On the other hand, this provision allows the Committee to provide interest rate support on terms that may depart from the specific eligibility requirements of PROEX III provided, however, that those terms are consistent with the terms practiced in the international market.

These new requirements, introduced by Resolution 002799, together with the previously existing requirements bring PROEX III in compliance with Brazil's obligations under the SCM Agreement.

Q2. In the original dispute, Brazil stated in respect of PROEX I that "PROEX presumably would always be more favorable to the purchaser than the terms it could obtain on its own; otherwise, the purchaser would have no interest in PROEX" (Panel Report on *Brazil – Aircraft* (WT/DS46/R), para 7.35). Does Brazil contest that payments under PROEX III allow a purchaser of regional aircraft to obtain financing for Embraer regional aircraft on terms more favourable than those otherwise available *to that purchaser* in respect of the *particular transaction* in the *commercial* marketplace? If so, please explain in what relevant respect PROEX III differs from PROEX I.

As questions 2 and 3 for Brazil raise similar issues, Brazil will answer the two questions together. It is important to understand how PROEX III works in the context of a transaction as a whole. The conclusion of the Article 21.5 Panel quoted in question 3 to the effect that under

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PROEX II "a borrower negotiates the best interest rate it can obtain in international financial markets, and then benefits from a buy down of that interest rate" does not accurately reflect the process, particularly with respect to PROEX III. The process of negotiating a sale and obtaining PROEX support is not a linear process, and does not result in a commercially-negotiated interest rate that is then further reduced by PROEX support. Put another way, the parties do not negotiate a commercial rate and then use that as the starting point in applying for PROEX support, which, if granted, would *further* reduce the commercially negotiated rate.

To the contrary, the negotiations are a complex process that involve several parties – including at a minimum the seller, the lender, and the buyer. There may be equity investors, guarantors, insurers and other parties also involved in the transaction. Frequently, the buyer also may be negotiating with several potential sellers and other lenders. These negotiations are controlled by the prevailing commercial rates in the market place. However, the possibility of PROEX involvement in the transaction does not reduce the net interest rate below what would otherwise be available in the marketplace; it simply places the rates available to purchasers of Brazilian aircraft at the same level as rates available for other regional jet aircraft from other vendors with their financial institutions.

This may arise in three situations. In the first, a buyer – assume a Chinese buyer – may be quoted an interest rate of eight percent (assume this is at/above the CIRR) by an international financial institution, such as Chase Manhattan or Citibank, to purchase Brazilian aircraft. A Brazilian bank may not be able to offer eight percent without PROEX support. In this case, PROEX may enable the Brazilian bank to provide the Chinese buyer the same terms as are available for that transaction in the international marketplace (*i.e.*, Chase Manhattan or Citibank) but with the added convenience of dealing with a bank with whom the seller is familiar, and a bank that is more familiar with transactions of that kind. In financial terms, however, PROEX would not place the buyer in any better situation or give it any better terms for the transaction than are available in the international marketplace.

In the second situation, the Chinese buyer may be offered eight percent terms by an international financial institution (again, assume this is at/above the CIRR) to finance a purchase of Brazilian aircraft. The Chinese buyer, however, would prefer to finance the transaction through a Chinese bank. The Chinese bank, however, is able to offer credit only at 10 percent. In this case, PROEX support may enable the Chinese bank to provide credit at eight percent and thereby facilitate the buyer's preference for its own bank. Again, however, PROEX would not place the buyer in any better situation or give it any better terms for the transaction than are available in the international marketplace.

In the third situation, assume that an airline is quoted a rate of eight percent for a purchase of regional aircraft by an international financial institution (assume also that this rate is at the CIRR). Brazil's manufacturer, Embraer, may want to compete for the sale and offer the same financing package. However, a Brazilian bank may not be able to provide financing at eight percent because of its higher cost of dollars, but rather might quote a rate of nine percent. In those circumstances, Embraer may apply for PROEX support to enable it to offer financing at the eight percent rate. Again, this would enable Embraer to offer terms that are equal to, though not more favourable than, the terms that are available to the borrower in the international marketplace.

Accordingly, in each of these three situations, the first Article 21.5 Panel's conclusion that PROEX reduces a previously-negotiated rate below the commercial rate does not reflect how the market operates and how PROEX becomes involved in transactions.

Brazil's statement that PROEX would always "be more favorable to the purchaser than the terms it could obtain on its own, otherwise the purchaser would have no interest in PROEX" must be read in the context of the examples given above. If PROEX were not involved in the transaction, the purchaser would be offered a financing package at 9 percent by the Brazilian bank. In that case, the

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purchaser would likely take the financing package offered by the competitor rather than the PROEX-supported package. However, the PROEX-support would still not result in a net interest rate that is lower than either the CIRR or the terms that might otherwise be available in the marketplace.

Thus, Brazil does indeed contest that PROEX III payments would allow a purchaser to "obtain financing on terms more favorable than those otherwise available to *that purchaser* in respect of the *particular transaction* in the *commercial* marketplace." While PROEX III payments may allow the purchaser a broader range of financing options, the rates offered with PROEX support would *not* allow the purchaser to obtain regional aircraft at terms more favorable than would be available through other financial institutions in the commercial marketplace. The requirement that the minimum interest rate must be the CIRR, of course, reinforces this fact.

These questions go to the issue of whether, as Canada claims, PROEX III confers a benefit in every case. For the reasons explained above, PROEX III does not reduce the interest rate below the commercial market rates. Rather, it enables Brazil's manufacturer and financing institutions to participate in the transaction at the market rates. Brazil notes in this regard that the Appellate Body framed the issue as whether PROEX reduced the *net* interest rate below the CIRR or other appropriate market benchmark. The Appellate Body thereby implicitly rejected the presumption that PROEX always and necessarily reduced the net interest rate below the market rates.

With respect to the final sentence of question 3, as explained above, Brazil contests the accuracy of the first Article 21.5 panel's description of the process for both PROEX I and PROEX III. While the panel's description may have sufficed as a shorthand description of the process, when the process itself was not the issue, it did not accurately reflect the complexity of these transactions. That said, there are nevertheless significant differences between PROEX III and previous iterations of the programme. First, PROEX III requires a minimum interest rate of the CIRR for all PROEX-supported transactions. This is the floor rate that the Appellate Body, and, indeed, Canada, have previously said that PROEX must apply. In contrast, PROEX I had no requirement of any minimum interest rate. Similarly, the minimum interest rate under PROEX II (T-bill plus 20 basis points) was below the CIRR. Moreover, PROEX III requires that the Committee on Export Credits must follow the rates prevailing in the market place in deciding whether to approve PROEX III support. This requirement was not present in either PROEX I or PROEX II.

Finally, even if PROEX III did bring the interest rate below the commercial rate in particular instances, the fact that PROEX III applies the interest rates provisions of the *OECD Arrangement* means that it is eligible for the safe haven of the second paragraph of item (k).

Q3. In the first Article 21.5 proceedings, the Panel found that, under PROEX II, "… a borrower negotiates the best interest rate it can obtain in international financial markets, and then benefits from a buy down of that interest rate… " (Article 21.5 Panel Report on *Brazil – Aircraft*, para. 6.89). In its oral statement to the Panel (para. 7), Brazil appears to contest that this is the case in respect of PROEX III. If this is correct, in what relevant respect does PROEX III differ from PROEX I and II?

Please refer to the response to question 2 above. Because of the similarity of the issues raised by questions 2 and 3, Brazil has provided a single response to the two questions.

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Q4. Is Brazil through its benefit arguments suggesting that in some cases financial institutions receiving PROEX III payments receive the payments without in any way improving the terms and conditions of the financing in respect of which PROEX III payments are made, i.e., that PROEX III payments are in some cases exclusively a subsidy to a financial institution? If so, and given that PROEX III payments may be provided where financing is provided by non-Brazilian banks, is Brazil suggesting that PROEX III is a subsidy for foreign banks?

As explained in the answer to question 2 above, PROEX III payments would enable Embraer to provide a net interest rate at the rates prevailing in the market place. This does not enable the seller to provide financing at terms more favorable than are otherwise available in the marketplace. However, it must be borne in mind that in the international aviation market, it is important that manufacturers are in a position to offer competitive financing at prevailing market rates. No aircraft manufacturer in the world tells airlines, "This is the price. Pay cash, or go borrow the cash from a bank." It is the custom in the trade, established long before Brazil began producing aircraft, for the manufacturers to have available a financing package for their sales, and these packages generally include some form of official government support for export credits.

Other manufacturers in other countries all have export credit support available – Canada through EDC, the United States through Eximbank. PROEX payments enable Embraer to avoid a competitive disadvantage in the marketplace by enabling it to offer financing at the CIRR and market rates. To the extent that PROEX III results in one bank rather than another providing the financing for a particular transaction, then it is the case that the bank profits or benefits from the PROEX support. This applies even where the bank is not a Brazilian bank, but is in another country, particularly a developing country. PROEX III support enables that bank to participate *at international market rates* in a financing transaction in which it would not otherwise be able to participate.

Q5. Is the Committee on Export Credits required to approve operations meeting the eligibility criteria set forth in BCB Resolution 2799 and Directive 374 and the National Treasury thus required to provide equalisation (i.e. is there a conditional entitlement to PROEX III support)? Or does the Committee retain discretion regarding whether or not PROEX III support is provided even where the eligibility criteria are met?

The Committee on Export Credits is not required to approve interest rate support financing even in the case of transactions where all the eligibility criteria provided by PROEX III are met. There is nothing in PROEX III that imposes on the Committee an obligation automatically to approve the granting of interest rate support once the Committee establishes that the eligibility criteria of PROEX III are met. The Committee thus retains discretion regarding whether or not PROEX III support is provided.

Article 1 of BCB Resolution 002799, for example, states that " … the National Treasury *may* provide to the financing or re-financing agency, as the case may be, equalization enough to render financing costs compatible with those practiced in the international market." (Emphasis ours.) Further, Article 2 of Resolution 002799 states: "Equalization *may* be granted when financing the importer, for cash payments to the exporter established in Brazil, as well as when re-financing granted to the latter." Resolution 002799 therefore imposes no obligation on the Committee to provide interest rate support even when all the eligibility criteria are met. The Committee must comply with certain mandatory requirements (e.g., the CIRR, 85 percent of the value of the sale, 10 year period of financing) but retains the authority – subject to the terms of the international marketplace – to determine the specific terms of the interest rate support "on a case by case basis, at levels that may vary according to the characteristics of each operation" as provided in Article 1, para. 1 of Resolution 002799.

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Q6. Is there a requirement, under Brazilian internal law, for the executive branch of the government to interpret provisions of internal law and exercise discretion conferred on it under internal law in such a way as to conform to Brazil's WTO obligations? If so, please explain and submit evidence.

The Congress of Brazil has the power to ratify treaties signed by the Executive. When the Congress does so, it normally adopts legislation incorporating the treaty's text into Brazilian law. However, treaties may not have direct effect in Brazil unless, in addition to the legislation incorporating the treaty, the Executive also issues regulations giving internal effect to the treaty. The WTO Agreements have been incorporated and implemented into the domestic law of Brazil in this manner.

Because Brazil's WTO obligations have been implemented and have become part of Brazil's domestic law, the executive branch must comply with those obligations as it does in the case of any other obligations imposed on it by any other provision of Brazil's domestic law. If other provisions of Brazil's domestic law *allow* the Executive to act in a way that may be inconsistent with its WTO obligations, the potential conflict would be resolved in favor of consistency with Brazil's WTO obligations. The Executive, even if permitted to act in a manner inconsistent with the WTO by other provisions of Brazil's domestic law, would still *have the duty* under domestic law to comply with its WTO obligations because the WTO Agreements have been implemented in Brazil' s domestic law. The only situation where a conflict would arise is if another provision of Brazil's domestic law *requires* the Executive to act in a manner inconsistent with Brazil's WTO obligations. In such a case, there would be a conflict between one provision of Brazil's domestic law and another provision of Brazil's domestic law. This is *not* the case with PROEX III. There is nothing in PROEX III that *requires* Brazil's executive branch to act in a manner inconsistent with Brazil's WTO obligations. In applying PROEX III, the executive branch remains bound by Brazil's WTO obligations as implemented in Brazil's domestic law.

Q7. In the *Canada – Aircraft* Article 21.5 panel proceedings (Article 21.5 Panel Report on *Canada – Aircraft,* Annex 1-2, para. 62, p. 75), Brazil argued that "Canada's 'Policy Guideline' merely suggests that prohibited export subsidies *via* Canada Account *might not* be granted; as noted above, to be sufficient, an implementation measure must instead *ensure* that prohibited subsidies *cannot* be granted." Should the same standard apply to Brazil in the context of Brazil's item (k) second paragraph defence in these proceedings? If not, why not?

In the *Canada – Aircraft* Article 21.5 Panel proceedings, Brazil argued that the standard referred to in the question should apply to the implementation measures announced by Canada with respect to Canada Account because Canada Account was found by the original Panel to be inconsistent with Canada's WTO obligations not only *de jure*, but also *as applied*. In the Article 21.5 proceedings, Canada argued that it had implemented the recommendations and rulings of the DSB because: (i) no new transactions had been financed through Canada Account; and (ii) it adopted a "Policy Guideline" stating that the Minister of International Trade would, as a policy matter, not approve transactions that are not in compliance with all of the provisions of the *OECD Arrangement*[1] Canada argued that because Canada Account was found inconsistent *as applied*, Canada had no obligation and bore no burden to demonstrate how it complies with the second paragraph of item (k) unless, at some time "in the future, there is a financing transaction under Canada Account in relation to which Canada claims the exception in Item (k) and the claim to that exception is challenged.[2] Further, Canada argued that the "Policy Guideline" stated an intention to "meet the criteria to qualify for an exception under the second paragraph of Item (k).[3]

[1] *See Canada – Measures Affecting the Export of Civilian Aircraft*, Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW, 9 May 2000, paras. 5.57-5.58 ("Article 21.5 Panel Report").

[2] *Id*., Annex 2-1 (Canadian First Submission), para. 67.

[3] *Id*., para. 68.

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Brazil responded to these arguments by pointing out that what Canada had done was insufficient. First, Brazil argued that Canada could not simply state that it had brought Canada Account in compliance only because there had been no new transactions. Second, Brazil argued that the "Policy Guideline" referred neither to the "interest rates provisions" of the *OECD Arrangement* nor to conformity with the second paragraph of item (k). It only stated an intention to comply with the *Arrangement* in its entirety, without any indication of the specific provisions with which it intended to comply[4] Brazil suggested that Canada should specify how it intended to comply with the interest rates provisions of the *Arrangement* and the particular interest rates provisions of the *Arrangement* with which it intended to comply[5] Brazil suggested that "[t]he minimum burden accorded to Canada must be to explain with some precision what 'comply with the OECD Arrangement' will mean.[6] Instead, Canada issued a one sentence "Policy Guideline" that merely suggested that under Canada Account prohibited export subsidies might not be granted. Under the Guideline, for example, Canada would have been free to utilize the "matching" provisions of the Arrangement. The Panel had found that these were not "interest rates provisions.[7]

PROEX III does considerably more than did Canada's implementation measures with respect to Canada Account and meets the standard proffered by Brazil, as described above. PROEX III is not a blanket statement that the programme complies with the *Arrangement*. PROEX III contains specific requirements that are consistent with the specific criteria set out in the interest rates and other relevant provisions of the *Arrangement* (e.g., the CIRR as a floor, financing up to 85 percent of the export value of a sale, financing for a period of up to 10 years). PROEX III imposes on the Committee specific eligibility criteria that meet or exceed the disciplines contained in the interest rates provisions of the *Arrangement*. Therefore, PROEX III does ensure that financing under its terms qualifies for the safe haven of the second paragraph of item (k).

Brazil also notes that the Appellate Body in *Canada – Aircraft* Article 21.5 proceedings found that "the words 'ensure' and 'future,' if taken too literally, might be read to mean that the Panel was seeking a strict guarantee or absolute assurance" as to the future application of the revised programme. The Appellate Body concluded that "[a] standard …, if so read, would … be very difficult, if not impossible, to satisfy since no one can predict how unknown administrators would apply, in the unknowable future, even the most conscientiously crafted compliance measure.[8] Brazil can thus do no more than adopt an implementation measure that specifically addresses the way in which it will, as a matter of law, comply with its WTO obligations – which is exactly what PROEX III does.

Q8. Brazil argues that "the maximum percentage allowed under PROEX III for the purpose of interest rate equalisation is 85 per cent of the export value of the sale" (Brazil's first submission, para. 43). Is it Brazil's position that PROEX III would not *allow* Brazil to exceed this maximum percentage in respect of regional aircraft? If so, why? When responding to this question, please specifically address:

(a) Article 5 of Directive 374;

(b) Article 8 of Directive 374;

[4] *Id*., Annex 1-2 (Brazil Rebuttal Submission), para. 69.
[5] *Id*., para. 72.
[6] *Id*., para. 76.
[7] *Id*., paras. 5.125, 5.126, 5.132-5.134, and 5.147(d) and (f).
[8] *Canada – Measures Affecting the Export of Civilian Aircraft*, Recourse by Brazil to Article 21.5 of the DSU, Report of the Appellate Body, WT/DS70/AB/RW, 21 July 2000, para. 38.

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(c) the statements reported by Canada in paragraph 11 of its first written submission and paragraphs 20-26 of its rebuttal submission.

(a) Brazil's position is indeed that PROEX III would not allow Brazil to exceed the maximum percentage for the purpose of interest rate equalization – 85 percent of the export value of the sale – with one possible exception. The rule is contained in Article 5 of Directive 374. Article 5 of Directive 374 prohibits interest rate equalization for more than 85 percent of the export value of the sale. The exception is contained in Article 8, para. 2 of BCB Resolution 002799, which allows departure from the specific eligibility criteria in PROEX III only when interest rate support is provided on terms consistent with the international market. Thus, if the Committee is satisfied by the applicant and its own research that interest rate equalization based on more than 85 percent of the export value of the sale would nonetheless be consistent with the terms prevailing in the international market, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. In that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

(b) Article 8 of Directive 374 does not allow Brazil to exceed the maximum percentage of 85 percent of the export value of the sale. This Article actually applies to requests of PROEX support that concern products that are not included in the Annex, or whose commercialisation in the international market require terms that exceed those set out in the programme. For example, the repayment term practiced in the international market could exceed the one stipulated in the Annex for that particular product. Article 8 ensures that the Secretaria de Comércio Exterior (SECEX) is aware of such situations with a view to reassess the operation of the programme in light of these circumstances. SECEX has no authority to approve the requests that do not conform to the basic guidelines of the programme. Such authority is vested on the Comitê de Crédito às Exportações, as established in Article 8 (c) of Banco Central Resolution 2799.

(c) Canada ignores the very text of the documents that constitute PROEX III and submits instead "evidence" that is based on newspaper articles and reports. In paragraph 11 of its first written submission, Canada refers to a newspaper report of a statement by then-Foreign Minister Lampreia. First, there is no guarantee that the newspaper accurately reported what Minister Lampreia actually said. Second, even if accurate, the statement was made *before* PROEX III was approved and adopted. Third, again even if accurate, the statement expresses the view of a Brazilian official who may or may not have approved of the proposed revisions of PROEX. Moreover, Minister Lampreia's Ministry is not involved in administering PROEX. Finally, whatever Minister Lampreia's views might have been at the time, PROEX III subsequently was approved and enacted. The relevant documents have been submitted to this Panel. This programme, rather than the Minister's statement, is before the Panel.

In paragraphs 20 through 26 of its rebuttal submission, Canada similarly uses newspaper reports that may or may not accurately reflect the statements made by Brazilian officials. For example, the statement by Ambassador Graça Lima, as reported, may be interpreted in different ways. Even if reported correctly, the statement in fact contains nothing objectionable from Canada's perspective because even before December 2000, PROEX required terms of financing of up to 10 years and up to 85 percent of the export value of the sale, and those terms in themselves do not depart from Brazil's WTO obligations. In addition, this statement also was made prior to adopting and enacting PROEX III. The other two press reports referred to in paragraphs 23 and 24 of Canada's rebuttal submission do not even cite names of Brazilian officials. They either express the views of the newspaper or the reporter or cite anonymous "Brazilian authorities."

Brazil does not suggest that newspaper articles and reported statements by government officials should *ab initio* be discarded without assessing their evidentiary value. In some cases, there may be no other evidence available. In this case, however, the newspaper articles (even assuming everything they report is accurate) provide at best evidence of the divergence of views in the Brazilian

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Government about revising PROEX and of some public comments about Brazil's negotiations with Canada. They do not provide evidence of what PROEX III *actually requires*. This evidence is provided by the documents constituting PROEX III. Brazil has submitted those documents to the Panel. There is no better evidence about what PROEX III is and what PROEX III requires than the evidence contained in the PROEX III documents themselves.

Finally, Canada grossly misstates and misinterprets the positions and views expressed by Brazil during their negotiations. Canada states that Brazil publicly insisted that it would not abide by the provisions of the *OECD Arrangement* and that, during the negotiations, Brazil refused to consider adjusting PROEX to the interest rates provisions of the *Arrangement*. Canada ignores the fact that Brazil consistently has adhered to the view that the second paragraph of item (k) does not require compliance with *all* of the provisions of the *Arrangement*. In addition, Canada omits to note that Canada and Brazil disagree on what are the interest rates provisions of the *Arrangement*. With those points in mind, Brazil's position is clear and consistent: Brazil has pledged to comply with the CIRR and has established the CIRR as a floor, complies with those provisions of the *Arrangement* that Brazil believes are the interest rates provisions, and does not believe it has an obligation to comply with the other provisions of the *Arrangement*.

Q9. Brazil argues that "the maximum length of the financing term under PROEX III is ten years" (Brazil's first submission, para. 48). Is it Brazil's position that PROEX III would not *allow* Brazil to exceed this maximum financing term in respect of regional aircraft? If so, why? When responding to this question, please specifically address:

(a) Article 3, paragraphs 1 and 2, of Directive 374;

(b) the statements reported by Canada in paragraph 11 of its first written submission and paragraphs 20-26 of its rebuttal submission;

(c) your statement in the first *Brazil - Aircraft* Article 21.5 proceedings that, under PROEX I and II, the ten-year maximum "was waived, and continues to be waived, for regional jet aircraft only" (Article 21.5 Panel Report on *Brazil – Aircraft*, Annex 2-4, question 6, p. 135). In this regard, does Brazil contend that the legal provisions allowing such a waiver no longer exist? If they still exist, (i) which are they and (ii) what is the basis for Brazil's assertion that the maximum length of the financing term under PROEX III is ten years?

(a) Brazil's position is indeed that PROEX III – and in particular Directive 374 – would not allow Brazil to exceed the maximum period of 10 years for the purpose of interest rate equalization. The only possible exception is contained in Article 8, paragraph 2 of BCB Resolution 002799 which allows departure from the specific eligibility criteria in PROEX III only when interest rate support is provided on terms consistent with the international market. Thus, presumably, if the Committee is satisfied by the applicant and its own research that interest rate equalization is provided in the international market for a period longer than 10 years, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. In that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

Article 3.1.I of Directive 374 simply ensures that the equalization payments will not exceed the financing term of the contract signed by the exporter, even if it is shorter than the term allowed in the Annex. Article 3.1.II limits the repayment term to that indicated in the Annex, except as provided in paragraph 2 of the same Article and Article 4.

Article 3.2 indicates that the repayment terms indicated in the Annex may be extended up to 96 months if warranted by the unit values, as indicated in the table reproduced in that paragraph. This

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provision obviously applies to products with repayment terms under 96 months in the Annex. This is not the case for regional aircraft.

Article 4 deals with exports that involve more than one product and the application of the methodologies set out in items (a), (b), and paragraph 1 could not mathematically result in repayment terms longer than the 10 year maximum.

(b) See response to Question 8(c) above.

(c) The basis for Brazil's assertion that the maximum length of the financing term is 10 years is the specific requirement to that effect in Directive 374, and the requirement of Article 1.1 of BCB Resolution 002799 that interest rate equalization must be provided in compliance with the CIRR. As explained in (a) above, the possibility for a waiver does exist. It is provided in Article 8, para. 2 of BCB Resolution 002799 which allows departure from the specific eligibility criteria in PROEX III but only when interest rate support is provided on terms consistent with the international market. Thus, the waiver is permissible only when the Committee is satisfied by the applicant and its own research that interest rate equalization is provided in the international market for a period longer than 10 years. In such a case, the Committee could (but would have no obligation to) provide interest rate support on the same terms as those available in the international market. Thus, if the length of the term of financing available in the international financial market exceeds 10 years, the Committee would have the discretion to apply the same length of the term of financing. Again, in that instance, PROEX III would not confer a benefit, since it would provide support consistent with that available to the recipient in the market.

Q10. Has Brazil issued any letters of commitment under PROEX III in respect of regional aircraft? If yes, did the transactions in question involve financing of greater than 10-years' duration and/or financing in excess of 85 per cent of the amount of the sale? Please provide supporting details with respect to each transaction.

No, Brazil has not issued any letters of commitment under PROEX III in respect of regional aircraft.

Q11. To the extent you have not done so, please address specifically whether and why PROEX III is "in conformity with" Articles 8, 9, 12-14, 16-26 of the 1998 OECD Arrangement as well as Articles 18-20, 23-24, 27-28, 29(b) and (c) of Annex III to the 1998 OECD Arrangement. Please substantiate your view.

Brazil notes that in its view, the provisions referred to above are not properly considered as interest rates provisions. Therefore, in order to qualify for the safe haven of the second paragraph of item (k), PROEX III should not be required to conform with each and every one of these provisions. Nevertheless, for the reasons explained below, Brazil submits that PROEX III does in fact conform to the provisions listed in the question.

Articles 8 and 9 of the *Arrangement* provide that the repayment term runs from the starting point of the credit, defined as the date on which the buyer takes possession of the goods in his own country, to the date of the final payment. PROEX III is in conformity with these requirements, in that Article 3 of Directive 374 stipulates that the payment term is the period from the date of shipment or *delivery* to the date of maturity of the last equalization payment. Since PROEX payments are normally made in 6-month increments over the term of the loan, this will coincide with the date of the last payment.

Article 12 (together with Article 10) of the *Arrangement* sets out maximum repayment terms for categories of countries. These provisions are superseded by the provisions of Article 21 of the Annex to the *Arrangement*, which establishes a maximum repayment term of 10 years for regional jet

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aircraft. PROEX III is consistent with this in that the Annex to Directive 374 establishes a maximum repayment term of 10 years for regional jet aircraft.

Article 13 of the *Arrangement* calls for repayment of principle in regular instalments not less than six months in frequency. Similarly, Article 14 of the *Arrangement* calls for the payment of interest on a six-monthly basis. Article 4 of Resolution 2799 conforms with these requirements in that it provides for calculation of the amounts due for equalization purposes on a six-month basis and calls for the issuance of NTN-I bonds on a six-monthly basis.

Articles 16 and 17 govern the calculation of the CIRR. Resolution 2799 provides that the net interest rate for a PROEX-supported transaction may not be below the CIRR. Since Brazil is not a Participant in the *Arrangement* , however, Brazil does not play any role in calculating the CIRR and therefore PROEX III does not contain parallel provisions to Articles 16 and 17 governing how the CIRR is to be calculated.

Articles 18 through 24 of the *Arrangement* govern cosmetic interest rates and minimum premiums. These provisions do not apply to interest rate support and, therefore, are not relevant to PROEX III.

Article 25 of the *Arrangement* refers to local costs. PROEX does not provide for financing of such costs.

Article 26 governs validity periods for lines of credit. This also does not apply to interest rate support such as PROEX.

Article 18 of the Annex to the *Arrangement* states that Part 2 of the Sector Understanding applies to aircraft other than large aircraft. The Article does not have any mandatory aspect. PROEX III may provide officially supported export credits for aircraft other than large aircraft and in that sense conforms with the Article.

Article 19 of the Annex imposes a hortatory burden on Participants to use best endeavours to respect the terms of the *Arrangement*. Since PROEX III requires a minimum interest rate of the CIRR, PROEX III is in conformity with this article.

Article 20 of the Annex divides the aircraft subject to part two of the sector understanding into three categories, and must be read in conjunction with Article 21 establishing maximum repayment terms. As explained in Brazil's First Submission (paragraph 55), PROEX III conforms with these articles in that the regional jets at issue in this dispute are Category A aircraft, for which, in accordance with Article 21, PROEX III establishes a maximum repayment term of 10 years.

Article 23 of the Annex stipulates that the Participants shall not waive insurance premium or guarantee fees. Since PROEX does not involve guarantees, this provision does not apply.

Article 24 stipulates that the Participants shall not provide aid support. PROEX III does not contain provisions permitting aid support.

Articles 27 and 28 of the Annex provide that, for used aircraft, the credit terms shall not be more favorable than for new aircraft. Article 28 provides specific repayment terms for used aircraft. PROEX III does not contemplate the issue of used aircraft or the possibility of PROEX support for used aircraft sales, and Brazil is not aware that the Brazilian industry has made any sales of used aircraft. There have been no PROEX commitments made to support sales of used aircraft. Accordingly, these provisions are not relevant to PROEX.

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Article 29 of the Annex provides for the financing of spare parts and engines. Brazil has stated its views on the applicability of Article 29(a) to PROEX in its First Submission (at paragraphs 59-61) and in its oral statement (at paragraphs 33-35). Articles 29(b) and (c) establish repayment terms of five years for spare engines and two years for other spare parts when not ordered with the new aircraft. Brazil notes that it does not manufacture engines and therefore does not sell engines separately from the aircraft. In any event, PROEX III conforms with these provisions to the extent that it establishes (in the Annex to Directive 374) that the maximum financing term for parts of aircraft shall be limited to five years (NCM Heading 8803) and one year (NCM Heading 8803.90). While the classification of goods is not entirely clear from the schedules, these classifications are consistent with – and indeed more stringent than – the requirements of Article 29 of the Annex to the *Arrangement*. Brazil notes again that spare parts financing has been a *de minimis* element of PROEX III support in the past and that spare parts financing has been provided only in connection with sales of new aircraft.

Q12. With respect to Article 6 of Directive 374, what is the basis for Brazil's contention that this provision confers discretion on the Committee on Export Credits? (Brazil's first submission, para. 61) If the term "may" provides the basis for Brazil's contention, please also address the meaning of the term "may" in Article 2 of Directive 374.

Article 6 permits applicants to include spare parts financing in their application for equalization support and grants the Committee discretion to approve equalization for spare parts financing. Article 2, in contrast, is a general provision regarding exports, which must be read as being limited by the maximum payment tenures referred to in Article 1 and listed in the Annex to Directive 374.

Q13. With reference to Article 1, paragraph 1, of BCB Resolution 2799, please elaborate on the precise meaning of the phrase "interest rate equalisation shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation". What are the characteristics at issue and how would they determine the level of interest rate equalisation?

This phrase means that applications for PROEX III support will be considered on a case by case basis. While Resolution 2799 establishes a minimum net interest rate – the CIRR – and PROEX III support is limited to a maximum amount of 2.5 percent, the Committee is not required to approve a net interest rate as low as the CIRR in every case. In addition, the Committee is not required to approve 2.5 percent PROEX support in every case (and, in fact, may not do so where that would reduce the net interest rate below the CIRR). Thus, the question of whether to approve PROEX support and, if so, to what extent, must be determined based on the individual merits, or "characteristics," of each proposal.

Q14. Regarding Brazil's reference to Article 8, paragraph 2, of BCB Resolution 2799, please answer the following questions:

(a) What is the relevant "international market"? Is this a reference to the market for the product for which PROEX eligibility is requested?

Because the international market for different products may vary, the term "international market" should be read as referring to the market in which the product for which PROEX support is requested competes.

(b) What is meant by the "financing terms"? Please give examples.

The phrase "financing terms" should be interpreted as referring to all of the terms on which financing is offered. The terms may, of course, vary from transaction to transaction.

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(c) What are the benchmark "financing terms"? (Those available to the borrower in question? The industry sector in question?)

The financing terms in question refer to the terms that would be available for a comparable transaction for that buyer in the commercial marketplace. Please refer to the answer to question 2 above for further details.

(d) Do the financing "practices" referred to include officially supported financing?

As explained previously, there is no accepted definition of "officially supported financing." Article 88 of the *OECD Arrangement*, for example, states that it was not possible for the Participants to agree on a definition of the term. Moreover, as indicated in Article 86 of the *Arrangement*, there is considerable debate as to whether so-called "market window operations" – where government export credit agencies purport to be purely commercial actors in the market – are properly considered as "officially supported financing."

Furthermore, there are many different types of officially supported financing, and it will not always be clear what, if any, official support is included in a transaction in the market place. To the extent that a transaction appears to conform with the marketplace, then that transaction would be deemed to be part of the "practices" that would be examined by the Committee.

(e) What is the meaning of the phrase "shall have as reference"? Does this language enable the Committee to approve financing of operations on terms more favourable than those prevailing in the international market at the relevant time?

This phrase means the Committee must conform to the financing terms of the international market. The language prevents the Committee from approving financing on terms more favorable than those prevailing in the international market. Brazil notes, however, that there may be situations in which the CIRR is *below* the marketplace rates (Canada has previously explained that due to time lags in calculating the CIRR, the CIRR may be above or below the market at a given point in time)[9] In those circumstances, the Committee could provide PROEX support according to the interest rates provisions of the OECD Arrangement, and nevertheless benefit from the save haven of the second paragraph of item (k).

(f) Specifically, how would the Committee determine the net interest rate for eligible operations involving the export of regional aircraft in situations where the financing terms practised in the international market "justified" repayment terms of, e.g., 15 years?

The Committee would have to consider any proposal for financing that deviated from the CIRR based on the evidence placed before the Committee on a case-by-case basis. Brazil cannot comment on what that evidence may be for a future transaction. Brazil would note, however, that the CIRR may nevertheless be an appropriate rate for such a transaction, given that Canada has previously told the Panel that the terms in the marketplace may include interest rates below the CIRR (for Canada's "market window" financing) and loans with 15-18 year terms[10] In this instance, of course, the transaction would not be eligible for the safe haven of the second paragraph.

[9] Brazil -- Export Financing Programme for Aircraft -- Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW para. 6.99 (9 May 2000).

[10] Article 21.5 Panel Report, page 81 (Canada's response to Question 2 posed by the Panel) and page 94 (Canada's response to Question 8 posed by Brazil).

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(g) What is the relationship between Article 8, paragraph 2, and Article 1, paragraph 1? What of a case where reference to the financing terms practised in the international market would indicate an above-CIRR rate? Could the Committee still approve net interest rates at CIRR level?

The CIRR is intended to be the floor, or minimum possible net rate that may be approved by the Committee. As explained above, where the market is above the CIRR, the Committee nevertheless may approve financing at a net interest rate equal to the CIRR and still qualify for the safe haven of the second paragraph of item (k).

(h) What is the relationship between Article 8, paragraph 2, and Directive 374? In particular, which would take precedence if the financing terms practised in the international market "justified" (i) repayment terms in excess of 10 years, (ii) loan-to-asset values in excess of 85 per cent?

Article 8, paragraph 2 grants the Committee discretion to approve PROEX support so long as that support is consistent with the international market. Thus, the Committee would enjoy discretion under that paragraph to deviate from the terms of Directive 374. However, as discussed above, this discretion is not unlimited.

(i) With reference to para. 17 of Brazil's oral statement, please explain in what way Article 8, paragraph 2, of BCB Resolution 2799 adds to what is already stated in Article 1 thereof. In addition, does the reference to Article 8, paragraph 2, add anything to Article 2 of Provisional Measure 1629?

Article 1 of Resolution 2799 establishes the general framework for equalization payments under the PROEX programme. Article 8, paragraph 2, imposes a specific affirmative requirement on the Committee to ensure that any PROEX support, in addition to meeting the specific criteria enumerated elsewhere, is consistent with the terms practised in the international markets. Thus, Article 8 paragraph 2, uses the mandatory verb "shall" in describing the Committee's obligations.

Article 2 of Provisional Measure 1629 deals with types of financing not covered by Article 1 of the same Provisional Measure. Article 1 refers to post-shipment PROEX operations. These are the only types of operations for which regulations have been issued and that PROEX currently supports. They could involve both direct financing and equalization payments. Resolution 2799 implements Provisional Measure 1629 with regard to equalization payments only. Article 8.2 of Resolution 2799 ensures that the financing terms practiced in the international market will be used as the reference by the Comitê de Crédito às Exportações, when approving equalization payments concerning post-shipment financing transactions that do not conform to the general rules of the programme.

Article 2 of Provisional Measure 1629 contemplated equalization payments for pre-shipment financing. This mechanism has never been implemented and PROEX has never made equalization payments under this mechanism.

(Addressed to Both Parties)

Q21. On the assumption that the second paragraph of item (k) provides for an *exception* to the first paragraph thereof, would a Member invoking the second paragraph need to establish (i) that its internal law *allows* it to act in conformity with the interest rates provisions of the relevant OECD Arrangement or (ii) that its internal law *requires* it to act in conformity with the aforementioned interest rates provisions? If (ii) is correct, how does this view fit with the traditional distinction between mandatory and discretionary legislation in the GATT/WTO?

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As a preliminary matter, Brazil wants to emphasize that it disagrees with the assumption that the second paragraph of item (k) provides for an exception only to the first paragraph of item (k). Under the second paragraph of item (k) "an export credit practice" which is in conformity with the interest rates provisions of the *OECD Arrangement* "shall not be considered an export subsidy prohibited by" the SCA Agreement. If the second paragraph of item (k) provided for an exception from the first paragraph only, "an export credit practice" must be understood to cover only practices within the scope of the first paragraph. In other words, "an export credit practice" must either be a "grant by governments" or a "payment" within the meaning of the first paragraph of item (k). Nothing in the plain meaning of the text can be interpreted to mean or even suggest that "an export credit practice" under the second paragraph of item (k) (or, indeed, under the *OECD Arrangement*) should be construed so narrowly. An export credit practice is a concept that is much broader than the scope of the first paragraph of item (k). The assumption that the second paragraph of item (k) provides for an exception only to the first paragraph would require Members to show that their export practices are a "grant" or a "payment" as defined by the first paragraph of item (k) before they can claim the safe haven.

The safe haven is thus an exception from Article 3 of the SCM Agreement. A subsidy contingent on exports that would otherwise be a prohibited subsidy would not be in breach of the SCM Agreement if it qualifies for the safe haven of the second paragraph of item (k) regardless of whether it is a "grant" or a "payment" as defined by the first paragraph of item (k).

Whether the second paragraph of item (k) allows an exception from the first paragraph or from the SCM Agreement as a whole, PROEX III does not allow the relevant Brazilian authorities the discretion to act in breach of Brazil's obligations under the SCM Agreement. On the contrary, PROEX III requires conformity with the SCM Agreement: it requires that the Committee on Export Credits act in conformity with the specific disciplines of the interest rates provisions of the *OECD Arrangement* unless financing is provided on terms available in the market, in which case no benefit is conferred. Nevertheless, even assuming that PROEX III is discretionary and allows Brazil to act in a manner inconsistent with its obligations under the SCM Agreement, PROEX III cannot be challenged unless and until it is applied in such a manner.

Under the traditional GATT/WTO doctrine regarding the distinction between mandatory and discretionary legislation, "discretionary legislation" refers to legislation that gives the Executive the ability to apply a law either consistently or inconsistently with the country's treaty obligations[11] Under traditional GATT/WTO jurisprudence, "discretionary" legislation cannot be challenged until it is actually applied in a GATT/WTO-inconsistent manner.

In Brazil's view, the mandatory/discretionary doctrine has its roots in general or customary principles of international law. It derives both from a rule of construction (i.e., that two potentially conflicting provisions of law will be interpreted in such a way as to make them consistent) and a presumption (i.e., that the WTO Member will in fact apply its law in a WTO-consistent manner). As explained by the United States in *United States - Antidumping Act of 1916*, WT/DS136/R (31 March 2000) (challenge brought by the EC):

[11] *See, e.g., United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206, para. 5.39 ("Recent panels addressing the issue of mandatory versus discretionary legislation in the context of both [GATT] Articles III:2 and III:4 concluded that legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation were being applied, whereas legislation merely giving the executive authority the possibility to act inconsistently with Article III would not, by itself, constitute a violation of that Article").

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> 3.33 . . . the distinction in GATT 1947/WTO jurisprudence between discretionary and mandatory legislation is not based upon a particular provision of the WTO Agreement, nor is it limited in its application to a particular WTO provision . . .The distinction is a general principle developed by panels that most likely has its origin in the presumption against conflicts between national and international laws. It is both general international practice and that of the United States that statutory language is to be interpreted so as to avoid conflicts with international obligations. There is thus a presumption against a conflict between international and national law. In general [according to OPPENHEIM'S INTERNATIONAL LAW (hereinafter "OPPENHEIM'S")],
>
> > "[a]lthough national courts must apply national laws even if they conflict with international law, there is a presumption against the existence of such a conflict. As international law is based upon the common consent of the different states, it is improbable that a state would intentionally enact a rule conflicting with international law. A rule of national law which ostensibly seems to conflict with international law must, therefore, if possible always be so interpreted as to avoid such conflict."[12]

Both GATT and WTO Panels have relied on similar reasoning in applying the doctrine. Thus, in *Canada - Aircraft*, the Panel reviewed Brazil's allegation that two of the challenged programmes (Export Development Corporation and Canada Account) required Canada to grant subsidies. The Panel determined, however, that Brazil had not offered evidence demonstrating that subsidization was required under these programmes. Rather, "the grant of subsidies would be the result of the exercise of the administering authority's discretion in interpreting its mandate.[13] In these circumstances, the traditional distinction between discretionary and mandatory legislation prevented the Panel from making findings on the programmes *per se*, and instead required that Brazil establish that the programmes, as applied, granted subsidies.

In addition, a Member may apply legislation in a manner that is consistent with its WTO obligations when it takes action affecting a fellow Member, but may apply the legislation in a manner that is inconsistent with the provisions of a WTO agreement when it acts against a non Member. Therefore, even assuming that PROEX III gives the Committee on Export Credits the ability to act in a manner inconsistent with Brazil's obligations under the SCM Agreement (which Brazil denies), PROEX III certainly does not require that Brazil act in a manner inconsistent with the SCM Agreement. Under this assumption, PROEX III is discretionary and cannot be challenged unless applied in a manner inconsistent with Brazil's WTO obligations.

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[12] OPPENHEIM'S INTERNATIONAL LAW, 9th ed., pp. 81-82 (footnote omitted).

[13] Canada - Measures Affecting the Export of Civilian Aircraft, WT/DS70/R (14 April 1999), para. 9.128. For GATT cases applying the doctrine, see, e.g., United States - Taxes on Petroleum and Certain Imported Substances, adopted on 17 June 1987, BISD 34S/136 (the Panel found that a U.S. law could not be challenged until it was applied because the U.S. executive possessed authority to apply the law in a GATT-consistent fashion); Thailand - Restrictions on Importation of an Internal Taxes on Cigarettes, adopted on 7 November 1990, BISD 37S/200 (the Panel found that the mere existence of a higher tax ceiling on imported cigarettes did not violate Article III:2 of GATT 1947 because an implementing regulation had established an identical tax on both imported and domestic cigarettes); EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990, BISD 37S/132 (the Panel ruled that a measure that allowed, but did not require, the imposition of a tax on certain imported products to avoid circumvention of an antidumping duty order could not be challenged under Article III of GATT 1947 until it was applied and recommended that the EEC never apply the measure); United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco, adopted on 4 October 1994, BISD 41S/131 (the Panel found that a U.S. statute was susceptible to many interpretations, including one that would violate Article VIII:1(a) of GATT 1947, but did not find it inconsistent with the GATT because it could also be interpreted and applied in a GATT-consistent manner).

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Q22. The Panel in *United States – Section 301* (WT/DS152/R, para. 7.96) found legislation presumptively inconsistent with the *WTO Agreement* in a case where legislation provided discretion to act in a WTO-inconsistent manner. Do the findings of this Panel on this issue have any relevance to this dispute? Please elaborate.

Again, as Brazil noted above and during the meeting of the Panel, PROEX III does not allow Brazil to act in a manner that would be inconsistent with Brazil's WTO obligations. It requires that the authorities act in conformity with the provisions of the SCM Agreement. Therefore, the discretionary v. mandatory distinction and the findings in the *Section 301* case are irrelevant. However, even under the assumption that PROEX III is discretionary and allows Brazil to act in a manner inconsistent with the SCM Agreement, the findings of the *Section 301* Panel are not applicable because they are based on very different facts.

In *Section 301*, the EC challenged a provision of US law that, in certain circumstances, *required* the US Trade Representative to determine whether another country was complying with its WTO obligations *before* a WTO dispute settlement Panel had issued a ruling on that very question. The EC argued that the US law was inconsistent with Article 23 of the Dispute Settlement Understanding, which specifically states that "Members shall not make a [unilateral] determination to the effect that a violation has occurred" before such a determination is made by the Dispute Settlement Body. The United States defended the measure on grounds that the USTR had the discretion to find that the other country was not acting in a manner inconsistent with its obligations. Consequently, according to the United States, the measure could not be challenged until the USTR had acted, *i.e.*, until it had issued a determination, prior to the completion of the WTO dispute settlement process, that another country had acted inconsistently with its WTO obligations. Thus, the United States explicitly retained the right to make unilateral determinations that were expressly prohibited by the DSU and was, indeed, *required by the statute* to make such determinations.

The Panel, without departing from the mandatory/discretionary doctrine, found that the vesting of discretion in the government could constitute a violation of the WTO obligations when the discretion is, *in itself*, a direct violation of an express provision of a WTO agreement. These facts are very different from the facts of PROEX III, as the SCM Agreement does not contain any provision expressly preventing a Member from granting some discretion to its Executive.

Brazil does not believe that any provision of PROEX III allows a violation of Brazil's obligations under the SCM Agreement. Canada, however, has raised the issue of spare parts. This issue would arise only if the Panel decides that PROEX III does confer a benefit and that, in order to qualify for the safe haven of the second paragraph of item (k), PROEX III must comply with the interest rates provisions of the 1998 version of the *OECD Arrangement*. In that case, the distinction between the *Section 301* case and the current case is apparent. PROEX III allows financing of spare parts *up to* 20 percent of the aggregate value of the other goods. It does not expressly reserve the right of Brazil or require Brazil to finance spare parts for regional aircraft in excess of the requirements of the 1998 *OECD Arrangement*.

Q23. What relevance, if any, does the language of Article 3.2 to the *SCM Agreement* ("A Member shall neither grant *nor maintain* subsidies referred to in paragraph 1") have to the consideration of PROEX III in this dispute.

The "*grant*" nor "*maintain*" language in Article 3.2. of the SCM Agreement is not relevant to the consideration of PROEX III in this dispute. PROEX III allows neither granting nor maintaining prohibited subsidies. In fact, as Brazil stated before this Panel and in its response to Question 10 above, to date no support has been granted under PROEX III and, therefore – obviously – no subsidies could have been granted or maintained under PROEX III. Subsidies that may have been granted or maintained under the previous versions of PROEX are not at issue in this dispute. Canada has sought and obtained the authorization to retaliate against those subsidies, and they are not within the terms of

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reference of this Panel. The only question before this Panel is whether PROEX III is consistent with Brazil's WTO obligations.

Q24. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?

The language of Article 20 of the *Arrangement* expressly limits the application of the minimum premiums to official support provided through direct credits/financing, refinancing export credit insurance and guarantees. Interest rate support, such as PROEX, is expressly omitted from the application of the minimum premiums.

Brazil is, of course, not a Participant in the *Arrangement* and was not involved in the drafting or negotiation of the terms of its terms. Brazil can therefore only offer speculation as to why interest rate support was excluded from the application of the minimum premiums. It is Brazil's understanding that the minimum premiums do not apply to interest rate support because the government providing interest rate support simply makes interest payments and does not assume any of the risk of the transaction. In contrast, governments providing direct financing or guarantees necessarily assume all or part of the risk of the transaction.

While the OECD makes available some information regarding how premiums are to be calculated (the so-called Knaeppen Package), as far as Brazil is aware, the actual premiums are not available to non-Participants in the *Arrangement.*

Q25. Please state clearly for the Panel your view regarding which provisions of the 1992 and 1998 Arrangement are "interest rates provisions" within the meaning of the second paragraph of item (k).

As explained in Brazil's First Submission, Brazil understands that the panel in *Canada – Aircraft* used an overly broad approach to identify what it believed were the interest rates provisions of the 1998 *OECD Arrangement*[14] As explained in its First Submission, Brazil submits that the interest rates provisions of the 1998 version of the *Arrangement* are Articles 15 through 19 of the main text and Article 22 of the Annex[15] Further, Brazil believes that the interest rates provisions of the 1992 version of the *Arrangement* are those set out in Article 5 of the main text and Article 21 of Annex IV: Sectoral Understanding on Export Credits for Civil Aircraft[16] These are the only provisions of the *Arrangement* governing the interest rate for a given transaction. The other provisions described by the *Canada – Aircraft* panel as interest rates provisions do not affect the interest rate for the transaction.

For example, Article 7 of the 1998 *Arrangement* requires that purchasers make cash payments equal to a minimum of 15 percent of the export contract value (*i.e.*, only 85 percent of the transaction value may be financed)[17] This is not an "interest rates provision" because the amount to be financed does not affect the interest rate, but simply the amount of the loan.

Similarly, Article 29(a) of the Annex provides that spare parts financing shall be limited to 20 percent of the value of the transaction. This provision also affects only the amount of the loan;

[14] Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW (9 May 2000), para. 5.78.

[15] Brazil's First Submission, 16 March 2001, para. 52.

[16] *Id*., para. 40.

[17] The corresponding provision of the 1992 version of the *Arrangement* is Article 3.

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there is no commercial reason why the level of spare parts financing in a given transaction would affect the interest rate for the transaction.

For these reasons, Brazil submits that the ordinary meaning of the term "interest rates provisions" in the second paragraph of item (k) is that it refers only to the provisions of the *Arrangement* that specify the interest rates. If the negotiators had meant to include other terms and conditions, they would have said so.

Brazil also notes that the second paragraph of item (k) purposefully refers to the "interest rates provisions" of the *Arrangement* rather than simply to the "provisions" of the *Arrangement*. In order to give meaning and effect to the inclusion of the words "interest rates" before the word "provisions," the Panel must interpret the second paragraph as requiring that Members that are not Participants in the *Arrangement* apply some, but not all, of the provisions of the *Arrangement*. The only provisions that must be applied are those relating to "interest rates." Accordingly, Brazil submits that the only interpretation of the term "interest rates provisions" that would be consistent with the text would be to limit the term to the provisions of the 1992 and 1998 versions of the *Arrangement* listed in paragraphs 40 and 52 of Brazil's First Submission and above.

Brazil believes that it is especially important to construe the term "interest rates provisions" narrowly if the Panel interprets the second paragraph of item (k) of the SCM Agreement as referring to the 1998, rather than the 1992, version of the *Arrangement*. If the 1998 version is deemed to apply, the Participants in the *Arrangement* will be empowered to change the rules governing officially supported export credits that affect well over a hundred WTO Members that are not Participants in the *Arrangement* and have no say in the formulation of OECD rules. This power must be limited to setting the interest rates governing officially supported export credits only, and should not be expanded to permit unlimited changes in the rules governing export credits.

* * * * * * *

Additional question for both parties

Q32. With respect to Brazil exhibit 3, please confirm the accuracy of the English translation of Article 3, paragraph 2 of Directive 374. In particular, is the phrase "may be extended to" an accurate translation of "poderà ser ampliado, para até"?

There is a small typographical error in the translation of Article 3 paragraph 2 of Directive 374. The phrase "poderá ser ampliado, para até" should be translated as "may be extended *up* to." The word "up" is missing from the translation provided in Exhibit Bra-3.

* * * * * * *

Questions from Canada to Brazil

Q1. In Exhibit CDA-24, an executive on behalf of Air Wisconsin Airlines Corporation states that Embraer has offered financing to Air Wisconsin but that Air Wisconsin cannot offer further details due to confidentiality commitments to Embraer. Will Brazil obtain Embraer's consent to waive these confidentiality commitments?

As Brazil explained in its closing statement to the Panel, dated 5 April 2001, Brazil is not responsible for what a sales person from Embraer might say. Brazil is responsible only for interest rate support approved under PROEX III. Brazil has not received an application for interest rate support for sales by Embraer to Air Wisconsin and has not approved any support for this transaction.

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Published reports confirm that Air Wisconsin has bought Canadian, rather than Brazilian, regional jets.

Q2. Canada has provided evidence that Embraer recently offered PROEX financing to SA Airlink for a 15 year term. On 14 December 2000 Embraer announced the sale of up to 70 regional jets to SA Airlink. Has Brazil issued any letter(s) of commitment in respect of the SA Airlink sale *other than under PROEX III*? If so, will Brazil provide it/them to the Panel? Have any applications been made to the Committee on Export Credits or to any other authority of the Government of Brazil to provide financing in support of the SA Airlink sale? If so, will Brazil provide it/them to the Panel?

As Canada itself has acknowledged, the sole issue before this Panel is whether PROEX III constitutes a prohibited export subsidy. As stated above, Brazil has not issued any letters of commitment under PROEX III. Accordingly, none of the information requested by Canada is relevant to the matters before this Panel.

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ANNEX B-6

BRAZIL'S COMMENTS ON RESPONSES TO QUESTIONS BY CANADA AND THIRD PARTIES

(20 April 2001)

Canada's Replies

Question 15

1. Brazil finds Canada's response difficult to understand. Canada seems to be saying that PROEX can *never* be in conformity with the SCM Agreement because, "however it is delivered, it enables Brazil to continue to grant prohibited export subsidies." This contradicts prior statements of Canada. In its second oral statement to the original Panel, Canada stated that it "would not have brought this case" if only "PROEX simply reduced the net interest rate offered to an airline to one that is above LIBOR or OECD rates."[1] In responding to the questions of the first Article 21.5 Panel, Canada unambiguously stated that "the relevant benchmark against which a net interest rate must be compared to determine whether a material advantage has been secured is CIRR."[2] Canada's response appears to be just one more example of Canada's practice, indulged in throughout these proceedings, of constantly moving the goal post.

2. Canada also states that it "is also challenging PROEX III payments made in support of regional aircraft exports." Yet, Canada has been unable to point to a single instance of a PROEX III payment made in support of regional aircraft exports, for the very good reason that there have been none.

3. Canada's moving of the goal posts, and its reliance on non-existent transactions cannot obscure the fact that the sole issue before this Panel is not what PROEX I and II, provided, or how they were applied in practice. The sole issue is whether PROEX III, on its face, by its terms, conforms to Brazil's obligations under the SCM Agreement.

Question 16

4. Brazil believes that Canada has misinterpreted both Article 13 of the *OECD Arrangement* and the provisions of PROEX. While Brazil is not a Participant in the *Arrangement* and therefore was not privy to the intent of the Participants in its drafting, Article 13 does not appears to contain any mandatory provisions. Unlike, for example, Article 15 governing minimum interest rates (the parties "shall apply"), Article 13 merely states that parties shall "normally" require the repayment of principal to begin within six months. Further, Article 13(c) describes this as a "practice" rather than a "rule" or "requirement."

5. Brazil previously has explained that it does not consider Article 13 to be an "interest rates provision" of the *Arrangement* within the meaning of the second paragraph of item (k). Even assuming that Article 13 is an "interest rates provision," however, the Article does not establish any mandatory requirement. Therefore, the fact that a Member's export credit practices may not conform exactly with the discretionary provisions of Article 13 should not prevent that Member's practices from qualifying from the safe haven of the second paragraph of item (k). Brazil further notes that Article 13(c) requires Participants in the *Arrangement* that do not intend to follow the "practice" of Article 13 to notify other Participants. There is no requirement that WTO Members that are not

[1] *Brazil - Export Financing Programme for Aircraft*, Canada' Second Oral Submission to the Panel, para. 109.

[2] Original Article 21.5 Panel Report, page 89 (Canada's Response to Question 12 of the Panel).

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Participants in the *Arrangement* be notified, and no means by which they could obtain this information. In these circumstances, WTO Members should not be required to conform to a "practice" of which they may not even be informed in order to qualify for the safe haven.

6. Brazil also disagrees with Canada's interpretation of the language of Article 13, in that the phrase "shall normally" qualifies both the reference to "equal and regular instalments" and the reference to "first instalment" later in the same sentence. The text does not support Canada's interpretation. Moreover, the subsequent language of Article 13 (b) and (c) refers to subsection (a) in the singular ("this profile" and "this practice"), indicating that Article 13(a) is to be read as a unitary whole, rather than establishing separate degrees of obligation for the "equal and regular" instalments and the "first instalment," as Canada suggests.

7. Canada's reference to Article 27(a) is also misplaced in that Article 27(a) states that Participants may not extend the repayment term of a loan by delaying the first payment of principle. This merely confirms the language of Article 10 governing maximum repayment terms, but does not appear to affect the interpretation of the word "normally" in Article 13(a).

8. Canada's interpretation in paragraph 3 of its answer of Article 2 of Brazil's Directive 374 is also misplaced. Brazil notes that Article 3, paragraph 1 of Resolution 2799 requires that interest shall be payable every six months on the outstanding balance of principal, starting from the date of shipment or delivery of the goods. Article 4 provides that the amounts due and payable for interest rate support shall be based on the same terms as the interest accrual term, including a maximum grace period of six months for the repayment of the principal.[3] Brazil notes also that this is consistent with the approach of the Article 22.6 Arbitrators, who assumed "semi-annual constant instalments for capital reimbursement" under PROEX.[4] These requirements limit any flexibility granted under Article 2 of Directive 374 regarding the terms and grace periods for principal. It is, therefore, incorrect for Canada to assert that PROEX III would not "respect" the "normal" practice of Article 13(a) of the *Arrangement*.

Question 17

9. The real answer is admitted by Canada in the first sentence of its response: "The 1998 OECD Arrangement does not define 'interest rate support.'"

10. Canada states that PROEX III payments "are significantly different from the interest rate support practices of the Participants." Canada claims that interest rate support provided by the Participants varies according to the difference between the prevailing short-term rate and the rate that was fixed for the borrower. Brazil has no basis for agreeing with or disputing this statement, as the *Arrangement* is silent on the point, and Canada has never offered any evidence concerning the interest rate support practices of Participants. Regardless of the practices of Participants, however, the practices of the Participants do not exhaust the field, and, even if they differ from PROEX, do not mean that PROEX is not interest rate support.

11. As Canada describes the interest rate support practices of Participants, it would appear that PROEX may place more risk on the lender than do those practices. PROEX is a fixed amount, and will not be adjusted upward if short-term rates rise. Thus, under PROEX, lenders are required to assume the entire risk of interest rate changes during the life of the loan.

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[3] Brazil notes that there is a typographical error in the English version of Resolution 2799 in Exhibit Bra-1, which rendered the Portuguese "máxima" into the English "minimum" in describing the permitted period of grace for the repayment of principal. The translation should read "maximum grace period."

[4] *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement,* WT/DS46/ARB (28 August 2000), para. 3.82.

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12. In the second bullet point to its second paragraph, Canada seems to suggest that PROEX III does not qualify as "interest rate support" because it is a one-way flow from the government to the bank instead of a two-way flow, "associated with interest rate equalization." Canada neglects two important points. First, whatever the flow between the government and the bank is, the effect on the borrower is the same: the borrower always receives funds at the same rate. Second, in the case of a "two-way flow" the bank is always guaranteed its margin of profit. If it makes more than the agreed margin, it will have to pay the difference to the government, but if it makes less the government will compensate it for the difference. In the case of a "one-way" flow, the bank takes all of the risk: its profit margin is not guaranteed and it can still incur losses depending on how the market moves.

13. In the third bullet-point to paragraph 1 of its response, Canada appears to criticize Brazil for not providing enough support through PROEX. It may well be, as Canada says, that "Participants provide credit risk insurance or guarantees in conjunction with interest rate support to cover [the risk of non-repayment from the borrower]." If so, this is support that PROEX does not provide. PROEX provides no protection to the lender for possible default by the borrower.

14. Finally, Canada's assertion that "PROEX is divorced from the interest rate that prevails in the market when the transaction is approved," is contradicted by the express terms of PROEX which, on their face, explicitly make the market a reference for PROEX.

Question 18

15. Brazil believes Canada's response does not make clear that the question of a "benchmark" is relevant only to Brazil's item (k) first paragraph defense. Benchmarks are not relevant to Brazil's other defenses (1) that PROEX III does not confer a benefit and therefore is not a subsidy and (2) that, in any event, PROEX III is eligible for the safe haven of item (k) second paragraph. As Brazil pointed out during the hearing, PROEX III does not confer a benefit because the CIRR is not the mandatory interest rate but the minimum, the floor, rate. Under Article 8, paragraph 2 of Resolution 002799, the interest rate must be determined on the basis of the rate available in the international market. Thus, under Resolution 2799 it is the international market, not the CIRR, that is the benchmark. As for Brazil's second defense – that PROEX III is eligible for the safe haven of item (k) second paragraph – that defense does not require establishing a benchmark. All Brazil needs to show is that it complies with the interest rates provisions of the *OECD Arrangement* which, as far as the rate of interest rate support, requires the CIRR.

16. The substance of Canada's response with regard to the benchmark is contradictory. It is quite clear that, as the Panel's question suggests, the Appellate Body was aware of the financing spreads required from airlines purchasing regional aircraft when it concluded that the CIRR was an appropriate benchmark. The Appellate Body stated that, "We believe that the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k) are 'used to secure a material advantage in the field of export credit terms.'"[5] Yet Canada states that it "has challenged Brazil's selection of the CIRR as an appropriate benchmark."

17. The Appellate Body made it abundantly clear that the CIRR would serve as a benchmark and that, while other rates in fact might or might not confer a material advantage, it was up to the party urging that fact to prove it. This, in Brazil's view, was the basis of the original Article 21.5 Panel's determination that Brazil had not established that PROEX II, in adopting a benchmark lower than CIRR, did not confer a material advantage.[6]

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[5] *Brazil – Export Financing Programme for Aircraft*, AB-1999-1, WT/DS46/AB/R, para. 181 (2 August 1999).

[6] *See, e.g., Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW paras. 6.92 and 6.93 (9 May 2000).

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18. Brazil must confess to some confusion about just what Canada's position is regarding the CIRR and the market. In paragraph six of its response to Question 18, Canada states that the airline with the best credit rating is American Airlines, and that the CIRR is 35 basis points lower than the rate American Airlines is able to achieve in the market. Canada made this point as well at paragraph 78 of its First Submission. As authority for the statement in its First Submission, Canada refers to page 13 of its Exhibit 17 which ostensibly shows that the debt of American Airlines trades at between 135 and 200 basis points above US Treasury rates which is, at a minimum, 35 basis points above the CIRR.

19. First, Brazil would point out that the securitization of aircraft *leases* is an operation that does not directly reflect the terms of the *original loan* itself. This complex and recently developed financial operation involves a number of additional steps. The enhanced equipment trust certificate ("EETC") securitization enhances the creditworthiness of traditional equipment trust certificates ("ETCs") secured by lease receivables and the leased aircraft as follows: first, the issuer of the EETCs is bankruptcy remote (and insulated from a bankruptcy of the lessee) to the satisfaction of the rating agencies; second, the EETCs are tranched to take advantage of the expected residual value of the aircraft, *i.e.*, the lower the advance level, the higher the rating; third, a liquidity facility is provided to ensure the continued payment of interest on the EETCs during the remarketing period following a possible default by the lessee. The term of the liquidity facility in an EETC securitization relies on the ability of a lessor to repossess an aircraft from a bankrupt lessee, if the lessee does not elect to perform.

20. The first EETC structure was closed by Northwest Airlines in 1994. As described above, the rating agencies concluded that the underlying corporate credit of a single airline could be enhanced through a combination of the ability to repossess and remarket the leased aircraft within a limited eighteen month period during which interest would continue to be paid by a liquidity facility. This was combined with tranched debt, to achieve ratings for all of the EETC classes of debt that were higher than that of the airline.

21. The securities of the EETC structure are offered in the secondary market and their prices then oscillate according to the financial market trends, with spreads that respond to various economic and market indicators (such as the behavior of the markets of stocks and bonds) that maintain no relationship whatsoever with the original financial structure of the loan obtained by the lessor when purchasing the aircraft. The spreads mentioned by Canada reflect nothing more than investors return expectations based on a range of commercial papers, with comparable coupons, yields, maturities, credit ratings, etc.

22. Canada's Exhibit 17 itself demonstrates the flaws in Canada's reasoning. With regard to its American Airlines illustration, on page 6 of Exhibit 17, it is stated that American Airlines "was placed on Watchlist negative by Moody's and CreditWatch negative by S&P after it proposed to acquire the assets of TWA and a portion of the assets of US Airways." This demonstrates that the papers from American Airlines today do not enjoy the same credit ratings that the airline once enjoyed.

23. Moreover, Canada's reliance on the January 2001 spread for American Airlines – or any airlines – is misplaced. That spread simply represents the current yield on the instrument. It has nothing to do with the original spread, at the time the EETCs were issued. In the case of American Airlines these ranged 112 to 147, considerably lower, but still above CIRR. However, as Exhibit 17 itself shows, many of the original spreads were below CIRR. This is the case for the very first transactions listed, for America West. It is also the case for a number of the Continental Airlines transactions listed.

24. One of the Continental transactions is particularly instructive – those issued on September 12, 1997 covering nine Embraer 50 seat 145 regional jets. This is set out on page 14 of Canada's

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Exhibit 17. The offering spread on those transactions ranged from 90 to 100 – in other words, from 10 basis points below the CIRR to the CIRR. This transaction, as Exhibit 17 shows, was comparable to other rates at the time. It was also before PROEX III. More important, following Canada's logic with its American Airlines example, Embraer'rs paper today is trading at 115 to 160 points above the CIRR – so what is Canada's problem?

25. These distinctions between the securitization of leases and the terms of the original loan may be the key to understand Canada's departure from its previous statements defending the adequacy of the CIRR as a benchmark. As the panel recalls, before the *Canada – Aircraft* Panel, Canada said that the CIRR is, "by definition, 'close to commercial rates.'"[7] Moreover, before the Article 21.5 Panel in *Brazil – Aircraft*, Canada said that financing offered by its Export Development Corporation ("EDC") at rates *below* the CIRR were, nevertheless "commercial" and did not confer a benefit within the meaning of Article 1 of the SCM Agreement.[8]

26. Finally, simply taking Canada's analysis as it is given, Canada does not explain how it is possible for the debt of the airline with the best credit rating to trade at 35 to 100 basis points above the CIRR when, at the same time, its own lending to airlines *below* the CIRR is "commercial."

27. Beyond this, Brazil cannot clarify this situation, but fortunately, Canada is in a position to do so. The American Airlines debt reported in Canada's Exhibit 17, at page 13, concerns only large civil aircraft manufactured by Boeing. No regional aircraft are included. However, the Canadian producer, Bombardier, itself has sold its 70-seat aircraft, the CRJ 700, to American Airlines' wholly owned regional carrier, American Eagle. Brazil understands that financing for this transaction was provided by EDC through its "market window" operations. In Canada's view its market window operations do not provide "official support," and are purely "commercial." Canada could, therefore, shed light on this matter by providing the Panel with the terms and conditions, including the interest rate, it offered or provided to support Bombardier's sale of the CRJ 700 to American Eagle.

28. Brazil would note that at the time of the transaction, Bombardier was the only producer in the world offering a 70-seat regional jet. Therefore, its transaction with American Eagle would have been on terms uninfluenced by competition.

Question 19

29. Brazil disputes Canada's claim that it "has demonstrated that the CIRR is not an appropriate generalized market benchmark because it does not generally reflect the rates available in the commercial marketplace for the financing of regional aircraft." Canada has produced *no* evidence concerning "the commercial marketplace for the financing of regional aircraft" despite the fact that Canada's EDC participates in that market. As Brazil noted above in its comment to Canada's response to Question 18, the only market evidence Canada has offered concerns the secondary market for American Airlines debt secured by large commercial aircraft.

Question 20

30. In Brazil's view, the Appellate Body considered the CIRR as a generalized market benchmark both because it is based on reasonably current market interest rates, and is a published, objectively derived rate that is easily administrable in the context of item (k) first paragraph. While a WTO Member is free to urge another rate, that Member has the burden of proof, a burden that Brazil in the

[7] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R at paras. 6.167, 9.223 (14 April 1999).

[8] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, para. 6.99 (9 May 2000).

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original Article 21.5 proceeding found difficult to meet, as does Canada here, albeit for different reasons.

31. The burden was impossible for Brazil because, while it was established that Canada provided support below the CIRR, Brazil could not establish with the required precision how far below Canada's rate was, and how that rate related to the market overall. Lack of transparency on the part of Canada and others in the market was a barrier Brazil could not surmount. Here, the barrier Canada cannot surmount is based on its unwillingness to disclose to the Panel the details of its own market operations. The consequence is, as Brazil noted above in its comment on Canada's response to Question 19, that Canada has offered only evidence of the secondary market for debt on large civil aircraft produced by Boeing, not for the original market for regional aircraft produced by Bombardier in which Canada participates.

Question 21

32. Canada's response admits that under the traditional distinction between mandatory and discretionary measures it is not sufficient to show that a measure might allow a Member to violate its WTO obligations but rather that the measure requires a Member to violate its WTO obligations. But then Canada argues that this distinction applies to every WTO provision with one exception: the second paragraph of item (k). Canada states that the mandatory v. discretionary distinction does not apply here because Brazil has the burden to establish an affirmative defense.

33. The premise of Canada's argument is false for several reasons. To begin with, Brazil's first argument is that PROEX III does not confer a benefit. This is not an affirmative defense. Canada must establish a *prima facie* case that PROEX III does confer a benefit.

34. Further, it is true that Brazil's second defense – the safe haven under the second paragraph of item (k) – is an affirmative defense and Brazil has the burden of proof. However, the mandatory v. discretionary distinction has nothing to do with the burden of proof. It is a substantive standard. Once Brazil establishes a *prima facie* case that PROEX III allows compliance with the interest rates provisions of the *OECD Arrangement*, PROEX III should, under the traditional mandatory v. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise. As Brazil has shown, PROEX III allows the Executive to comply with the interest rates provisions of the *Arrangement* even if it might also allow Brazil not to comply with those provisions.

35. Brazil notes that when a WTO Member decides to challenge a measure of another Member, it has two options. It can challenge the measure either as applied or the measure as such. When making that choice the Member also makes a choice concerning the evidence it needs to submit in order to establish a *prima facie* case. Canada chose to challenge PROEX III as such. Therefore, under GATT/WTO jurisprudence and the mandatory v. discretionary doctrine, Canada imposed on itself the burden to prove that PROEX III *requires* action that would constitute a violation of Brazil's WTO obligations. This was Canada's choice, not Brazil's. It was Canada's choice to rush and file this dispute – accusing Brazil of dragging its feet – without an appropriate opportunity for bilateral consultations.

36. Thus, contrary to Canada's assertions, under the mandatory v. discretionary doctrine, the burden of proof is quite different. Canada must establish that PROEX III requires Brazil to violate its WTO obligations. Brazil, on the other hand, needs only to show that PROEX III is discretionary and allows the Executive to apply it in a manner fully consistent with the WTO. Once Brazil meets that burden of proof, PROEX III, under the traditional mandatory v. discretionary doctrine, must be considered to be in conformity with Brazil's WTO obligations.

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37. In this answer, Canada again refers to "evidence" that "establishes" Brazil's failure to comply with the interest rates provisions of the *Arrangement*. One assertion – that Directive 374 on its face allows financing for a period exceeding 10 years – will be addressed in Brazil's comments on Canada's response to Question 32. Brazil would like to point out, however, that Canada keeps referring to "unrebutted evidence" about Brazil's non-compliance without identifying that evidence. Brazil has submitted the evidence that must prevail in these proceedings: the documents constituting PROEX III. All Canada has submitted in exchange is newspaper reports. Canada has now – for the first time – attempted in its answers to claim that Directive 374 on its face allows financing for a period exceeding 10 years. As Brazil will show in its comment on Question 32, this assertion is untenable.

Question 22

38. Canada repeats its unsubstantiated assertion that Brazil has not shown that PROEX III allows for an application that is consistent with the SCM Agreement. Canada, however, has not, by any reasonable standard, even remotely made a *prima facie* case that PROEX III *requires* a violation of Brazil's WTO obligations.

39. Further, Canada misinterprets the *Section 301* case. It is incorrect to state, as Canada does, that "the *Section 301* panel found legislation to be presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner." In *Section 301*, the US legislation *required* USTR, under certain circumstances, to make a unilateral determination on whether another government acted in compliance with its WTO obligations. While USTR retained the discretion to determine whether another government acted in compliance with its WTO obligations, it was required by the legislation to make that determination unilaterally. Thus, the *Section 301* finding is not inconsistent with the traditional mandatory v. discretionary distinction and is not applicable to the facts of this case. PROEX III, contrary to Canada's assertion, does not *require* that Brazil act in a manner inconsistent with its WTO obligations.

Question 23

40. Brazil has not granted any subsidies under PROEX III; therefore, Brazil does not maintain any subsidies under PROEX III.

Question 24

41. Brazil would like to refer the Panel to the answer provided by Korea, as a third party, to Question 27. Korea's answer contains a detailed and persuasive explanation as to why the concept of minimum premiums does not apply to interest rate support.

42. Canada seems to provide support for Brazil's view, also shared and supported with detailed arguments by Korea. In the second paragraph of its answer to Question 24, Canada argues that interest rate support does not remove the risk of non-payment by the borrower for the lending institution. Brazil agrees. That risk is removed only when the government assumes it by providing interest rate support in association with a guarantee or insurance. PROEX III does not do that (and Canada has never argued that it does). This is precisely why Article 20 of the 1998 *Arrangement* does not apply to PROEX.

43. Finally, as Canada is compelled to admit, the minimum premium benchmarks defined by the participants in the *OECD Arrangement* are *not* available to non-Participants. Yet Canada – and the EC and the US – argues that the 1998 version of the *Arrangement* is the relevant version. They would require Members of the WTO to comply with commitments that they cannot even know about.

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Question 25

44. Brazil already has enumerated the provisions of the OECD Arrangement it considers as "interest rates provisions" and will not now restate those provisions. However, Brazil disagrees with Canada's views on this issue and has the following comments.

45. Canada states that its interpretation encompasses provisions that "affect what the interest rate and the amount of interest payable will be in a given transaction." However, many of the provisions listed by Canada have nothing to do with the interest rate or even the amount of interest. Thus, provisions of the Arrangement such as Article 7, governing cash payments, and Article 9, governing the starting point of credit, affect important – indeed even critical – terms of a transaction, but they simply to do affect the interest rates.

46. A more significant problem with Canada's definitions is that Canada continues to include in its definition the matching provisions of Article 29 of the *Arrangement*. The matching provisions of Article 29 require that Participants notify each other in the event that they depart from the provisions of the *Arrangement* in order to match terms and conditions offered by either Participants or non-Participants. Brazil does not agree that a decision *not* to follow the interest rates established in the *Arrangement* and the provisions governing that decision can in themselves constitute *interest rates provisions*. This is clear from the language of the *Arrangement* itself, which allows Participants to match "credit terms and conditions." This term must necessarily be broader than the term "interest rates provisions" as used in the second paragraph of item (k), as it appears to encompass *all* the credit terms and conditions of a transaction, rather than simply the *interest rates* provisions referred to in item (k). The *Canada - Aircraft* Article 21.5 Panel also found that the term "interest rates provisions" could not be read to refer to *all* of the provisions of the *Arrangement*, as that would "seriously undermine the disciplines of the SCM Agreement."[9]

47. Moreover, the *Arrangement* does not require Participants to notify non-Participants of their intent to "match" non-conforming offers either by other Participants or by non-Participants. If Canada's definition of the term "interest rates provisions" is correct, therefore the second paragraph of item (k) means either that (1) the second paragraph of item (k) creates different rules for Participants in the *Arrangement* (who may match) and non-Participants (who may not), or that (2) non-Participants in the *Arrangement* must also be permitted to match. There is no legal basis for the first interpretation, as the entire purpose of the second paragraph is to enable Members that are non-Participants in the *Arrangement* to abide by the same rules as the Participants; an the second interpretation would render the safe haven of the second paragraph redundant, in that non-Participants could simply match in every instance.

48. For these reasons, the term "interest rates provisions" as used in the second paragraph must be interpreted literally to refer to the provisions of the *Arrangement* that establish *interest rates*, and not to provisions that govern the other terms of the transaction. Had the drafters of the SCM Agreement intended otherwise, they would have referred to "the provisions of the relevant undertaking" or "the credit terms and conditions of the relevant undertaking" making it clear that all the provisions of the *Arrangement* must be complied with.

Question 32

49. Canada's translation of this provision is simply wrong. This is the first time Canada advances the argument that PROEX III on its face allows financing for a period of 10 years *to be extended for an additional period of 8 years*. Such a reading of the text of Directive 374 is incorrect. This is not

[9] *Canada - Measures Affecting the Export of Civilian Aircraft - Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (9 May 2000), para. 5.113.

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what the drafters said or intended to day. In fact, such an interpretation would probably have never occurred to them had Canada not advanced it in these proceedings.

50. The Portuguese phrase "poderá ser ampliado para até" means "may be extended up to" ("jusqu'à" in French, "hasta" in Spanish). The Annex to Directive 374 provides for the maximum term of financing for the specific categories of goods, category by category. For aircraft, it is a maximum of 10 years. Article 3, paragraph 2 of Directive 374 provides that the term of interest rate support may be extended up to a certain period contingent upon the value of the goods.

51. Thus, for example, according to the Annex, the term for interest rate support for balloons cannot exceed 7 months. Under Article 3, paragraph 2, assuming balloons are in the first category, between $1,000 and $5,000, the maximum tenure can be extended from 7 months up to a maximum of 12 months. The provision of Article 3, paragraph 2, is not relevant for aircraft. The maximum term under that provision is 8 years. The provision of the Annex, specific to aircraft, allows financing for a maximum term of up to 10 years. Thus, the ceiling under the Annex is higher than the ceiling of Article 3, paragraph 2, and no further extension is allowed. As Brazil has stated on numerous occasions, the exception from this rule can be based only on the provision of Article 8, paragraph 2 of Resolution 2799 which allows the Committee to extend the term of financing if different terms are available in the international market.

Third Party Responses

European Communities' Responses

Question 27

52. Brazil agrees with the EC's statement in its response to Question 26 that PROEX III "is therefore interest rate support within the meaning of Article 2." However, Brazil does not agree with several points raised by the EC in its response to Question 27.

53. The EC at great length discusses risk premiums, but the 1998 version of the *Arrangement* refers only to country risk, not to company risk, and, as the EC admits, those country risk benchmarks are not available to non-participants. There are no references to risk premiums in the 1992 version of the *Arrangement*, the version that was incorporated by the WTO in 1995.

54. In Brazil's view, the point made by the EC in paragraph 7 of its response demonstrates forcefully why the term "interest rates provisions" in the *Arrangement* should be interpreted narrowly, and why the Panel should conclude that it is the 1992 version of the *Arrangement* that is relevant, not the 1998 version, adopted three years after the WTO came into being.

55. The EC describes the OECD and its *Arrangement* as if it were an exclusive club, which perhaps it is. The *Arrangement* is a "gentlemen's agreement" and, "One consequence of this is that circumvention of its provisions is not considered legitimate." However, WTO Members are entitled to know with reasonable clarity and precision what rules they are and are not expected to observe. They are not to be left to the vague standards of etiquette that a group of gentlemen sitting in Paris consider appropriate.

Korea's Response

Question 26

56. Note 53 from the original Article 21.5 Panel Report, quoted by Korea in its response, is a generally accurate description of PROEX III.

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Question 27

57. Korea accurately observes that, "The concept of minimum premiums does not apply to interest rate support" and that the *Arrangement's* minimum premium benchmarks are not even available to non-Participants.

United States' Response

Question 26

58. Brazil agrees with the statement of the United States, in the first paragraph of its answer, that, "The purpose of the [OECD] arrangement is to allow the commercial bank to provide fixed rate financing at the appropriate CIRR rate." This is precisely what PROEX III does.

59. The United States goes on, in that paragraph, to describe much of what PROEX III does *not* do. PROEX does *not* compensate the bank for its own floating rate funding risk. Beyond its fixed, maximum 2.5 percent payment, PROEX does *not* pay interest rate shortfalls to the bank depending upon the relationship between the fixed rate of the loan and the floating rate during the life of the loan. If, as the United States maintains, "most OECD governments offering interest rate support" also offer this kind of protection, they are offering much more than PROEX III offers.

60. PROEX III meets the criteria the United States sets out in the second paragraph of its response: (a) the interest rate the borrower sees after the interest rate support is the appropriate CIRR and (b) PROEX is not offered in a manner or at a level that is used to cover other costs of the borrower.

Question 27

61. The US states that "when a government does offer interest rate support in conjunction with insurance or a guarantee, the government must charge the appropriate minimum premium rate because it is providing insurance or guarantee cover." Thus, the US acknowledges that the only reason to charge a premium rate is to cover insurance or a guarantee – not for interest rate support. Since PROEX III does not provide insurance or guarantee cover, there is no need for a premium.

62. In the second paragraph of its answer (paragraph 4 of the document) the United States provides the web address of the OECD for the benefit of Brazil and the other 110 or more non-participant WTO Members. The EC, in its Third Party Submission – *noblesse oblige* – was good enough to do the same. While it is kind of the US and the EC to tell Brazil and the rest of the developing world how to find the OECD on the web, the point is that WTO Members should not be required to check the web site of the OECD in order to learn the nature of their WTO obligations. This is all the more reason why the Panel should conclude that the 1992 version is the relevant version of the *Arrangement* for purposes of item (k) second paragraph.

Question 29

63. The US admits that *Arrangement* Participants make notifications of non-conforming terms available to each other, but not to non-participants. While the US states its willingness to support reform of this procedure within the OECD, this is hardly a compelling argument for concluding that non-participants should be bound by the provisions concerned. It also demonstrates the elusive and changing character of the "gentlemen's agreement," and is further argument why the more clear, and now fixed, terms of the 1992 version of the *Arrangement* are those that were incorporated into item (k) second paragraph.

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Question 30

64. The argument of the United States in support of its contention that the negotiators meant "provisions" of the *Arrangement* rather than the "interest rates provisions" suggests that the Panel should impose added disciplines on WTO Members in order not to inconvenience the 30 Members who choose to belong to the OECD. To permit Members to qualify for the safe haven by applying only the "interest rates provisions," the US claims, "would undermine the disciplines of the Arrangement."

65. It is not the task of this Panel to undermine or to avoid undermining the OECD and its *Arrangement*. It is the task of this Panel to interpret item (k) second paragraph, a provision adopted by the entire Membership of the WTO in light of their objects and purposes, which had nothing whatsoever to do with the objects and purpose of the OECD. If a sub-set of WTO Members wishes to participate in other international organizations, they are, of course, free to do so. But they should not be heard to suggest that WTO Panels have any responsibility whatsoever to interpret WTO provisions in light the "disciplines" of those other organizations.

66. The WTO Membership did not adopt the entire *Arrangement* and the Participants should be permitted to drag that entire Membership into whatever non-interest rates provisions the *Arrangement* may contain, or into future amendments of the interest rates provisions themselves.

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ANNEX C

SUBMISSIONS OF THIRD PARTIES

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ANNEX C-1

SUBMISSION OF THE EUROPEAN COMMUNITIES AS A THIRD PARTY

(23 March 2001)

TABLE OF CONTENTS

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I. INTRODUCTION

1. The European Communities (hereafter "the EC") makes this third party submission because of its systemic interest in the correct interpretation of the Agreement on Subsidies and Countervailing Measures ("*SCM Agreement*").

2. The questions before the Panel are of considerable importance and complexity. The EC hopes that the comments it offers below will help the Panel in its task. It also hopes that the Parties will provide it with all their submissions to the first and only meeting of the Panel (including therefore their second written submissions), as required by Article 10.3 *DSU*, so that it can make a further contribution at the meeting with the Panel.

3. As an original signatory of, and a current participant in, the only international undertaking satisfying the conditions of the second paragraph of item (k) of the Illustrative List in Annex I to the *SCM Agreement*, that is the *OECD Arrangement*, the EC considers its close involvement in the work of this Panel to be particularly important.

II. SCOPE OF THIS PROCEEDING

4. The EC understands that the present proceeding does not concern contracts covered by PROEX I and II and that the question before the Panel is whether PROEX III is consistent or not with the *SCM Agreement*.[1]

5. The only basis on which the EC can express an opinion on this issue is from the terms of the new scheme as described in Section III, paragraphs 7 to 9 of Brazil's first written submission to the Panel and the documents referred to therein.

6. The EC notes that the only change in the scheme described by Brazil is the introduction of a requirement to comply with CIRR and that:[2]

> PROEX III interest rate equalization remains subject to the maximum percentages established by the Central Bank of Brazil in its Circular Letter No. 002881, dated 19 November 1999. Circular Letter No. 002881 sets the maximum allowable interest equalization payment at 2.5 percent.[3] This maximum amount is subject to the stipulation of Article 1, paragraph 1 of Resolution 00279 that interest rate equalization for regional aircraft must comply with the terms of the CIRR established under the *OECD Arrangement*.
>
> In addition, PROEX III interest rate equalization remains subject to the requirement that interest rate equalization may be provided for only 85 percent of the value of the sale, pursuant to Article 5, paragraph 1 of Directive number 374 of the Ministry of Development, Industry, and Foreign Trade, dated 21 December, 1999.[4] Directive 374 also establishes a maximum financing term of 10 years for regional jet aircraft.[5]

7. Canada seems to agree since it states that: [6]

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[1] First written submission of Canada, paragraph 19.

[2] First written submission of Brazil, paragraphs 8 and 9.

[3] Brazil's footnote: The original Portuguese version and the official English translation of Circular Letter No. 002881 are attached as Exhibit Bra-2.

[4] Brazil's footnote: The original Portuguese version and the official English translation of Directive 374 are attached as Exhibit Bra-3.

[5] Brazil's footnote: *Id.*, Annex, NCM Heading 8802 (attached as Exhibit Bra-3).

[6] First written submission of Canada, paragraph 12.

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In effect, the only discipline that Resolution 2799 imposes on PROEX payments is that they must be "in accordance with the CIRR".

8. The EC notes Canada's view that the scheme allows considerable flexibility and that the new scheme can be for unlimited periods and for 100% of the contract amount. The EC does not dispose of the necessary information to express a view on how Brazil does or will apply PROEX III and can only reserve its position on this question.

III. LEGAL ARGUMENT

9. Brazil makes three arguments in its defence:

- That PROEX III confers no benefit since financing is provided at CIRR which is at or above the "market rate";
- That PROEX III falls within the "safe haven" of the second paragraph of item (k);
- That PROEX III falls under the *a contrario* exception of the first paragraph of item (k).

10. These arguments will be considered in turn.

A. THE EXISTENCE OF A SUBSIDY

11. The EC does not agree that interest rate equalisation in the form offered in PROEX III does not confer a benefit for the purposes of Article 1 of the *SCM Agreement*.

12. It is paid to reduce the interest payment of a commercially negotiated contract by up to 2.5% per annum. It therefore inevitably – indeed *ex hypothesi* – provides a benefit compared with the market rate and thus a subsidy.

13. This conclusion is not contradicted by the various statements that Brazil refers to from the Norwegian export credit agency,[7] Mr Stafford and Mr Fumio Hoshi?[8]

14. These statements relate to whether the CIRRs actually correspond to rates available to first class borrowers in all cases and in no way support the suggestion that such rates are available to all borrowers on the market (especially in the absence of a guarantee or other security).

B. THE OECD SAFE HAVEN

15. Brazil's main defence is now that PROEX III falls under the safe haven of the second paragraph of item (k) of Annex I to the *SCM Agreement*.

1. The applicable version of the *OECD Arrangement*

16. Brazil bases its argument in the first instance on text of the 1992 version of the *OECD Arrangement.* The EC disagrees that the 1992 version is applicable. The text referred to as the *1998 version*[9] has replaced that of 1992

17. That the text of the second paragraph of item (k) of Annex I to the *SCM Agreement* makes a *dynamic* reference to the *OECD Arrangement* as in existence from time to time (rather than a *static*

[7] Paragraph 12.
[8] Paragraph 13.
[9] The text was agreed in 1997 and published in 1998.

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reference to a given version) is made clear by the fact that it provides for the applicability of *successor* undertakings. If it had been intended that only a given version of the *OECD Arrangement* should be relevant, this would have been specified in the text of item (k) itself. Since a successor undertaking can be become the basis for the application of this provision, *a fortiori* the same must be true of amendments to the *OECD Arrangement.*

18. The context of the provision, represented by the *OECD Arrangement* itself, confirms this interpretation. The *OECD Arrangement* is a non-binding gentlemen's agreement that was always designed to be evolutive in character, developing stricter disciplines and responding to changes in circumstances. Concretely, this is reflected in the provisions on annual review and on future work contained in all versions of the *OECD Arrangement*.[10]

19. The negotiating history of item (k) also strongly suggests that a dynamic reference was meant. It was first adopted in 1979 as part of a result of the Tokyo Round negotiations. The fact that the identical words were adopted as part of the *WTO Agreement* indicates that it was presumed to have the same meaning as under the Tokyo Round Code and this can only mean that the references in both texts were dynamic references to the version of the *OECD Arrangement* applicable from time to time.

20. The EC notes that the Article 21.5 panel in *Canada – Aircraft* came to the same conclusion as the EC that the *1998 version* of the understanding was applicable and relevant to assessing the conformity of export credit practices with the second paragraph of item (k) of Annex I to the *SCM Agreement*.[11]

21. The first argument that Brazil makes to the contrary is that the words "has been" in the phrase "a successor undertaking that *has been* adopted" can only refer to versions that were adopted before the conclusion of the WTO Agreement.[12]

22. The EC shares Brazil's view of the meaning of the perfect tense – that it refers to a "time regarded as present"[13] – but not Brazil's conclusion. The use of the perfect tense in the parentheses to the second paragraph of item (k) of Annex I to the *SCM Agreement* contrasts with the neutral present used elsewhere in that paragraph and indicates that the successor undertaking (or amendment) must *have been adopted* before the export credit measure which is the subject of dispute is taken.

23. That this is the intent is also confirmed by the consideration that Members of the WTO cannot be expected to comply with undertakings that have not yet entered into force nor with undertakings that have been recognised as inadequate and thus have been replaced.

24. Brazil's second argument is that a dynamic reference would imply an amendment of the *SCM Agreement* derogating from the Article X of the WTO Agreement and add to WTO obligations contrary to Article 3.2 *DSU*.[14]

25. The EC does not agree that a change in the *OECD Arrangement* implies an amendment to the *SCM Agreement* at all. The text is not changed in any way. What is allowed or not allowed changes – but this is what the WTO Members agreed when adopting a text that makes a reference to another understanding. In the same way, what is allowed or not allowed under other provisions of the *WTO*

[10] See Articles 82 to 88 of the 1998 version, Article 21 and Annex IX of the 1992 version of the *OECD Arrangement* and paragraph 13 of the original 1978 version.

[11] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft ("Canada – Aircraft")*, WT/DS70/AB/R, adopted 20 August 1999, esp. paragraph 5.78. It seems that Brazil had not contested that 1998 Arrangement was the relevant text. Note the discussion of "successor undertakings " in footnote 69.

[12] First written submission of Brazil, paragraphs 20 to 22.

[13] First written submission of Brazil, paragraph 20.

[14] Paragraphs 23 to 31.

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Agreement may depend on decisions taken elsewhere. For example, Article XXI GATT 1994 allows Members to take action required by resolutions of the Security Council of the United Nations, which can lead to prohibitions of trade under a sanctions regime.

26. The change in the rights and obligations of Members resulting from changes in the *OECD Arrangement* is also analogous to the change resulting from the expiry of Articles 6.1, 8 and 9 of the *SCM Agreement* pursuant to its Article 31, which also did not require the application of Article IX of the *WTO Agreement*.

27. As for Article 3.2 *DSU*, this only provides that dispute settlement should not change the rights and obligations of Members, not that no provision of the *WTO Agreement* can be construed as allowing changes to what is permitted and not permitted by those provisions over time.

28. Brazil also argues that "amendment" of item (k) in this way would not be transparent, would conflict with the object and purpose of the Agreement),[15] that it cannot be presumed that the WTO Members intended to give a small group of them the right to change the rights and obligations under the WTO Agreement and that such a power would be manifestly absurd and unreasonable.[16]

29. The EC disputes that the changes in the *OECD Arrangement* are untransparent. The current version of the *OECD Arrangement* is publicly disclosed by the OECD and is available on the OECD web site.[17]

30. It may appear strange that the WTO Members should have agreed to apply a text that could only be changed by a small number of them.

31. However, it is not unprecedented in the *WTO Agreement* for a small number of Members to be in a position to adopt texts that are of significance for all Members. Both the *SPS Agreement* and the *TBT Agreement*[18] require Members to base their measures on international standards when these are available and there are no imperative reasons for doing otherwise. These international standards can be drawn up by small numbers of WTO Members (and even non-Members) within the framework of other international organisations, such as Codex Alimentarius Commission in the case of the *SPS Agreement*.

32. There are objective reasons for the *SCM Agreement* to refer to rules established within the framework of the OECD: it is mainly the OECD Members who use export credits and have the necessary expertise and interest in developing the disciplines.

33. The EC would also point out that the WTO Secretariat is invited to attend the meetings of the participants in the *OECD Arrangement* and thus could be informed of any new development. The OECD Secretariat would certainly inform the WTO Secretariat of any new version of the *OECD Arrangement*.

2. The identification of the "interest rate provisions" of the *OECD Arrangement*

34. Brazil also disagrees with the Canada – Aircraft panel (recourse to Article 21.5) on the question of what are the "interest rate provisions" of the arrangement[19] and claims that this only refers

[15] First written submission of Brazil, paragraphs 32 to 35.
[16] Paragraphs 36 to 39 and also paragraph 31.
[17] http://www.oecd.org/ech/act/xcred-en.htm
[18] Articles 2.4 and 5.4 TBT Agreement and Article 3.1 of the *SPS Agreement.*
[19] Paragraphs 34 to 50, contradicting notably paragraph 5.147 of the *Canada – Aircraft Article 21.5* panel Report

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to the single provision in the main text and the Sectoral Understanding on Export Credits for Civil Aircraft that specify the minimum interest rates.[20]

35. The EC also disagrees with the view expressed by the above panel but for the opposite reasons. It considers that the *Canada – Aircraft* panel took too narrow a view of the "interest rate provisions" of the *OECD Arrangement*.

36. In particular, the EC submits that that panel failed to take adequately into account the fact that the *OECD Arrangement* is a non-binding instrument which is designed to provide a framework for transparency and fair competition in the field of export credit transactions between the participants and to be applied flexibly. The EC believes that a failure to take this circumstance into account leads to the terms of the *OECD Arrangement* and the scope of the safe haven being interpreted too narrowly. A notable consequence of this narrow interpretation is that the "matching" of supported rates, provided for in Article 29 of the *OECD Arrangement* would not be within the safe haven. The EC is firmly of the view that matching is in conformity with the *OECD Arrangement* and that the provisions that allow it are interest rate provisions and that therefore matching is covered by the second paragraph of item (k). Matching is specifically envisaged and authorised by the *Arrangement* but must comply with a strict set of conditions and procedures.[21]

37. Although the panel in the Canada – *Aircraft* case correctly gave a wide interpretation to the term "export credit practices"[22] which implies that that "interest rate buy downs" (that is interest rate equalisation) were covered by the second paragraph of item (k), it gave an excessively narrow interpretation to the "interest rate provisions" of the *OECD Arrangement*.[23]

38. The EC considers that it makes no sense to consider interest rates in isolation from all the conditions that influence the interest rate. That is why it considers that the reference to the "interest rate provisions" of the *OECD Arrangement* refers to all the provisions that may affect the interest rate – that is all provisions containing substantive rather than procedural obligations.

39. It is, in particular, completely unjustified to consider interest rates in isolation from the provisions relating to the *risk* involved and in particular the provisions on premiums.

40. Article 14 of the OECD *Arrangement*, which immediately precedes the definition of CIRR, contains a definition of interest that reads as follows:

> (c) interest excludes:
>
> any payment by way of premium or other charge for insuring or guaranteeing supplier credits or financial credits. Where official support is provided by means of direct

[20] First written submission of Brazil, paragraph 40.

[21] The EC recognises that the *procedures* of the *OECD Arrangement* cannot be applied to non-participants. But this does not mean that non-participants would be disadvantaged. In fact the opposite is the case. The safe haven only require non-participants in the *OECD Arrangement* to apply in practice the interest rate provisions of the *OECD Arrangement*, which the EC believes means the substantive provisions which can affect interest rates and not the procedural provisions. Of course non-participants would not receive the notifications that participants receive but this should not stop them from matching an offer of export credit terms on a transaction that their companies are competing for. If a non-participant has doubts about the reliability of the alleged offer of non-Arrangement terms that it is invited to match, it may request confirmation of them from the offeror. Under the *OECD Arrangement* participants consider themselves entitled to match after they have taken appropriate measures to verify the terms (see e.g. Article 53). If non-participants are not required to follow the procedural requirements of the *OECD Arrangement*, they are nonetheless able to apply them by analogy.

[22] In paragraph 5.80 of the Report

[23] *Id.* paragraphs 5.80 – 5.92

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> credits/financing or refinancing, the premium either may be added to the face value of the interest rate or may be a separate charge; both components are to be specified separately to the Participants,
>
> any other payment by way of banking fees or commissions relating to the export credit other than annual or semi-annual bank charges that are payable throughout the repayment period, and
>
> withholding taxes imposed by the importing country.

41. Article 15 on CIRRs goes on to make clear that

> CIRRs should represent final commercial lending interest rates in the domestic market of the currency concerned,

42. For the EC these provisions together make clear that CIRR is an interest rate based on an assumption of minimal risk of non-payment.

43. It is important to take into account:

(1) the pure cost of money for a prime borrower in a country with high creditworthiness; and,

(2) cost elements linked to the financial institution having a good creditworthiness and providing export credits; and,

(3) remuneration of the debtor risk that the financial institution bears.

44. CIRR was designed for taking care of 1) and 2), while 3) is to be covered by a separate premium.

45. This is made clear in the provisions in Chapter II of the *OECD Arrangement* relating to what is called "pure cover" – that is, Articles 7c), 19b second indent, 25 c as well in the Annex III). These provisions demonstrate that official support can be restricted to the assumption of the risk element of an export credit transaction. When official support is given in the form of insurance ("pure cover"), the loan has to fulfil all provisions for export credit of Chapter II of the Arrangement or of one of its sector understandings (except the minimum interest rate provisions).

46. It is implicit in these provisions that a payment is required for this assumption of risk. Article 22 of the *OECD Arrangement* sets out the disciplines that the are to be respected in calculating premia. Article 22 integrates the obligations of item (j) of Annex I to the *SCM Agreement* into the *OECD Arrangement* since it requires that premia, as well as being consistent with the level of risk, shall not be "inadequate to cover the long term operating costs and losses." That this was the intention is demonstrated by the description of the Schaerer Package contained in Exhibit Bra-8.

47. There is no obligation in the *OECD Arrangement* to apply for an insurance/guaranty (against political risks of non-payment of the loan), even if in practice both CIRR financing and credit risk cover are often linked. Here again it is worthwhile to remember that the main principle of CIRR financing is to provide buyers with rates close to rates normally given, only, to first class borrower of high-income OECD countries and then add the premium element.

48. As mentioned above, the level of CIRR does not depend on the creditworthiness of the buyer. Even if insurance/guarantee is not really compulsory in the *OECD Arrangement*, almost all

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Participants provide such insurance/guarantee in case of CIRR financing in order to minimise the potential cost for the budget of giving first class borrower rates to riskier countries/buyers.

49. One way of analysing PROEX III is to consider that it effectively compensates for the credit risk that would normally be charged to the borrower by the lending bank. As such it is equivalent to the payment of an insurance or guarantee payment and is an interest related official support for export credit that is not in conformity with these provisions of the *OECD Arrangement*.

50. The EC agrees with the statement of the Article 21.5 Panel in *Canada – Aircraft* that:[24]

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

51. The EC therefore disagrees with Brazil's statement in paragraph 52 of its first written submission that PROEX III conforms to "Articles 3 through 7 of the main text, and Articles 17 through 22 and Articles 24 and 25 of Annex IV."

C. THE FIRST PARAGRAPH OF ITEM(K)

52. The EC view on the first paragraph of item (k) is already known to the Panel.[25]

53. On the issue of "material advantage" it would appear that this is now being provided through the assumption of credit risk without remuneration.

IV. CONSULTATIONS IN ARTICLE 21.5 PROCEEDINGS

54. The EC has always maintained that consultations are an obligatory pre-condition to the establishment of a panel under Article 21.5 DSU. It repeats its position so as to make clear that it does not consent to what may be considered an evolving practice.

55. The first occasion when the question of whether consultations were required prior to the establishment of an Article 21.5 panel was in the context of the *Bananas* dispute. The EC made clear[26] that it considers consultations under Article 4 of the DSU to be necessary before the establishment of a panel can be requested under Article 21.5. The reason is the reference contained in Article 21.5 that any dispute on implementation "shall be decided through recourse to these dispute settlement procedures". In the view of the EC, "these dispute settlement procedures" include consultations and a right to an appeal. This is so for reasons related to the multilateral character of the procedures, which include procedural rights of other WTO Members, particularly potential third parties, and a standardised dispute settlement procedure the basic features of which may not be amended simply because that pleases the parties in an individual cases.

56. The EC considers that the obligatory requirements of the *DSU* can also not be modified by agreement between the parties.[27] If the parties to a dispute were entirely free to develop procedures of

[24] Paragraph 5.114.

[25] First written submission of the EC to the original Article 21.5 panel, paragraphs 20 to 26 and oral statement, paragraphs 43 to 46.

[26] Cf. the statement of the EC representative at the DSB meeting of 22 September 1998, doc. WT/DSB/M/48, p. 7.

[27] The EC notes that there is no such agreement in the present case although there was such an agreement in the original Article 21.5 proceeding. A similar situation prevailed in the Article 21.5 proceeding concerning *Canada – Aircraft* and in the unfortunate and problematic case *Australia – Leather*, where the

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their own choice (*quod non*), this would jeopardise third party rights enshrined in the *DSU* (particularly in Articles 4.11 and 10). Nothing would stop the parties from agreeing bilaterally not only to jump the procedural step of consultations, but also to jump other procedural steps such as the panel stage and to submit their dispute to the Appellate Body straight away (e.g. in order to "gain time" and to exclude third parties who cannot participate in Appellate Body procedures if they did not reserve their right to participate in the preceding panel procedure). It would also mean that the parties are free to agree among themselves that a panel report under Article 21.5 is not binding and that it may be subjected to some kind of review by another international body, such as the WHO in a case concerning human health considerations. It would, therefore, constitute circumvention, indeed, an undermining, of the system for dispute settlement established by the *DSU*.

57. The EC believes that these scenarios are not compatible with the multilateral nature of the procedures under the DSU, the procedural rights of third parties and indeed the general matrix of procedural checks and balances built into the DS system. The *DSU* contains sufficient flexibility to adapt the basic procedural requirements to the needs of the parties in individual disputes. As an example, Article 4.7 (second sentence) of the *DSU* allows the parties to shorten the 60-day period on the basis of a bilateral agreement. If the parties to the dispute agree, a panel under Article 21.5 of the DSU may be established at the first meeting where the request is considered by the DSB (Article 6.1 of the *DSU*). The panel may propose special working procedures after consultations with the parties (Article 12.1 of the *DSU*). All these provisions indicate that there is some flexibility in the procedures, which is largely dependent on the agreement of the parties to the dispute. None of these provisions however allows the parties to the dispute to simply omit one of the essential procedural steps before requesting the next one.

58. The procedural step of holding consultations is of fundamental importance for the dispute settlement system. Consultations give the parties an opportunity to resolve their differences without an adjudication of the dispute and will, at the very least, allow the parties to clarify on what precise issues their disagreement continues. In this way, consultations contribute to discharging panel proceedings from issues on which there is no real and serious disagreement. In addition, any request for consultations under Article 4 of the *DSU* must be circulated to the entire WTO membership in order to identify and circumscribe the dispute, thus allowing potential third parties to prepare their request to participate in the procedure. In this regard, it must be recalled that third parties may participate in consultations requested under any of the provisions cited in Article 4.11 and footnote 4 of the *DSU*. Thus, third party rights are clearly impaired by the omission of the formal consultation stage in a dispute settlement procedure.

59. All these important functions of the consultations are undermined if the parties to the dispute are considered to be free to "jump the gun" and go to a panel procedure without holding formal consultations under Article 4 of the *DSU* first. Moreover, consultations must anyhow take place in order to agree on the procedure to be followed, and it is obvious that this is also an occasion to consult

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parties agreed to dispense with Article 4 consultations as well as certain essential procedural guarantees such as an appeal (cf. doc. WT/DS126/8 of 4 October 1999). In all these cases an explicit agreement was reached between the parties before the request for the establishment of a panel under Article 21.5 of the DSU was submitted to the DSB. In the dispute on *Australia-Salmon*, it appears that no formal consultations were held before Canada requested the establishment of a panel under Article 21.5 of the DSU. It appears moreover that the fact that the parties renounced their rights to formal consultations in that case was also the result of an agreement between the parties, but that agreement was not circulated to WTO Members (cf. doc. WT/DS18/14 of 3 August 1999).

Similarly, in the S*hrimp/turtle* case, an understanding was reached between Malaysia and the United States regarding possible proceedings under Articles 21 and 22 of the DSU (cf. doc. WT/DS58/16 of 12 January 2000). According to this agreement, Malaysia "will consult with the United States before requesting the establishment of a panel under Article 21.5". While it is not specified whether these consultations will be held under Article 4 of the DSU, no other relevant provision on consultations of the DSU would seem to be applicable.

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on substantive issues. Thus, in reality no time is gained in jumping this procedural step, except that third parties are put at a disadvantage and that the panel may have to address issues on which there is no real disagreement.

60. In conclusion, the EC is firmly of the view that the existing rules of the *DSU* do not allow parties to a dispute to agree bilaterally to dispense with consultations under Article 4 of the DSU. Any other approach leads to unacceptable uncertainty about the limits of the procedural guarantees for both parties and to a curtailing of third party rights clearly enshrined in the *DSU*.

61. As stated in the Appellate Body report in the *Bananas* case[28], "a panel request is normally not subjected to detailed scrutiny by the DSB". The Appellate Body concludes that "it is incumbent upon a panel to examine the request for the establishment of the panel very carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the *DSU*".

V. CONCLUSION

62. The state of the arguments presented by the parties and the information and time for reflection available to the EC has not allowed it to make as full a contribution to the work of the Panel as it might have liked. It will therefore supplement its arguments at the Third Party Session in the light of the other submissions to be presented to the Panel before that meeting.

[28] Cf. doc. WT/DS27/AB/R at para. 142.

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ANNEX C-2

SUBMISSION OF KOREA AS A THIRD PARTY

(23 March 2001)

I. INTRODUCTION

1. Korea's interest in this DSU Article 21.5 proceeding is systemic. This has to do with the permissibility of an *a contrario* exception from the first paragraph of item (k) of the Illustrative List of Export Subsidies (the Illustrative List)[1].

2. Korea expresses no opinion about other issues and arguments raised by Canada and Brazil in this proceeding.

II. THE PERMISSIBILITY OF AN *A CONTRARIO* EXCEPTION

3. Under the first paragraph of item (k) of the Illustrative List, only those export credits that are used to secure a material advantage are categorized as prohibited export subsidies.

4. As a matter of logic, as well as of textual interpretation, then, an export credit practice that is not used to secure a material advantage cannot be a prohibited export subsidy within the meaning of Article 3.1(a) of the SCM Agreement. Rather, it must be a permitted practice. Any other interpretation renders meaningless item (k)'s limitation.

5. It has been argued that because the Illustrative List is not an exhaustive listing of all possible prohibited subsidies, an *a contrario* interpretation is not appropriate.[2] Korea does not share this view. Two situations should be differentiated: first, when there is a type of subsidy practice not identified in the Illustrative List; and, second, when, as in this dispute, a subsidy practice is identified and declared a prohibited export subsidy under certain conditions.

6. In the first situation, one cannot argue *a contrario* that the absence of a practice from the Illustrative List establishes that the practice is not a prohibited export subsidy. However, one cannot extend this argumentation to the second situation. Otherwise, the result would be that a practice, such as an export credit not used to secure a material advantage, that was excluded from categorization as a prohibited export subsidy by the text of the Illustrative List would nonetheless be considered one by virtue of being a prohibited export subsidy that was not included in the Illustrative List. Such a result is not logical and it violates the interpretive principle of effectiveness.

7. It also has been argued that, by virtue of footnote 5 of the SCM Agreement, the only subsidy practices that can be categorized as outside the scope of Article 3.1(a) of the SCM Agreement are those which the Illustrative List expressly asserts are not prohibited export subsidies.[3] Korea does not agree with this argument either. It would render meaningless situations, such as those under the first paragraph of item (k) of the Illustrative List, where a practice is declared to be a prohibited export subsidy only where a specified condition (in this case "secur[ing] a material advantage") is satisfied. In Korea's view, the only interpretation that does not render meaningless the conditional application of item (k) is an interpretation that "referred to," as used in footnote 5, encompasses not only practices

[1] Annex I to the Agreement on Subsidies and Countervailing Measures (SCM Agreement).

[2] First Submission of Canada, Brazil — Export Financing Programme for Aircraft — Second Recourse by Canada to Article 21.5 of the DSU, WT/DS46 (2 March 2001) (First Canadian Submission) at paras. 58-59.

[3] *Id.* at paras. 47-55.

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expressly declared not to be prohibited export subsidies, but also practices that are prohibited export subsidies only where a specific condition (such as "secur[ing] material advantage") is satisfied.

8. The Appellate Body appears to share the position Korea takes. In its Article 21.5 report, it states that if Brazil had satisfied its burden of proof, "we [the Appellate Body] would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List."[4]

9. Apparently, the above statement by the Appellate Body deals only with the case of "the payment (of the costs incurred in obtaining credits)" within the meaning of the first paragraph of Annex I (K) of the SCM Agreement. Korea pays further attention to the textual interpretation of the paragraph, according to which this material advantage condition also applies to the other case of "the grant of export credits," juxtaposed in the same paragraph.[5]

10. Accordingly, for the reasons set out above, Korea believes that an *a contrario* interpretation of the first paragraph of item (k) of the Illustrative List is appropriate so as to give meaning to the material advantage condition. If an export credit practice, whether it is a grant of credits or a payment of costs, does not secure a material advantage, that practice must be viewed as a permitted practice.

[4] Brazil — Export Financing Programme for Aircraft — Recourse by Canada to Article 21.5 of the DSU, WT/DS46/AB/RW (21 July 2000) at para. 80.

[5] Attention should be paid to the use of comma in front of "in so far as …" and the subject in the plural ("they") in the phrase of ", in so far as they are used to secure a material advantage …" (SCM Agreement Annex I(K)).

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ANNEX C-3

**SUBMISSION OF THE UNITED STATES
AS THIRD PARTY**

(23 March 2001)

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I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the second Article 21.5 proceeding requested by Canada to review Brazil's implementation of the Dispute Settlement Body's ("DSB") recommendations and rulings in *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R, 14 April 1999 ("Panel Report"); WT/DS46/AB/R, 2 August 1999 ("Appellate Body Report").

2. Canada claims that the revisions made by Brazil on 6 December 2000 in respect of the *Programma de Financiamento às Exportações* ("PROEX") do not bring PROEX into conformity with the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and the findings and recommendations of the Panel and the Appellate Body. Brazil argues in response that PROEX is not a subsidy under the SCM Agreement and that, even if it *is* a subsidy, it is not a prohibited subsidy. Due to the importance of various issues that the parties raise, the United States wishes to make certain brief observations that it hopes will assist the Panel in reaching its own determinations.

II. THE *A CONTRARIO* ISSUE

3. As it has in the past, Canada argues that the first paragraph of item (k) of the Illustrative List is not susceptible to an *a contrario* interpretation. Brazil disagrees with Canada's position. The United States has commented on this issue on numerous occasions over the course of these proceedings. For purposes of the present dispute, however, the United States takes no position on this issue other than to agree with Canada's statement that the second paragraph of item (k), footnote 59, item (h), and item (i) are all covered by footnote 5 of the SCM Agreement.[1]

III. THE RELEVANT *OECD ARRANGEMENT* REFERRED TO IN THE SECOND PARAGRAPH OF ITEM (K) IS THE VERSION OF THE *OECD ARRANGEMENT* IN EFFECT WHEN THE EXPORT CREDIT IS GRANTED

4. Brazil claims that the "relevant undertaking" referenced in the second paragraph of item (k) is limited to the version of the *OECD Arrangement* in effect on the date that the SCM Agreement entered into force (specifically, the 1992 version of the *Arrangement*). Brazil's argument is based on an erroneous interpretation of item (k). In the view of the United States, a proper textual analysis of the applicable language of item (k) demonstrates that the version of the *OECD Arrangement* in effect on the date that a Member grants the export credit at issue is the "relevant undertaking" with which the Member must comply.

5. The first sentence of the second paragraph of item (k) refers to "a successor undertaking which has been adopted by those original Members . . . ." Brazil claims that the term "has been" is central to a proper interpretation of this issue, on the grounds that the ordinary meaning of the term "has been" refers to a "'time regarded as present' when the text became effective on 1 January 1995."[2] In Brazil's view, the term "is a reference to a successor undertaking *already in existence* – an undertaking that '*has* been adopted.'"[3] Brazil is mistaken.

6. The basis of Brazil's error is its belief that the term "has been" adopted refers to the time "regarded as present" <u>when the text of item (k) became effective on 1 January 1995</u>. In actuality, the term refers to the time "regarded as present" when a Member <u>grants</u> the export credit in question. The purpose of the second paragraph of item (k) was to create a safe harbor for Members who comply with the terms and conditions of the *OECD Arrangement* in their granting of export credits. Thus, the

[1] *See* Canada submission at ¶ 54 and n.42.
[2] Brazil submission at ¶ 20.
[3] Id.

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relevant question for determining the availability of the safe harbor is whether, at the time a Member grants the export credit in question, it is doing so in conformity with the relevant provisions of the *Arrangement* then in effect. To paraphrase the second paragraph of item (k), if a Member is a party to the latest version of the *OECD Arrangement* that has been adopted, or if in practice a Member applies the interest rate provisions of that agreement, then an export credit practice which is in conformity with those provisions shall not be considered a prohibited export subsidy.

7. A contrary interpretation of this language would be illogical, since it would suggest that a Member could grant export credits that are not in compliance with the most recent version of the *Arrangement*, and yet still benefit from the safe harbor in item (k). This would undermine the entire purpose of the safe harbor.

8. The drafting history of item (k) also demonstrates that Brazil's interpretation of this issue is mistaken. The final sentence of item (k) was inserted by the Tokyo Round negotiators of the Subsidies Code. The language in the Tokyo Round version of item (k) was virtually identical to the language in the present version, including the reference to parties "as of 1 January 1979".[4] Since the Tokyo Round Subsidies Code was completed in 1979, the drafters used the term "as of 1 January 1979" to refer to the version of the *OECD Arrangement* that was in effect at the time that the text of the Subsidies Code became effective, and the term "or a successor undertaking" to refer to future versions of the *Arrangement*.[5] As one authority has noted, "[t]he wording in question thus provided a safe harbor while allowing other signatories of the [Subsidies] code to follow the same practices and allowing for changes in the Arrangement.[6] The second paragraph of item (k) contemplates and provides for revisions to the *OECD Arrangement*, and there is, therefore, no basis to Brazil's claim that interpreting item (k) to include post-1995 versions of the *Arrangement* would effectively result in an amendment of the SCM Agreement.[7] On the contrary, it is Brazil's interpretation that would effectively amend the SCM Agreement by reading the "successor understanding" provision out of item (k).

9. Finally, Brazil suggests that it would not be fair to interpret the second paragraph of item (k) as applying to successor versions of the *Arrangement* because not all WTO Members are participants in the *Arrangement*. The United States observes, however, that the sole purpose of the relevant provision is to create a safe harbor from the prohibition in the first paragraph. Under the terms of Article 27 of the SCM Agreement, the export subsidy prohibition does not even apply to developing country Members until 2003, subject to compliance with the provisions of paragraph 4 of Article 27. Accordingly, item (k) is not even relevant to developing country Members unless they fail to adhere to the requirements of that paragraph. In any event, the fact that not all WTO Members are participants in the *Arrangement* cannot be legally determinative since neither were they all participants in the *Arrangement* at the time that item (k) was approved as an integral component of the SCM Agreement.

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[4] The only difference is the use of the term "signatory" or "signatories" where the present version uses "Member" or "Members".

[5] Brazil asserts that if the drafters had intended the safe harbor to apply to future versions of the *Arrangement*, they would have used the future tense "will" or "may" be adopted. On the contrary, the drafters' use of the term "has been adopted" demonstrates that the drafters did contemplate that the *Arrangement* would be changed. If the drafters had intended the second paragraph of item (k) to refer solely to the version of the *Arrangement* in effect on the date that the Uruguay Round Agreements entered into force, they would have said so.

[6] John E. Ray, Managing Official Export Credits 38 (1995) (emphasis added), attached hereto as U.S. Exhibit 1. Mr. Ray headed the Division of Financing and Other Export Questions in the Trade Directorate of the OECD from 1985 until 1993. He was an Assistant U.S. Trade Representative from 1979 to 1985, and with the U.S. Treasury Department prior to that date.

[7] Accordingly, Brazil's long discussion of the process of amendments under the WTO Agreement (at paras. 31) is beside the point.

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10. In sum, the United States agrees with Brazil that the law of treaties states that governments may agree to be bound by the provisions of a future treaty. The language of the second paragraph of item (k) states that if a Member is party to an international undertaking on official export credits or "a successor undertaking", then an export credit practice which conforms with the provisions of that undertaking is not an export subsidy prohibited by the SCM Agreement.[8] The term "successor undertaking" in the second paragraph of item (k) demonstrates an intent to be bound by successor undertakings, which logically include an amended *OECD Arrangement*. The drafters of the SCM Agreement, keenly aware of the need for flexibility to update agreements, included the realistic possibility of an updated *OECD Arrangement* in the language "a successor undertaking." The item (k) safe harbor is an important part of the package of rights and obligations that Members accepted when they agreed to the WTO Agreements, and there is no basis to limit it in the manner that Brazil asserts.

IV. INTEREST RATE SUPPORT AT OR ABOVE CIRR DOES NOT *IPSO FACTO* MEAN THE RECIPIENT RECEIVES NO BENEFIT

11. Brazil claims that "interest rate support at or above CIRR does not confer a benefit."[9] The United States takes no position on whether Brazil's use of CIRR, in conjunction with other export credit terms, confers a benefit. Rather, the United States wishes to note only that interest rate support at or above CIRR does not, *ipso facto*, mean no benefit is conferred.

12. Brazil relies on the Appellate Body's designation of CIRR as a commercial rate.[10] Brazil's reliance is mistaken because the Appellate Body mentioned CIRR as a commercial rate in the context of the *OECD Arrangement*.[11] Brazil then tries to establish CIRR as a market rate by noting that some Canadian and Norwegian commercial rates below CIRR *may* not confer a benefit. In addition, Brazil points to a Norwegian loan with similar terms to the terms offered by PROEX. Yet Brazil's analysis focuses entirely on the interest rate and loan maturity. Brazil makes no mention of the creditworthiness of the borrower. The true test in determining if an export credit practice confers a benefit is whether all of the loan terms, in their entirety, confer a benefit on the recipient.

13. A benefit is conferred if the Member grants interest rate support at a rate lower than the recipient could obtain on the open market. This concept is embedded in the SCM Agreement. The Appellate Body referred to Article 14 in Part V of the SCM Agreement as "relevant context for the interpretation of 'benefit' in Article1.1(b)".[12] Article 14(b) defines a benefit to include the difference in payment between a government loan and "a comparable commercial loan which the firm could *actually obtain* on the market" (emphasis added).[13]

14. Accordingly, to determine whether an export credit practice confers a benefit, one must evaluate whether that recipient could obtain such a loan, on such terms, from a commercial lender. In a previous analysis, the Appellate Body considered the type of product being financed, the interest rate, and whether the Member offered a loan guarantee or interest rate equalization payments.[14] Under such a thorough analysis, consideration of the interest rate alone (CIRR or any other rate) does not determine whether an export credit confers a benefit.

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[8] SCM Agreement, Annex I, item (k).

[9] Brazil submission at ¶ 15.

[10] *Id.* at ¶ 11.

[11] The Appellate Body stated, "Under the *OECD Arrangement*, a CIRR is the *minimum* commercial rate available in that range for a particular currency." Appellate Body Report at ¶ 182.

[12] *Canada -Measures Affecting the Export Of Civilian Aircraft*, WT/DS70/AB/R (2 August 1999), Report of the Appellate Body at ¶ 155 ("*Canada-Aircraft*").

[13] SCM Agreement, Article 14(b).

[14] See Brazil-Export Financing Programme for Aircraft - Recourse by Canada to Article 21.5 of the DSU, WT/DS46/AB/RW (21 July 2000), Report of the Appellate Body at ¶ 74.

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V. USE OF CIRR ALONE IS INSUFFICIENT TO MEET THE "SAFE HARBOR" OF THE SECOND PARAGRAPH OF ITEM (K) IN ANNEX I OF THE SCM AGREEMENT

15. Brazil claims that PROEX satisfies the requirement for the "safe harbor" under the second paragraph of item (k) because PROEX uses CIRR and thus applies the interest rate provisions of the *OECD Arrangement*.[15] The United States disagrees that use of CIRR alone qualifies Brazil for the "safe harbor" exemption under item (k).

16. According to the Panel, a Member must conform to all of the terms, conditions and accepted practices of the *OECD Arrangement* to benefit from the "safe harbor" exemption under item (k).[16] To claim exemption under the "safe harbor," CIRR must be applied in conjunction with the entire framework of the *OECD Arrangement*. Applying CIRR alone is insufficient to claim exemption under the "safe harbor" of item (k). Thus unless Brazil applies all of the accompanying terms, conditions and accepted practices of the *OECD Arrangement,* it will not benefit from the "safe harbor" under item (k).

VI. INTEREST RATE BUY-DOWNS CONSTITUTE THE "PAYMENT BY [GOVERNMENTS] OF ALL OR PART OF THE COSTS INCURRED BY EXPORTERS OR FINANCIAL INSTITUTIONS IN OBTAINING CREDITS"

17. Canada claims that PROEX payments are not "payments" under the first paragraph of item (k) because interest rate buy-downs are excluded from the scope of the payment clause of item (k).[17] While Canada cites the Panel's attempt to rule that Brazil's PROEX was not within the payment clause of item (k), the Appellate Body later declared those Panel findings moot.[18]

18. Brazil argues in response that PROEX is a "payment by [Brazil] of all or part of the costs incurred by exporters or financial institutions in obtaining credits."[19] The United States agrees with Brazil that interest rate buy-downs such as PROEX *do* fall within the scope of the payments clause of item (k).

19. The United States believes that the Panel should interpret the payment clause of item (k) within the context of the SCM Agreement and general export credit practice. Despite changing export subsidy practices, the text of item (k) remains essentially unchanged since its inception in 1958.[20] Very little guidance exists on the interpretation of the payment clause of item (k). Thus the intent of the payment clause of item (k) should be viewed within the context of general export credit practice and the SCM Agreement. Viewed as such, it is clear that the intent of the payments clause is to reduce the risk to the exporter or financial institution lending money to a borrower.

20. While buying-down interest rates does not constitute a direct payment, it does reduces the risk incurred by the exporter or financial institution. Through measures such as insurance, guarantees, and interest make-up, a Member can remove the risk that the financial institution or exporter would

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[15] *See* Brazil submission at ¶ 18.

[16] The Panel stated that a Member benefits from the "safe harbor" if it "applies the interest rate provisions" of the *OECD Arrangement* "in conformity with those [*i.e.*, the interest-rate] provisions." *Brazil-Export Financing Programme for Aircraft - Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (9 May 2000), Report of the Panel at ¶ 6.61 ("*Article 21.5 Panel Report*").

[17] Canada submission at ¶ 68.

[18] Brazil-Export Financing Programme for Aircraft - Recourse by Canada to Article 21.5 of the DSU, WT/DS46/AB/RW (21 July 2000), Report of the Appellate Body at ¶ 78.

[19] Brazil submission at ¶ 67.

[20] In 1958, the OEEC expanded its list of prohibited measures to include the costs born by governments in paying all or part of the costs incurred by exporters in obtaining credits. John E. Ray, Managing Official Export Credits 38 (1995) (emphasis added), attached hereto as U.S. Exhibit 1.

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normally incur in lending money. Reduced risk results in lower lending costs. Without the Member's payment, the exporter or financial institution would have to charge higher rates to cover the risk themselves. Instead, the Member bears the cost of the credit and the exporter or financial institution saves from the reduced risk costs. The savings gained from reduced risk constitutes the "payment ... of all or part of the costs incurred by exporters or financial institutions." Thus buying-down interest rates is within the scope of the payment clause in the first paragraph of item (k).

VII. ADDITIONAL COMMENTS ON BRAZIL - EXPORT FINANCING PROGRAMME FOR AIRCRAFT OF 9 MAY 2000

21. The United States would like to bring to the attention of the Panel several statements by the Panel in its report *Brazil - Export Financing Programme for Aircraft*, WT/DS46/RW, 9 May 2000 ("Article 21.5 Panel Report"), which the United States believes misconstrue the relationship between the *OECD Arrangement* and item (k) of the *Illustrative List*. These statements were *dicta*, and were not within the scope of the appeal of that case to the Appellate Body. Nevertheless, from a systemic perspective, the United States would like to present its views on these issues.

22. In footnote 68, the Panel narrowly defines the "interest rate provisions" of the *Arrangement* to exclude guarantees in "pure cover" transactions.[21] The Panel also states that when a Participant matches the terms and conditions of non-conforming transactions offered by Participants or non-Participants, "it cannot be said that such matching credit "is 'in conformity with' the interest rate provisions of the *Arrangement*."[22]

23. In the view of the United States, for the purposes of the second paragraph of item (k), the term "interest rate provisions" should be seen as a form of "shorthand" for encompassing all of the terms and conditions of the *Arrangement.* It would defeat the logic of the *Arrangement* if a WTO Member were unable to make use of the matching provisions of the *Arrangement* -- its key enforcement provision -- for fear that such action might be deemed an export subsidy under the SCM Agreement.

24. The United States also observes that a non-Participant that seeks the protection of paragraph 2 of item (k) by applying "an export credit practice which is in conformity with those provisions" must also conform with the transparency provisions of the *Arrangement*.[23] These provisions require notification to other Participants of non-conforming terms. Participants can then seek to consult with the Participant offering non-conforming terms and, if appropriate, match the non-conforming credit. Participants are unable to react to a credit offered by a non-Participant if they are not advised as to the terms being offered. Non-Participants should not be given a "free ride" to pick and choose which provisions of the *Arrangement* they choose to follow if they expect to enjoy the protection of the second sentence of item (k).

VIII. CONCLUSION

25. The United States thanks the Panel for providing an opportunity to comment on the important issues at stake in this proceeding, and hopes that its comments will prove to be useful.

[21] *Article 21.5 Panel Report*, Report of the Panel at ¶ 6.65 n.68.
[22] Id.
[23] *OECD Arrangement*, e.g. Articles 42-53.

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ANNEX C-4

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(5 April 2001)

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I. INTRODUCTION

1. The European Communities appreciates the opportunity that it has been given to address the Panel as a third party in this dispute. The European Communities' interest in the dispute relates not only to its desire to ensure a correct interpretation of the Agreement on Subsidies and Countervailing Measures ("*SCM Agreement*") but also from its position as an original signatory of, and a current participant in, the *OECD Arrangement.*

2. The European Communities thanks the parties for having provided it with copies of their second written submission, which has helped it to understand the issues and the arguments.

3. The European Communities will refrain from repeating the arguments contained in its written submission and confine itself to a few additional comments arising out of the rebuttal submissions of the parties and the submissions of the third parties.

II. THE FACTUAL BACKGROUND

4. The European Communities is not in a position to comment on the terms on which PROEX III is actually made available to customers of Embraer. It would make the following comments:

- The fact that factual allegations are being made for the first time in rebuttal submissions may be a consequence of the fact that no consultations were held as required by Article 4 of the *DSU* and underlines the importance of the European Communities' arguments on this issue;[1]

[1] Third Party Submission of the European Communities, paragraphs 52 to 61.

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- Faced with the evidence produced by Canada that Brazil in fact provides PROEX on more favourable terms than allowed under the *OECD Arrangement*, the Panel may consider it necessary to seek confirmation or refutation of these allegations from Brazil. In this respect it would also be important for the Panel to clarify the legal status of Circular Letter No 002881 and Directive 374 referred to by Brazil in paragraphs 8 and 9 of its first submission;

- In the absence of cooperation by Brazil, the Panel should draw the necessary inferences from the evidence that it does have and the refusal of Brazil to confirm or refute it, as explained by the Appellate Body in its report in the proceeding *Canada – Aircraft.*[2]

III. THE OECD SAFE HAVEN

5. Brazil's main defence is now that PROEX III falls under the safe haven of the second paragraph of item (k) of Annex I to the *SCM Agreement*.

A. THE APPLICABLE VERSION OF THE *OECD ARRANGEMENT*

6. As the Panel is aware, the European Communities is firmly of the view that the *1998 version of the OECD Arrangement*[3] is the only one relevant to the present dispute.

7. The *OECD Arrangement* is an evolving understanding that is regularly revised to take account of changing circumstances and the second paragraph of item (k) of Annex I to the *SCM Agreement* makes a *dynamic* reference to the *OECD Arrangement* applicable at the time the measure under consideration is taken. This is clear from the language and the reference to *successor* undertakings.

8. An interpretation of the second paragraph of item (k) of Annex I to the *SCM Agreement* that froze the text of the *OECD Arrangement* as it was on the day the *WTO Agreement* was concluded would lead to unacceptable results:

- It could allow the development of trade-distortive export subsidies through the exploitation of lacunae in the frozen version of the *OECD Arrangement.* Export credits is a field where new practices are constantly being developed and the evolution of the *OECD Arrangement* is indeed characterised by the need to adopt rules to deal with new practises and factual circumstances in the market place;

- It could lead to the participants to the *OECD Arrangement* being put in a situation where it would be impossible to fulfil both their obligations under the WTO and their commitments under the *OECD Arrangement.* Moreover such situation could lead to obvious distortions of competition. This could arise for example if a new *OECD Arrangement* were to contain obligations relating to the maximum repayment terms or the repayment profile that differ from the obligations under the frozen version.

9. As Canada has remarked[4] the circumstances in which item (k) was originally drafted confirms this view. The Tokyo Round subsidies code was adopted a year after the first OECD arrangement and it cannot have been anticipated at that time that there would already be a successor undertaking in existence when the subsidies code was concluded. Therefore, the reference to a "successor undertaking which *has been* adopted by those original members" can only have been intended to refer

[2] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft ("Canada – Aircraft"),* WT/DS70/AB/R, adopted 20 August 1999, paras. 200 – 205.

[3] The text was agreed in 1997 and published in 1998.

[4] Second written submission of Canada, paragraph 64.

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to successor undertakings adopted after conclusion of the Tokyo Round subsidies code and before the measure under consideration.

B. THE IDENTIFICATION OF THE "INTEREST RATE PROVISIONS" OF THE *OECD ARRANGEMENT*

10. The European Communities explained in its written submission[5] that it makes no sense to consider interest rates in isolation from all the conditions that influence the interest rate and that the reference to the "interest rate provisions" of the *OECD Arrangement* must refer to all the provisions that may *affect* the interest rate – that is all provisions containing *substantive* rather than *procedural* obligations.

11. The panel in the *Canada – Aircraft Article 21.5* proceeding took a very restrictive view of the "interest rate provisions" but later in its report came to the (correct) view that

> .. the *Arrangement* seems to recognize that financing terms and conditions must be treated as a package, and that derogation from one will undercut the others.[6]

12. Which led it conclude that:

> … full conformity with the "interest rates provisions" – in respect of "export credit practices" subject to the CIRR – must be judged on the basis not only of full conformity with the CIRR but in addition full adherence to the other rules of the *Arrangement* that operate to support or reinforce the minimum interest rate rule by limiting the generosity of the terms of official financing support.[7]

13. These other provisions that "support or reinforce" those that the panel identified as "interest rate provisions" include:

> … the amount of the cash down payment, the maximum repayment term, the timing of principal and interest payments, maximum "holding periods" or lock-in periods for interest rates, risk premiums, and similar terms.[8]

14. The *Canada – Aircraft* panel therefore seemed to be of the view that only those provisions that directly relate to minimum interest rates constitute "the interest rate provisions" whereas *conformity* with "the interest rate provisions" requires conformity with all those provisions that "support or reinforce" those "interest rate provisions."

15. The European Communities considers that this is an artificial construct that finds no support in the text of item (k). The logic of the *Canada – Aircraft* panel report in fact leads to the conclusion that all the provisions that "support or reinforce" the minimum interest rate disciplines are to be considered included within the term "interest rate provisions." As noted above, they include the provisions on premia.

16. As the European Communities explained in its written statement, one way of analysing PROEX III is to consider that it effectively compensates for the credit risk that would normally be charged to the borrower by the lending bank. As such it is equivalent to the payment of an insurance or guarantee payment and is an interest related official support for export credit that is not in conformity with the interest rate provisions of the *OECD Arrangement*[9] 9

[5] Third Party Submission of the European Communities, paragraphs 38 and 39.
[6] Paragraph 5.112 *in fine*.
[7] Paragraph 5.114.
[8] Paragraph 7.109.
[9] Written Submission of the European Communities, paragraphs 40 to 48.

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C. EXPORT CREDIT GUARANTEES ARE COVERED BY THE SAFE HAVEN

17. A further consequence of the European Communities' position is that export credit guarantees are covered by the safe haven provided that they satisfy the conditions set out in Article 22 of the *OECD Arrangement* – one of which is that they are at rates "not inadequate to cover long term operating costs and losses." The European Communities draws the Panel's attention to the fact that Article 22 has integrated the conditions set out in item (j) of the Illustrative List in annex I to the *SCM Agreement* into the *OECD Arrangement*. It has also developed the conditions of item (j) by including other conditions, not found in item (j), within the *OECD Arrangement*.

D. MATCHING

18. The above considerations also lead to the conclusion that the "matching" provisions of the *OECD Arrangement* are also part of the "interest rate provisions". They also serve to "support and reinforce" the other interest rate provisions. The European Communities would refer the Panel to the comments it made in its written submission.[10]

19. The *Canada – Aircraft* panel did not share this view.[11] The textual basis for this conclusion appears very weak – the panel reasoned that matching – although allowed by the *OECD Arrangement* – could not be considered to be "in conformity" with it since matching was a "derogation". This is strained reasoning that ignores the informal and "gentleman's agreement" character of the *OECD Arrangement*.

20. A more teleological reason for the panel's conclusion was its view that matching would "directly undercut the real disciplines on official support for export credits."[12] That view, however, is not shared by the Participants to the *Arrangement* themselves, who obviously regard matching as being compatible with effective disciplines on export credits.

21. A further reason for not considering "matching" to be part of the " interest rate provisions" seems to be the panel's concern that

> … a reading that would, for example, include within the safe haven in the second paragraph of item (k) a transaction involving matching of a derogation, would put all non-Participants at a systematic disadvantage as they would not have access to the information about the terms and conditions being offered or matched by Participants.[13]

22. The European Communities considers that this concern is unfounded. Although the *procedures* of the *OECD Arrangement* cannot be applied to non-participants, this does not mean that non-participants would be disadvantaged. In fact the opposite is the case. The second paragraph of item (k) only requires non-participants to the *OECD Arrangement* to *apply in practice* the interest rate provisions of the *OECD Arrangement*, which the European Communities believes means the substantive provisions which can affect interest rates and not the procedural provisions. Of course, non-participants would not receive the notifications that participants receive, but this should not stop them from matching an offer of export credit terms on a transaction that their companies are competing for. If a non-participant has doubts about the reliability of the alleged offer of non-Arrangement terms that it is invited to match, it may request confirmation of them from the offeror. Under the *OECD Arrangement* participants consider themselves entitled to match after they have taken appropriate measures to verify the terms (see e.g. Article 53). If non-participants are not

[10] Written Submission of the European Communities, paragraph 36.
[11] Paragraphs 5.120 *et seq.*
[12] Panel report, para. 5.125.
[13] Paragraph 5.132.

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required to follow the procedural requirements of the *OECD Arrangement*, they are nonetheless able to apply them by analogy.

IV. THE FIRST PARAGRAPH OF ITEM (K)

23. The European Communities did not discuss the first paragraph of item (k) in its written submission to the Panel, stating that it maintained its previously expressed views that were already known to the Panel from the previous proceeding.[14]

24. There appears to be one issue on which the European Communities has not stated its view – that of the kinds of measure that may fall under the first paragraph of item (k).

25. Whereas the second paragraph of item (k) covers all "export credit practices," a broad term, the scope of the first paragraph of item (k) is defined differently. It covers:

> The grant by governments … of export credits … or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits ….

26. Interest rate equalisation payments are not export credits. The only question is whether they can be "payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits."

27. The Panel was of the view in the first Article 21.5 proceeding that payments to a *lender* that amount to interest rate support cannot reasonably be understood to be payments of all or part of the costs of obtaining export credits.[15]

28. The Appellate Body considered that it did not need to consider this issue and that the Panel's findings on this issues were "moot, and, thus, of no legal effect.[16]

29. The European Communities considers that the interpretation of the first paragraph of Item (k) should not turn on who formally receives the payment or incurs the cost. Such an approach would allow circumvention of the disciplines. The purpose underlying both paragraphs of item (k) and the *OECD Arrangement* is to avoid distortions of competition arising out of export credit practices so that competition between exporters can relate to the other conditions they are being able to offer buyers. It is therefore the resulting attractiveness of the package for the buyer that is important – not the details of the payments between the various actors. A payment to one of these actors can reduce the burden on another – in other words be considered an indirect payment to that other.

V. CONCLUSION

30. The European Communities hopes that these remarks are helpful and wishes the Panel well in its consideration of the complex and difficult issues that are before it.

Thank you for your attention.

[14] Written submission to the Panel, paragraph 52 referring to the first written submission of the European Communities to the original Article 21.5 panel, paragraphs 20 to 26 and oral statement, paragraphs 43 to 46.

[15] Article 21.5 Panel Report, paragraphs 6.71 to 6.73.

[16] Article 21.5 Appellate Body Report, paragraph 78.

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ANNEX C-5

ORAL STATEMENT OF THE UNITED STATES

(5 April 2001)

1. Mr. Chairman, members of the Panel, I am pleased to have this opportunity to appear before you today in this Article 21.5 proceeding. We know the Panel has carefully reviewed our written submission, so I will not repeat those statements here. Instead, I will limit my comments today to a brief observation on the second paragraph of item (k) of the Illustrative List.

2. Mr. Chairman, the purpose of the *OECD Arrangement* is to provide for the orderly use of officially supported export credits. The second paragraph of item (k) of the illustrative list establishes a safe harbor for export credit practices that comply with all of the terms and conditions of the *Arrangement*. A Member cannot comply with just some of the terms and conditions, such as CIRR, and claim the protections of the safe harbor. A contrary conclusion would undermine the entire purpose of the *Arrangement*.

3. This concludes my presentation.

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ANNEX C-6

RESPONSES BY THE EUROPEAN COMMUNITIES TO QUESTIONS OF THE PANEL

(17 April 2001)

Q26. Please discuss your understanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. Article 2 of the *OECD Arrangement* starts by stating that it applies to all "official support" for exports with a term of two years or more. It then specifies the categories of measure covered. These are "direct credits/financing or refinancing, interest rate support, guarantee or insurance." It therefore appears that "interest rate support" is a residual category of "official support" for exports, that is, not in the form of direct credits/financing or refinancing or guarantees or insurance. It covers measures by which "official" bodies support interest rates without directly financing or refinancing transactions or providing guarantees or insurance.

2. PROEX III is a government (or "official") measure that allows the effective rate of interest for purchasers of certain Brazilian goods to be lower than it would otherwise be. It is therefore interest rate support within the meaning of Article 2.

Q27. Please discuss, how, if at all, the concept of minimum premium as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?

3. The EC explained in paragraph 49 of its written submission to the Panel and in paragraph 16 of its Oral Statement that it considered interest rate support in the form of an interest rate buy-down such as that provided by PROEX III to be the economic equivalent of a security or a guarantee.

4. According to Article 15 of the *OECD Arrangement*, CIRR corresponds to the interest rate payable by "first class" borrowers, that is, those for which the risk of non-repayment is the smallest. The interest rate that a borrower such as an airline must actually pay on financing will defend on the risk of non-repayment that the lender incurs and therefore on the security that is offered to guarantee repayment. Providing security involves a cost for the borrower. For example, if a borrower provides security in the form of a mortgage on its assets, it will be restricted in its freedom to use those assets and in particular to pledge those same assets to other lenders. If it provides the lender with a guarantee from a third party with better credit, such as a bank or the state, it will have to pay a premium for this guarantee and offer security or undertake obligations towards the guarantor.

5. In the field of both marketable and officially supported export credits three cost elements are charged to the borrower: the pure cost of money, the handling/administrative costs linked to the provision of financing and the cost of the risk of not being paid back by the debtor (see paragraph 43 of the EC written submission). Usually, the market charges an all-in rate covering those three cost elements, while the "officially suported sector" charges them separately (cf. Article 14c) of the 1998 OECD Arrangement). The CIRR rate (being government bond yields plus a 100/120 basis point margin) is deemed to cover the first two cost elements, whereas the minimuM premium is deemed to cover the third cost element (cf. Article 20 of the 1998 Arrangement).

6. Interest rate and premium, as well as their related disciplines, are complementary within the 1998 OECD Arrangement. Therefore, "interest rate support" is not identified in Article 20, devoted to

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officially supported insurance/guarantee, just like insurance/guarantee is not identified in Article 15, devoted to officially supported financing. Direct credits/financing and refinancing are identified in both articles so as to avoid confusion because in those export credit techniques financing and insurance are mixed being specified that official support may be provided to only one part of the deal.

7. The fact that interest rate support is not expressly mentioned in Article 20 of the *OECD Arrangement* does not mean that it can be concluded that a practice such as PROEX III having the effect described above is consistent with the *OECD Arrangement.* The *OECD Arrangement* is described in the section "status" of the introduction as a "gentleman's agreement". One consequence of this is that circumvention of its provisions is not considered legitimate.

8. The benchmarks have not yet been published. If the Panel considers that the non-publication of the benchmarks is a reason why the minimum premia provisions cannot be considered part of the provisions that non-participants should apply "in practice" in order to benefit from the safe haven of the second paragraph of item (k), the EC would invite it to state this expressly so that it can be clear to all that once the benchmarks are published these provisions will be among those that non-participants must apply "in practice" in order to benefit from the safe haven.

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ANNEX C-7

RESPONSES OF THE REPUBLIC OF KOREA TO QUESTIONS OF THE PANEL

(17 April 2001)

The Panel posed two questions to the third parties in this dispute. The responses of the Republic of Korea follow.

Q26. Please discuss your understanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. Article 2 of the 1998 OECD Arrangement deals with the scope of application of the Arrangement. It identifies five means by which official support for exports can be given – direct credits/financing, refinancing, interest rate support, guarantee or insurance. Korea believes that the Panel in the original recourse to Article 21.5 of the DSU in this dispute gave an accurate illustration of "interest rate support." At note 53 of its Report, the Panel stated:

> To take a hypothetical and highly simplified example, imagine that the yield on the relevant US Government bonds (and thus the US Government's cost of borrowing) is 5 per cent. Brazil's cost of borrowing is 10 per cent and the interest rate on commercial export credits is 8 per cent. Because it is constructed based on the relevant US Government bond yields plus 1 percentage point, the US dollar CIRR would be 6 per cent. While developed countries could afford to borrow at 5 per cent and provide export credits at 6 per cent, Brazil could only do so by providing direct export financing at 4 percentage points below its own cost of borrowing, an expensive proposition. It would be much less costly to Brazil to allow a commercial lender to provide the export credits, and pay the lender 2 percentage points in the form of interest rate support.[1] In other words, a government can provide either: (i) direct export credit financing; or (ii) interest rate support by buying down financing provided by a commercial lender (reducing the interest rates charged to the borrower to the level allowed by the OECD Arrangement).

2. Korea chooses not to provide views on whether PROEX III payments are "interest rate support" within the meaning of the 1998 OECD Arrangement.

Q27. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?

3. The concept of minimum premiums does not apply to interest rate support. The text of Article 20(a) lists only four of the five means, set out in Article 2, by which official support for exports can be given; interest rate support is not included. The Panel Report in this dispute confirmed this and, in Korea's opinion, provided a sound explanation of why interest rate support is not included:

> Paragraph 20, however, excludes "interest rate support" from the categories of official support for which a minimum premium must be charged, presumably because in the case of interest rate support the government does not bear the risk of loss in the case

[1] *Brazil-Export Financing Programme for Aircraft-Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (9 May 2000) at paragraph 6.53, note 53 (emphasis added).

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> of default. In any event, these premia relate to the risk relating to the country of the *buyer/borrower*, not that of the *lender*.[2]

4. The Panel in Brazil's DSU Article 21.5 recourse regarding Canada's aircraft financing support also noted that the concept of minimum premiums does not apply to interest rate support:

> Moreover, we note that the *Arrangement* establishes explicit rules concerning guarantees and insurance, specifically by establishing minimum premium benchmarks. The minimum benchmarks are set with respect to adequacy of premiums to cover the "sovereign" and "country" credit risk involved in supported transactions. These benchmarks also apply explicitly to official financing support. Thus, both the minimum premium rule and the minimum interest rate rule on their faces make clear whether or not they apply to guarantees and insurance.[3]

5. Thus, interest rate support is not subject to the minimum premium provisions of Article 20 of the 1998 OECD Arrangement. Where a Participant provides interest rate support, unlike the other four types of support, the commercial lender, not the government, bears the risk of loss in the case of default. Thus, there is no need to ensure adequacy of premiums to cover the government's credit risk.

6. The Canadian Article 21.5 Panel Report also answers the third part of the Panel's Question 27 – minimum premium benchmarks are not available to non-Participants. As the Panel stated:

> We note that, by contrast, no information is published on the minimum premium benchmarks. Thus, only Participants have access to this information. Given this, it is at present impossible for a non-Participant to have any idea whether a given transaction respects the rules concerning minimum premiums. Thus, until such time as the Participants make this information publicly available, non-Participants should be presumed to be respecting the minimum premium rules in the context of any analysis under the second paragraph of item (k). Canada also has recognized this issue and come to the same conclusion. In particular, Canada states that "it would be unreasonable to expect a non-OECD WTO Member to charge a premium level which is unknown to such Member, in order for that Member to be in full compliance with the interest rates provisions of the *Arrangement*. Canada is prepared to accept the consequence that in relation to premiums and for the purpose of the second paragraph of Item (k), a higher threshold is imposed on those WTO Members that are also OECD Participants" (Canada's reply to the Panel's Canada Account question 3(h)).[4]

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[2] *Brazil—Export Financing Programme for Aircraft—Report of the Panel*, WT/DS46/R (14 April 1999) at paragraph 7.31, note 206 (emphasis in original).

[3] *Canada-Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (9 May 2000) at paragraph 5.100 (*Canada-21.5*). *See also*, Export Credits and Related Facilities, Background Paper by the Secretariat, G/AG/NG/S/13 (26 June 2000) at paragraph 27(f).

[4] *Canada—21.5* at paragraph 5.134, note 118 (emphasis added).

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ANNEX C-8

**RESPONSES OF THE UNITED STATES
TO QUESTIONS OF THE PANEL**

(18 April 2001)

For Third Parties

Q26. Please discuss your understanding of the meaning of the term "interest rate support" as used in Article 2 of the 1998 OECD Arrangement. Are PROEX III payments "interest rate support" within the meaning of the 1998 OECD Arrangement?

1. The term "interest rate support" as used in Article 2 of the 1998 *OECD Arrangement* refers to practices under which a government enters into an agreement on interest rates with a commercial bank that is providing the export credit financing for an export transaction. The purpose of the agreement is to allow the commercial bank to provide fixed rate financing at the appropriate CIRR rate. Commercial banks typically fund themselves on a floating interest rate basis such as LIBOR. In order for the bank to avoid losses associated with mismatched funding (i.e., funding itself at a floating rate and lending at a fixed rate), the government interest rate support provides the bank with a payment to compensate the bank for the funding risk. Typical of most OECD governments offering interest rate support, the government agrees that the commercial bank will receive a minimum return above its cost of funds to cover overhead and a normal profit margin on its services. On each semiannual repayment date under the loan, the difference between the bank's funding base plus the interest make-up margin and the CIRR rate is calculated. If the CIRR provides an interest rate that is lower than the commercial bank's funding rate plus the interest make-up margin, then the government pays the shortfall to the commercial bank. Thus, the interest rate support allows the commercial bank to offer CIRR financing without the interest rate risk associated with its funding at a floating rate. In addition, interest rate support allows commercial banks to help provide CIRR financing.

2. The United States is not sufficiently familiar with the facts of PROEX III to opine on whether PROEX III payments, as applied, constitute "interest rate support." As a general matter, the United States would consider interest rate support to be consistent with the *OECD Arrangement* if (a) the interest rate that the borrower sees after the interest rate support is the appropriate CIRR rate; and (b) the interest rate support is not offered in a manner or at a level that is used to cover other borrower costs associated with the transaction (such as the risk premium or the cost of the exported item).

Q27. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 Arrangement available to non-Participants?

3. The minimum premiums reflected in Article 20 of the 1998 *OECD Arrangement* apply to all transactions in which a government provides support that shifts the repayment risk of the borrower from the lender to the government providing support. Interest rate support, in and of itself, does not shift the repayment risk of the borrower to the government providing the support because the government does not take on the risk of repayment. Hence, interest rate support is not mentioned in Article 20. Under Article 20, when a government does offer interest rate support in conjunction with insurance or a guarantee, the government must charge the appropriate minimum premium rate because it is providing insurance or guarantee cover.

4. Virtually all of the information regarding the minimum premium benchmarks under the 1998 *OECD Arrangement* is available to non-Participants. This information is available on the OECD web

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site (at http://www.oecd.org/ech). The only piece of information not currently available is the country classifications. Discussions are underway within the Participants to post these classifications on the OECD web site, thereby making all information necessary to apply the minimum premium benchmarks publicly available. However, for transactions with borrowers in High-Income OECD countries, the *Arrangement* provides that the minimum premium benchmarks do not apply. Rather, the premium charged shall not undercut the pricing of the private market.[1] Thus, for these countries, there are transparent rules for the application of risk premiums – market rates apply.

For the United States

Q28. The United States contends that "buying down interest rates . . . reduces the risk incurred by the exporter or financial institution" (US third-party submission, para. 24). Interest rate buy-downs are not however necessarily accompanied by an assumption of risk by the government/export credit agency. Please comment.

5. Interest rate buy-downs reduce the financial risk of the transaction by reducing the cost of the credit and the debt service impact on the borrower. All things being equal, buy-downs enhance the borrower's net cash flow position by the amount of the foregone or avoided interest payments, improving its ability to service any given level of debt service, and thereby reducing the risk of the transaction.

6. Interest rate buy-downs do not necessarily involve an assumption of risk on the part of the government or export credit agency, because, in making the interest rate buy-down, the government or export credit agency assumes no additional legal obligation to make payments to the exporter or commercial lender in the event the borrower fails to make timely payment on the loan.

Q29. The United States argues that non-Participants which want to use the safe haven provided by the second paragraph must also conform with the transparency provisions of the Arrangement (US third-party submission, para. 24). Is the United States suggesting that non-Participants would be obliged to make notifications of non-conforming terms to Participants? Do Participants make notifications of non-conforming terms available to non-Participants?

7. At a minimum, all countries invoking item (k) protection must be obligated to respond bilaterally to a query from a competitor as to whether all the terms it is offering conform to the *Arrangement* and to respond in a timely and meaningful manner. Transparency minimizes the chance of premature or incorrect matching and the transparency obligation also inhibits the initiation of non-conforming offers. While the Participants do not currently make notifications of non-conforming terms available to non-Participants, the United States would be willing to support the transparent exchange among all governments of prior notified non-conforming terms.

Q30. With reference to the U.S. oral statement, could the United States elaborate on why it believes that the reference to "interest rates provisions" in the second paragraph of item (k) is a reference to all of the terms and conditions of the OECD Arrangement? In particular, if the second paragraph of item (k) referred to all of the terms and conditions of the OECD Arrangement, why does it not refer to the "provisions of the relevant undertaking" (as opposed to the "interest rates provisions of the relevant undertaking")?

8. The first paragraph of item (k) describes a certain type of government practice that constitutes a prohibited export subsidy. Thus, in interpreting the second paragraph of item (k), the treaty interpreter must keep in mind that the practice at issue is one that normally, but for the second paragraph of item (k), would be prohibited by the SCM Agreement.

[1] *See Arrangement* Article 22 b.

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9. The *OECD Arrangement* itself also provides relevant context for resolving this issue. The purpose of the *OECD Arrangement* is:

> to provide a framework for the orderly use of officially supported export credits. The Arrangement seeks to encourage competition . . . based on quality and price of goods and services exported rather than on the most favorable officially supported terms.[2]

10. The premise of the item (k) safe harbor is that Members create a level playing field in the use of officially supported export credits by complying with the terms and conditions of the *Arrangement*. It would not be logical to read the second clause of the second paragraph of item (k) as permitting a Member to comply with something less than all of the terms and conditions of the *Arrangement* and still qualify for the safe harbor, since to do so would undermine the disciplines of the *Arrangement*, which is the entire basis of the safe harbor. In interpreting the language at issue, the Panel should keep in mind the object and purpose of the *Arrangement* and the safe harbor, as well as the absurd consequences that would result from interpreting the relevant language in a narrow manner. As the United States noted in its written submission, the wording of the second paragraph of item (k) was meant "to provide[] a safe harbor while allowing other signatories of the code to follow the same practices," not to permit other signatories to benefit from the safe harbor without applying all of the terms and conditions of the *Arrangement*.[3]

11. Furthermore, the only way to make sense of the second paragraph of item (k) is to read it as requiring the application of all of the substantive rules of the *Arrangement*, because every piece of the Arrangement implicitly assumes all of the others. The *Arrangement* defines the reference point of a level playing field as the cost of export credits from the borrower's perspective. The borrower's perspective is of an all in-cost. The term "all in-cost" refers to the cost to the borrower, in net present value terms, of the financing costs at the time the exporter ships the export item to the buyer. The all in-cost depends on the interest rate charged, any up-front fees, and the average life of the transaction (made up of the tenure and repayment pattern of the transaction). Without taking all of these factors into consideration, there is no way to determine, from the borrower's perspective, what the real cost of the export credit is.

12. For example, a ten-year export credit at CIRR is very different from a 100-year export credit at CIRR, just as a ten-year export credit at CIRR with equal semiannual repayments is very different from a ten-year export credit at CIRR with a single bullet payment at the end of the ten years. Likewise, financing a maximum of 85 percent of the export credit value at CIRR, with the remaining 15 percent financed with cash or privately on market terms, is different from a financing on *Arrangement* terms for one hundred percent of the transaction. In addition, fees and interest rates are interchangeable – with up-front fees being converted into interest rate spreads or interest rate spreads being converted into up-front fees. Thus, the CIRR regime only makes sense in the context of all of the other *Arrangement* rules, such as maximum repayment terms, repayment profiles, and risk premiums.[4]

[2] OECD, The Arrangement on Guidelines for Officially Supported Export Credits (Paris: OECD, 1998), Introduction.

[3] United States written submission at para. 8, *citing* U.S. Exhibit 1 at 38 (emphasis added).

[4] In fact, the *Arrangement* sets the CIRR based on the repayment terms of the transaction.

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13. The Appellate Body has stated that "[t]he duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties."[5] The wording of the second paragraph of item (k) indicates an intention on the part of the drafters to create a limited safe harbor from the prohibition in the first paragraph of item (k) for Members who comply with the terms and conditions of the *OECD Arrangement*.

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[5] *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, WT/DS141/AB/R, Report of the Appellate Body at para. 83.

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